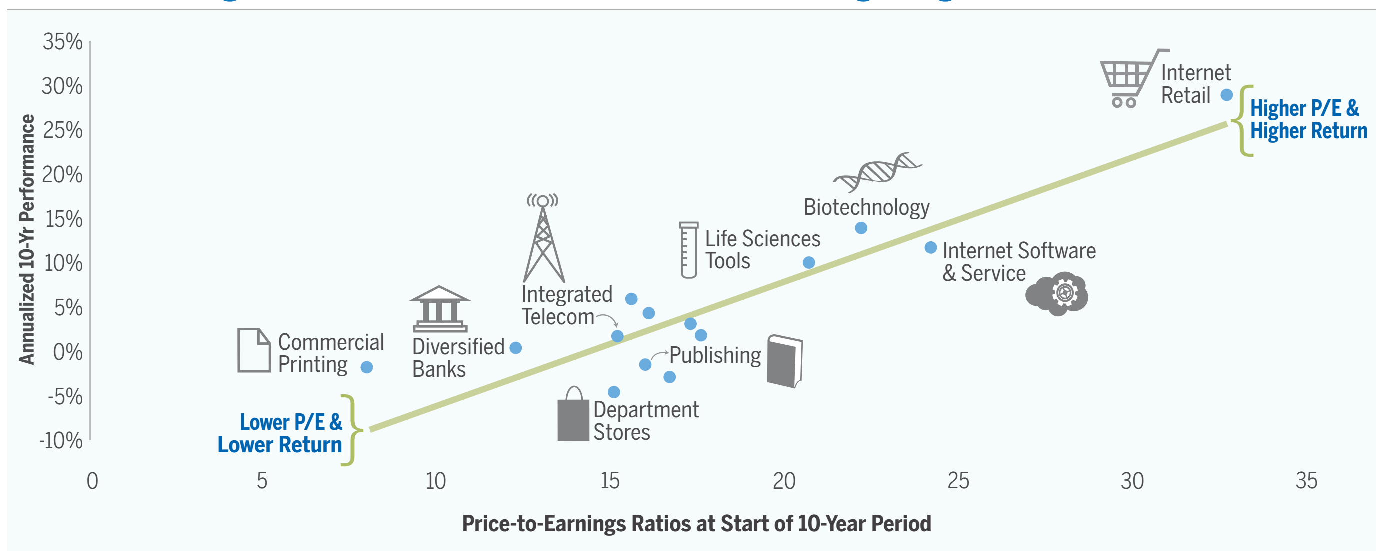
ALGER

Alger On the Money

Focus on the "E" in P/E

Among areas of the economy experiencing intense change, certain industries with high price-to-earnings (P/E) ratios have outperformed, a result of strong innovation and vibrant earnings growth. Rather than focus on P/Es, investors should assess earnings growth potential and the consequences of innovation.

Innovation Changes the Rules of Valuation – Performance vs. Beginning Valuations



Source: FactSet. Internet Retail, Internet Software, Biotechnology, Paper Products, Life Sciences Tools, Electronic Retail, Food Retail, Department Stores, Asset Management, Pharmaceuticals, Integrated Telecom, Commercial Printing. 12/2006 – 12/2016.

- Biotechnology, Internet Software & Services, and Internet Retail had the highest P/Es at the start of the 10-year period shown above. However, impressive innovation resulted in those industries generating strong earnings growth and substantially outperforming industries such as Department Stores, Commercial Printing, and Integrated Telecom.
- The accelerating rate at which innovation is being adopted (see Alger On the Money *"Champions of Change"*) means that high-growth sectors have potential to continue rapidly growing their earnings and outperforming.
- Low P/E categories may be "value traps" that are losing market share to more innovative industries. For example, during the 10-year period ended December 31, 2016, the Department Stores industry generated a -5% annualized return compared to the 29% annualized gain for Internet Retail. We believe investors should focus on earnings growth potential rather than simply favoring industries with lower P/Es.

Inspired by Change, Driven by Growth.

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