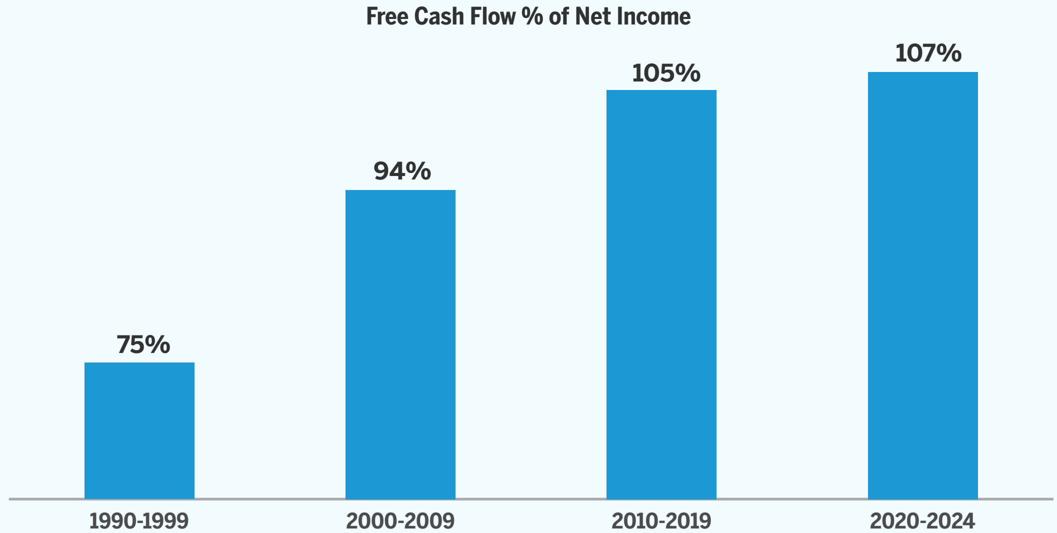
Follow the Cash Flow

Investors often rely on earnings-related metrics, such as price-to-earnings (P/E), to assess valuation and make decisions on asset allocation. The trouble is that the relationship between earnings and free cash flow, what we believe is the real driver of long-term shareholder value, has been changing considerably over time. What are the implications for equity investors in today's market environment?

Increasing S&P 500 Free Cash Flow Conversion



Source: FactSet and Standard & Poor's as of 6/30/2024.

- Free cash flow conversion, or the percentage of free cash flow generated per dollar of net income, has been rising in recent years. In the 1990s, S&P 500 companies produced approximately $0.75 of free cash flow for every $1 of net income but in the past several years they have produced more free cash flow than net income, as seen in the chart above.
- This increase is due to companies investing more in intangible assets (e.g., research and development), which are expensed immediately on the income statement rather than capitalized (i.e., recorded as an asset on the balance sheet where the cost would be spread out over time). In turn, this may be causing earnings to decline relative to free cash flow thereby boosting free cash flow conversion. For example, the growing software industry generally has much higher free cash flow conversion than automobile manufacturers because software providers are less capital intensive and more of their investments are expensed rather than capitalized.
- We believe that higher free cash flow conversion implies that a higher price-to-earnings ratio is appropriate relative to history. This may have a profound impact on security selection as well as asset allocation models that utilize accounting-based valuation metrics like P/E, potentially implying higher equity allocations.

The views expressed are the views of Fred Alger Management, LLC ("FAM") and its affiliates as of August 2024. These views are subject to change at any time and may not represent the views of all portfolio management teams. These views should not be interpreted as a guarantee of the future performance of the markets, any security or any funds managed by FAM. These views are not meant to provide investment advice and should not be considered a recommendation to purchase or sell securities.

Risk Disclosures: Investing in the stock market involves risks, including the potential loss of principal. Growth stocks may be more volatile than other stocks as their prices tend to be higher in relation to their companies' earnings and may be more sensitive to market, political, and economic developments. Local, regional or global events such as environmental or natural disasters, war, terrorism, pandemics, outbreaks of infectious diseases and similar public health threats, recessions, or other events could have a significant impact on investments. **Past performance is not indicative of future performance.** Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Important Information for US Investors: This material must be accompanied by the most recent fund fact sheet(s) if used in connection with the sale of mutual fund and ETF shares. Fred Alger & Company, LLC serves as distributor of the Alger mutual funds.

