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SMID Offers Access to the Full Spectrum of Growth

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Key Takeaways

- The small and mid cap (SMID) growth market spans a broad spectrum — from early-stage innovators to established companies with recurring revenues, strong cash flows and durable competitive positions.
- A measured SMID allocation can introduce sector exposures, business models and earnings drivers that differ from those of large cap portfolios, making its contribution to total portfolio risk more important than its stand-alone volatility.
- A dynamic benchmark and wide dispersion in business quality make active research valuable not only for identifying future leaders, but also for avoiding businesses with fragile balance sheets, temporary growth or excessive embedded expectations.

Small Does Not Mean Immature

Conversations with investors often begin with a familiar assumption: investing in smaller companies means accepting exposure to young, speculative or financially vulnerable businesses. Such companies are part of the market, but they do not define the full SMID opportunity set.

The Russell 2500 Index encompasses the smallest 2,500 or so of the 3,000 largest U.S. companies. Within its growth segment, nearly 60% of benchmark market value is from companies with market capitalizations above $5 billion, while only 17% is below $2.5 billion.[1] The investable universe can extend from approximately $500 million to more than $30 billion in market cap. We view “small” and “mid cap” as assessments of market value rather than judgments about business maturity, financial quality or competitive position.

One Market, Multiple Stages of Growth

One way to understand the opportunity is through the corporate life cycle. Companies can generate some of their strongest growth after moving beyond the riskiest start-up phase but before reaching the slower growth and greater complexity that can accompany large scale. Established products, growing market share and free cash flow can provide the resources to fund research, expand into new markets or acquire complementary businesses.

However, SMID is broader than any one point on that life cycle. It includes hyper growers addressing large markets but offering less visibility into future earnings; middle growers with established operations and increasing earnings consistency; and steady growers with high returns on capital, high barriers to entry and recurring or lower-volatility revenue.

The differences are visible in individual companies. Casey’s General Stores, one of the largest U.S. convenience store chains, represents an established compounder supported by a loyal customer base, a strong financial position and continued reinvestment. Construction Partners, which builds and maintains roads and bridges in the southeastern U.S., is a middle grower combining an established business with organic expansion and acquisition opportunities. Rubrik, a cybersecurity software company focusing on data backup and recovery, represents an innovation-led hyper

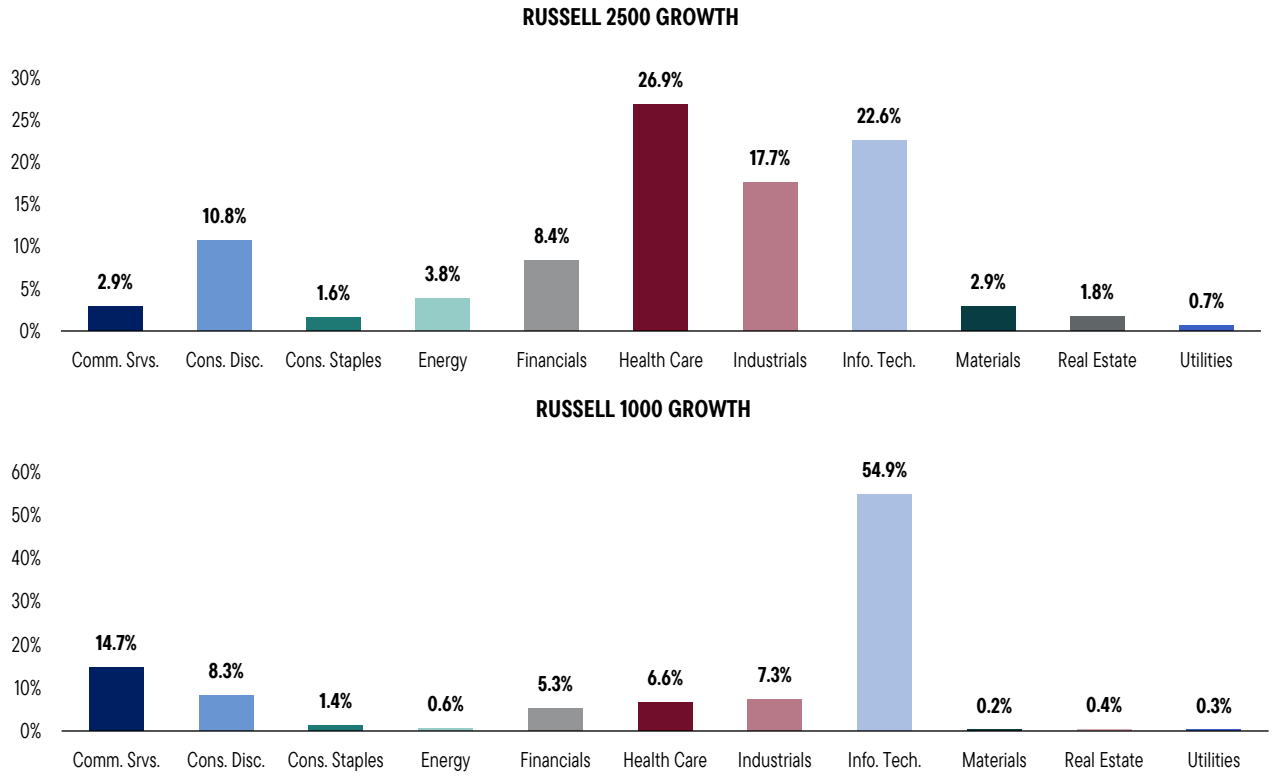
[1] As of October 31, 2026

grower benefiting from a differentiated cloud platform taking share from legacy solutions while also positioning itself to benefit from AI-driven security tailwinds.

