

### Portfolio Flexibility May Increase Potential for Generating Strong Returns

Portfolio manager Peter Lynch earned the nickname of “the chameleon” by modifying his investment approach as market conditions changed so he could pursue the most appealing securities, regardless of market capitalization, style characteristics, or industry sectors. In doing so, he generated an impressive history of strong performance that propelled him into an elite group of legendary portfolio managers such as Warren Buffett and Bill Miller. Like Lynch, they are well known for their flexible strategies that involve searching the entire field of equities to find compelling opportunities. In fixed-income, bond manager Bill Gross of PIMCO has also become highly successful by embracing flexible investing.

Today, however, many stock pickers focus on specific categories of securities, such as small cap growth or large cap value. Institutional investors and financial advisors can therefore seek to manage overall portfolio volatility by maintaining set allocations of assets among specialty managers. In theory, this approach may reduce the likelihood of different stock pickers inadvertently holding the same, or similar, securities. Unfortunately, this approach prevents talented managers from searching market wide for the most attractive investments. In other words, managers can no longer use flexible investment strategies to follow in the footsteps of legends like Lynch, Buffett, and Miller.

Many investors, of course, may be tempted to minimize, or even dismiss, the significance of portfolio management flexibility. After all, flexibility is only one aspect of the legends’ successful strategies. Yet, over the past few years, a growing pool of research—some of which we summarize in this paper—has concluded that investing flexibility can greatly enhance performance.

We maintain that investors do not have to forgo the benefits of flexible investing to manage risk. At Alger, we believe that strategies that are anchored in specific categories, rather than subject to rigid category restrictions, can potentially deliver the strong performance associated with flexible portfolio management while producing consistent investment characteristics that clients need to build diversified investment programs.

#### Origins of Portfolio Restrictions

Broadly speaking, investment restrictions are an unintended outcome of creating tools that facilitate peer group comparisons of portfolio managers. In order to make peer group reviews meaningful, members of each group must have similar investment strategies, which requires a system to classify portfolio managers. With that in mind, Morningstar created style boxes in 1992 by devising a grid that divides the equity universe into nine categories based on

two distinct characteristics: market capitalization, which includes small, mid, and large; and style, which includes value, growth, and blend (See Figure 1). These categories were created as a convenient way to divvy up the equity universe.

When ranking managers, Morningstar assigns mutual funds and separate accounts to individual style box categories based on portfolio holdings. That way, performance of mutual funds and separate accounts can be compared to universes consisting of similar portfolios.

Figure 1

	Value	Blend	Growth
Large Cap			
Mid Cap			
Small Cap			

Style boxes quickly became popular and Morningstar eventually created 29 different categories covering domestic equities for institutional investors. Other firms, such as Lipper, also launched similar systems.

As style box popularity grew, investors began using the system for functions other than classifying asset managers. Today, many investors treat style box categories as distinct asset classes and seek to diversify portfolio assets among different managers that focus on securities that correspond with assigned style boxes. Furthermore, by fine tuning the weighting of assets assigned to each style box, investors can create portfolios with specific risk-return profiles. More aggressive investors may overweight allocations to small cap growth and small cap value boxes, which are typically more volatile than other groups, but offer greater return potential. On the other hand, more conservative investors may overweight larger cap categories, which offer less potential for strong returns while being less volatile than smaller stocks.

To Morningstar’s credit, style boxes have aided in the acceptance of establishing and maintaining strategic asset allocations. Today, many investors seek to maintain a consistent allocation among style boxes by occasionally rebalancing holdings among managers with style mandates that correspond with specific style boxes. In doing so, investors avoid market timing because portfolio rebalancing often entails the disciplined process of increasing allocations to style box categories that have recently underperformed and selling securities from categories that have outperformed. This practice helps investors avoid panic selling of an asset class that has declined in value and avoid buying top performing assets with hopes of capturing future gains. In most cases, this pattern is disastrous as it results in buying at the top and selling at the bottom.

In another unintended use of the Morningstar system, investors use style boxes to avoid having different portfolio managers inadvertently hold the same securities. This problem, which is often referred to as overlap, can result in having assets concentrated in a limited number of securities, which can present excessive risk. By selecting mutual funds or separate accounts that invest only in securities that correspond with their respective style boxes, investors seek to avoid this problem. Portfolio managers, meanwhile, are expected to observe style box constraints to avoid overlap with other managers. Managers who don’t observe those constraints are frequently penalized by clients.

