Altura Capital Group, LLC

Asset Class Research Note

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US Mid Cap Equity Performance by Size of Manager

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Asset Class Report: US Mid Cap Equity

Summary

There are many studies showing that smaller managers perform better than their larger peers. In this paper, we review the data for US Mid Cap Equity managers and we find that this result holds for both the mid cap core and mid cap value styles, when utilizing longer-term data. However, there appears to be an advantage to size in small cap growth. Our previous studies show that a three year time frame appears to be too short to show clear trends, so in this study we focus on 5 year time periods. In order to reduce end-period dependency, we look at time periods ending June 2009, June 2010 and June 2011, and the conclusions appear uniform across periods.

In previous studies, we show that categorizing firms by size on an ex-ante (at the beginning of the performance period) versus ex-post (at the end of the performance period) basis produces results that would be more relevant to an investor, who is not going to have access to ex-post information. Therefore, in this study, we categorize managers into size buckets by ex-ante assets under management.

Finally, we find that smaller managers are more diverse and less clustered in their results than larger managers, which might allow intensive research to add value in manager selection among smaller managers. We also note that tracking error reduces with size of manager, which suggests that the case for using multiple managers is higher among smaller firms.

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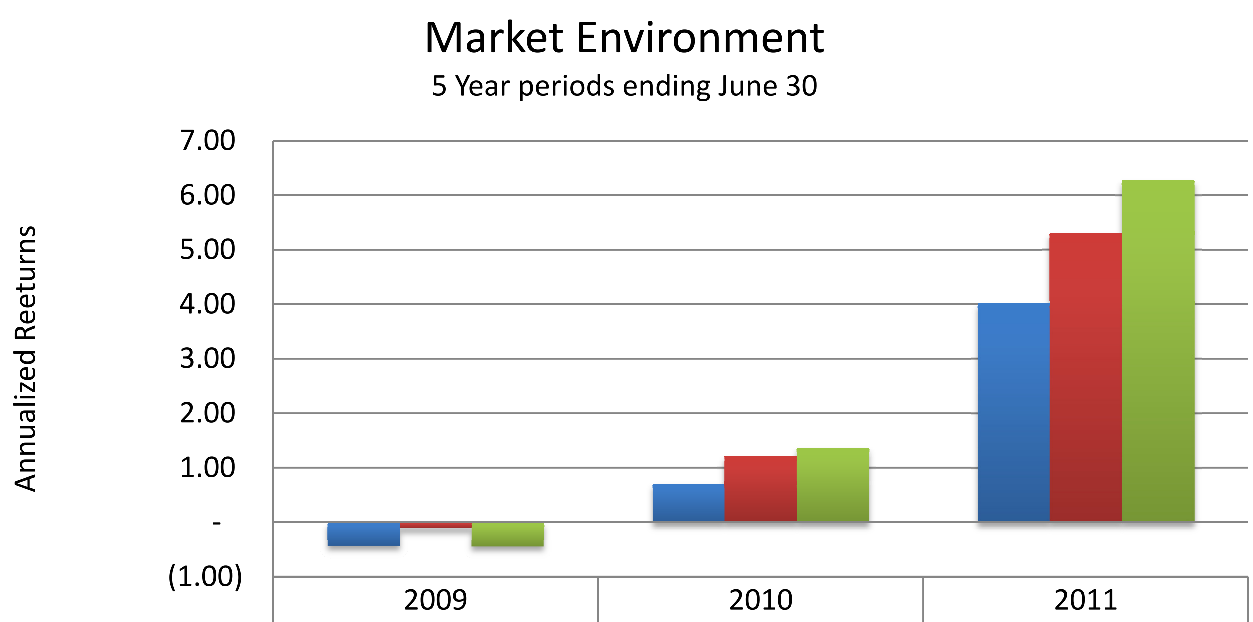
Market Environment



	2009	2010	2011
Mid Cap Value	(0.43)	0.71	4.01
Mid Cap Core	(0.11)	1.22	5.30
Mid Cap Growth	(0.44)	1.37	6.28

In the chart above, we can see that returns, based on index performance[1] has ranged from poor to moderate over these three five year periods. The strong markets in 2006, 2009 and 2010, and the first half of 2011 help the numbers ending 6/30/2011. The weak numbers for the five year period ending 6/30/2009 reflect all the impact of the “Great Recession” without any of the subsequent bounce. It is worth noting that in 2 of the three periods Mid Cap Growth stocks outperformed Mid Cap Value stocks by a significant amount. Value stocks have been depressed by the terrible performance of the financial sector during the market decline.

[1] Returns are annualized. The Mid Cap Growth category is represented by the total return of the Russell Mid Cap Growth index. The Mid Cap Core category is represented by the total return of the Russell Mid Cap index. The Mid Cap Value category is represented by the total return of the Russell Mid Cap Value index. The returns were calculated using the Morningstar Direct platform.