Why Small: More Sources of Growth

SMID growth is not simply a scaled-down version of large cap growth. The health care and information technology (IT) sectors both represent more than 20% of the Russell 2500 Growth Index, with industrials at 18%. By contrast, the IT and communication services sectors alone represent nearly 70% of the Russell 1000 Growth Index.

Exhibit 1: Smaller Growth Companies Span More Sectors



As of October 31, 2026. Source: FactSet.

This breadth provides investors in smaller companies exposure to medical innovation, advanced manufacturing, aerospace and defense, transportation, data infrastructure, specialized semiconductors and consumer services. Many of these companies are also more domestically oriented than large multinational businesses, with earnings driven by their own customers and investment cycles. For investors whose equity allocations have become closely tied to a relatively small group of mega caps, SMID can introduce different end markets, competitive advantages and sources of earnings growth.

Risk Budget Is a Portfolio Question

SMID growth portfolios have, admittedly, exhibited greater stand-alone volatility than their large cap growth peers historically. However, allocators do not experience an asset class in isolation. The more relevant question is how a thoughtfully sized allocation changes the return, volatility, drawdown and concentration of the total portfolio.

Portfolio risk depends on position size, correlation and the interaction among underlying return drivers. A SMID allocation that introduces different industries, customers and company-specific catalysts may consume less marginal risk than its stand-alone volatility implies. It may also reduce reliance on the performance of a narrow group of large companies.

Why Active: Discernment Over Exposure

The SMID growth market is large and comparatively under-researched, creating opportunities for active managers with the resources to conduct detailed fundamental work. The deeper argument for active management, however, lies in the wide dispersion in business quality, financial strength, competitive durability and the expectations embedded in share prices.

Recent market behavior illustrates the challenge of active management within the SMID market. In the second quarter of 2026, leadership within the Russell 2500 Growth Index favored higher-beta companies with lower returns on equity, elevated valuations and, in many cases, limited or no current earnings. The pattern of lower-quality leadership extends across the broader small cap universe: roughly 40% of Russell 2000 constituents carry negative trailing earnings, according to Apollo Global Management, yet since April 2025 those unprofitable companies have returned approximately 60%, well ahead of the 38% gain for their profitable peers. Much of that leadership reversed in the third quarter. As interest rates reset higher and the Russell 2500 Growth Index declined 10.4%, the cheapest quintile of benchmark stocks by price-to-earnings multiple gained 7.6% while the most expensive fell 19.1%, and the quintile with the lowest returns on equity declined 11.5%.

The benchmark itself is also dynamic. Successful smaller companies graduate into larger cap indexes, while annual reconstitutions introduce new businesses and alter sector and quality characteristics. In 2026, Russell 2500 Growth turnover approached twice its historical average as several AI beneficiaries left the universe, biotechnology representation increased and a larger cohort of lower-quality growth companies entered. An index is a useful opportunity set, but it is not a quality filter.

Yet active management cannot be reduced to avoiding every company perceived as lower quality. Powerful investment cycles can produce genuine fundamental improvement. When AI-related demand meets constrained industry supply, companies can gain pricing power, accelerate revenue, absorb fixed costs and improve margins, cash flow and balance sheets. Some of those gains may prove structural, particularly where stronger cash generation supports reinvestment and creates a more durable competitive position.

The task is therefore to distinguish among durable compounders whose existing advantages are being amplified, cyclical companies whose through-cycle economics are genuinely improving, and more fragile beneficiaries whose results remain dependent on scarcity, pricing and repeated earnings surprises. This is particularly important in SMID, where earlier-stage businesses and established companies undergoing meaningful change can coexist within the same benchmark.

Expectations are central to that assessment. Strong operating results do not have to reverse for a stock to stop working; they may only need to become less surprising. Revenue can continue to grow and margins can continue to expand, but smaller earnings beats, slower estimate revisions or flattening incremental margins may indicate that expectations have caught up with results. Even a seemingly lower forward valuation can reflect a substantial earnings increase that must still be delivered.

Static quality screens are unlikely to capture these distinctions. Fundamental research must examine the durability of pricing power, incremental margins, cash conversion, customer concentration, recurring revenue, switching costs, reinvestment discipline and valuation. Active portfolio construction can then balance opportunity against risk through position limits, diversification across revenue sources and business models, ongoing valuation review and independent risk oversight.

Active Access to the Full SMID Opportunity

A SMID growth allocation expands the investable universe beyond today's largest companies and provides access to businesses across a wider range of industries and stages of development than the large caps to which most equity allocations are biased. Active management seeks to capture that breadth while remaining selective about quality, valuation and portfolio risk — and flexible as the evidence changes.

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