## Understanding Portfolio Diversification

Before discussing the adverse impact on investment performance resulting from curtailing investment flexibility, it is important to understand the limitations of managing risk by diversifying assets across style boxes as opposed to diversifying assets across much broader categories, such as alternative investments, precious metals, and real estate. In general, risk can be divided into two categories: systematic and unsystematic.

Systematic risk results from developments that have broad impacts upon markets, such as inflation, interest rate changes, recessions, or threats of war. When such events occur, no amount of diversification among stocks will provide complete protection against price declines. Broadly speaking, those same events may cause other types of assets, such as precious metals, alternative investments, and real estate, to react differently. In its purest sense, diversifying a portfolio

by adding non-equity asset classes can therefore dampen portfolio volatility because different types of investments, for the most part, perform differently.

Unsystematic risk, in comparison, results from factors that influence the performance of individual companies or narrow portions of the market, such as industry sectors. Failure of management to execute business plans, new regulations, and changes in technology are all forms of non-systematic risk. Unlike systematic risk, this form of risk can be dampened by diversifying equity holdings.

What then are the ideal characteristics of assets for portfolio diversification? Ideally, asset classes should have three distinct characteristics.

First, asset class membership is exclusive. In other words, an asset should not fall into more than one specific category. It would be nonsensical to classify gold, for example, in any category other than precious metals. In a similar manner, real estate and various alternative investments are each classified in their own respective asset class. With this definition, dividing equities into smaller groups that are intended to serve as distinct asset classes would be inappropriate because some of the categories will not always have distinct constituents. As an example, some securities may be classified as both growth and value (See Figure 2).

Figure 2

Examples of Russell 3000 Index Constituents with Both Growth and Value Characteristics	
The Boeing Co.	Microsoft Corp.
Coca-Cola Co.	PepsiCo Inc.
Exxon Mobil Corp.	Philip Morris International Inc.
General Electric Co.	United Technologies
Intel Corp.	Wal-Mart Stores Inc.

As of 9/30/2010  
Source: Russell Investments

Secondly, an asset class typically has performance that has a low correlation to the performance of other asset classes. For example, the performance of precious metals has a low correlation to stocks. In a similar manner, the performance of equity securities usually has a low correlation to the performance of fixed-income investments. The performance of different sectors of equity markets, such as small cap or large cap, however, is usually highly correlated (See Figure 3).

Correlation of Indexes

Figure 3

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	Russell 1000 Growth TR USD															
2	Russell 1000 Value TR USD	0.92														
3	Russell 1000 TR USD	0.98	0.98													
4	Russell Mid Cap Growth TR USD	0.99	0.90	0.96												
5	Russell Mid Cap Value TR USD	0.94	0.99	0.98	0.93											
6	Russell Mid Cap TR USD	0.98	0.96	0.99	0.98	0.98										
7	Russell 2000 Growth TR USD	0.96	0.95	0.98	0.96	0.97	0.98									
8	Russell 2000 Value TR USD	0.82	0.97	0.91	0.79	0.95	0.88	0.90								
9	Russell 2000 TR USD	0.91	0.98	0.97	0.90	0.99	0.96	0.97	0.97							
10	S&P 500 TR	0.97	0.98	1.00	0.95	0.99	0.98	0.97	0.92	0.97						
11	BarCap US Aggregate 10+ Yr TR USD	-0.18	0.00	-0.09	-0.16	-0.06	-0.11	-0.15	-0.05	-0.10	-0.08					
12	BarCap US Treasury Bill 1-3 Mon TR	-0.36	-0.33	-0.35	-0.38	-0.35	-0.37	-0.33	-0.25	-0.30	-0.34	-0.08				
13	FTSE NAREIT Composite TR	0.78	0.94	0.88	0.76	0.94	0.86	0.86	0.97	0.94	0.89	-0.02	-0.25			
14	MSCI EAFE Free USD	0.94	0.92	0.95	0.94	0.92	0.95	0.92	0.81	0.89	0.95	0.10	-0.31	0.79		
15	DJ Precious Metals PR USD	0.56	0.35	0.46	0.63	0.43	0.54	0.43	0.16	0.30	0.44	0.12	-0.35	0.22	0.57	

Time Period: 10/1/2007 to 9/30/2010

■ 1.00 to 0.60 ■ 0.60 to 0.20 ■ 0.20 to -0.20 ■ -0.20 to -0.60 ■ -0.60 to -1.00

Source: Morningstar

Numbers across the horizontal axis correspond with the numbers show adjacent to each asset classes. For example, number 5, which represents the Russell Mid Cap Value Index, has a -0.35 correlation to the Barclays Capital US Treasury Bill 1-3 Month Index.