Mid Cap Core

There is a reasonable set of data[2] in each size category with 5-year returns. Based on previous research, we believe that the size of the firm at the start of the measurement period provides us with a better perspective on the potential benefits of investing in managers of a given size. The ex-ante measure of size allows insight into how smaller versus larger managers subsequently performed.

Data Count

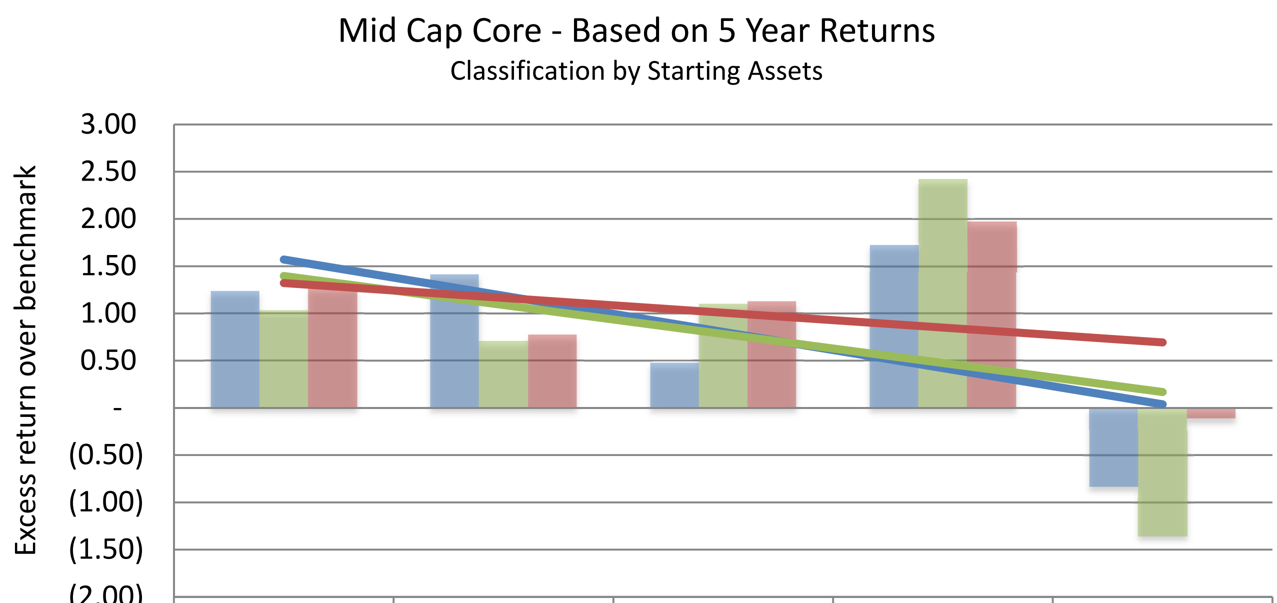
Size	**Range in Firm AUM (billions)**	**Products with 5 year returns ending**		
		6/30/2009	6/30/2010	6/30/2011
Very Small	Less than $2	18	23	19
Small	$2 - $10	30	24	31
Medium	$10 - $50	10	15	15
Large	$50 - $250	26	30	32
Giant	More than $250	8	7	7

As can be seen from the chart above, there is a small segment of firms in the Giant size, and the number of firms in any category does vary over time.

[2] The data shows the number of firms that a) Have provided AUM data at the start of the measurement period b) have performance for the entire 5 year period and c) the AUM fits within a certain size category.

Excess Return

We now look at the excess returns[3] generated by managers[4] depending on size[5].



	Very Small	Small	Medium	Large	Giant
5yr 2009	1.24	1.41	0.48	1.73	(0.83)
5yr 2010	1.04	0.71	1.10	2.42	(1.36)
5yr 2011	1.27	0.78	1.13	1.98	(0.11)

We can draw the following conclusions by looking at the excess returns[6] and their correlation to firm size.

1. There appears to be a negative trend between size of assets and returns – i.e., smaller managers seem to produce better returns. This trend has an exception among Large managers, who appear to have done well.

