TUESDAY, MAY 31, 2016

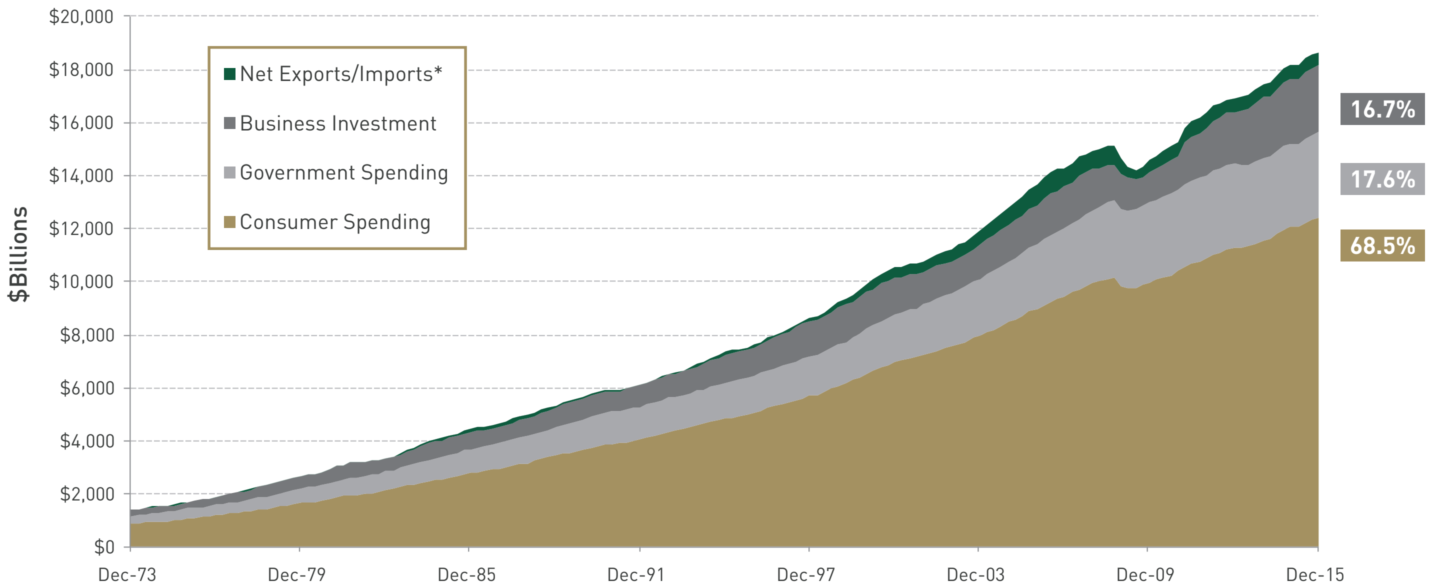
MARKET VIEW

U.S. STOCKS: SMALL- AND MID-CAPS' HOME-COURT ADVANTAGE

For those concerned about developments overseas, U.S. small- and mid-cap stocks, which are positioned to benefit from strength in domestic consumer spending, may be worth considering.

CHART 1. THE CONSUMER DRIVES THE U.S. ECONOMY

COMPONENTS OF U.S. GROSS DOMESTIC PRODUCT (GDP), AS OF DECEMBER 31, 2015



Source: U.S. Bureau of Economic Analysis. *Net imports are a detractor that reduces GDP, net exports would contribute to increasing GDP. Net imports had a -2.9% impact as of 12/31/2015. Reflects most recent final quarterly GDP available. For illustrative purposes only.

Bracing for "Brexit"? Challenged by China? You're not alone. A scan of recent headlines underscores the challenges in the global investment landscape. The United Kingdom is facing a fractious vote (June 23) on whether to leave the European Union. China is grappling with a slowing economy. The eurozone is hindered by sluggish growth and the prospect of more fiscal drama with Greece. Japan is trying to jump-start its moribund economy and counter deflation. The list goes on.

Then there's the United States. While growth for the world's largest economy has not been spectacular, it has been steady, with gross domestic product (GDP) expanding at an average annual rate of about 2% in recent years. Indeed, a number of U.S. Federal Reserve (Fed) officials have cited a strengthening U.S. economy as a policy consideration in the run-up to the next Federal Open Market Committee meeting on June 14-15.

What's behind the persistent strength of the U.S. economy? Actually, it's not a "what," but a "who": the consumer. Consumption spending accounts for nearly two-thirds of U.S. GDP (see Chart 1). The U.S. economy is uniquely dependent on internal consumption, and Zane Brown, Lord Abbett Partner and Fixed-Income Strategist, noted that total U.S. exports account for only 13% of U.S. GDP. By contrast, China's export sector makes up 23% of its economic output, while Germany's comprises around 46%, according to World Bank data.

