JENNISON ASSOCIATES

PERSPECTIVES

GROWTH EQUITY

June 2022

Growth Investing During Turbulent Times

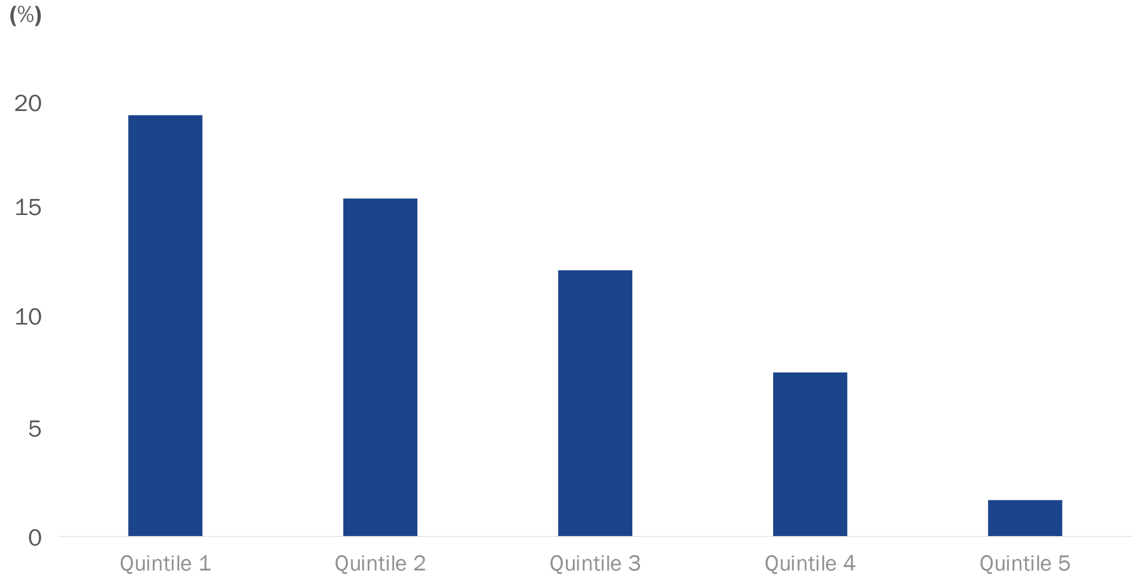
- Uncertainty is the dominant theme in the market today, driven by a confluence of major risk factors, including a sharp rise in inflation, policy tightening by the Federal Reserve, ongoing COVID-related lockdowns in China, and war in Eastern Europe.
- Due to this extraordinary uncertainty, risk aversion has risen and risk assets have been de-rated. This has been particularly true for growth stocks, as the market's willingness to pay a premium for long-dated profits has diminished in the face of sharply rising interest rates.
- We believe that uncertainty and market volatility will persist until investors have confidence that inflationary pressures are under control and a degree of consensus emerges on the outlook for economic growth and interest rates.
- In the face of these numerous headwinds, global growth is clearly slowing, and earnings expectations are being lowered in a number of industries.
- We believe companies in areas undergoing a secular shift in demand will continue to offer attractive absolute and relative growth. These areas include: enterprise software; the cloud transition; electric vehicles; luxury and branded consumer goods; and a number of sub-sectors within healthcare.

There are plenty of reasons for investors to feel uncertain today—inflation at 40-year highs, a Federal Reserve tightening cycle, war in Ukraine, and COVID-19–related shutdowns in China—and markets are undergoing a significant repricing of risk. This repricing has been especially hard on stocks that had previously led performance—higher-growth, higher-valuation companies.

This reversal of fortune is illustrated dramatically by the poor recent performance of companies that have delivered the highest historical earnings growth. Over the past 25 years, the group of companies reporting the highest 5-year earnings growth has, on average, generated the highest returns (Exhibit 1). However, over the past year, a sharp rise in interest rates and a degree of cyclical tailwind turned this relationship on its head, with the companies showing the slowest historical earnings growth leading performance (Exhibit 2). While the timing of a return to growth leadership is highly dependent on investor clarity around the economic growth and inflation backdrop, we continue to believe that earnings growth will drive stock prices over the long term.

