LA FRANÇAISE

ALGER
Alger Management, Ltd.

Capital Markets: Observations and Insights

Earnings Resurgence

Spring 2017

Inspired by Change, Driven by Growth.

Key Observations

- After diverging in 2016, **fundamentals once again drove performance** in 1Q17
- There is a **resurgence in earnings growth** after a couple of years of weakness
- Leading indicators suggest that **economic and corporate profits will continue to expand**
- Some **areas of the equity market are attractively valued**, particularly relative to fixed income and real estate

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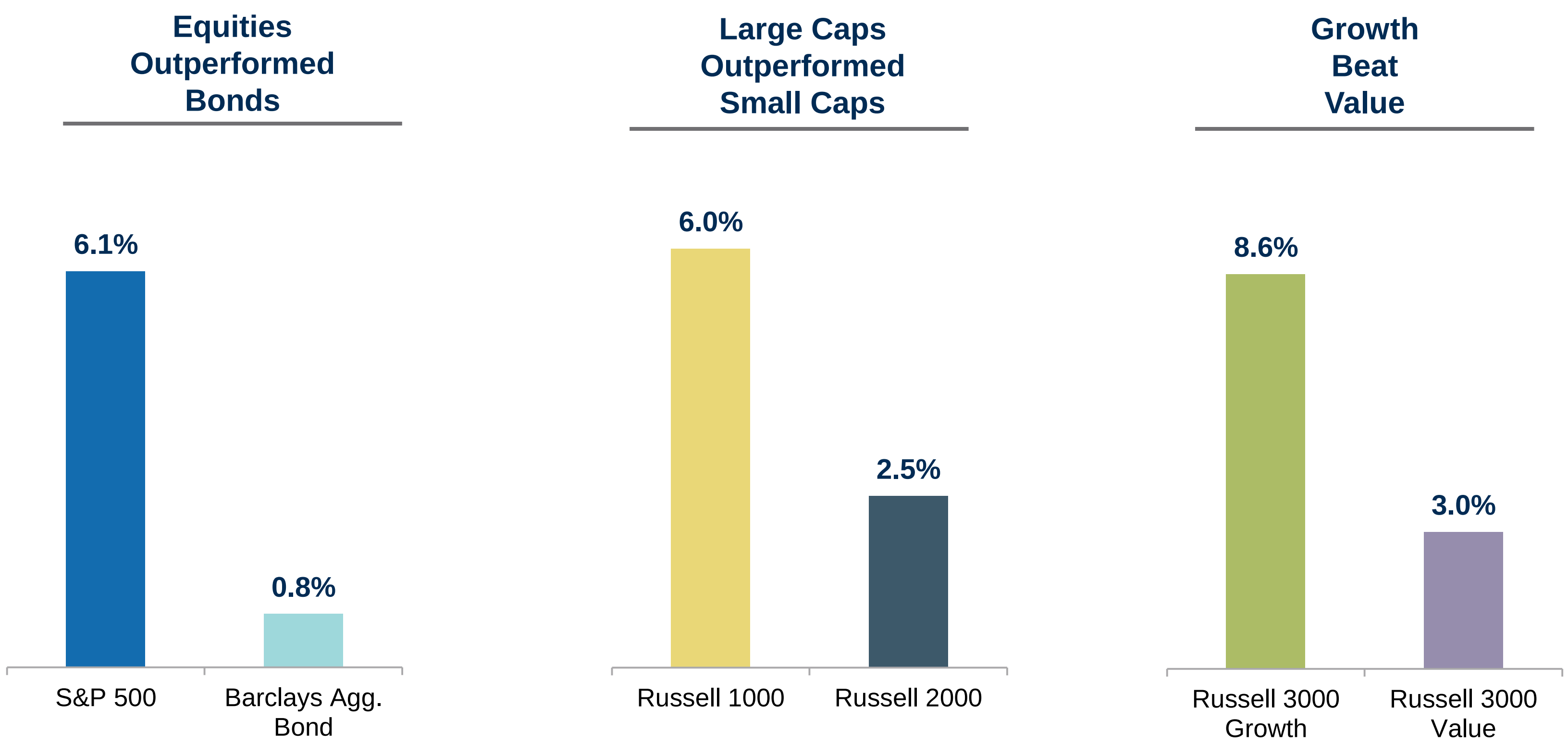
Performance

Strong Fundamental Data Drove Performance

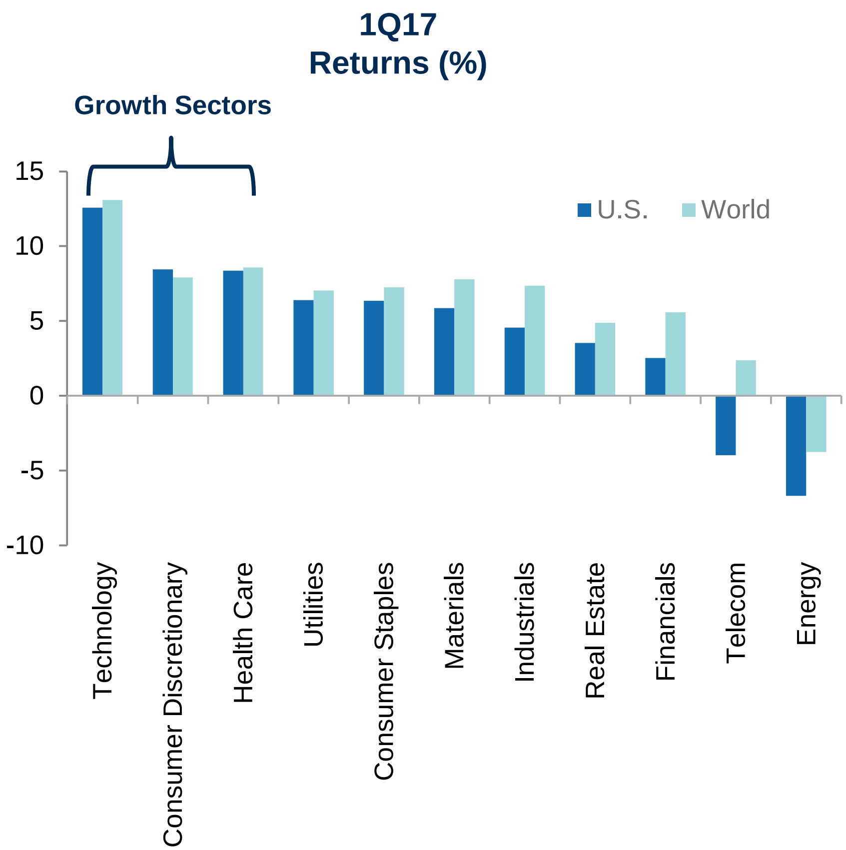
1Q17 Performance

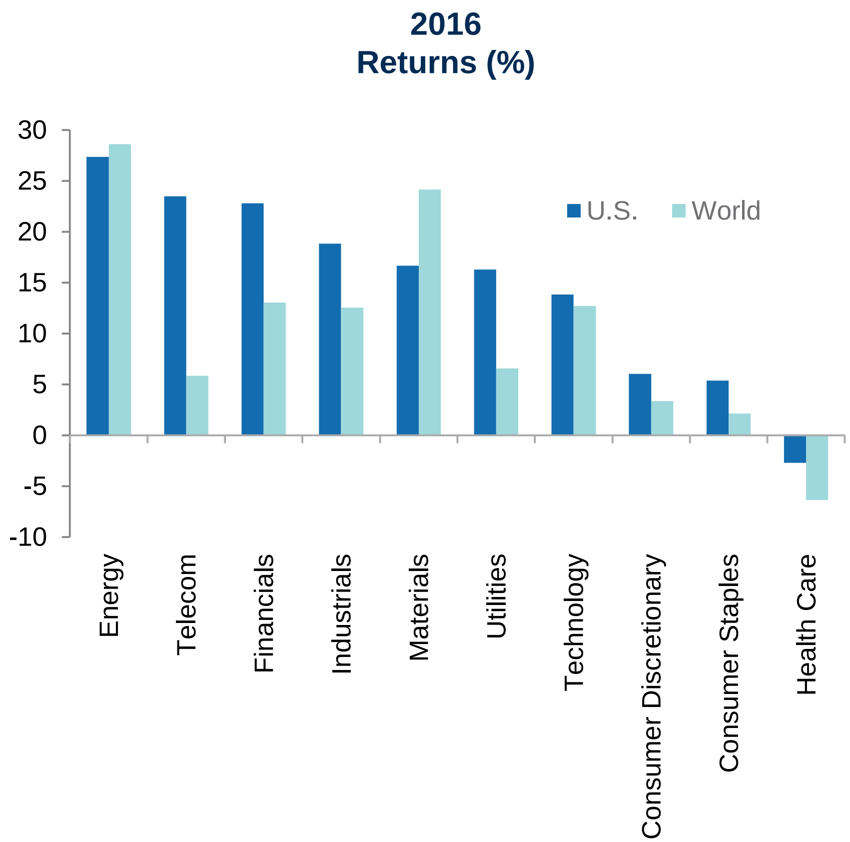


Source: FactSet as of 3/31/2017.

Growth Sectors Led in 1Q17

- As investors refocused on growth and current fundamentals, growth sectors such as Technology, Health Care, and Consumer Discretionary outperformed