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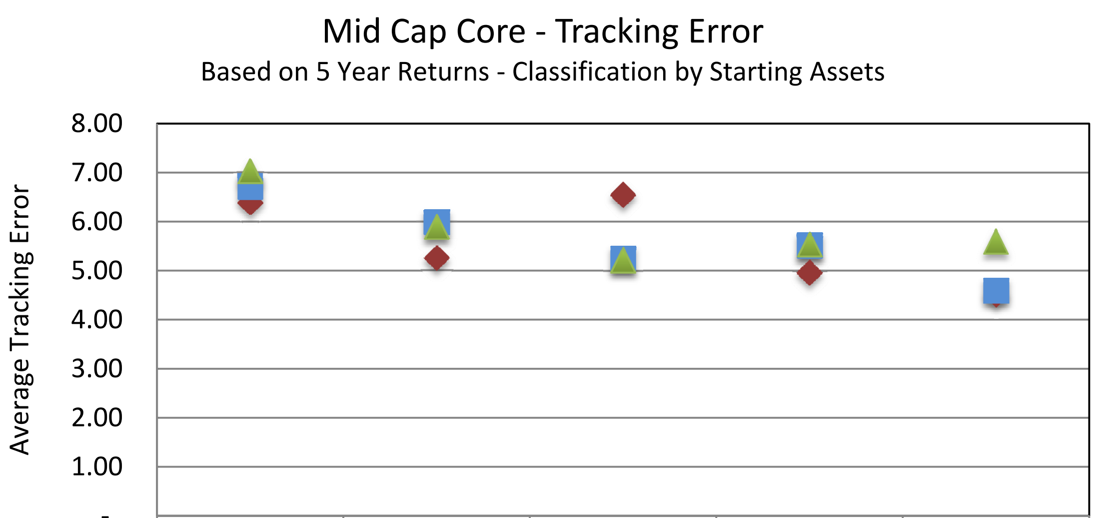
[3] The excess return is defined as the difference between the annualized return for a product and the annualized return for the benchmark. The benchmarks are as previously defined. The excess return for the set is the return for every product that falls within a certain group and that has a full set of data for that time frame. For example, the excess return for the group of "Very Small" managers for the 5 yr 20011 period is the arithmetic average of the 5-year returns for all managers that have returns ending 6/30/2011, and that have provided an "assets under management" number as of 6/30/2006 that puts them in the "Very Small" category.
[4] All manager and product data for this study was extracted from the Morningstar Direct platform on October 12th, 2011. The data is based on the Morningstar Direct classification of size and style, and all data is from the Morningstar Direct separate account universe. Index Funds and ETFs were excluded from the search in order to limit the universe to actively managed products.
[5] Size is defined by the total AUM ("assets under management") of the firm. The firm must have provided AUM as of the starting date of the appropriate time period in order to be counted, and it must also have returns covering the appropriate time period. The categories are defined in the table.
[6] The scale on each chart is drawn different for visual clarity.

2. The inverse relationship of performance and size holds true among all three time periods, although it should be noted that there is overlap among the periods, and that these are not truly independent observations.

3. With the exception of giant managers, all mid cap core manager segments added value vis-à-vis the benchmark in all time periods, which is a heartening result.

This result of excess returns being inversely related to firm size is consistent with previous research done by others, and with previous unpublished research by Altura.

Tracking Error



	Very Small	Small	Medium	Large	Giant
5yr 2009	6.40	5.26	6.55	4.97	4.52
5yr 2010	6.72	5.99	5.25	5.52	4.60
5yr 2011	7.03	5.90	5.22	5.54	5.60

Of course, with any discussion of excess return, one must also consider risk, and while there are several ways of looking at risk, tracking error[7] is one of the most utilized for larger institutional investors. As can be seen from the chart above, smaller managers do generally display higher average tracking error, indicating the possibility of more concentrated portfolios, more style variance, more deviation from benchmark weights, or some combination of the above. Our qualitative research of managers does show that smaller firms tend to run more concentrated portfolios on average.

[7] Tracking error is calculated by the Morningstar Direct platform and is defined as the standard deviation of the differences between each product's monthly returns and the returns of the benchmark. The number is then annualized.

Alternative measures of risk

There were two other measures of risk we looked at, shown in the tables below:

5 Year Average Risk[8] *Manager Classification based on Starting AUM*			
Size	**Ending 6/30/2009**	**Ending 6/30/2010**	**Ending 6/30/2011**
Very Small	19.45	20.57	20.93
Small	19.24	19.74	20.88
Medium	20.73	20.86	21.69
Large	17.54	18.97	19.75
Giant	17.98	19.31	21.67
Russell Mid Cap Index	19.37	20.64	21.42

5 Year Product Spread[9] *Manager Classification based on Starting AUM*			
Size	**Ending 6/30/2009**	**Ending 6/30/2010**	**Ending 6/30/2011**
Very Small	2.43	2.87	3.08
Small	3.06	2.48	2.43
Medium	2.96	1.61	1.79
Large	1.72	2.13	1.94
Giant	1.72	2.26	2.67

We can draw several conclusions from the tables above:

- While the tracking error of smaller managers is larger, the absolute level of manager risk seems to have no relationship to size. It also seems to be the case that most managers tend to have lower risk than the benchmark. This is a heartening result because it makes the excess return more impressive, particularly for smaller managers.
- The larger the firm, the less differentiation exists among product returns, as shown by the product-spread table. This could be because smaller managers, who tend to be more concentrated, allow themselves to deviate more from the benchmark, and from each other.

