Small Cap Focus Update

THE HIDDEN APPEAL OF SMALL CAP GROWTH STOCKS

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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.

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.