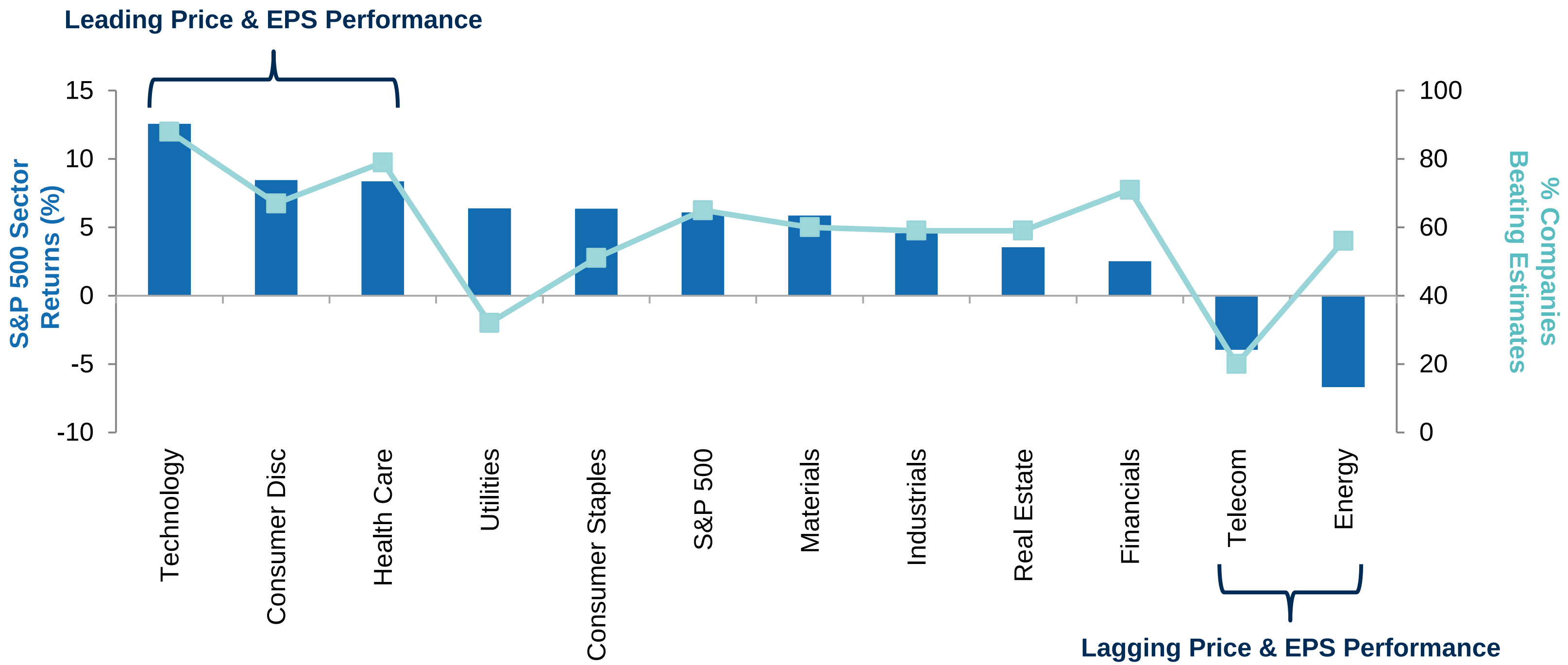


Source: FactSet as of 3/31/2017. U.S. represented by S&P 500 and World is represented by MSCI All Country World Index.

Performance

Earnings Drove Sector Performance in 1Q17

- In contrast to much of last year, sectors with strong earnings performance in 1Q17 had the best stock performance (i.e. Technology, Consumer Discretionary, and Health Care)
- In the same way, sectors with poor earnings relative to expectations underperformed (i.e. Telecom and Energy)



Source: FactSet as of 3/31/2017. Companies beating estimates based on Q416 earnings results relative to consensus, reported during 1Q17.

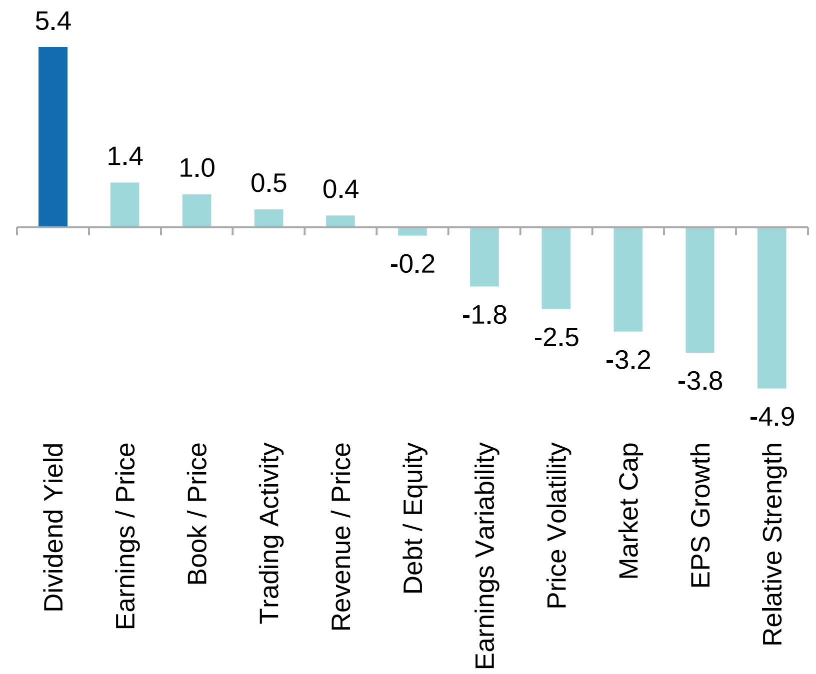
Performance

The First Shall be Last

- Stocks with strong relative strength (strong performers in 2016) underperformed the most in 1Q17
- The trough in interest rates in 2016 helped drive the search for dividend yield amid the rotation to bond-like equities

1Q17
Excess Return (%)

2016
Excess Return (%)



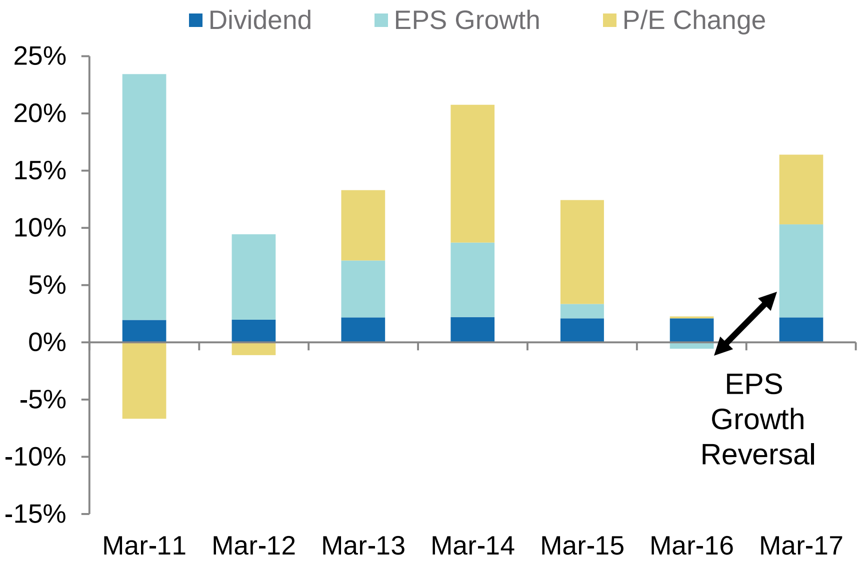
Source: FactSet as of 3/31/17 using Northfield defined quantitative factors for the Northfield broad U.S. market database.

Performance

The Earnings Growth Resurgence is Boosting Performance

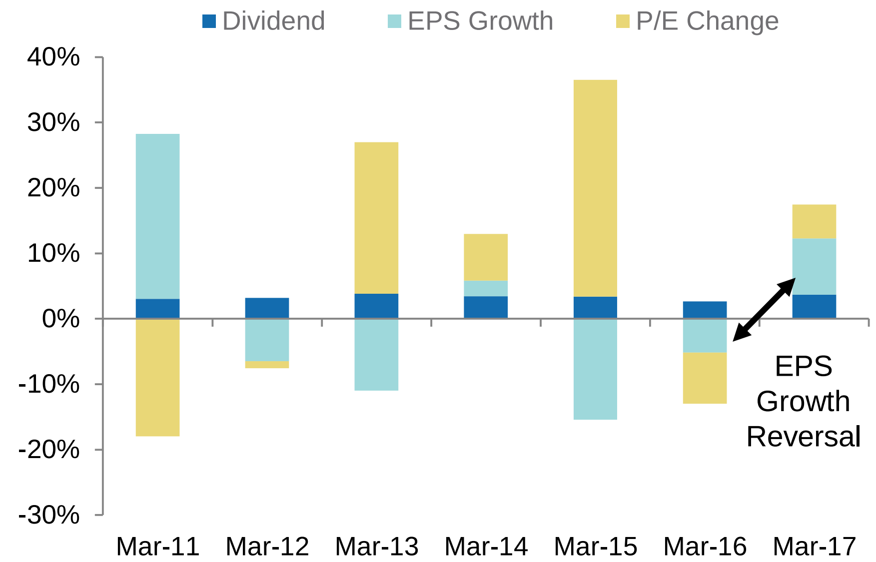
Total Return = Dividend Yield + EPS Growth +/- P/E Change

S&P 500



12-Month Total Return:	16%	9%	14%	22%	13%	2%	17%

MSCI All Country World Index ex-USA

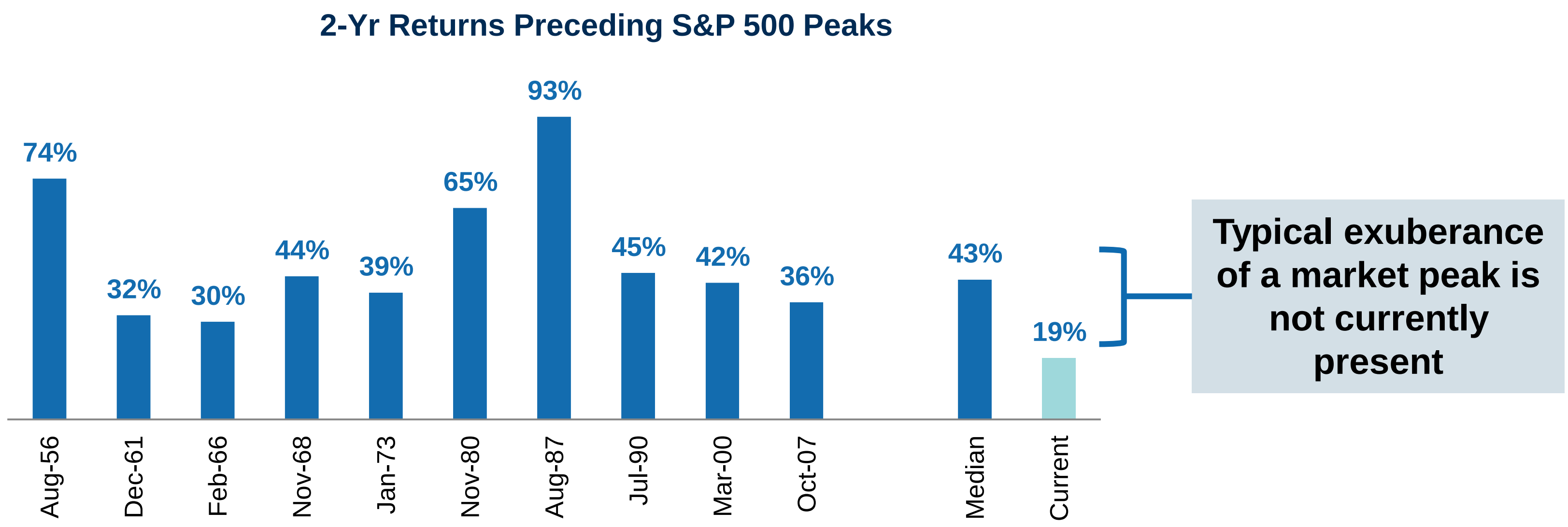


12-Month Total Return:	6%	-4%	14%	13%	16%	-10%	18%

Source: FactSet as of 3/31/17. Based on consensus estimates of next 12-month EPS. Actual earnings per share might be materially different than shown. MSCI ACWI ex-US performance based on local currency.

