

Amid the pandemic and volatile global markets, the healthcare sector has emerged as one of the best-performing areas of the market this year¹. In this investment note, Steven Slaughter, an equities specialist in global healthcare, looks at the sector’s resilience in difficult market and economic conditions and provides compelling insights for developments in the sector.

Global healthcare: the search for a cure

The COVID-19 pandemic has upended everyday life and financial markets. As the human toll measurably increases, this pandemic has galvanised scientists and investors alike to search for a potential cure. While the spread of COVID-19 may be unique in its compressed time frame, the healthcare sector is well versed in addressing similar clinical challenges with profound health implications daily, including pursuing treatments and cures for cancers, diabetes and Alzheimer’s disease, to name a few. Indeed, it is these unmet needs, and their potential economic payoff, that shape the sector’s bright outlook which can offer unique opportunities.

Healthcare’s resilient performance in volatile markets

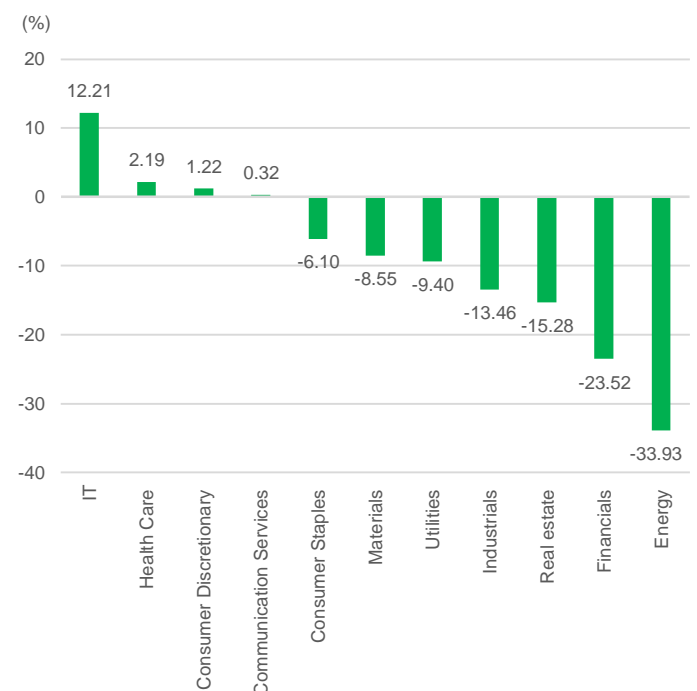
The healthcare sector has come to the forefront against the backdrop of recent unprecedented volatility. During the first quarter of 2020, COVID-19’s worldwide advance sent global share prices into bear-market territory².

Healthcare then emerged as the best performing sector following the sharp selloff in March, and in April, when the market rebounded swiftly on the prospect of potential peaking coronavirus cases. In

May and June, the sector’s returns moderated somewhat as share prices normalised, despite important medical advances emerging in the diagnostic, therapeutic and vaccine landscape for COVID-19.

Overall, healthcare moved higher by roughly 2.2% through the first half of 2020 compared to a roughly 5.5% loss for the broader global equities index (see Chart 1)³, outperforming many sectors.

Chart 1: Health care as a top-performing global sector on a year-to-date basis⁴



¹ Source: FactSet, as of 30 June 2020. MSCI Healthcare was the second-best performing global equities sector with a total return of 2.19% year-to-date after Information Technology (returning 12.21% year-to-date).

² Source: Bloomberg. On 23 March, the MSCI World index was mired in a bear market, down 34% from its February peak.

³ Source: Bloomberg, as of 30 June 2020. The MSCI World Health Care Index gained 2.19% (total return) through 30 June 2020, while the MSCI World Index fell by 5.5% over the same time period.

⁴ Source: Bloomberg, as of 30 June 2020.

Although some of the volatility has subsided, mainly due to unprecedented fiscal and monetary stimulus, markets may still face a tough climb given the challenging economic conditions. That said, we believe that the secular drivers of the healthcare industry position it well in the current environment and beyond.

Defensive characteristics and growth

Three factors underpin the case for healthcare: the sector's defensive characteristics, its strong organic growth prospects, and relatively attractive historical valuation levels.

Healthcare has historically delivered strong performance, particularly during economic downturns. Over the past 25 years (1995–2020),

global healthcare equities have, on average, outperformed global equities⁵. These excess returns have been more pronounced during periods of heightened market volatility or economic distress. (see Chart 2).

The sector's defensiveness stems from the supply-and-demand dynamic of healthcare products and services. While cyclical industries usually experience a sizable reduction in demand during economic downturns, healthcare demand generally remains resilient, with consumers having an inelastic appetite for medical goods and services.