Important Information for UK and EU Investors: This material is directed at investment professionals and qualified investors (as defined by MiFID/FCA regulations). It is for information purposes only and has been prepared and is made available for the benefit investors. This material does not constitute an offer or solicitation to any person in any jurisdiction in which it is not authorized or permitted, or to anyone who would be an unlawful recipient, and is only intended for use by original recipients and addressees. The original recipient is solely responsible for any actions in further distributing this material and should be satisfied in doing so that there is no breach of local legislation or regulation.

Certain products may be subject to restrictions with regard to certain persons or in certain countries under national regulations applicable to such persons or countries.

Alger Management, Ltd. (85 Gresham Street, Suite 308, London EC2V 7NQ, UK) is authorized and regulated by the Financial Conduct Authority, for the distribution of regulated financial products and services. FAM, Weatherbie Capital, LLC, and/or Redwood Investments, LLC, U.S. registered investment advisors, serve as sub-portfolio manager to financial products distributed by Alger Management, Ltd.

Alger Group Holdings, LLC (parent company of FAM and Alger Management, Ltd.), FAM, and Fred Alger & Company, LLC are not authorized persons for the purposes of the Financial Services and Markets Act 2000 of the United Kingdom ("FSMA") and this material has not been approved by an authorized person for the purposes of Section 21(2)(b) of the FSMA.

Important information for Investors in Israel: Fred Alger Management, LLC is neither licensed nor insured under the Israeli Regulation of Investment Advice, of Investment Marketing, and of Portfolio Management Law, 1995 (the "Investment Advice Law"). This document is for information purposes only and should not be construed as an offering of Investment Advisory, Investment Marketing or Portfolio Management services (As defined in the Investment Advice Law). Services regulated under the Investment Advice Law are only available to investors that fall within the First Schedule of Investment Advice Law ("Qualified Clients"). It is hereby noted that with respect to Qualified Clients, Fred Alger Management, LLC is not obliged to comply with the following requirements of the Investment Advice Law: (1) ensuring the compatibility of service to the needs of client; (2) engaging in a written agreement with the client, the content of which is as described in section 13 of the Investment Advice Law; (3) providing the client with appropriate disclosure regarding all matters that are material to a proposed transaction or to the advice given; (4) a prohibition on preferring certain Securities or other Financial Assets; (5) providing disclosure about "extraordinary risks" entailed in a transaction (and obtaining the client's approval of such transactions, if applicable); (6) a prohibition on making Portfolio Management fees conditional upon profits or number of transactions; (7) maintaining records of advisory/discretionary actions. This document is directed at and intended for Qualified Clients only.

The S&P 500 Index is an index of large company stocks considered to be representative of the U.S. stock market. The indices presented are provided for illustrative purposes, reflect the reinvestment of dividends and do not assess fees and expenses that would have the effect of reducing returns. Investors cannot invest directly in any index. The index performance does not represent the returns of any portfolio advised by Fred Alger Management, LLC and actual client results might differ materially than the indices shown. **Note that past performance is no guarantee of future results.** The S&P indexes are a product of S&P Dow Jones Indices LLC and/or its affiliates and has been licensed for use by Fred Alger Management, LLC and its affiliates. Copyright 2024 S&P Dow Jones Indices LLC, a subsidiary of S&P Global Inc. and/or its affiliates. All rights reserved. Redistribution or reproduction in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC. S&P® is a registered trademark of Standard & Poor's Financial Services LLC and Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC. Neither S&P Dow Jones Indices LLC, Dow Jones Trademark Holdings LLC, their affiliates nor their third party licensors make any representation or warranty, express or implied, as to the ability of any index to accurately represent the asset class or market sector that it purports to represent and neither S&P Dow Jones Indices LLC, Dow Jones Trademark Holdings LLC, their affiliates nor their third party licensors shall have any liability for any errors, omissions, or interruptions of any index or the data included therein.

Free cash flow is the cash a company generates after taking into consideration cash outflows that support its operations and maintain its capital assets.

FactSet is an independent source, which Alger believes to be a reliable source. FAM, however, makes no representation that it is complete or accurate.

Price-to-earnings is the ratio for valuing a company that measures its current share price relative to its earnings per share.

Alger pays compensation to third party marketers to sell various strategies to prospective investors.

Fred Alger Management, LLC 100 Pearl Street, New York, NY 10004 / www.alger.com
800.305.8547 *(Retail)* / 800.223.3810 *(Institutional)*