Missing: Exuberance that Typically Accompanies End of Bull Run

- The voyage of a bull market begins in despair, sails forward in anxiety, catches the winds of enthusiasm, and finally hits the rocks of exuberance
- Over the past 60 years, equity markets typically have had very large increases preceding their peaks

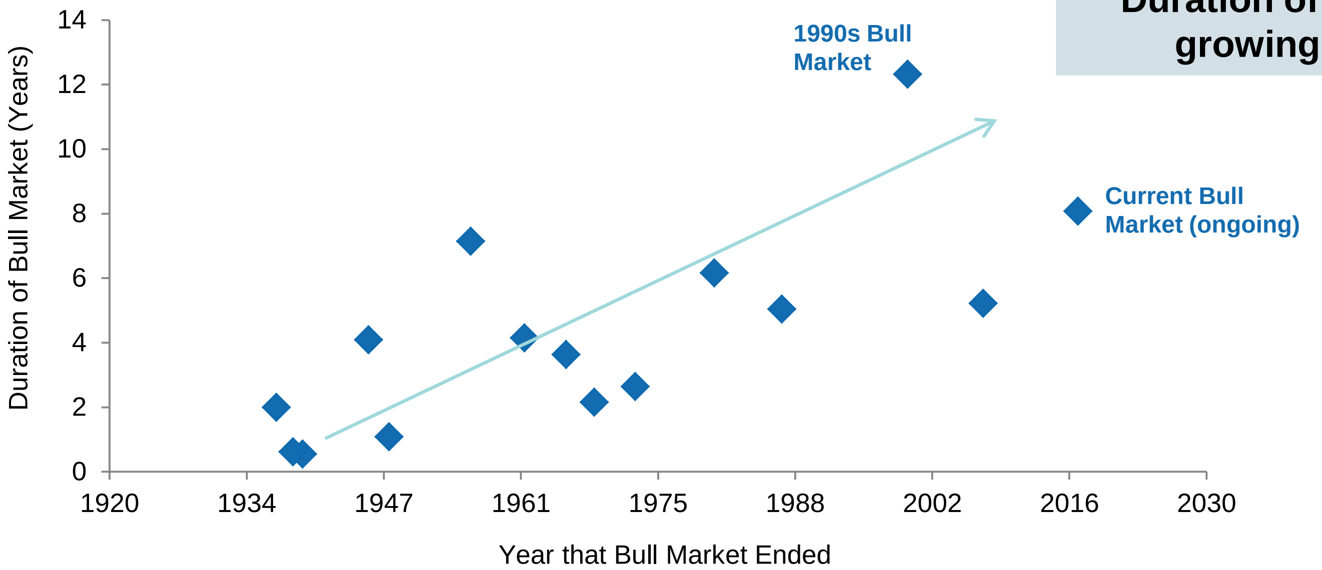


Source: BofA ML U.S. Equity & Quant Strategy and FactSet.

Waiting on the Sidelines Can Be Costly

- Bull markets have been getting longer over time
- The current bull market is four years younger than the 1990s bull market
  - Those last four years produced >150% total return; even through the trough of the following correction, equities generated a high-single digit annual return

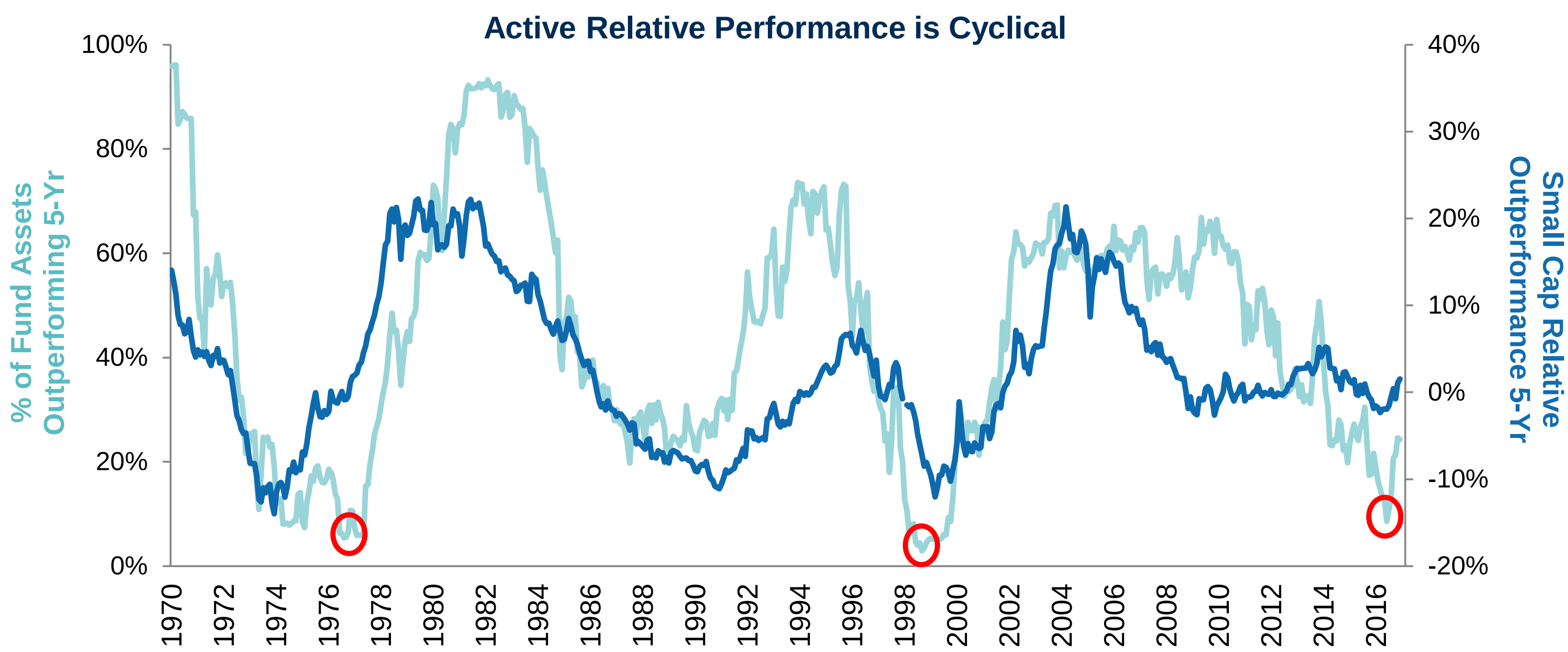
Duration of bull markets growing over time



Source: FactSet and Goldman Sachs. Bull markets over 6-months in duration since 1930.

Has Active Relative Performance Troughed?

- While there are secular pressures affecting active management, cyclical factors tend to be much more powerful in the short- and medium-term
- We believe the trough in cyclical active performance may be behind us as small caps, the largest of several factors that drive active relative performance, are likely to perform better in the future (see pg.18)

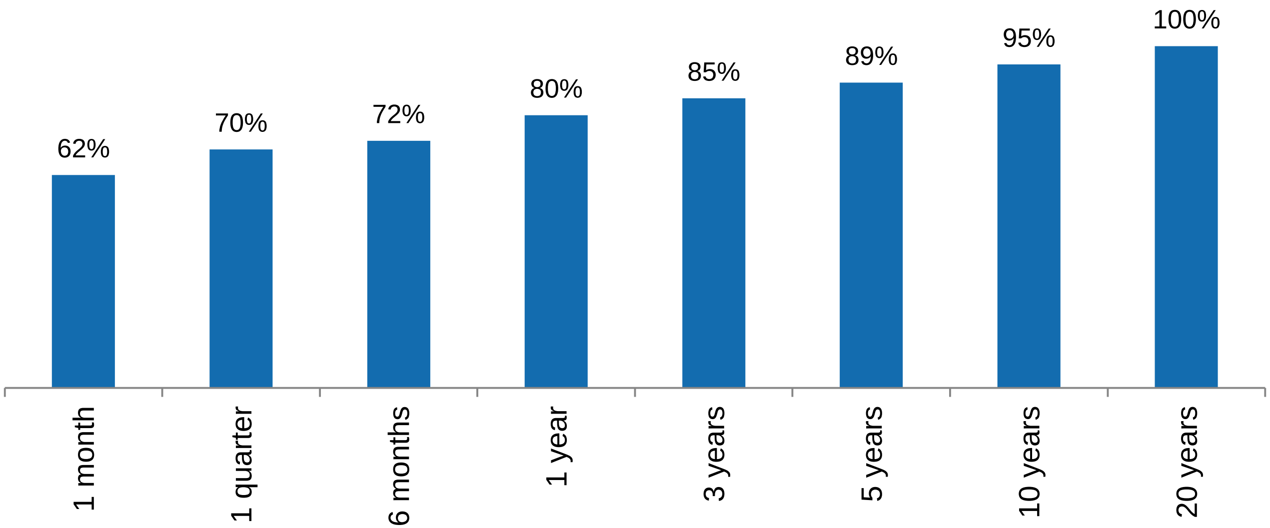


Source: Nomura/Instinet Quantitative Investment Strategy and FactSet through 12/31/16. Fund performance is trailing 5-year data and Small Cap Outperformance is Ibbotson US Small Stock Premium 5-year rolling return.