Exhibit 1: The Fastest Growers Have Outperformed over the Long Term

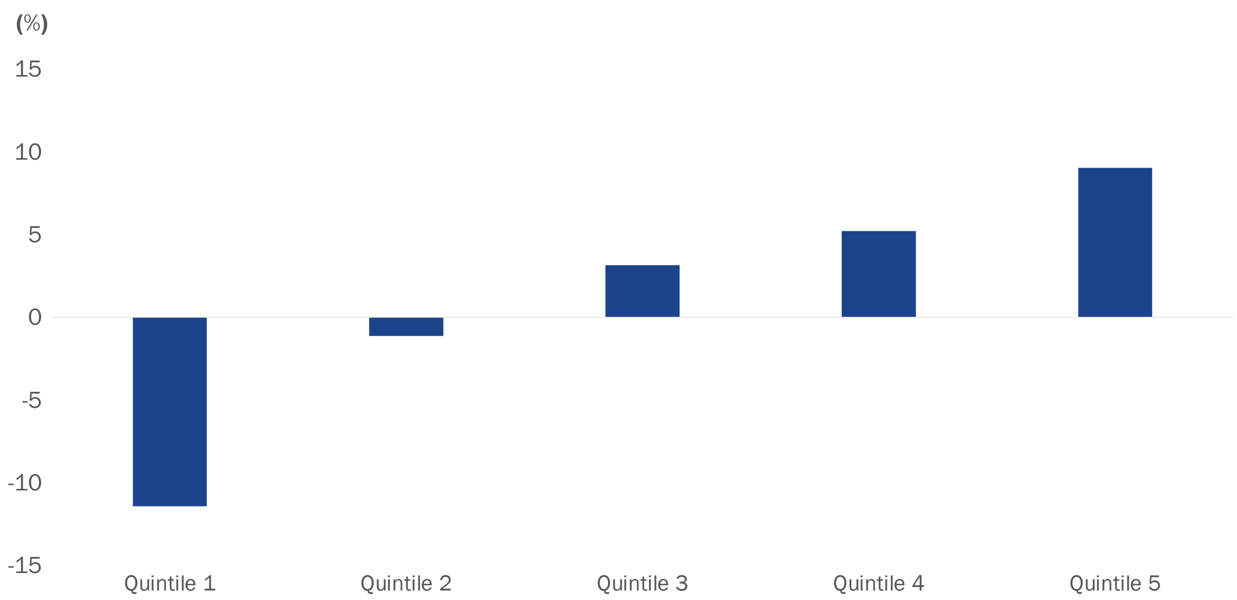
Russell 1000® Index Performance by Historical 5-Year Earnings Growth Quintile



Data based on rolling 5-year returns for periods from 12/31/92 to 12/31/21.
Source: Jennison, FactSet. Average median annualized returns of stocks over rolling 5-year periods, ranked by 5-year historical earnings growth quintiles (1=highest, 5=lowest). Quintiles are rebalanced quarterly. Past performance does not guarantee future results.