[8] The average risk is the arithmetic average of the standard deviation of each of the products in a given size category. It is a measure of the risk of the "average product" within a given size category.
[9] The product spread is the standard deviation of the annualized returns of the products within a certain size category. It measures the consistency of the results within a given size category. A high number indicates more variance between returns within the same size class.

- Absolute levels of risk seem to have increased over the past 3 years, which should be of no surprise to any investor.

Given the above, we believe that an investor may be well served hiring multiple smaller managers to reduce tracking error, AND, that intensive manager research should be able to differentiate between firms more substantially in the smaller manager space, given the larger spread between returns.

Mid Cap Value

The next question we wanted to address was if the results would hold true in the Value and Growth styles. We first look at the size of the data set in the value space.

Data Count

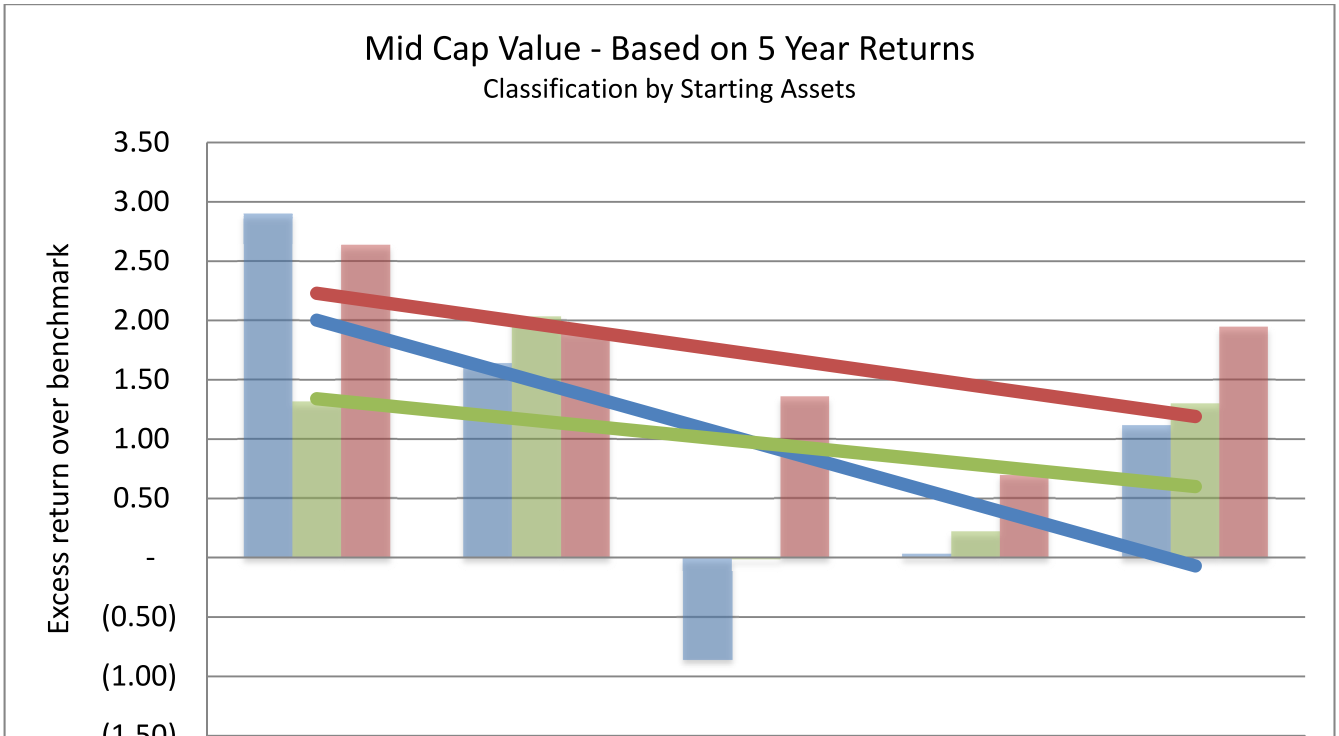
Size	Range in Firm AUM (billions)	Products with 5 year returns ending		
		6/30/2009	6/30/2010	6/30/2011
Very Small	Less than $2	13	15	19
Small	$2 - $10	37	37	37
Medium	$10 - $50	15	19	21
Large	$50 - $250	32	32	37
Giant	More than $250	9	9	10

We can see that there is a reasonable data set in the value space, and in fact, the data set is a little larger than that in the core space. Again, there is a small data set among the largest firms.