Put Probability on Your Side

- The probability of positive returns increases over time
  - Valuations, such as P/Es, can vary widely over short periods of time, driving volatility
  - In the long-run P/Es are mean-reverting, allowing earnings growth, which is typically positive over long periods of time, to drive stock prices higher

Historical Probability of Positive Returns Based on Holding Period



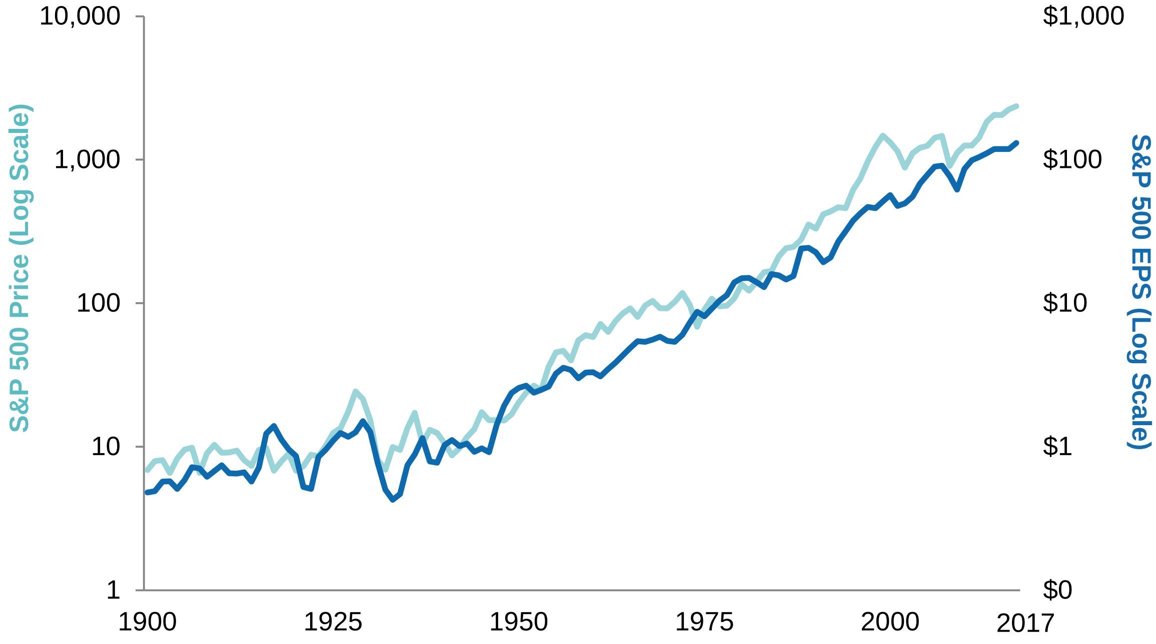
Longer holding periods typically increase probability of positive returns

Source: FactSet and Alger calculations using S&P 500 monthly total return data from January 1970 – March 2017.

Fundamentals

The Stock Market Engine Runs on Earnings Growth

- “In the short run, the market is a voting machine, but in the long run, it is a weighing machine.” –Ben Graham
- EPS growth has averaged approximately 6% annually over the past 50 years

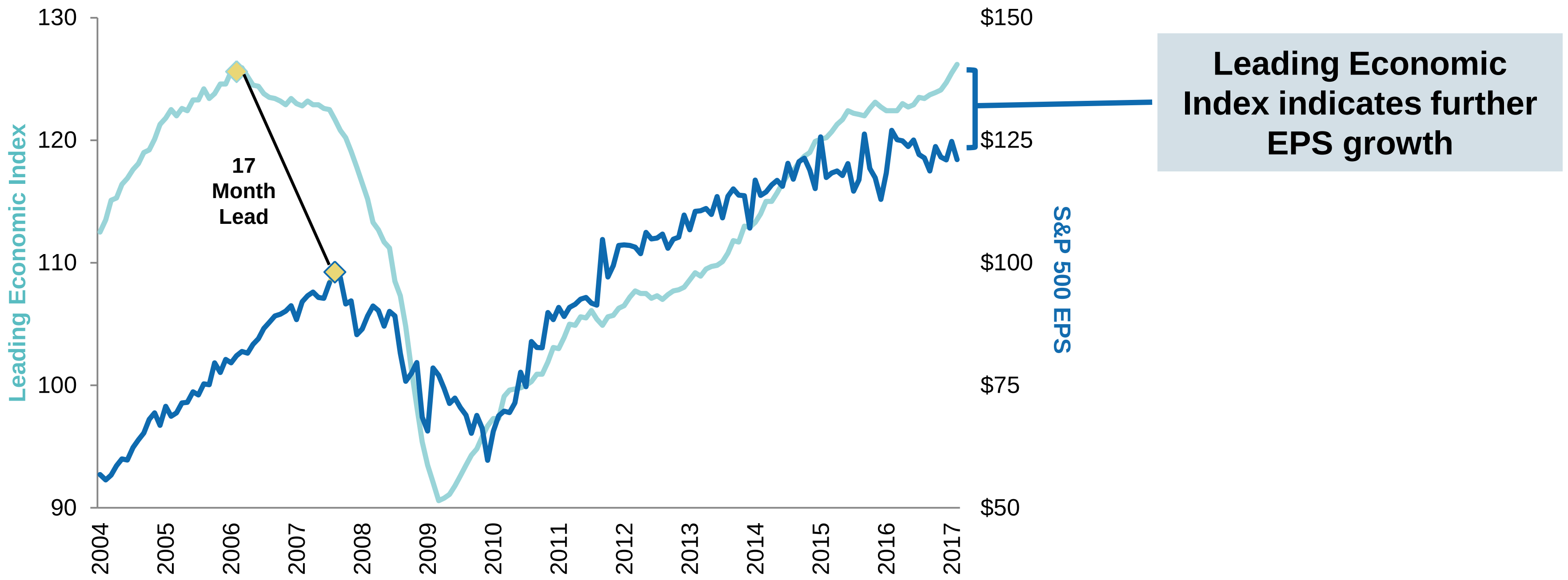


In the short term, sentiment/valuation drives returns; in the long term, stock prices grow exponentially with earnings

Source: FactSet, S&P, Robert Shiller. Data through March 31, 2017.

Leading Indicators Suggest Earnings Will Continue to Rise

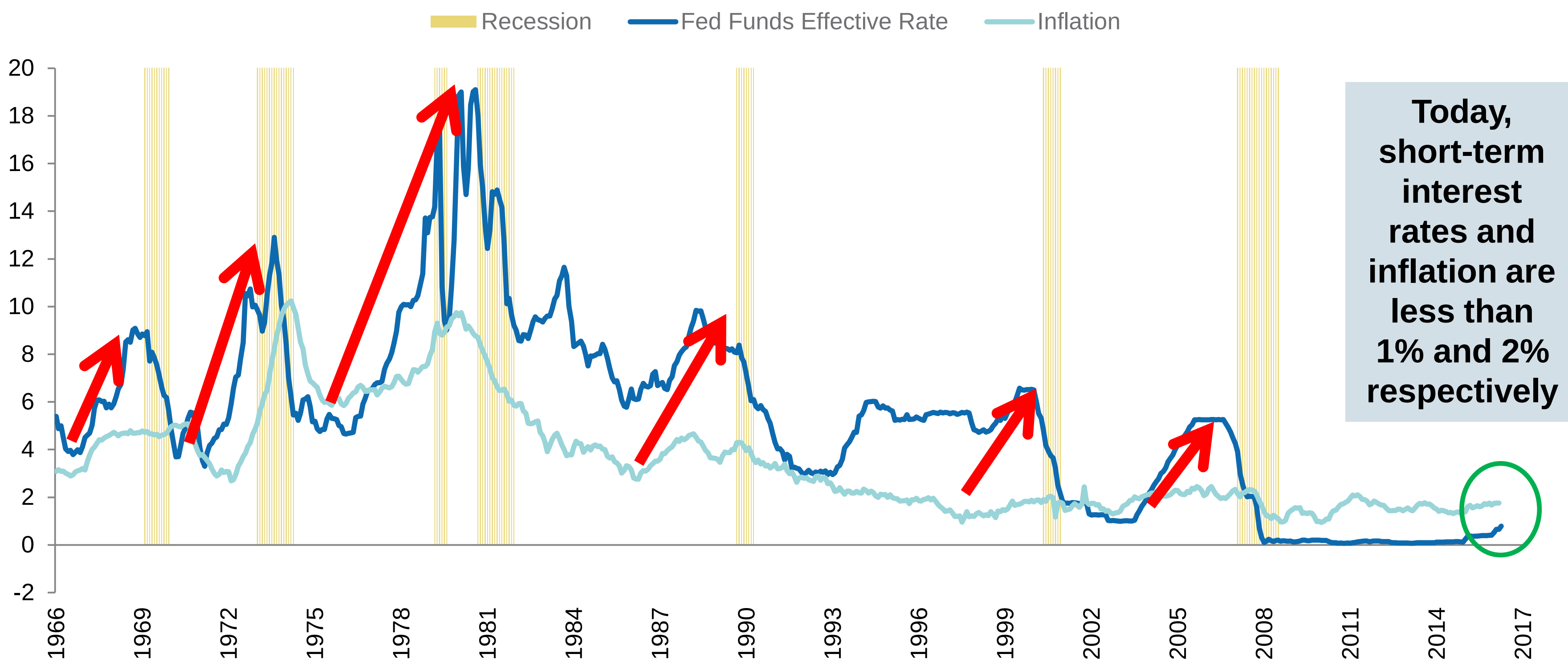
- The Conference Board Leading Economic Index (LEI) typically leads earnings by 6-18 months and usually peaks one to two years prior to a recession
- Given that the LEI is increasing solidly year-over-year and hit a record high in 1Q17, we believe the economy and earnings have room to run



Source: FactSet, Conference Board.

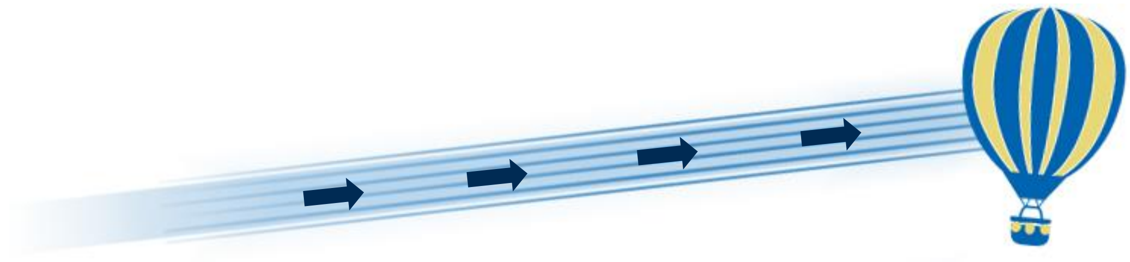
Leading Cycle Indicators Are Not Flashing Red

- Every major recession in the past 75 years has been preceded by substantial Fed Funds rate tightening or inflation acceleration, or both
- On average, the U.S. has not entered a recession until about three years after *material* Fed tightening, which we believe is beginning this year



Source: FactSet as of 3/31/17. Inflation represented by PCE Price Index ex-food and energy (year over year).

