



IS THERE MORE TO THE US GROWTH STORY THAN FAANGS?

JUNE 2018

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US growth investing delivered particularly strong performance in 2017 and, indeed, in the last decade. The frequently-cited FAANG companies (Facebook, Amazon, Apple, Netflix and Google/Alphabet) have played a significant role in driving the stellar performance of growth indices. But contrary to widely-held opinion, the rally in US growth stocks is more than just a FAANG story: there are many diversified sources of alpha beyond the five technology giants, if investors know where to look.

FAANG companies have been successful because they are innovative and disruptive, effectively changing the way their respective industries operate. However, there are examples of other growth companies that we believe exhibit similar features. While they fly a little lower under the radar, the following are examples of those we believe are well positioned to take a major share of established markets and generate significant free cash flows.

- **Intuit (Software)**

Intuit is a tax returns filing and small business accounting software company that is disrupting its industry. Its technology architecture has allowed the company to grow online subscription services in these areas – which are both popular and tend to retain customers – at relatively low capital intensity.

- **Red Hat (Software)**

Red Hat is an open-source software company that allows seamless access to on-premise database storage and cloud database service providers. Our insight – that companies would need to maintain a presence both on and off-premise – underpins our investment rationale. Companies can choose the cloud provider they want to use, as Red Hat's software can interface with AWS, Microsoft Azure and Google cloud.

- **Stryker (Medical Equipment & Devices)**

Stryker is an innovative healthcare company specializing in hip and knee replacement surgery. Its leading position in 3D printing of replacement hips and knees and its robotic surgery product, are leading to dramatically better patient outcomes. The company is taking outsized market share, leading to higher profitability.

- **Boeing (Aerospace & Defense)**

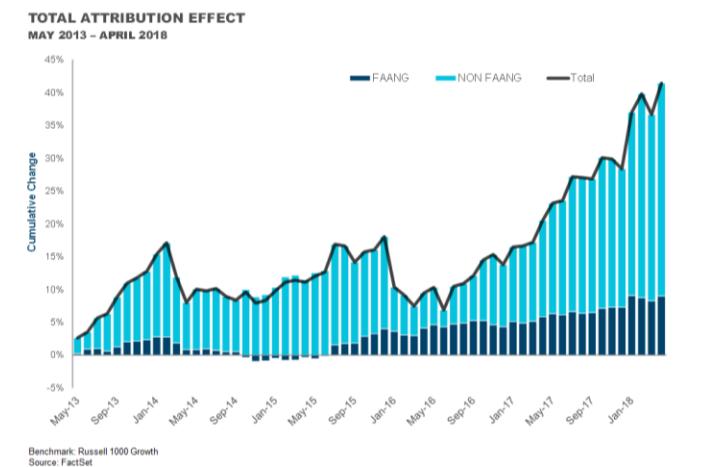
Boeing is perhaps not recognized by the market as an innovator, nor a growth company. However, it is precisely this misperception that has provided us with an investment opportunity. We believe Boeing is a leader in a global duopoly and is a less cyclical business than the market believes. Air passenger trends

are favorable globally, while Boeing's 787 aircraft with its composite fuselage is the most innovative, fuel-efficient product available and so is attracting strong demand and generating significant free cash flow.

We have exposure to the FAANG stocks and have been significant owners of some of these companies in the T. Rowe Price US Large Cap Growth Equity strategy for some time. However, to put the relative performance contribution into context, the FAANG stocks have collectively accounted for only 21% of our outperformance of the benchmark over the past five years, while the vast majority of the alpha generated has come from sources outside these FAANG companies (Figure 1).

Figure 1: Majority of alpha generated by non-FAANG growth stocks

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Past performance is not a reliable indicator of future returns.

Benchmark: Russell 1000 Growth Index

Source: Factset as of April 2018

We are clearly in the later stages of the market cycle in the US. However, stock valuations still appear adequately supported at current levels by solid growth and a low inflation rate. Corporate earnings expectations have increased in 2018, boosted by US tax reforms. Even excluding this contribution, on a fundamental basis, many companies reported improving top-line and earnings growth above consensus expectations in the most recent quarter.

In this environment we continue to find many examples of the type of innovative, disruptive and cash flow generative businesses we look for – the majority of which are outside the high-profile FAANG companies.

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