Excess Return

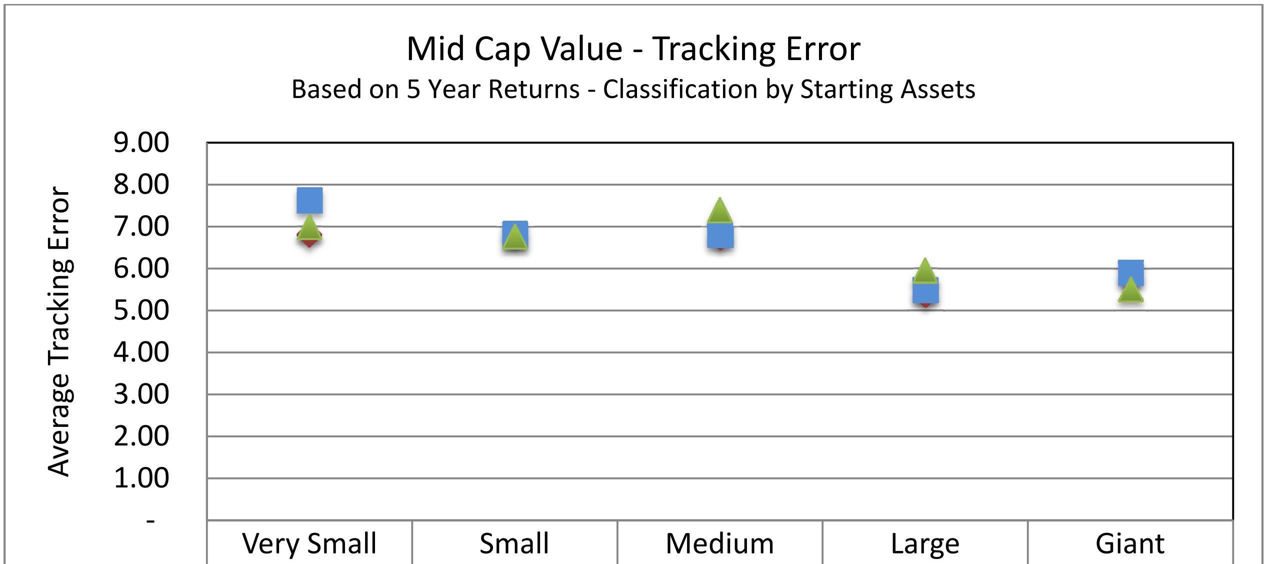
When one looks at the excess returns of managers in the value sub-segment of the Mid Cap space, one can make the following observations:

1. As a general trend, smaller managers have added more value than larger managers
2. This trend holds true over all three time periods, although it should be noted that there is overlap among the three time periods, and that these are not truly independent observations.
3. Value managers, in general have added value relative to the benchmark, with the exception of the "Medium" group of managers for the five year period ending 6/30/2009.



	Very Small	Small	Medium	Large	Giant
5yr 2009	2.90	1.64	(0.86)	0.03	1.11
5yr 2010	1.32	2.03	(0.02)	0.22	1.30
5yr 2011	2.64	1.91	1.36	0.70	1.95

Tracking Error



	Very Small	Small	Medium	Large	Giant
5yr 2009	6.81	6.81	6.75	5.37	5.79
5yr 2010	7.63	6.82	6.80	5.49	5.90
5yr 2011	7.00	6.78	7.41	5.96	5.51

As we saw earlier in the core space, smaller managers do display a higher level of tracking error vs. the benchmark. Again, we believe that the prevalence of concentrated portfolios among smaller managers explains some of the higher tracking error.

It is worth noting that tracking error is higher among all managers in the value space, regardless of size. We believe that some style drift towards “core” or “growth” names could account for the tracking error AND for the higher level of excess returns, given that value stocks were the worst performing over this 3 and 5 year time period (see market environment section). Therefore any movement by any manager to core and growth stocks would add to excess returns and tracking error.

Alternative measures of risk

There were two other measures of risk we looked at, as shown in the tables below:

5 Year Average Risk *Manager Classification based on Starting AUM*			
Size	**Ending 6/30/2009**	**Ending 6/30/2010**	**Ending 6/30/2011**
Very Small	17.97	20.23	19.96
Small	18.53	19.62	20.34
Medium	20.72	21.82	22.28
Large	18.38	19.70	20.74
Giant	18.63	20.15	20.87
Russell Mid Cap Value Index	19.58	21.14	21.96

5 Year Product Spread *Manager Classification based on Starting AUM*			
Size	**Ending 6/30/2009**	**Ending 6/30/2010**	**Ending 6/30/2011**
Very Small	2.59	4.95	2.82
Small	2.63	2.73	2.77
Medium	2.90	2.31	2.32
Large	3.37	2.96	3.18
Giant	0.54	0.78	0.69

We can draw several conclusions from the tables above:

- While the tracking error of smaller managers is larger, the absolute level of manager risk seems to have no relationship to size. It also seems to be the case that most managers tend to have lower risk than the benchmark. This is a heartening result because it makes the excess return more impressive, particularly for smaller managers.
- The larger the firm, the less differentiation exists among product returns, as shown by the product-spread table. This might be because smaller managers, who tend to be more concentrated, allow themselves to deviate more from the benchmark, and from each other.
- Absolute levels of risk seem to have increased over the past 3 years, which should be of no surprise to any investor.