Tailwinds



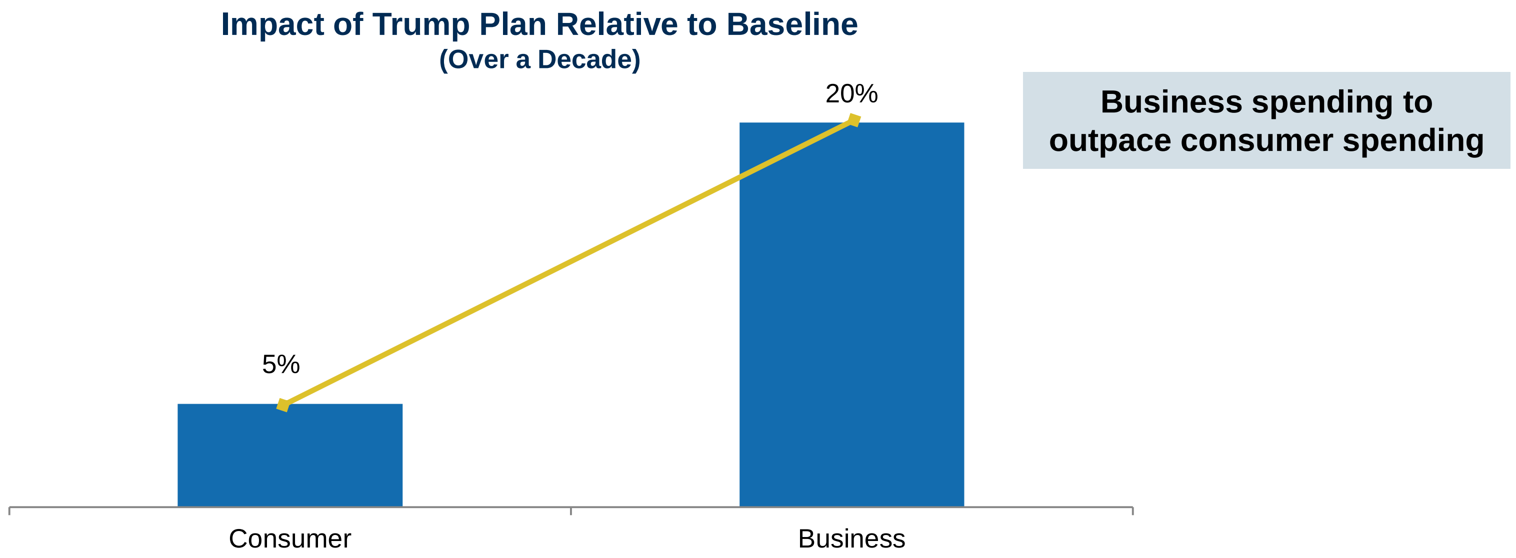
- Strong consumer balance sheet
- Rising real disposable income
- Improving consumer and business confidence
- Fiscal stimulus

Headwinds

- Tightening monetary policy (U.S. and China)
- Political risk
- Rising U.S. dollar
- Increasing energy prices

Fiscal Policy Could Boost Earnings Materially

- A 10 percentage point decline in the corporate tax rate would likely boost S&P 500 EPS by about 8%
- Business spending would likely benefit more than consumer spending given lower corporate tax rates→ increase in enterprise cash flow→ higher business spending
  - The Tax Foundation's analysis of the Trump plan suggests that wages should increase 5% but capital stock (i.e. business spending) would be 20% higher!

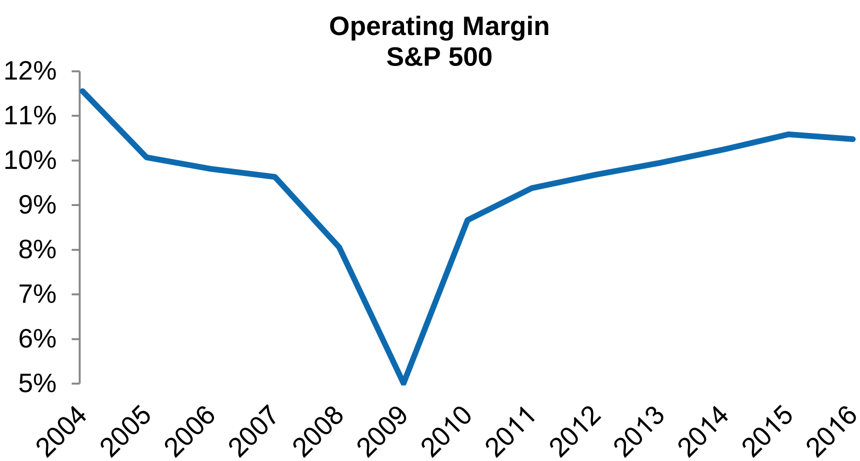


Source: Tax Foundation and Cornerstone Macro. "Consumer" is higher wages and "Business" is capital stock.

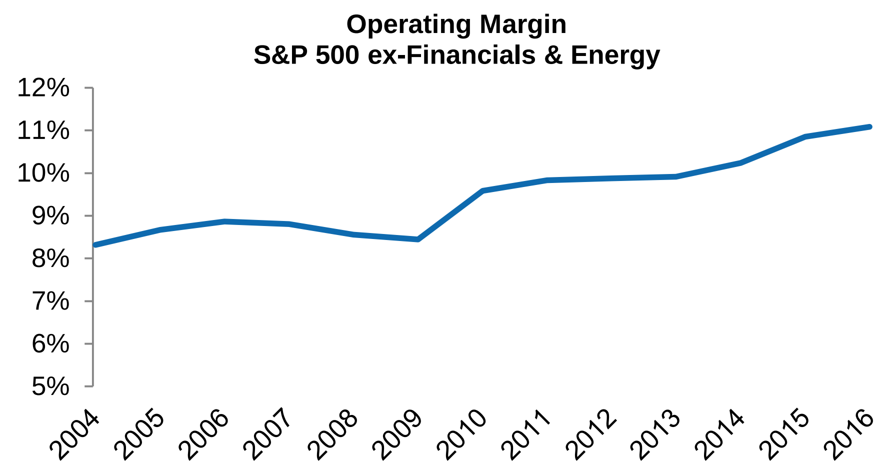
Margins Set to Drive Earnings Higher

- Corporate operating margins have been range-bound
- After being decimated by the Financial Crisis, they are still being dragged down by Financials and Energy
- Ex-Financials and Energy, however, margins have been in a secular uptrend
- As the other two sectors recover and the secular trend continues, overall margins could hit new highs, driving earnings to new records

Margins have not been able to Breakout…



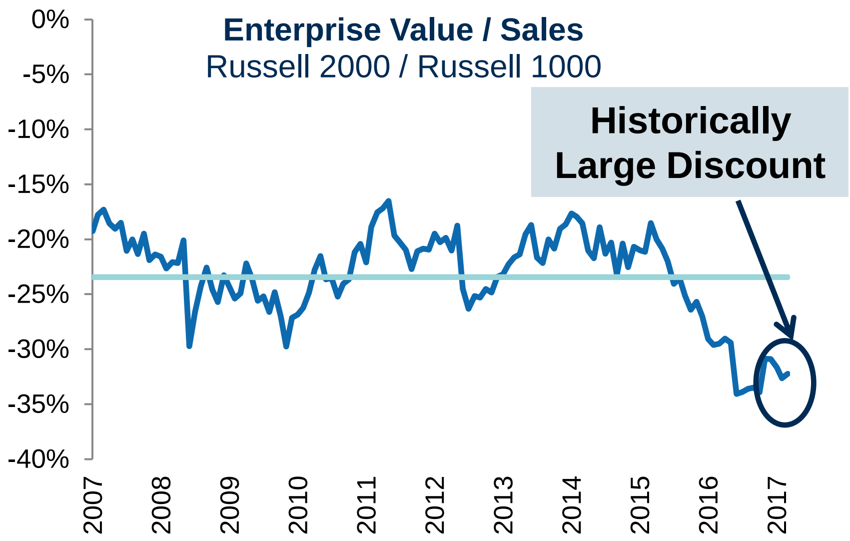
…Masking Strong Underlying Progress

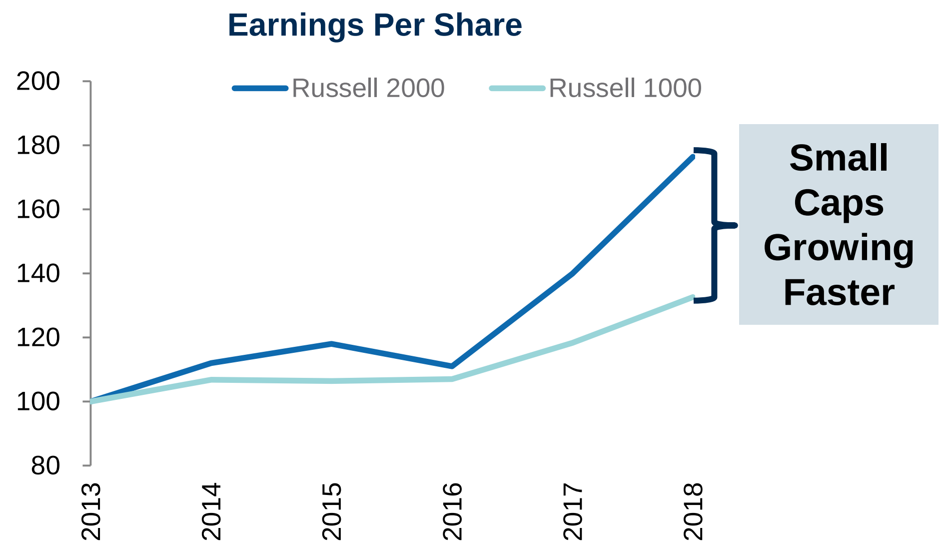


Source: BofA using current S&P 500 constituents through 12/31/16.

Smaller Capitalization Stocks Poised to Outperform

- Smaller capitalization tailwinds
  - **More levered to fiscal stimulus**: Small caps are more U.S. oriented and have higher operating leverage
  - **Rising interest rates**: Small caps have historically outperformed large caps in rising rate environments and vice versa in falling rate environments
  - **Attractive valuation**: Small cap sales multiple discount implies opportunity
  - **Stronger fundamentals**: Estimated EPS growth for 2017 approximately double that of large cap





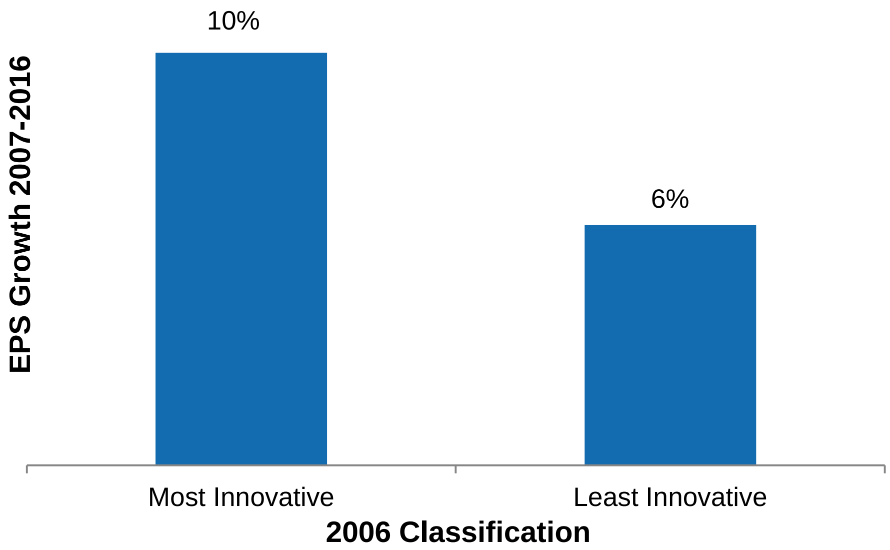
Source: FactSet as of March 2017. EPS for 2017-2018 are consensus estimates and actual earnings per share might be materially different than shown.