Finally, asset class constituents don't change over time. Gold, for example, is a constant member of precious metals, just as government bonds are always part of the fixed-income asset class. Yet, the classification of equities by size, such as small, mid or large, or by style, such as value or growth, changes over time. A mid cap company may grow in size and become a large cap company or the pricing and performance of a stock may change over time, causing its style classification to change.

Since dividing equities into smaller groups does not create additional asset classes, some investors may question the merits of diversifying portfolio holdings among different categories, or style boxes. We believe, however, that investors should still diversify assets across the style box spectrum to manage non-systematic risk, but they should also be aware that style box diversification is different than diversification by broader asset classes with low correlations.

Overlapping of securities among different portfolios, furthermore, can occur even with specialty asset managers because securities may be constituents of more than one style box. As a result, preventing portfolio managers from investing in securities other than those within their corresponding style boxes may not prevent an inadvertent overlap of holdings. At the same time, overly rigid invest-

ment restrictions decrease portfolio managers' potential for generating attractive long-term returns.

### The Impact of Portfolio Manager Restrictions

The notion that restricting investment flexibility harms performance gained much attention in 2001 when Richard Ennis published his landmark paper "The Case for Whole Stock Portfolios." In the paper, Ennis evaluated performance of 168 pension funds that use managers that specialize in narrow categories. He concluded that the group, overall, trailed market benchmarks, on average, by 1.18% net of fees for the eight-year period ended 1999. Ennis also evaluated the performance of professionally managed multimanager funds. The products were based on professional screening and monitoring of specialty asset managers, so, in principle, they should include some of the best performing portfolios. For this category, he identified 13 products with track records of at least five years. As of 1999, only three of the products had outperformed their benchmarks on an average annualized basis. Even more discouraging, the overall group underperformed market benchmarks by 1.34% net of fees on an average annualized basis.

Ennis concluded that restricting managers' flexibility contributed to the poor performance. He cited various

studies, including one by Eugene Fama and Kenneth French in 1993 that concluded that characteristics such as market capitalization and book-to-market ratios account for 90% of variation in stock returns. Unfortunately, managers with strict constraints are unable to pursue opportunities across the full range of market cap and book-to-market valuations. Ennis also concluded that hiring a stable of specialty managers produces market-like diversification, making it difficult to generate performance in excess of benchmarks.

A 2005 study “The Problematic ‘Style’ Grid” also determined that constraints lead to underperformance. In the study, Charles T. Howard and Craig Callahan ranked individual securities based on screening methods of Benjamin Graham, John Neff, William O’Neil, and T. Rowe Price for 1995 through 2003. Depending on each manager’s screening process, factors such as earnings per share, price to equity, operating margins, sales growth, cash flow, and net margins were used to rank stocks within the S&P 1500 universe.

For each screening method, the top 20 ranked holdings were identified for each year from 1995 through 2003. The researchers determined that each screening method found top-ranked stocks in multiple style boxes. In the case of Graham, 53% of the top-ranked stocks were in the small cap value style box and the remainder was in other boxes. Graham’s style, furthermore, had top ranked securities from among all of the style boxes. The same is true for the results generated by other portfolio managers’ screening systems. Furthermore, during the study period, each screening method resulted in different allocations across style boxes as time progressed. The variations resulted from changing market characteristic as the screening methods stayed the same over the nine-year period. The study’s authors concluded that what may appear to be style drift—that is a change in a portfolio manager’s allocation of assets among style boxes—resulted not from a change in the manager’s style but from changing characteristics of equities within each style box.

