

Small Cap Focus Update

THE HIDDEN APPEAL OF SMALL CAP GROWTH STOCKS

Equity Selloff Defies Strong Fundamentals

This autumn has been highlighted by a considerable equity selloff driven by concerns about rising interest rates, indiscriminate selling by momentum-driven exchange traded funds and a potential trade war with China. We maintain the selloff was unrelated to company fundamentals, especially when considering that earnings growth has been particularly strong in the aftermath of tax reform.

We maintain that the Alger Small Cap Focus portfolio is an attractive strategy for investors who are concerned about interest rates and rising trade tension with China. We invest in what we believe are exceptional small companies with powerful secular growth drivers. The companies have compelling fundamentals including accelerating revenues, strong earnings per share (EPS) growth and expanding margins.

Managing Interest Rate Risk

We believe the following factors may help insulate the portfolio from the adverse impact of rising interest rates:

- By generating strong revenues and earnings growth, our portfolio holdings are less dependent on external sources of financing and typically have low debt levels.
- As of September 30, 2018, the portfolio's debt to total capital ratio was only 20.2, substantially lower than the 34 ratio of the Russell 2000 Growth Index. We believe these low debt levels could make our holdings less susceptible to rising interest rates.
- We use a research-intensive strategy to find businesses that are truly differentiated. They are innovative adopters of technology, including medical breakthroughs and internet-related advancements, so our portfolio companies tend to have strong pricing power. This strong pricing power combined with business models that are not capital intensive means that many of our holdings are well positioned to weather inflation.

Other Considerations

We believe our holdings may be relative safe havens as trade tension with China lingers because smaller companies tend to generate the bulk of their earnings within the U.S.

Finally, we note that many of our holdings may be attractive acquisition targets. By offering unique and innovative products, the companies may be highly sought after by acquirers and can potentially be purchased at substantial premiums relative to their current market valuations.



Amy Y. Zhang, CFA®

SENIOR VICE PRESIDENT
PORTFOLIO MANAGER

Market Volatility and Valuations

Our strategy is earnings driven and most of its outperformance this year can be attributed to the strengthening profits, accelerating revenues and EPS growth of our holdings. One silver lining to the selloff is that the decline has occurred before the next period of corporate earnings announcements. The combination of lower valuations resulting from the recent selloff and potentially strong earnings results could be favorable for the performance of small cap growth equities and our portfolio in the coming months. As a long-term investor that takes a patient approach to our holdings, we strive to use market volatility to buy attractive companies when there is a disconnect between fundamentals and stock prices. The current market decline is no exception.

Going Forward

We urge investors to focus on fundamentals and to consider investing in what we believe are exceptional small companies with secular growth drivers that are well positioned to generate earnings growth by offering innovative products and services. The ebb and flow of fears about the economy and interest rates are likely to persist, but exceptional companies with innovative products can potentially generate durable earnings growth that in the long term might reward patient investors by supporting equity valuations.

Risk Disclosure: Investing in the stock market involves gains and losses and may not be suitable for all investors. The value of an investment may move up or down, sometimes rapidly and unpredictably, and may be worth more or less than what you invested. Stocks tend to be more volatile than other investments such as bonds. Growth stocks tend to be more volatile than other stocks as the prices of growth stocks tend to be higher in relation to their companies' earnings and may be more sensitive to market, political, and economic developments. Investing in companies of small capitalizations involves the risk that such issuers may have limited product lines or financial resources, lack management depth, or have more limited liquidity. The investments may be more concentrated and therefore more vulnerable to changes in the market value of a single issuer and may be more susceptible to risks associated with a single economic, political or regulatory occurrence than a more diversified portfolio. The investments are concentrated in the health sciences sector and may be more volatile than those that do not similarly concentrate their investments. Changes in applicable regulations could adversely affect companies in these industries, and the pace of product development and technological advancement in comparative companies may result in greater volatility of the price of securities of such companies. Many technology companies have limited operating histories and prices of these companies' securities have historically been more volatile than other securities due to increased competition, government regulation, and risk of obsolescence due to the progress of technological developments. A significant portion of the assets will be invested in securities of healthcare companies, which may be significantly affected by intense competition, aggressive pricing, government regulation, technological innovations, product obsolescence, patent considerations, product compatibility and consumer preferences, and may be more volatile than the securities of other companies. The cost of borrowing money to leverage may exceed the returns for the securities purchased or the securities purchased may actually go down in value more quickly than if borrowing had not been utilized. Foreign investing involves special risks including currency risk and risks related to political, social, or economic conditions. The discussion of the Fund's investments

and investment strategy (including current investment themes, the portfolio managers' research and investment process, and portfolio characteristics) represents the Fund's investments and the views of the portfolio managers at the time of this letter, and are subject to change without notice. Holdings and sector allocations are subject to change; do not constitute recommendations by Fred Alger Management, Inc.

The performance data quoted represents past performance, which is not an indication or a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. Performance figures assume all distributions are reinvested.

The Russell 2000® Growth Index is an index of common stocks designed to track performance of small-capitalization companies with greater than average growth orientation. Index performance does not reflect deduction for fees, expenses, or taxes. Investors cannot invest directly in any index.

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