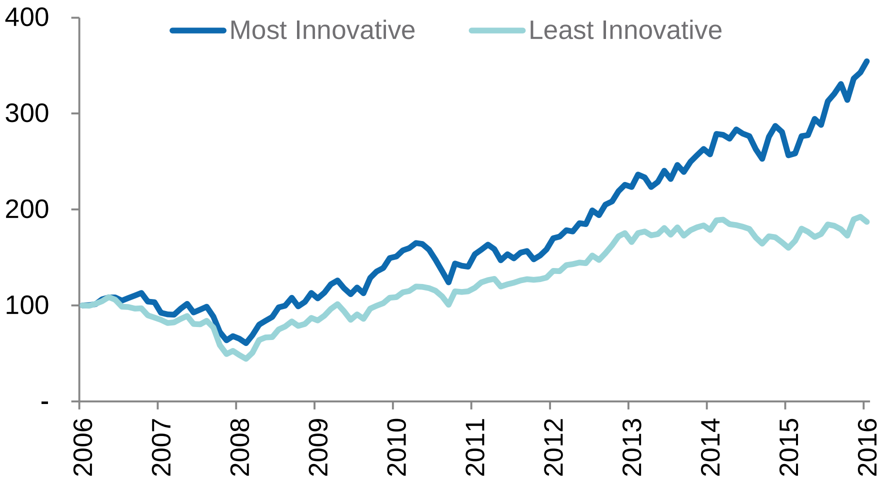
Innovative Companies Grow Earnings and Stock Prices Faster

- Innovation propels economic growth over time
- Studies have shown, and our research demonstrates, that the most innovative companies grow their sales and stock prices faster*

Innovation Drives:

EPS Growth… **and** **…Stock Prices**



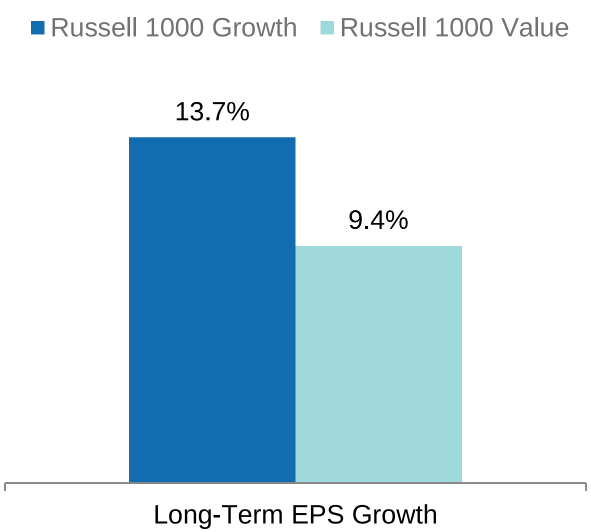


Source: FactSet. Most/least innovative based on R&D % of sales. Actual 2007-2016 EPS growth measured after classification of S&P 1500 companies into innovation quintiles in Dec-06. Most/least innovative stock performance based on S&P 1500 quintiles one month returns. *Baruch Lev and Suresh Radhakrishnan, "The Stock Market Valuation of R&D Leaders."

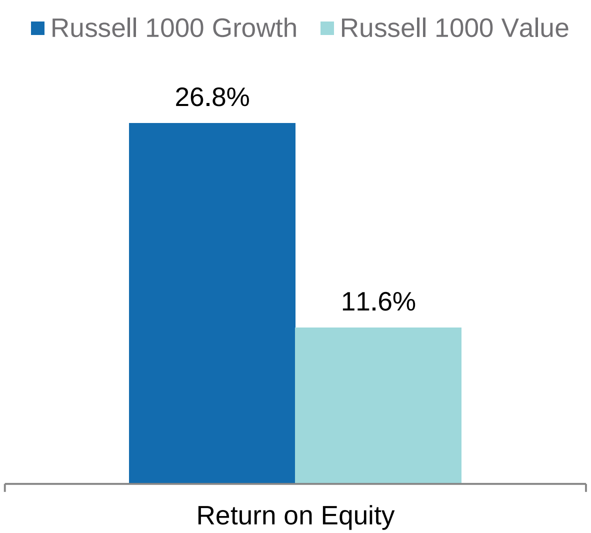
The Growth Advantage

- Three variables drive P/E multiples: growth, returns, and risk
- As compared to the Russell 1000 Value, the Russell 1000 Growth has higher expected EPS growth, higher returns on equity, and lower risk in the form of better balance sheets

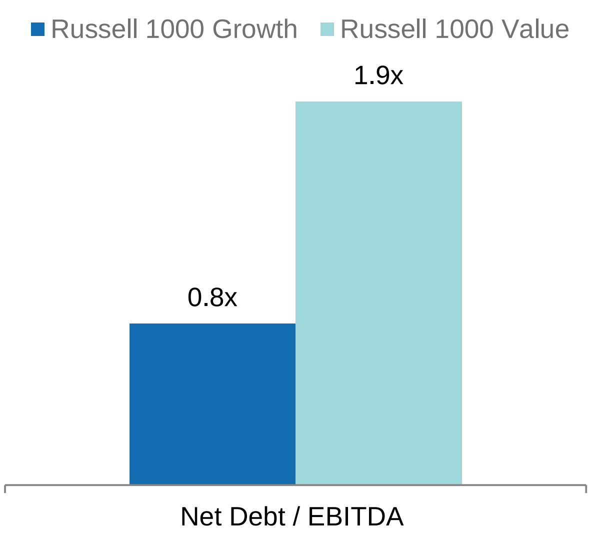
Stronger Growth



Higher Returns



Lower Risk



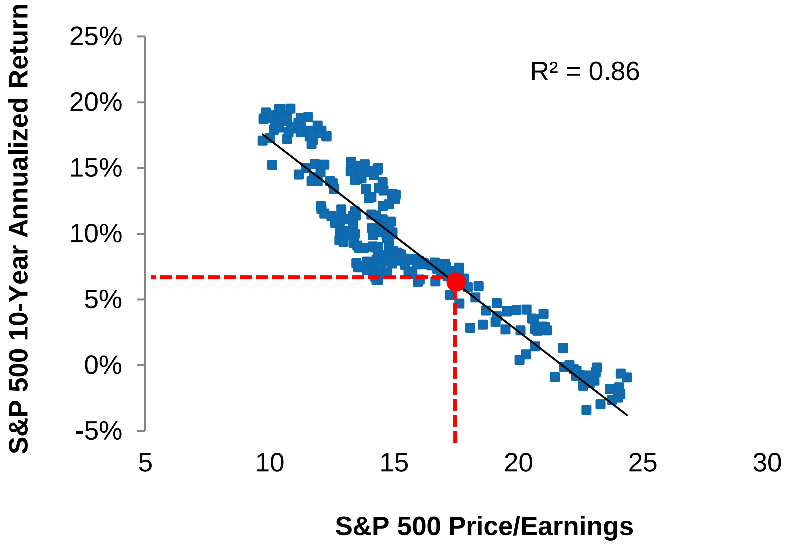
Source: FactSet as of March 2017. Growth represent consensus long-term analyst estimates, and actual future EPS growth rates might be materially different than the forecasts shown

The Single Greatest Predictor of Future Stock Market Returns

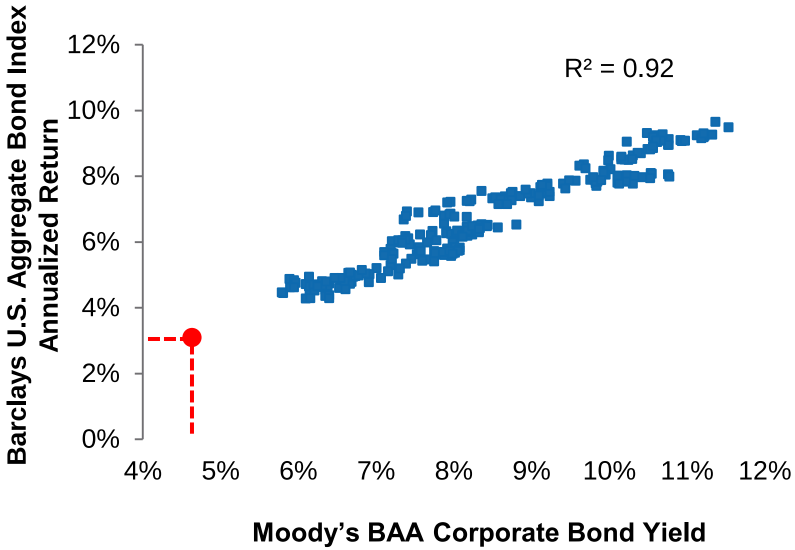
- There is a strong relationship between starting valuation and ensuing 10-year returns for both stocks and bonds
- Current valuations suggest equities should materially outperform bonds over the coming decade (mid-to-high single-digit vs. low-single digit annualized returns)

S&P 500 P/E vs. 10-Year Returns

■ = month
● = current



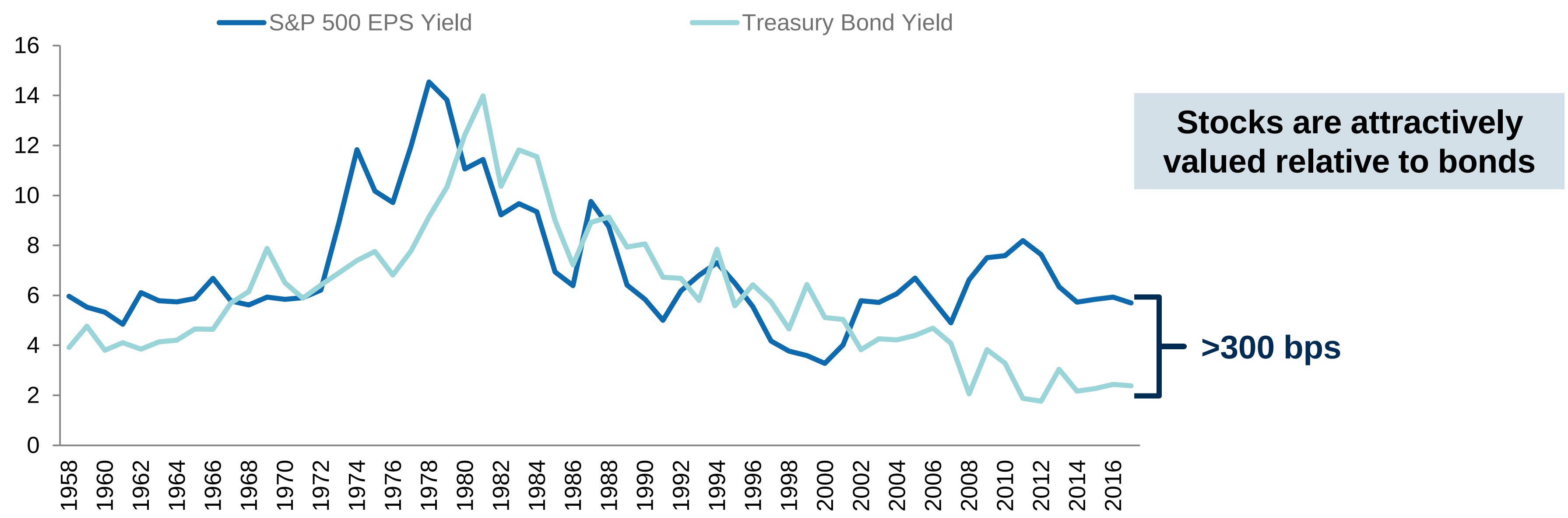
BAA Bond Yield vs. U.S. Aggregate Bond Returns



Source: FactSet, monthly data since 1986.