Is the consumer, then, likely to be the continuing booster of the U.S. economy? In a recent commentary, Brown identified five factors that should support ongoing U.S. consumer spending and, by extension, U.S. economic growth. They include:

- Faster job growth
- Rising wages
- Lower oil prices, accompanied by a stronger U.S. dollar
- Stronger household balance sheets
- Solid housing-market fundamentals

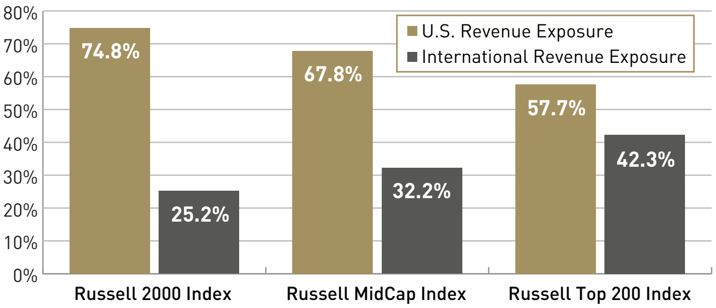
Brown noted that the U.S. economy may show "surprising strength" in the months ahead as a result of those factors.

Another positive signal comes from the May update of the University of Michigan's consumer sentiment index, which climbed to 94.7 for the month, from 89.0 in April, the highest level in 11 months. In an accompanying release, a university economist noted that "consumers became more optimistic about their financial prospects, and anticipated a somewhat lower inflation rate in the years ahead."

So, how might equity investors benefit from this trend? To answer that question, let's look at which companies might be most closely linked to the strength of the U.S. consumer. As Chart 2 shows, small- and mid-cap companies tend to be more domestically focused. Based on data from FactSet, small-cap companies derived nearly 75% of their revenue from the United States, based on fiscal year 2015 revenue estimates, while mid-cap companies garnered around 68%.

CHART 2. SMALL- AND MID-CAP COMPANIES HAVE HIGHER DOMESTIC SALES

REVENUE EXPOSURE BY MARKET CAPITALIZATION, BASED ON FISCAL YEAR 2015 REVENUE ESTIMATES



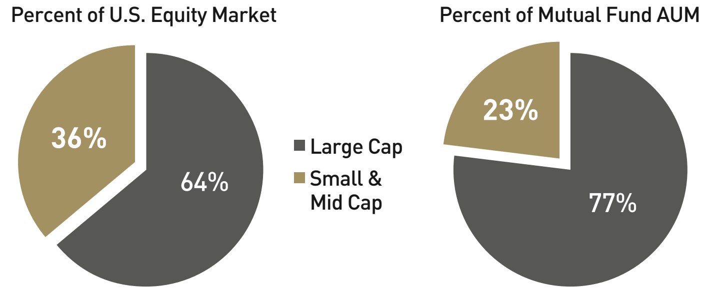
Source: FactSet. Domestic sales as a percentage of total geographic sales. Segments are collected as reported by each company in its respective index. If a company reports by region instead of country, the total domestic sales percentage is based on the home country's or country of domicile's region. For illustrative purposes only. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

To be sure, U.S.-based large- and mega-cap companies, typically with substantial global footprints, still derive more than half their revenues from the United States. But for investors who may prefer a more direct exposure to the U.S. economy—and the stalwart U.S. consumer—increasing allocations to U.S. small- and mid-cap companies might make sense.

For all the attractive qualities of small- and mid-cap stocks, however, they often are overlooked as investors place a greater focus on the large-cap segment of the market. (See Chart 3.) While small and mid caps comprise 36% of U.S. equity market capitalization, they represent only 23% of U.S. equity mutual fund assets.

CHART 3. INVESTORS ARE UNDEREXPOSED TO SMALL AND MID CAPS

SHARE OF THE U.S. EQUITY MARKET AND TOTAL EQUITY MUTUAL FUND ASSETS UNDER MANAGEMENT BY MARKET-CAP CATEGORY, AS OF MARCH 31, 2016



Source: Bloomberg, FactSet, and Morningstar. AUM=Assets under management. Large caps represented by the Russell Top 200 Index; mid caps by the Russell Midcap Index; and small caps by the Russell 2000 Index.

Past performance is no guarantee of future results. The historical data shown are for illustrative purposes only and do not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

Investors who are considering adding small- and mid-cap stocks to their portfolio allocations may wish to consider an actively managed approach when doing so. Why? Active managers may be better positioned to identify attractively valued stocks in those categories. "We believe that markets are inefficient, especially as you move down the market-cap spectrum," noted Justin Maurer and Thomas Maher, Lord Abbett partners and portfolio managers. "Active management allows skilled managers to exploit these opportunities."

IMPORTANT INFORMATION

A Note about Risk: The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. Small-cap and mid-cap company stocks tend to be more volatile and may be less liquid than large-cap company stocks. Small-cap companies also may have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies. Mid-cap companies typically experience a higher risk of failure than large cap companies. No investing strategy can overcome all market volatility or guarantee future results.

Market forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

The **Russell 1000® Index** measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index.

The **Russell 2000® Index** measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The **Russell 3000® Index** measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market.

The **Russell Midcap® Index** measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 31% of the total market capitalization of the Russell 1000 Index.

The **Russell Top 200® Index** measures the performance of the largest cap segment of the U.S. equity universe. The Russell Top 200 Index is a subset of the Russell 3000® Index. It includes approximately 200 of the largest securities based on a combination of their market cap and current index membership and represents approximately 68% of the U.S. market. The Russell Top 200 Index is constructed to provide a comprehensive and unbiased barometer for this very large cap segment and is completely reconstituted annually to ensure new and growing equities are reflected.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment

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