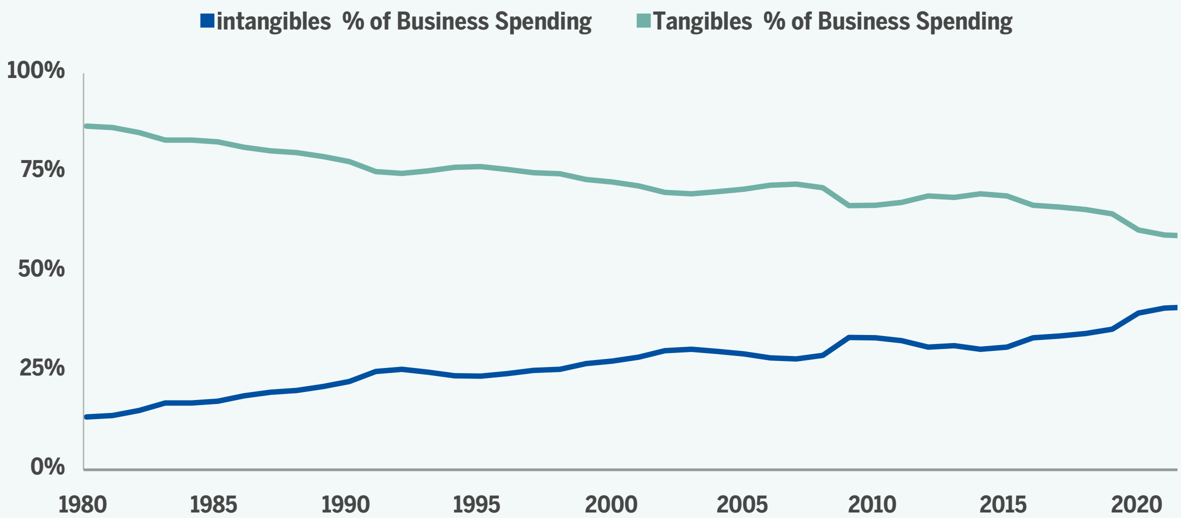
ALGER

Alger On the Money

Intangible Impact

Companies have been investing more and more in intangible assets such as patents, brands and research & development for decades. However, we believe this shift has distorted accounting and valuation metrics with significant implications for investors.

Share of U.S. Business Spending



Source: Bureau of Economic Analysis as of 12/31/2022. Data represents nonresidential fixed investment. Tangible spend is comprised of structures and equipment and intangible spend is comprised of intellectual property products including software and R&D.

- The share of intangible business spending has nearly tripled over the past 40 years from 15% to over 41%, as exhibited in the chart above. This has created accounting issues given that internally generated intangible assets are generally expensed (i.e., immediately recorded on the income statement). On the other hand, tangible assets (e.g., factories, inventory, equipment) are generally capitalized (i.e., recorded as an asset on the balance sheet), where their cost is spread out over years via depreciation.
- One implication of this trend is that the balance sheet may be missing more of a company's true asset value, rendering book value less meaningful and impacting the style classification of growth versus value stocks, in our view.
- We believe another implication is that earnings in aggregate are potentially being understated. It has been estimated that EPS could be around 10% higher for the S&P 500 Index if intangible spending were capitalized[1]. As a result, with this view, today's adjusted price-to-earnings ratio may be lower than it appears, comparing more favorably with historical levels. In our view, this may have potentially encouraging implications for equity investors.

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The Bureau of Economic Analysis (BEA) of the United States Department of Commerce is a U.S. government agency that provides official macroeconomic and industry statistics, most notably reports about the gross domestic product (GDP) of the United States and its various units—states, cities/towns/townships/villages/counties, and metropolitan areas.

[1] Bank of America and Alger estimates. Source: https://www.bloomberg.com/news/articles/2021-11-11/bull-market-exposes-old-school-accounting-rules-penalizing-r-d

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

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock.

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

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