Given the above, we believe that an investor may be well served hiring multiple smaller managers to reduce tracking error, AND, that intensive manager research should be able to differentiate between firms more substantially in the smaller manager space, given the larger spread between returns.

Mid Cap Growth

Finally, we look at the data in the growth space.

Data Count

Size	Range in Firm AUM (billions)	Products with 5 year returns ending		
		6/30/2009	6/30/2010	6/30/2011
Very Small	Less than $2	48	53	49
Small	$2 - $10	64	68	73
Medium	$10 - $50	20	25	29
Large	$50 - $250	36	39	41
Giant	More than $250	9	11	15

We can see that there is a large set of data in the Growth space, and in fact the largest concentration of Mid Cap products is in the Growth segment.

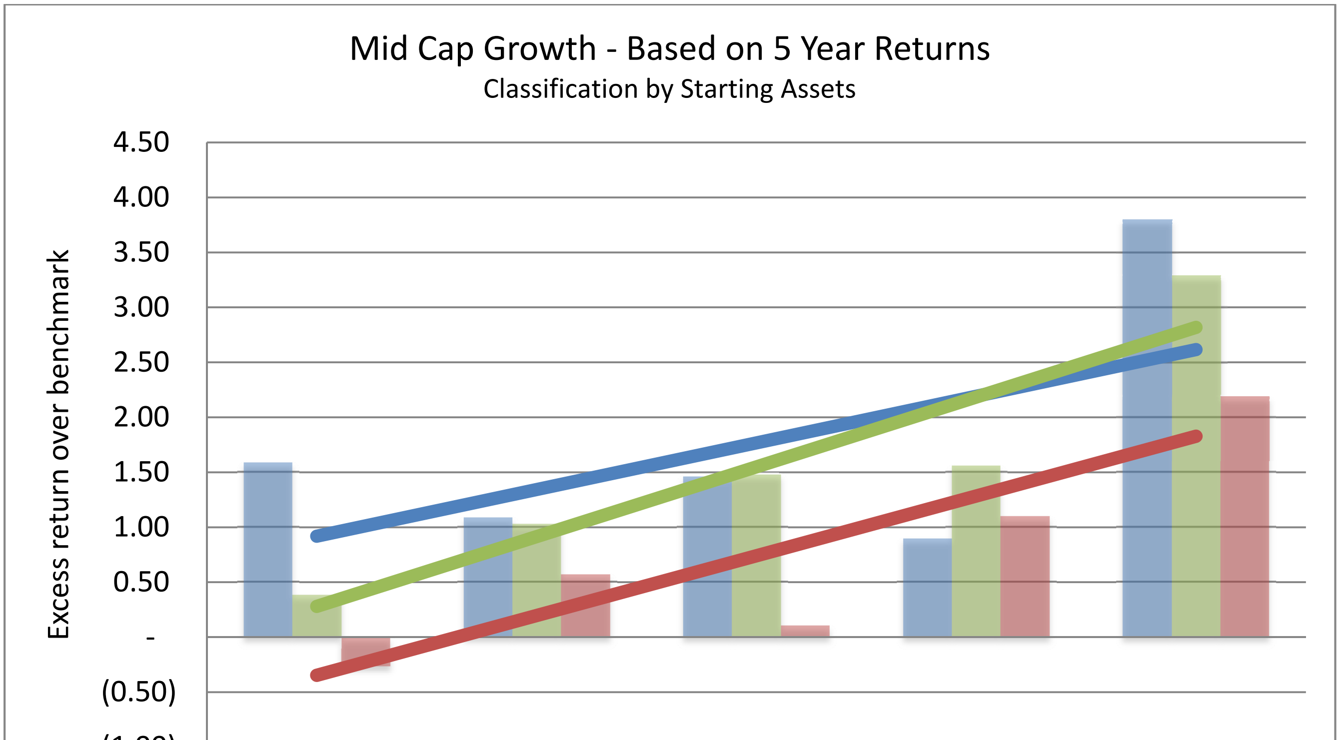
Excess Return

As can be seen from the chart below, we can draw several conclusions:

1. Managers of all sizes have tended to add value over the growth benchmark, even though the growth benchmark was the best performing in the Mid Cap space.

