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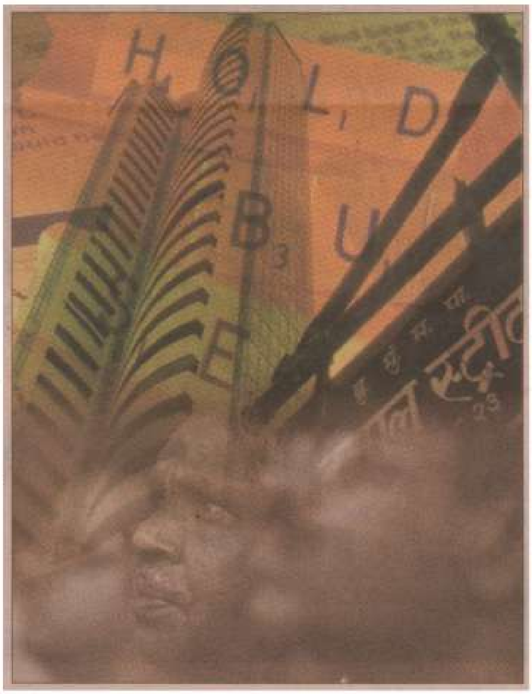
Investing based on market cap

Kavita Sriram explains how the three segments – large, small and mid cap stocks – work for investors

Market cap is market capitalisation or the equity value of a company. A company's market capitalisation is obtained by multiplying the current market price with the number of shares outstanding. Stocks are classified as mid-cap, large-cap and small-cap, based on this. Investing in small-cap stocks is considered risky while new investors prefer the more stable large-cap companies. Let's find out more about investing based on market capitalisation.



Investing in large-cap stocks

Characteristics: Large-cap stocks are big players in the stock markets. Considered as safe stocks owing to the size of these companies, the stock prices are usually stable. A diligent investor must have a look at a company's financial statement and fundamentals before investing his money. This is because large-cap stocks can have a direct bearing on the overall economic climate.

The stability offered by these stocks comes at a price. Large-cap stocks do not usually deliver huge unanticipated returns like small-cap stocks. This is because large-cap companies have already seen phenomenal growth and it takes a tremendous effort to go higher from there.

Investors who find these ideal: Stability and steady returns offered by large-cap companies make them a perfect choice for investors who are unwilling to take more risks. Large-cap stocks are usually held for long periods like parking towards retirement savings or children's marriage.

Investing in mid-cap stocks

Characteristics: Mid-cap stocks boast of stability yet retaining tremendous growth potential. Mid-caps provide a moderate alternative between large-caps that may find it difficult to increase shareholder value and the riskier small-caps. Further, mid-cap stocks/funds have evolved as an attractive investment option because of the high cost of large-cap stocks.

However, investors need to prudently identify worthy mid-cap stocks that may not have a bad fall in a plunging market. The associated stock volatility is a cause for concern. Investing excessively in mid-caps could give rise to liquidity issues when you intend to sell. This is especially true in a bad market. In such a case, you must be prepared to hold the stock for a longer time.

A well-diversified portfolio of mid-cap stocks that hold tremendous growth potential could hold the key to successful investing.

Investors who find these ideal: New and young investors can safely invest in mid-cap stocks.

Investing in small-cap stocks

Characteristics: Small-cap companies exhibit considerable volatility and are riskier. Hence, investors must select these stocks after a thorough research on the stock's fundamentals. To tackle the volatility and short-term losses, you must be prepared to stay invested for extended periods.

While investing in small-cap stocks, investors must be cautious not to end up with illiquid stocks and glitter stocks. An illiquid stock in a company does not trade actively as there is not much investor interest in this stock. Glitter stocks are those attention-hogging stocks that were in the news, had high trading volumes or extreme movements in the price.

Unlike large-caps, some small-caps have grown at high speeds. But investors must be aware that the associated returns come at a high risk. Small-caps may hold potential for profits, however, investors must exit if its financial performance doesn't meet its target growth.

Investors who find these ideal: These are the favorites of young and aggressive investors who dream of building wealth at a brisk pace.

Finally, the choice of market capitalisation you desire to invest in largely depends on your objectives, financial health and risk tolerance level. Investors who do not have time for research can invest in mutual funds that offer a wide platter of investment options based on stock size.