We also believe that the sector is poised for strong organic growth. With an economic recession looming (or having landed) in several markets, it is worth noting that healthcare has traditionally shown higher long-term sales per share (SPS) growth compared to the broader market (see Chart 3).

Chart 2: Healthcare historically outperforms global equities in periods of market volatility⁶

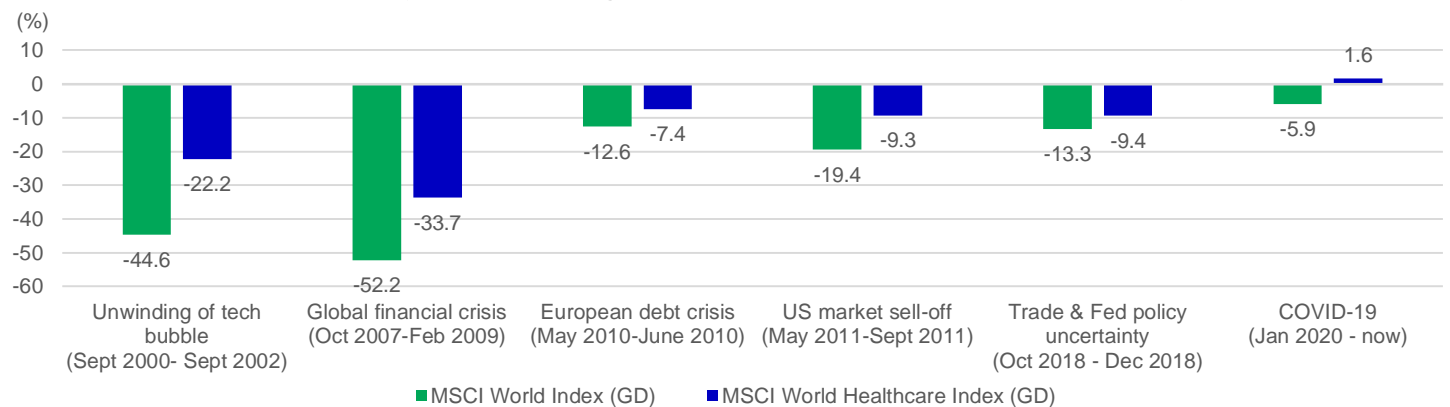
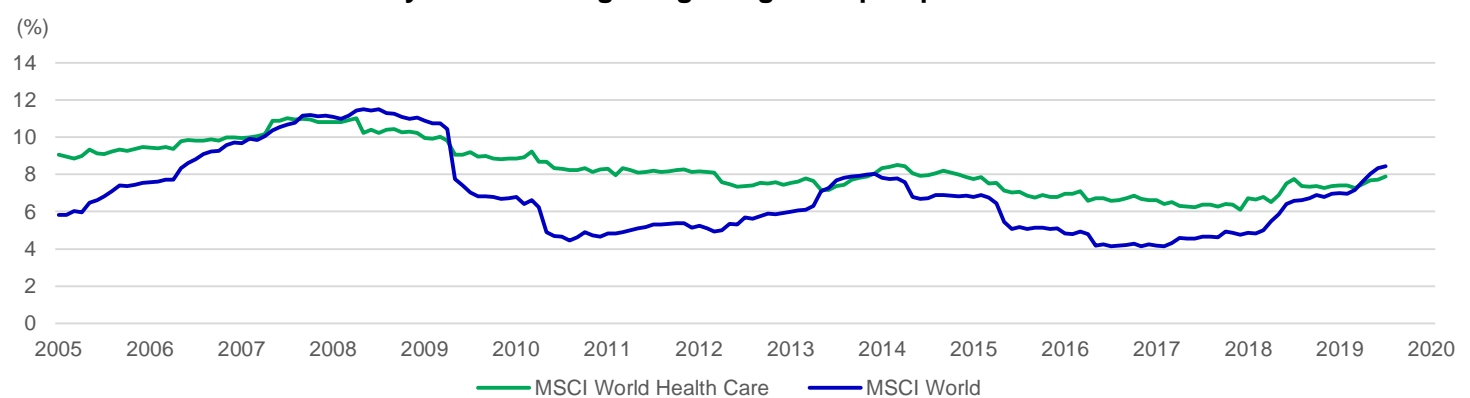


Chart 3: Healthcare historically boasts stronger organic growth prospects⁷



⁵ Source: MSCI World Health Care Index posted 11.02% annualised returns versus 7.25% for MSCI World from 12/31/1994 to 04/30/2020.

⁶ Source: Morningstar Direct as of 30 June 2020.

⁷ Source: Bloomberg as of 30 June 2020.