If strict constraints were applied, the resulting portfolios would be populated with holdings that didn’t make the top 20 list. In the case of Neff, for example, holdings for a specific style box would have rankings that averaged from 68 to the 183, depending upon which style box was targeted. In other words, style box constraints prevented managers from

delivering their highest ranked securities for their clients. The researchers then compared the performance of each manager’s top ranked holdings to holdings that would be used to comply with style box constraints. Howard and Callahan concluded that the style box constrained portfolios would have underperformed portfolios with no constraints by 339 basis points per year from 1995 to 2003.

### Rethinking Portfolio Risk

Investors may also infer from the study that style box constraints introduce risk into a portfolio. Investors typically embrace active investment management because they believe portfolio managers can find securities that will potentially provide the best performance on a risk-adjusted basis. Yet, an overly rigid application of style box constraints may cause managers to build portfolios that don’t consist of their highest conviction stocks. The resulting portfolios of lower conviction stocks may offer less potential for long-term gains and less attractive risk-return profiles.

### Consistent Style, Inconsistent Style Box Classification.

Broadly speaking, a consistent investment process will focus on securities that have similar characteristics. With that in mind, for a manager to consistently focus on securities within the same style box, one of two factors must exist. One factor would be a lack of any change in the characteristics of securities within the style box. That way, when a manager uses a consistent investment process to find securities with specific characteristics, the securities will always be found within the same style box. This approach, however, is unrealistic as the characteristics of securities and style boxes change over time.

A second factor would be for the manager to change the investment process in order to continue selecting securities within a specified style box as the characteristics of securities change. Most portfolio managers, however, have high conviction regarding their methods for selecting securities, so they are, understandably, unlikely to modify their management approach as the characteristics of style box members change.

### The Benefits of Investment Flexibility

The performance of individual style box categories, as measured by market indexes, varies over time. Eventually the style box category with the best performance loses its market leadership position as other style box categories

Market Leadership Changes Over Time

Figure 4

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Russell Midcap Growth 51.29	Russell 2000 Value 22.83	Russell 2000 Value 14.02	Barclays Capital 10.27	Russell 2000 Growth 48.54	Russell Midcap Value 23.71	MSCI EAFE 14.02	MSCI EAFE 26.86	Russell 1000 Growth 11.81	Barclays Capital 5.24	Russell Midcap Growth 46.29
Russell 2000 Growth 43.09	Russell Midcap Value 19.18	Barclays Capital 8.42	Citigroup BIG 1.70	Russell 2000 Value 46.03	Russell 2000 Value 22.25	Russell Midcap Value 12.65	Russell 2000 Value 23.48	MSCI EAFE 11.63	Citigroup BIG 1.80	Russell 1000 Growth 37.21
Russell 1000 Growth 33.16	Barclays Capital 11.63	Citigroup BIG 4.09	Russell Midcap Value -9.64	Russell Midcap Growth 42.71	MSCI EAFE 20.70	Russell Midcap Growth 12.10	Russell 1000 Value 22.25	Russell Midcap Growth 11.43	Russell 2000 Value -28.92	Russell 2000 Growth 34.47
MSCI EAFE 27.30	Russell 1000 Value 7.01	Russell Midcap Value 2.33	Russell 2000 Value -11.43	MSCI EAFE 39.17	Russell 1000 Value 16.49	Russell 1000 Value 7.05	Russell Midcap Value 20.22	Russell 2000 Growth 7.05	Russell 1000 Value -36.85	Russell Midcap Value 34.21
Russell 1000 Value 7.35	Citigroup BIG 5.96	Russell 1000 Value -5.59	Russell 1000 Value -15.52	Russell Midcap Value 38.07	Russell Midcap Growth 15.48	Russell 1000 Growth 5.26	Russell 2000 Growth 13.35	Barclays Capital 6.97	Russell 1000 Growth -38.44	MSCI EAFE 32.46
Citigroup BIG 4.74	Russell Midcap Growth -11.75	Russell 2000 Growth -9.23	MSCI EAFE -15.66	Russell 1000 Value 30.03	Russell 2000 Growth 14.31	Russell 2000 Value 4.71	Russell Midcap Growth 10.66	Citigroup BIG 4.74	Russell Midcap Value -38.44	Russell 2000 Value 20.58
Russell Midcap Value -0.11	MSCI EAFE -13.96	Russell Midcap Growth -20.15	Russell Midcap Growth -27.41	Russell 1000 Growth 29.75	Russell 1000 Growth 6.30	Russell 2000 Growth 4.15	Russell 1000 Growth 9.07	Russell 1000 Value -0.17	Russell 2000 Growth -38.54	Russell 1000 Value 19.69
Barclays Capital -0.83	Russell 1000 Growth -22.42	Russell 1000 Growth -20.42	Russell 1000 Growth -27.88	Barclays Capital 4.11	Barclays Capital 4.34	Citigroup BIG 3.00	Citigroup BIG 4.76	Russell Midcap Value -1.42	MSCI EAFE -43.06	Barclays Capital 5.93
Russell 2000 Value -1.49	Russell 2000 Growth -22.43	MSCI EAFE -21.21	Russell 2000 Growth -30.26	Citigroup BIG 1.07	Citigroup BIG 1.24	Barclays Capital 2.43	Barclays Capital 4.33	Russell 2000 Value -9.78	Russell Midcap Growth -44.32	Citigroup BIG 0.16