- Moving from monetary stimulus and quantitative easing to fiscal stimulus and increased deficits should drive a Great Rotation from bonds to stocks
- The magnitude of the rotation will be fueled by the valuation disparity as equities are inexpensive relative to bonds
  - The earnings yield for equities is more than 300 bps greater than 10-year Treasury notes vs. a 50 bps median over the past half century

Yield Over Past 50+ Years



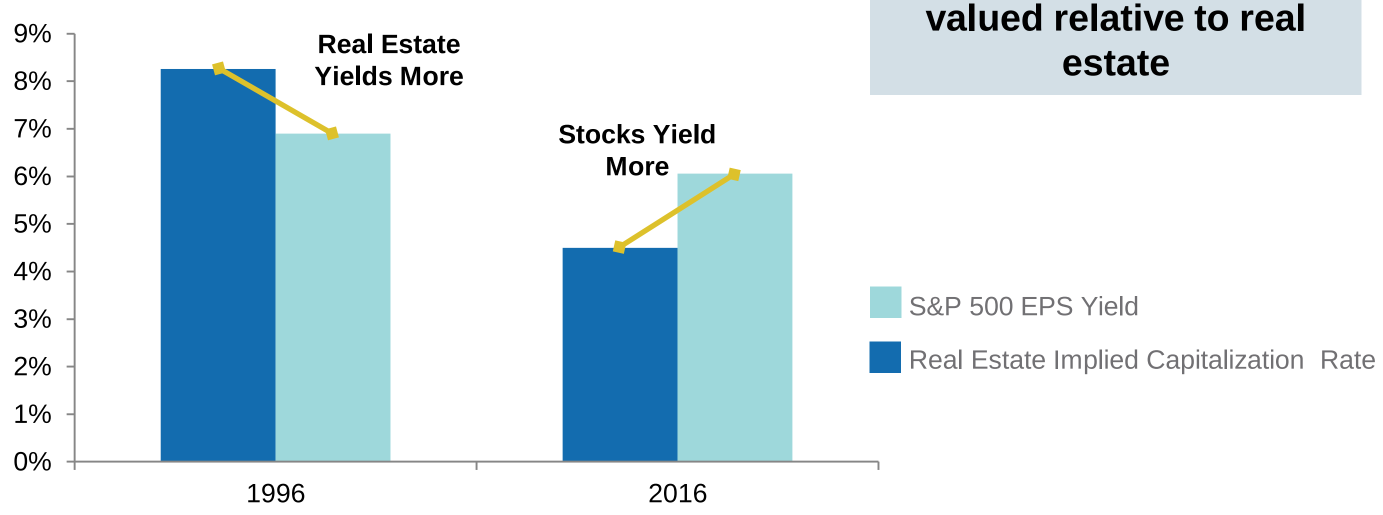
Source: FactSet, Federal Reserve, S&P as of 3/31/17.

Valuation

Stocks Compelling Relative to Real Estate

- In addition to bonds, other asset classes that provide income streams to investors have become expensive as interest rates have declined over the past couple of decades
- Real estate valuations are now very high, as illustrated by implied capitalization rates reaching their lowest levels in over 20 years
  - Real estate used to yield more than stocks and now yields much less

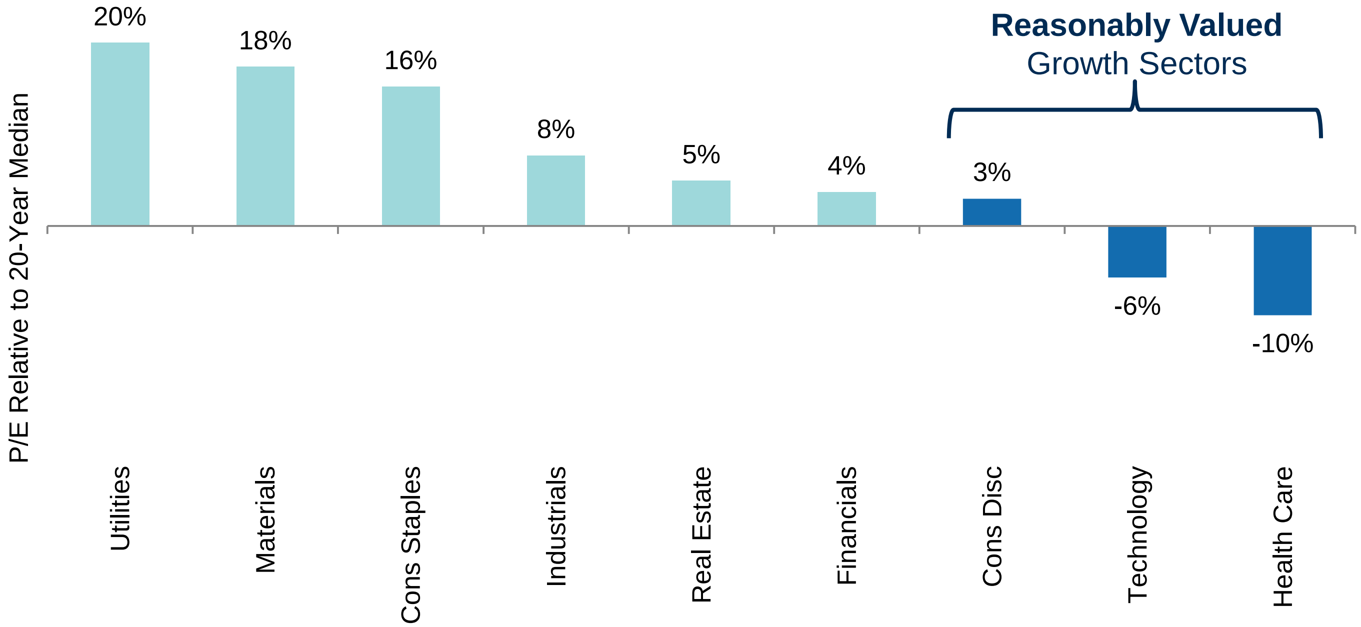
Stocks are attractively valued relative to real estate



Source: FactSet, NCREIF and Alger estimates. Real estate cap rate index is based on trailing 4-quarter Net Operating Income / appraised value and then weighted by value for U.S. apartments, industrial, office and retail properties. EPS yield based on NTM consensus estimates.

Not All Sectors are Expensive

- Bond-like equities such as Utilities remain expensive due to the search for yield while some cyclicals have become more expensive in the wake of the U.S. presidential election
- Growth sectors are reasonably valued relative to other sectors and compared to history, particularly given low levels of interest rates

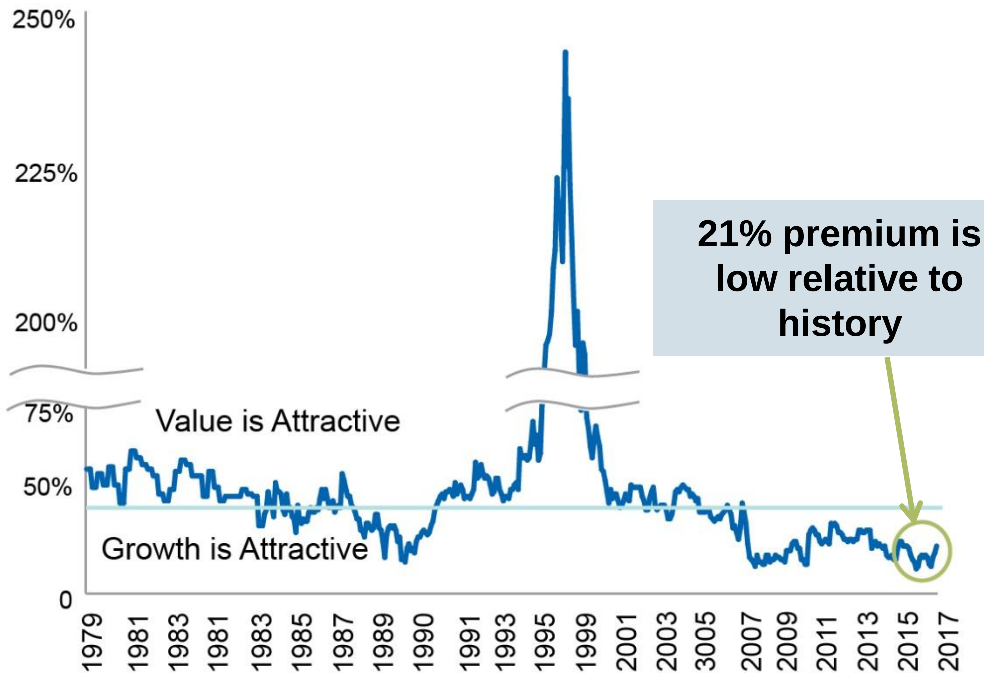


Source: FactSet, based on S&P 500 Index, 3/31/17. Note: energy and telecom are excluded; the former because of an extremely high P/E due to depressed earnings and the latter owing to a small number of constituents. Real estate is a new sector classification, so for the historical data shown above, an industry group category that has approximately 15 years of data was utilized.