Exhibit 2: Low Growth Has Outperformed over the Past 12 Months

Russell 1000® Index Performance by Historical 5-Year Earnings Growth Quintile

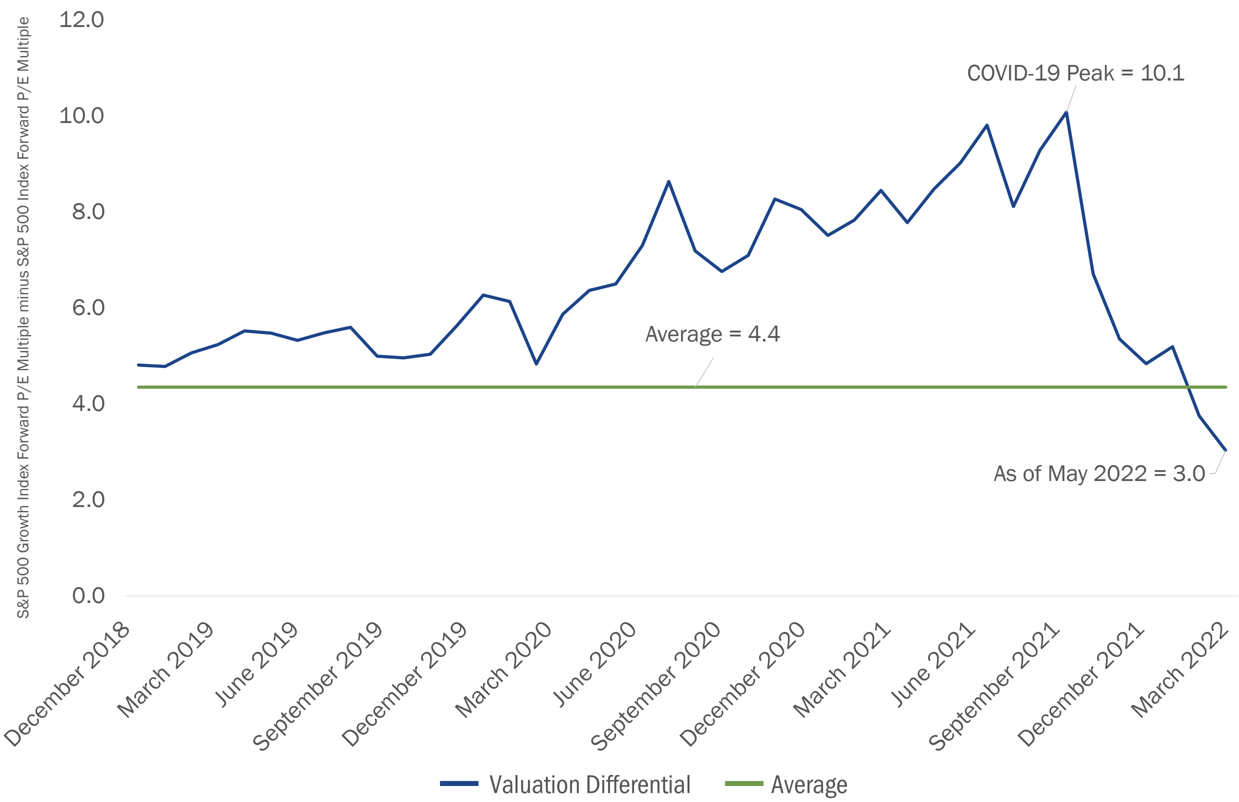


Data based on trailing 1-year period ending 4/30/22.
Source: Jennison, FactSet. Period returns of index stocks, ranked by 5-year historical earnings growth quintiles (1=highest, 5=lowest). Quintiles are calculated based on beginning of period shown. Past performance does not guarantee future results.

Long-Term Growth

As uncertainty recedes, we believe investors will focus on finding growth in a slowing-growth world. Valuations of many secular growth companies have already corrected significantly over the past six months, and we believe this has helped create the conditions for growth to perform. As an example, the valuation premium of the S&P 500 Growth Index over the standard S&P 500 Index (using forward P/E multiples) has fallen below the levels seen in 2018 and 2019, more than erasing the "COVID premium" the market ascribed to those companies whose growth trajectory steepened significantly during the lockdowns (Exhibit 3). Today, we see secular growth stock valuations much closer to long-term averages, despite the attractive growth rates many companies continue to offer.

Exhibit 3: The COVID-19 Growth Valuation Premium Has Been Erased



Data from 11/30/18 to 5/31/22.
Source: Jennison, FactSet. Calculated monthly. The "Average" reflects data from 12/31/99 to 5/31/22.

We should note that, in some cases, significant price corrections were justified by a deceleration in growth. This is most evident in the e-commerce, social media, and streaming entertainment areas, where the significant growth acceleration enjoyed in 2020 and 2021 seems to have pulled forward demand from future years and invited meaningful competition. Recent results for several of these companies have fallen short of market expectations, with limited visibility around future revenue growth.

However, we are not seeing this broadly in other growth areas, particularly those focused on the enterprise customer or benefiting from generational shifts in demand preferences, such as electric vehicles. The goal of an active manager during these volatile times is to discern true fundamental changes that alter the growth trajectory of a company from market sentiment and multiple compression. Our research is focused on exactly that.

Secular Growth Opportunities

Despite heightened uncertainty and negative headlines, transformational change continues largely unabated in a number of growth sectors. Technology is an important component of this, but we are finding exciting opportunities across industries.

- Software as a service (SaaS) and cloud applications allow companies to meet the changing needs of a global workforce and customers that increasingly operate on the move. Enterprise software and the transition to the cloud are mission critical initiatives that are likely to proceed, despite cyclical headwinds;
- Fully connected, smart electric vehicles (EVs) promise to revolutionize the auto industry's 100-year old business model by fundamentally changing the relationship between the car owner and the automaker. We believe the leading EV companies eventually will expand the revenue streams they derive from each car long beyond the point of sale, through software subscriptions and insurance plans based on driver safety data collected by the vehicle;
- Luxury brands continue to benefit from strong demand and pricing power, demonstrating impressive resilience against macro uncertainty and pressure on consumer wallets from higher energy and food prices. The top luxury brands have benefited from their strong positioning with consumers and sustained profitability on the strength of their operational and financial models;
- In healthcare, opportunities are prevalent across a variety of areas, from healthcare benefit platforms to innovative medical devices. Large pharmaceutical companies are making important advances against global health challenges, such as obesity and diabetes. Some companies are also benefiting from the reopening of hospitals and the resumption of elective procedures.

Growth Is a Long-Term Opportunity

At Jennison, we have consistently applied our growth philosophy and process to generate competitive returns for clients. Over more than five decades, we have navigated all manner of market environments and, we must admit, the past 2+ years have been among the most challenging in our firm's history. While market volatility may be a feature of the market for much of this year, we believe incremental clarity around the major drivers of uncertainty—inflation, economic growth, interest rates, and the conflict in Ukraine—can help growth stocks find support, at valuations that are more attractive relative to their prospects than we have seen in a number of years. To that end, we will continue to focus our attention on identifying companies that can generate superior growth and profitability in a 3- to 5-year time frame. Over time, we believe these growth attributes will be rewarded through strong equity returns.

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