Source: Russell and Reuters

that may have been out of favor with investors become more popular. Indeed, style box categories that have had the best recent performance are likely to trail the performance of the broad market and the performance of other style box categories. This pattern is often referred to as regression to the means (See Figure 4). Portfolio managers with investment flexibility can potentially exploit this pattern by seeking out the most compelling opportunities, which in many cases are found in style box categories that may be out of favor with investors.

The regression pattern by market capitalization is considerably more prominent among growth styles than value styles (See Figure 5). This variation in regression suggests that growth style managers can potentially add the most value by selecting securities from the full spectrum of market cap categories. With that in mind, investment flexibility is most likely to enhance long-term performance with growth style managers.

### Finding Middle Ground

Research illustrating the adverse impact on performance resulting from portfolio manager constraints presents investors with a quandary. That is, must investors give up the perceived benefits of style box constraints, such as reducing the possibility of securities overlap among portfolio managers, in order to benefit from the superior investment performance that is generally associated with unconstrained investment strategies? Or, similarly, must investors forgo the potentially strong performance associated with giving portfolio managers increased flexibility to achieve the perceived benefits of style box constrained strategies?

We maintain that the debate is moot as an alternative approach to the issue exists—many managers that vary their security selection among different style box categories tend to maintain the core of their holdings in a single category. So, a large cap growth manager, while investing

in securities of various market capitalizations, will generally have a portfolio with an anchor in the large cap growth universe. Most established growth managers, fortunately, have long-term track records that illustrate the style box categories that they have favored, consistently, over the years.

What is important, we maintain, is to understand that an overly rigid application of style box constraints can harm investment returns and possibly increase risk. In a similar manner, mandates are assigned to portfolio managers based on the stock pickers' expertise in finding compelling investment opportunities, so it makes little sense to impose overly rigid restrictions on the range of securities within which a manager may invest. Finally, it is important to note that a variety of factors—including the changing characteristics of the overall market and of style box categories—may create the deception that a portfolio manager's style is changing over time.