And despite the sector's recent outperformance and positive growth outlook, valuations are still reasonable. Healthcare equities, both in the US and globally, maintain reasonable valuations based on forward P/E multiples (price-to-earnings per share) versus the broader market indices.

Pharma and healthcare equipment sub-sectors have potential

Based on these industry drivers, we believe that stock selection remains a critical factor in facilitating outperformance. Accordingly, we think that several industry segments have potential and are constructive on the following areas:

- **Pharmaceuticals and biotechnology**

Our focus remains on firms with best-in-class product solutions addressing unmet medical needs and participating in underappreciated market opportunities. We remain diligent in examining the treatment landscape with particular emphasis in the areas of COVID-19, cancer, and diabetes. In addition, we continue to monitor potential volatility in this sub-sector, particularly as the US presidential election grows closer.

- **Healthcare equipment & supplies and life science tools**

We continue to see opportunities in specific pockets of this sub-sector but acknowledge that some companies will likely face significant

disruption and adverse financial consequences from the COVID-19 pandemic.

- **Healthcare insurers, providers and services**

Our view on healthcare insurers remains constructive as dislocation in medical procedures and surgeries may prove a strong profit tailwind in the short and intermediate term. Conversely, we expect to see pandemic-induced pressures on healthcare providers and select services companies going forward.

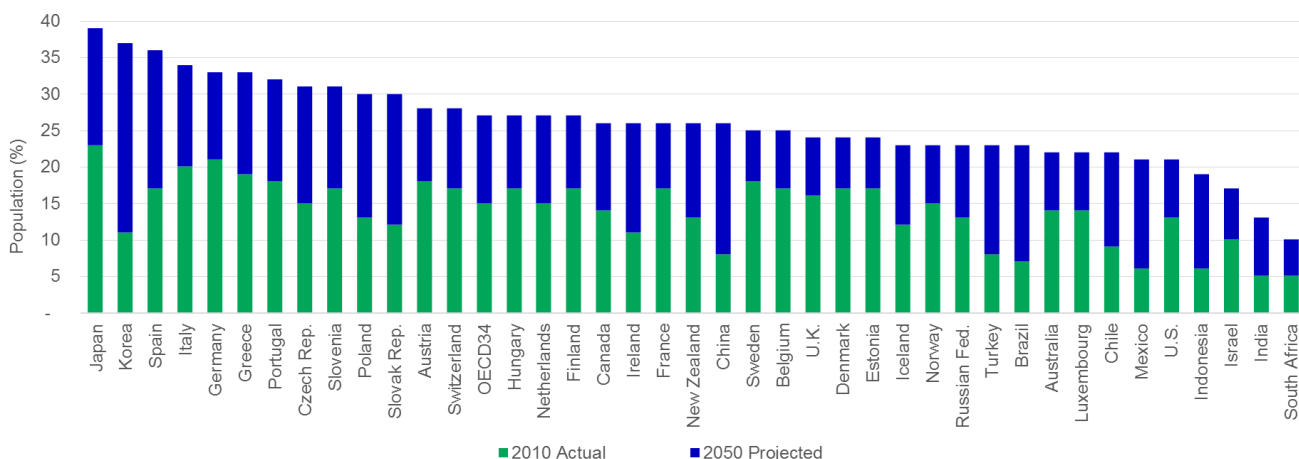
Long-term: Secular demand drivers make for a bright future

It should be said that the case for healthcare is not limited to favourable cyclical drivers associated with the COVID-19 pandemic. There are also several long-term secular trends creating opportunities in the sector:

1) The ageing population is driving increases in expenditures

Regardless of location, the world's population is rapidly aging and forecast to live longer (see Chart 4). This should translate into greater demand for health-related services, rising costs, and an expanding array of treatment and therapeutic options.

Chart 4: Population aged 65 years and older by OECD countries⁸



⁸ OECD Historical Population Data and Projections Database, 2013

2) Medical advances

As evidenced by recent progress seen with approvals of COVID-19 treatments and ongoing development of multiple potential vaccines, medical advances continue to drive the sector forward.

3) Other unmet medical needs

Healthcare companies continue to pursue unmet medical needs beyond COVID-19. These include central nervous system disorders (CNS), metabolic syndrome/obesity, and rare/orphan disorders.

Conclusion: Healthcare – a sector driven by advances and opportunities

The current pandemic presents unprecedented challenges for global leaders and the medical community. However, in a brief period, medical research has produced new diagnostics, therapeutics, and prospective vaccines, enabling the identification/treatment/prevention of COVID-19 infections. The cases for healthcare are compelling, given the advances being made in the treatment of diseases now and potential developments that may emerge in the future.

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