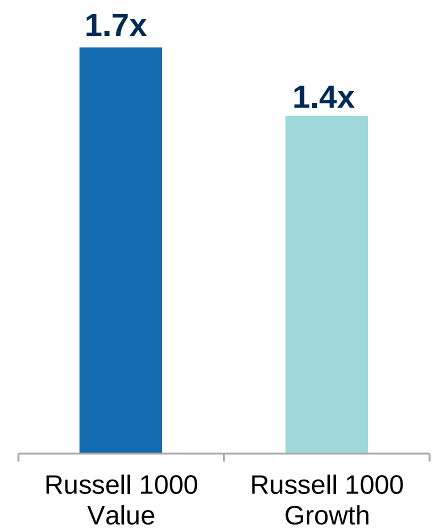
Valuation
Growth Valuations Are Compelling

- The search for yield, and more recently optimism for economically sensitive Value stocks, has driven Growth stocks to attractive relative valuations

Russell 1000 Growth vs. Russell 1000 Value P/E



Russell 1000 Growth vs. Russell 1000 Value PEG Ratio
(P/E Divided by Long-Term Growth Rate)

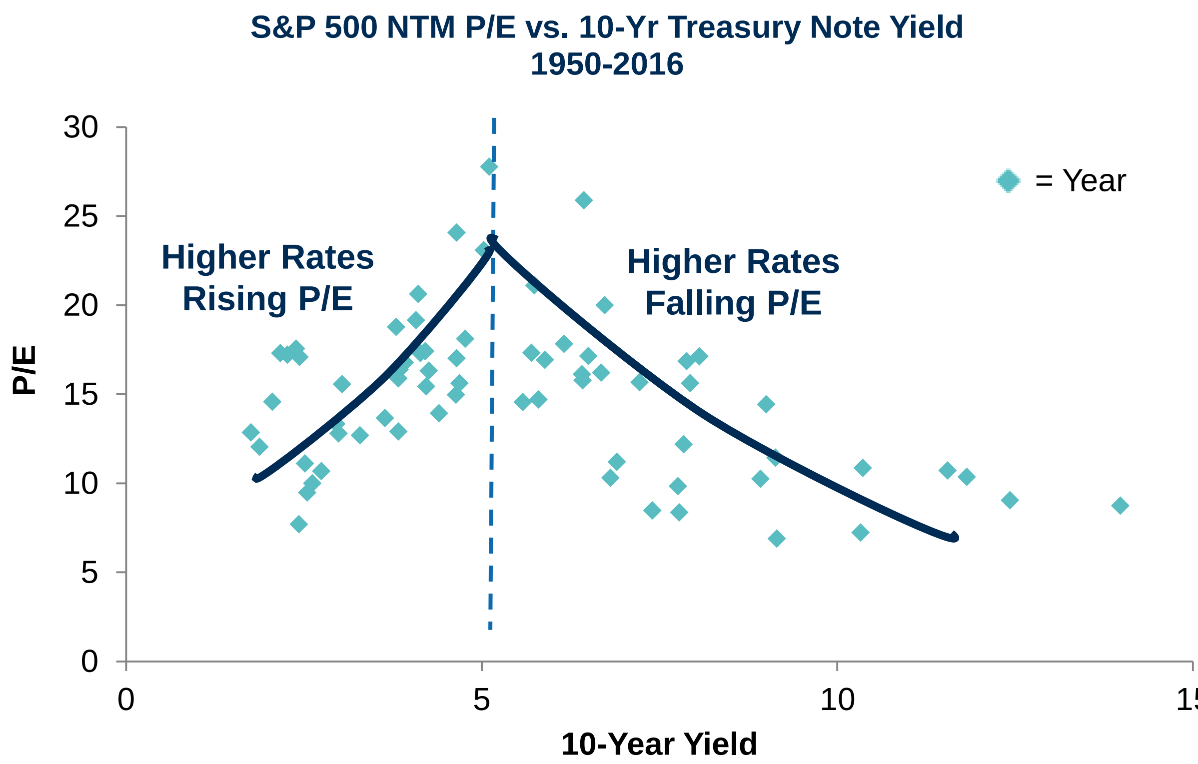


Source: FactSet, Bank of America as of 3/31/2017.

Valuation

Addressing Interest Rate Risks—It's Too Soon to Worry

- **Potential Risk**: higher bond yields → lower equity valuations?
- **Potential Solution**: favor equities over bonds given that increasing interest rates have supported higher P/E multiples at low absolute levels

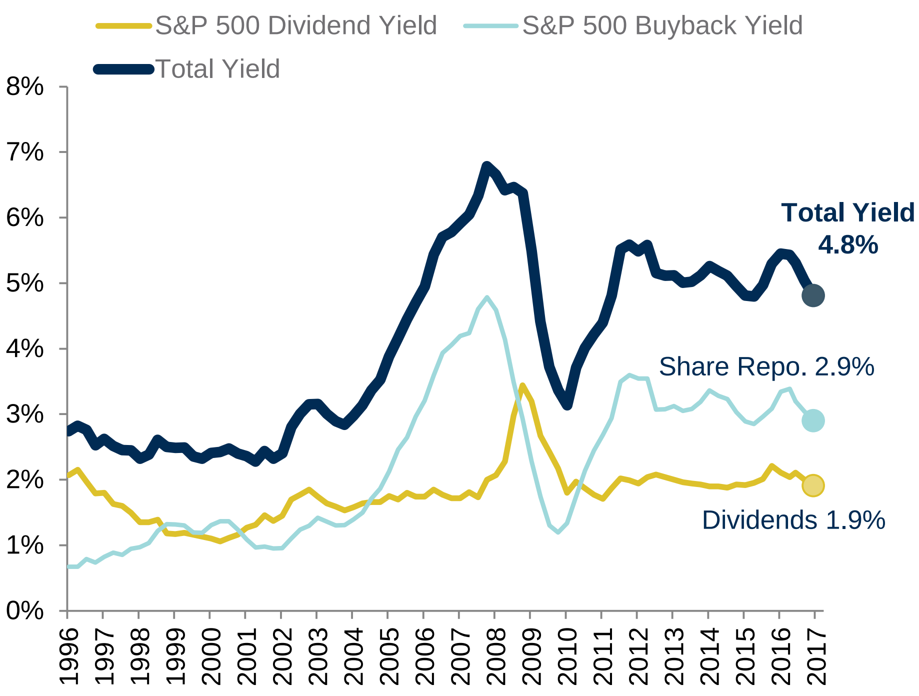


Source: FactSet as of 3/31/17.

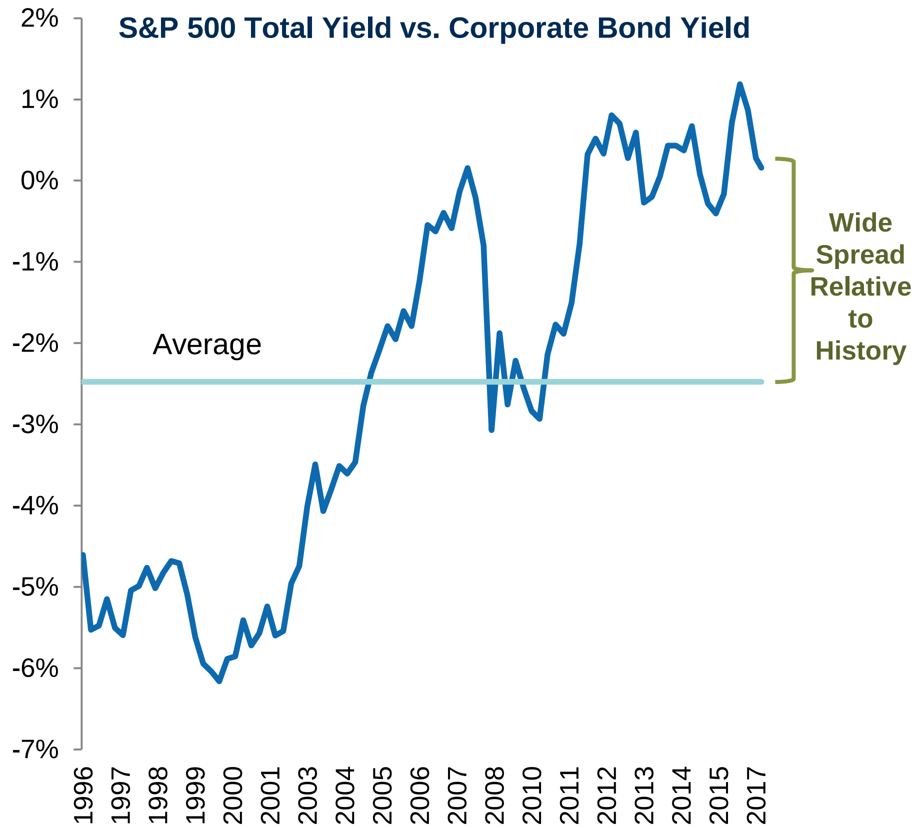
Valuation

Total Yield Compelling

- Dividends + Share Repurchases = Total Yield



- Equity Total Yield is attractive relative to corporate bonds



Source: FactSet and Alger estimates as of 3/31/17. Corporate Bond Yield is Moody's Baa Corporate Bond Yield.

Valuation

Prospective Returns Appear to Favor Growth

- Growth sectors have significant return potential relative to value and bond-like sectors

Framework for Estimating S&P 500 Sector Returns

	EPS Growth (3-5 year consensus, reduced by 20%) +	Dividend Yield (last 12 months) +	P/E Change (reversion to 20-year median P/E) =	Five-Year Return (hypothetical)
Value or Bond-Like Sectors				
Utilities	4%	3%	-4%	**Underperformance?**
Consumer Staples	7%	3%	-3%	**Underperformance?**
Materials	9%	2%	-3%	**Underperformance?**
Growth Sectors				
Health Care	8%	2%	2%	**Outperformance?**
Consumer Discretionary	15%	1%	-1%	**Outperformance?**
Technology	11%	1%	1%	**Outperformance?**

Source: FactSet as of 3/31/17. Table contains annualized S&P 500 GICS sector data. Figures for the EPS Growth represent consensus long-term analyst estimates, and actual future EPS Growth rates might be materially different than the forecasts shown. P/E assumes reversion to 20-year historic norm, and actual future P/E change may be materially different than the forecasts shown.

Disclosure

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The S&P 500 Index is an unmanaged index generally representative of the U.S. stock market without regard to company size. The Russell 1000® Growth Index is an unmanaged index designed to measure the performance of the largest 1000 companies in the Russell 3000 Index with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Growth Index is an unmanaged index generally representative of common stocks designed to track performance of small-capitalization companies with greater than average growth orientation. The Russell 2000 Value Index is an unmanaged index generally representative of the small-cap value segment of the U.S. equity universe and measures the performance of Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 3000® Growth Index is an unmanaged index designed to measure the performance of those Russell 3000® Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 3000 Value Index is an unmanaged index generally representative of stocks from the Russell 3000 Index with lower price-to-book ratios and lower expected growth rates. 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, Inc. and actual client results might differ materially than the indices shown. Note that past performance is no guarantee of future results. Comparison to a different index might have materially different results than those shown.

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