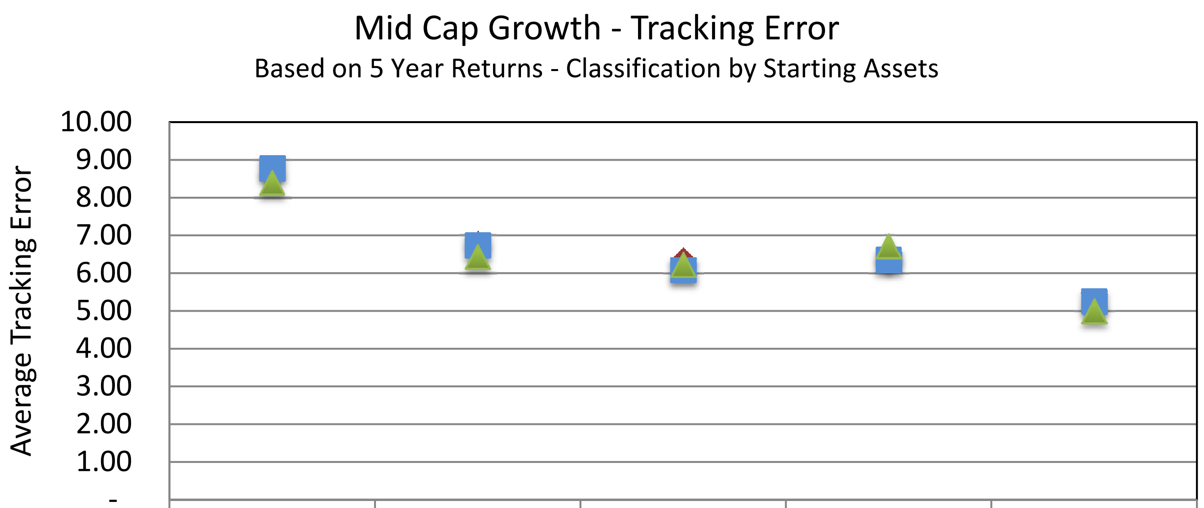
2. Unlike the value and core segments, there appears to be a trend for larger managers to perform better than smaller managers. This is similar to the behavior we have previously noted in both the large cap and the small cap space.

3. It should be noted that the trend is exaggerated by the very strong performance of the "Giant" managers, and the relatively small data set of the "Giant" managers.



	Very Small	Small	Medium	Large	Giant
5yr 2009	1.59	1.09	1.46	0.90	3.80
5yr 2010	0.39	1.03	1.48	1.56	3.29
5yr 2011	(0.26)	0.57	0.10	1.10	2.19

Tracking Error



	Very Small	Small	Medium	Large	Giant
5yr 2009	8.68	6.78	6.34	6.35	5.15
5yr 2010	8.78	6.74	6.09	6.36	5.25
5yr 2011	8.40	6.43	6.22	6.71	5.00

As we saw earlier in the core space, smaller managers do display a higher level of tracking error vs. the benchmark. Again, we believe that the prevalence of concentrated portfolios among smaller managers explains some of the higher tracking error.

Alternative measures of risk

There were two other measures of risk we looked at, as shown in the tables below:

5 Year Average Risk *Manager Classification based on Starting AUM*			
Size	**Ending 6/30/2009**	**Ending 6/30/2010**	**Ending 6/30/2011**
Very Small	19.54	20.67	21.17
Small	19.47	20.13	20.90
Medium	19.49	19.93	20.61
Large	19.34	20.14	20.89
Giant	19.15	20.04	20.75
Russell Mid Cap Growth Index	19.83	20.69	21.41

5 Year Product Spread *Manager Classification based on Starting AUM*			
Size	**Ending 6/30/2009**	**Ending 6/30/2010**	**Ending 6/30/2011**
Very Small	6.02	4.73	4.56
Small	2.31	3.14	2.60
Medium	1.93	1.96	2.66
Large	1.98	2.35	2.28
Giant	3.06	2.98	2.19

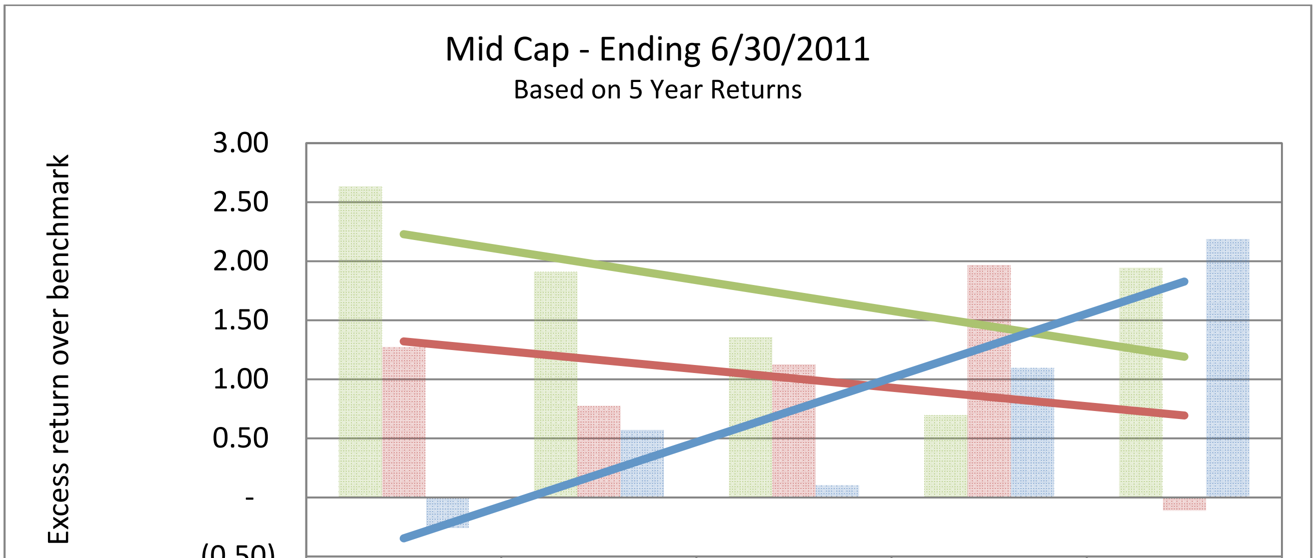
We can draw several conclusions from the tables above:

- While the tracking error of smaller managers is larger, the absolute level of manager risk seems to have no relationship to size. It also seems to be the case that most managers tend to have lower risk than the benchmark. This is a heartening result because it makes the excess return more impressive, particularly for smaller managers.
- The larger the firm, the less differentiation exists among product returns, as shown by the product-spread table. This might be because smaller managers, who tend to be more concentrated, allow themselves to deviate more from the benchmark, and from each other.
- Absolute levels of risk seem to have increased over the past 3 years, which should be of no surprise to any investor.

Conclusions:

1. Many studies have shown that smaller managers tend to perform better than larger managers. In this paper, based on longer-term 5 year data[10], we confirm that assertion in the US Mid Cap Equity space, across value and core styles. In the growth style, while active managers generally outperformed, there seemed to be an advantage to larger managers. A summary of excess returns are shown below.

2. We also show that smaller managers are more diverse in their returns, which means that due-diligence might have more opportunity to differentiate between managers. Smaller managers also show higher levels of tracking error, so a multi-manager portfolio may be required to achieve an implementation with which institutional investors are comfortable.



	Very Small	Small	Medium	Large	Giant
Mid Cap Value	2.64	1.91	1.36	0.70	1.95
Mid Cap Core	1.27	0.78	1.13	1.98	(0.11)
Mid Cap Growth	(0.26)	0.57	0.10	1.10	2.19

Please feel free to contact our CEO at monika@alturacap.com, or (212) 378-7133 for more information.

[10] In aggregate there are 207 Mid Cap Growth products, 104 Mid Cap Core products and 124 Mid Cap Value products represented in the 5 year data shown.

About Altura Capital

Altura Capital was established in March 2005 with the mission of creating new alpha generating opportunities for institutional investors by unleashing the economic potential of undiscovered, under-utilized or undercapitalized investment talent and markets, frequently described as "Emerging Managers."

Our groundbreaking and comprehensive database, coupled with the investment expertise of our team and our commitment to research and innovation in the emerging manager space, has positioned the firm as a new and compelling emerging manager-of-manager service provider. Our innovative value proposition allows investors to tap into Altura's unique manager sourcing and investment expertise, from manager due diligence to portfolio construction and monitoring.

A flagship product of Altura is the Altura Emerging Managers Information Platform, a groundbreaking, web-based, annual subscription application. The Platform provides institutional investors with daily updated research, data, analytics, due diligence, market intelligence, and collaborative tools.

Altura Capital is headquartered in New York City and has other offices in Seattle, Washington and Chicago, IL. Altura is a Women-owned and Hispanic-owned Company.

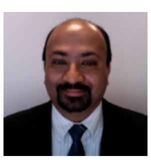
Our Research Team

Rev. Jeffrey Van Orden *Chair, Investment Committee*

Mr. Van Orden is responsible for leading Altura's investment committee, to provide oversight and insight to manager selection, fund construction, and investment department operation.

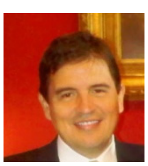
Lisa Kopp *Director of Research*

Ms. Kopp is responsible for emerging manager selection and due diligence, manager of manager portfolio construction analysis, and assessment of broader manager and universe trends.



Ravindra Deo *Chief Investment Officer & Chief Technology Officer*

Mr. Deo is responsible for the philosophy, process, and operation of the investment department, and for the technology infrastructure of the firm, including the management of the Emerging Manager Information Platform.



Jay Garcia *Chief Financial Officer & Chief Operating Officer*

Mr. Garcia is responsible for oversight and management of Altura's financials, operations, and infrastructure. He also provides research insight and strategic guidance based on his experience as a director of securities analysis and partner/portfolio manager.

Monika Mantilla *President and CEO*

Ms. Mantilla is responsible for the overall strategic direction and leadership of the firm, including client relationship, marketing, product development, human capital development and financial management.

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