## Going Forward

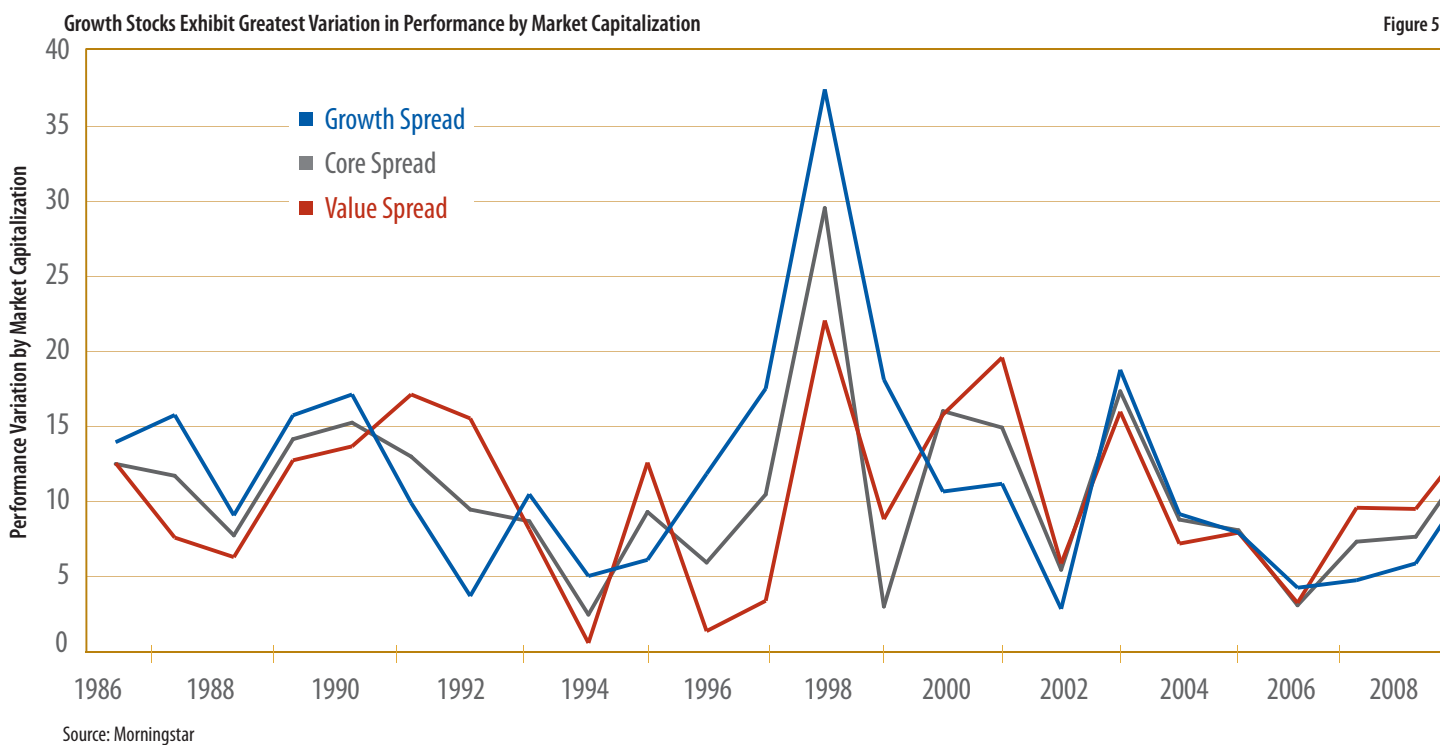
Alger believes strongly in using in-depth proprietary research as the foundation of active portfolio management. Armed with our internal research, Alger managers seek companies undergoing Positive Dynamic Change across the

entire market capitalization spectrum while rigorously adhering to Alger's time honored investment philosophy. We believe this combination of investment flexibility, in-depth proprietary research, and investment discipline creates the best opportunity for attractive long-term performance.

Alger's flexible portfolios are typically anchored to a specific market capitalization box within the growth style. These portfolios have the flexibility to invest outside of focused areas but will maintain overall characteristics that are in line with corresponding categories. Our disciplined and consistent approach allows our clients to ensure that assets are diversified among different portfolio managers and to clearly understand the specific role that each strategy can play within an asset allocation.

At Alger, portfolio managers of strategies with broad mandates are typically given the greatest leeway when pursuing investment opportunities. Such strategies include the following:

- Spectra, which can invest in growth companies regardless of market capitalization while seeking to enhance returns with short positions. It has traditionally been anchored in large cap companies.



- SMid Cap Growth, which can invest in growth stocks of small and mid capitalization companies.
- Dynamic Opportunities, which is a long-short fund that seeks long-term capital appreciation. It can take positions in companies regardless of market capitalization.
- Capital Appreciation, which can invest in growth companies regardless of market capitalization. It has traditionally been anchored in large cap companies.

For each strategy, portfolio managers utilize the Alger style of growth investing that has been refined over more than 45 years. It focuses on finding companies that are undergoing Positive Dynamic Change, a characteristic which we believe offers the best long-term growth potential. We find Positive Dynamic Change in companies that are experiencing High Unit Volume Growth or Positive Life Cycle Change. High Unit Volume Growth involves companies with strong business models, market dominance, free high cash flow and growing demand. Positive Life Cycle Change, meanwhile, can occur when companies change management teams, make acquisitions, benefit from regulatory changes or develop new products.

