



Cap Size

by Bill Dickneider

You've probably heard stories that were too strange to believe, so you may not believe what I'm about to tell you. It happened a few days ago when I bought a new baseball cap. It looked cool when I tried it on in the store, and the cap's size was perfect. But I had no idea what would happen after I bought it.

Thinking Cap

When I put it on the next day, the words *cap size* began buzzing around in my head. At first, I didn't think anything about it. But look what happened a short time later. It started when the radio reported that the Dow Jones Industrial Average had risen to a record high. I couldn't stop thinking that the story had something to do with cap size. But why would the Dow have anything to do with the size of my cap? If I took the hat off, the thought went away. When I put it back on, the thought returned.

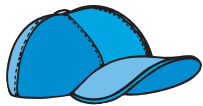
I know it sounds weird, but my new hat was trying to teach me something by using the report about the Dow. Let me tell you what I learned.

You see, the Dow measures the stock prices of 30 very large compa-

nies. A company is large when its total market value is greater than \$10 billion, although that number isn't a hard-and-fast rule. A company's market value is its market capitalization, or market cap for short. All the companies in the Dow, for instance, are large-cap companies because each one has a market value greater than \$10 billion.

Coca-Cola is one of them. It has roughly 2.3 billion shares outstanding, which is the number of shares stockholders own. Multiply that number by Coke's recent stock price of \$45, and you get its market cap of \$108.1 billion. That number is way above \$10 billion, so Coke's stock is a large-cap stock.

I knew then that cap size is the size of a company's market capitalization. Of course, all companies don't have large cap sizes. At the other end of the spectrum are small-cap stocks,



The term *cap size* can refer to a baseball cap, but it also has meaning in the stock market. What is that meaning?

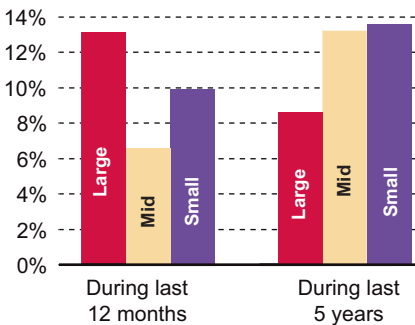
and in between are mid-cap ones. Here, too, there's no hard-and-fast number, but small companies are often defined as those with market caps below \$1 billion. Mid-cap companies are those with market-caps between those of small-cap and large-cap companies. Here are a few examples.

Company	Cap Size	Shares Outstanding	Stock Price	Market Cap
Coca-Cola (KO)	Large	2.3 billion	X \$47 =	\$108.1 billion
Circuit City (CC)	Mid	175 million	x \$27 =	\$4.7 billion
Hot Topic (HOTT)	Small	44 million	x \$11 =	\$484 million

Sources: Yahoo!Finance, <http://finance.yahoo.com/?u>; Morningstar, <http://www.morningstar.com/>

I still couldn't believe that a hat was teaching me all these things. I even learned that stock returns can vary according to cap size. Look at the following chart, for instance. During the last 12 months, large-cap stocks, measured by the Dow, have earned higher returns than mid-cap or small-cap stocks. Over the last five years, however, large-cap stocks had the lowest average yearly return.

Yearly Return of Stocks by Cap Size



Large-Cap stocks are the Dow Jones Industrial Average; mid caps are the Standard & Poor's 400; small caps are the Russell 2000.
Sources: <http://indexes.dowjones.com/>; <http://www2.standardandpoors.com/>; <http://www.russell.com/>.

Large-cap stocks are generally the least risky of the three groups because their stock prices tend to jump around less than the others. Small stocks tend to jump around the most, so they're usually the most risky.

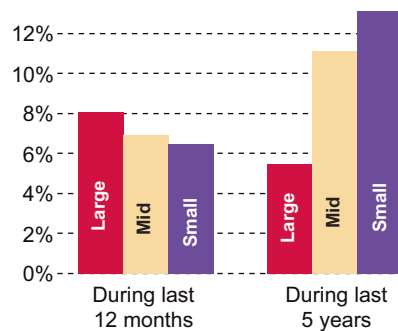
Mutual Funds

The superior returns of large-cap stocks over the last year have also applied to *mutual funds* that specialize in those stocks. Mutual funds are investment companies that pool

savers' money to invest in many different stocks. Just like individual stocks, these funds are also categorized according to cap size. Funds that own mostly large-cap stocks are large-cap funds. Other funds are mid-cap or small-cap ones.

Mutual funds can also have different returns depending on the market caps of the companies they own. The following chart is an example. It shows that large-cap funds have generally had higher returns lately compared with those of mid-cap and small-cap funds. Was that also true during the last 5 years?

Yearly Return of Mutual Funds by Cap Size



Source: "Mutual Funds Quarterly Review", *The Wall Street Journal*, October 3, 2006.

Thanks to my new hat, I was learning a lot about investing. I wondered if I shouldn't divide my investment eggs among large-cap, mid-cap, and small-cap baskets. After all, the stocks or funds of one market cap might be rising much faster than another. Or those of one market cap might be rising while those of another are falling.

By allocating my investments among those of different cap sizes, I can reduce this risk of losing money.

I still have a lot more to learn about smart investing. But do you know what I now do whenever I want to know more about the stock market? I put on my thinking cap!

Write Now

Pick one of the following and write a paragraph to explain your answer.

Do you think an understanding of cap size is important when investing in stocks and mutual funds? Why or why not?

The storyteller's hat used the Dow Jones Industrial Average to begin a lesson about cap size. Why do you think it used the Dow?