The Outlook for Healthcare Investing

We recently hosted a webinar with two of the top healthcare specialist managers with whom we have investments, Avoro and Perceptive. The webinar covered views on the virus and why the investment outlook is so compelling for the sector, key points of which are outlined below:

- Innovation led growth, particularly in biotechnology, is happening at an unprecedented pace.
- Society's perception of the value of the sector (which influences the risk of regulation) has shifted massively from highly negative to positive.
- US political developments in 2020 have been positive for the sector.
- Healthcare earnings are much more defensive than most other sectors in a recession.
- The sector entered this crisis trading at and unusually low valuation.
- Long term trends such as an ageing global population and increased demand from emerging markets continue to provide powerful long-duration growth tailwinds.

Innovation, particularly in biotech, continues at an unprecedented pace. There has never been a more exciting time for innovation across healthcare in general and within biotechnology in particular. Our broadening understanding of science combined with advances in information technology have created an explosion in the tools available to develop new drugs. Additional drug development tools plus a better understanding of medical science provide two key drivers for growth. One is that they increase the number of drugs which are in clinical trials. This is easily observable. Less easily observable, but equally important, is that they likely increase the success rate for drugs which are currently in trials. Most experts expect that we will look back on this current period and see that drug success rates dramatically improved due to better, more targeted drug development technology.

This pace of drug trial enrolment has been affected by COVID-19. Trials for drugs to treat severe illnesses have largely continued unabated but trials for less severe illnesses have been delayed due to participants being hesitant to visit doctors and hospitals. The market has understood that these pauses are transient. Drug trials will continue again, there is true pent-up demand. Companies are also generally well capitalised and therefore largely able to withstand current trial delays.

Society's perception of the value of the sector (which influences the risk of regulation) has shifted massively from highly negative to highly positive. A major headwind for biotech has been drug pricing pressure which has been high on the list of US political campaigns. The pharma and biotech industry has been an easy political target due to low public regard for the value of the sector and general dissatisfaction with high drug prices. At a time when over $7trn has been put to work on combatting the damage caused by the COVID-19 virus,

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Stenham has over 20 years' experience investing in the healthcare sector.

Given the very highly specialised nature of the industry there are only approximately 130 specialist managers that cover the sector globally. Of these managers, we have met and researched over 100 and through that research process it has become evident that understanding the science combined with having investment experience is critical. The sector is complex and having the medical knowledge to properly evaluate the innovation potential of a company is crucial. Therefore the funds in which we invest will typically comprise of PhDs alongside investment professionals, an important differentiator and value add for investors.

On average we aim to have a higher weighting to biotech, where the majority of the innovation takes place. We believe this to be an advantage both in terms of active management versus passive as most ETFs do not have much exposure to biotech, as well as the fact that most of the innovation comes from small and mid-cap biotech companies. We also recognise the volatility of the subsector and therefore take a diversified approach enabling us to reduce risk and volatility.

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"The combination of attractive fundamentals, unprecedented innovation and powerful long-term demographic trends makes it an interesting time to invest in the healthcare sector".
Bruce Harington

it is difficult to see that we could be faced with a contentious drug pricing debate. The COVID pandemic has certainly served as a reminder of the value of having a cutting edge biopharmaceutical industry. The US is extremely fortunate to have the world's leading biopharma innovation engine. This could easily be considered to be an important source of national security given the pandemic. Some may argue that human behaviour is such that, once the pandemic is under control and people's behaviours return to normal, so too will the perception of these issues. However there is no denying that, at least in the medium term, there has been a societal shift with the result that the biggest headwind for the industry has been massively diminished.

US political developments have been positive for the sector. Entering 2020 the US Presidential election was viewed as the biggest single near term risk to the healthcare sector. It would be hard to find a single issue that better highlighted differences between the Democratic candidates. Most of the debate was centred on Medicare-for-all and tightening controls around drug pricing, with divisiveness evident between the democratic candidates. The most left leaning of the candidates have now fallen out of the race leaving the Presidential election to be contested between Joe Biden and Donald Trump. This removes extreme tail risk scenarios. Individual policies aside, it is in any case difficult to see a scenario where sweeping changes are made irrespective of the presidency.

Healthcare earnings are more defensive than most other sectors in a recession. A key benefit of investing in healthcare in that it is perhaps the only sector globally that offers both long term growth and defensive attributes in a recession.

The sector entered the current COVID crisis trading at an unusually low valuation. Healthcare tends to mostly trade at a premium to broader markets. However, regulatory and US political concerns resulted in the sector trading at a large discount to broader markets at the start of 2020. Entering the crisis healthcare was actually the second cheapest sector in the S&P 500, only financials were cheaper. The sector has since outperformed broader markets somewhat but it still trades at a discount to the market. This seems especially illogical given the sector's growth and defensive profile plus the fact that potential headwinds have recently been diminished or extinguished.

Long term structural growth trends remain unchanged. The world's population is ageing. This is an inexorable trend which will be with us for our lifetimes. Healthcare is by far the biggest direct beneficiary of this trend because spending on healthcare increases exponentially as people grow old. Add to this the fact that healthcare spending as a percentage of GDP increases as emerging markets become wealthier and it becomes clear that spending on healthcare should grow faster than the broader economy for multiple decades.

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INCEPTION DATE

January 2013

PERFORMANCE

One Month	3.72%
Year To Date	0.13%
One Year	15.86%
Three Years	9.09%
Annualised Return	11.04%

RISK AND RETURN (SINCE INCEPTION)

Standard Deviation	12.14%
Sharpe Ratio	0.83
Sortino Ratio	0.77
Profitable Months	62.92%
Correlation	
MSCI World Healthcare	0.77
JPM Global Govt Bond	-0.09
Beta	
MSCI World Healthcare	0.73
JPM Global Govt Bond	-0.16

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In summary we believe now is a great time to allocate to healthcare. Strong tailwinds exist which we believe will persist and drive the sector for many years to come. We are very thoughtful in our construction of the Stenham Healthcare Fund, taking advantage of the exciting innovation that is occurring whilst being mindful of sector and market volatility.

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