Style boxes will continue to play an important role in helping investors reach their long-term goals, although it's important to consider their limitations for functions other than classifying portfolio managers. Indeed, even Morningstar has voiced this concern. In a column in *Investment Advisor* magazine, John Rekenenthaler, who is vice president of research at Morningstar, emphasized that style boxes are "undeniably useful instruments for categorizing funds, for understanding a portfolio's positioning, and for communicating with clients. There is no reason to expect more from them."

The performance data quoted represents past performance, which is not an indication or a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. Recent performance has been impacted by an unusually strong period in the U.S. equity market and emerging markets; there is no guarantee that such conditions will be repeated.

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There are additional risks when investing in an active investment strategy, such as increased short-term trading, additional transaction costs and potentially increased taxes that a shareholder may pay, which can lower the actual return on an investment. Certain Alger Funds, such as Spectra, SMid, and Capital Appreciation, can use leverage, and the cost of borrowing money to leverage could exceed the returns for the securities purchased or securities may actually go down in value; thus, a Fund's net asset value could decrease more quickly than if it had not borrowed. | The Alger Spectra Fund and the Alger Dynamic Opportunities Fund may engage in short sales. Short sales involve arrangements with a broker to borrow the security being sold short. In order to close out the short position, the Fund will replace the security by purchasing the security at the price prevailing at the time of replacement. A Fund will incur a loss if the price of the security sold short has increased since the time of the short sale and may experience a gain if the price has decreased since the short sale. | Certain Alger Funds, such as Dynamic Opportunities and Spectra, may invest in derivative instruments, including options. A small investment in derivatives could have a potentially large impact on a Fund's performance. When purchasing options, a Fund bears the risk that if the market value of the underlying security does not move to a level that would make exercise of the option profitable, the option will expire unexercised. When a call option written by a Fund is exercised, the Fund will not participate in any increase in the underlying security's value above the exercise price. When a put option written by a Fund is exercised, the Fund will be required to purchase the underlying security at a price in excess of its market value. Use of options on securities indexes are subject to the risk that trading in the options may be interrupted if trading in certain securities included in the index is interrupted, the risk that price movements in the Fund's portfolio securities may not correlate precisely with movements in the level of an index, and the risk that Fred Alger Management, Inc. may not predict correctly movements in the direction of a particular market or of the stock market generally. Because certain options may require settlement in cash, the Fund may be forced to liquidate portfolio securities to meet settlement obligations. Forward currency contracts are subject to currency exchange rate risks, the risk of non-performance by the contract counterparty, and the risk that Fred Alger Management, Inc. may not predict accurately future foreign exchange rates. | Morningstar and Lipper track and analyze investment performance. | The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the Russell 3000 Index. | The Russell 1000 Growth Index is an unmanaged index designed to measure the performance of the largest 1,000 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 the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. | The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. | The Russell Midcap Growth Index measures the performance of the mid-cap growth segment of the U.S. equity universe. It includes those Russell Midcap Index companies with higher price-to-book ratios and higher forecasted growth values. | The Russell Midcap Value Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values. | The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 8% of the total market capitalization of that index. | The Russell 2000 Growth Index measures the performance of the small cap growth segment of the U.S. equity universe. It includes those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. | The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. As of June 2007, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. | The Barclays Capital U.S. 10+ Year Treasury Bond Index includes public obligations of the U.S. Treasury, excluding TIPs and STRIPs, with maturities exceeding 10 years. | The Barclays Capital Treasury Bill Index includes U.S. Treasury bills with a remaining maturity from one month to, but not including three months. It excludes zero coupon strips. | The Citigroup BIG Treasury Bill Index is an unmanaged index of three-month Treasury bills. | The FTSE NAREIT Composite Index is comprised of equity securities of U.S. real estate companies. | The Dow Jones Precious Metals Index represents the performance of U.S.-trading stocks of companies engaged in the exploration and production of gold, silver and platinum-group metals. | The S&P 500 Index is an unmanaged index generally representative of the U.S. stock market without regard to company size. Investors cannot invest directly in any index. Index performance does not reflect deduction for fees, expenses, or taxes.

**Before investing, carefully consider a fund's investment objective, risks, charges and expenses. For a prospectus or a summary prospectus containing this and other information about a fund, call us at (800) 992-3863 or visit us at [www.alger.com](http://www.alger.com). Read it carefully before investing. NOT FDIC INSURED. NOT BANK GUARANTEED. MAY LOSE VALUE.**

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