

For agents, distributors & institutional investors



With its combination of defensive characteristics, attractive valuations, and strong organic growth prospects, in our view, the global healthcare sector presents a compelling investment opportunity. What’s more, secular demand trends should continue to provide support over the longer term. In this investment note, Steven Slaughter, lead portfolio manager of the Global Healthcare strategy, examines the industry landscape and highlights why this is an excellent time for his highly experienced team to identify and invest in high quality healthcare stocks.

## Global healthcare: An attractive investment opportunity

The global healthcare sector presents a compelling investment opportunity today. The defensive characteristics of the sector coupled with its strong organic growth prospects should allow the sector to continue to thrive. Further, a number of secular demand trends should continue to support the sector’s long-term growth trajectory.

Current valuations in the healthcare sector are also attractive on both a Price/Earnings and EV/EBITDA basis compared to historical averages<sup>1</sup>. Against this backdrop, we view this as an opportune time to be investing in the sector, with a focus on the importance of stock selection as a potential driver facilitating outperformance.

### A defensive sector with substantial growth potential

Healthcare is unique in that it is the only defensive sector that provides a buffer to general market volatility while still producing solid growth. With earnings per share and sales growth that have, on average, been historically superior to the broader market. Accordingly, the healthcare sector has

consistently outperformed the broader market over multiple economic cycles for almost 25 years (Chart 1).

**Chart 1: For almost 25 years healthcare equities outperformed the broader markets<sup>2</sup>**



Traditionally, healthcare companies have also declined less than the overall market in downturns. If we look at two recent economic recessions, data shows that the healthcare sector outperformed by an average of around 19%, with significant excess returns in each of these periods<sup>3</sup>:

- Excess returns of around 22% during the unwinding of the technology bubble
- Excess returns of around 15% during the Great Financial Crisis.

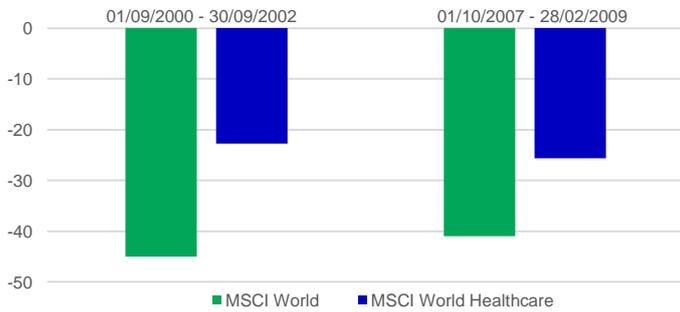
These results underline the sector’s recession-resistant characteristics (Chart 2).

<sup>1</sup>Source: Factset as of 31 August 2019.

<sup>2</sup>Source: Morningstar Direct, as of 30 June 2019.

<sup>3</sup>Source: Morningstar Direct, as of 28 February 2009.

**Chart 2: Cumulative returns (%) — outperformed throughout two recent recessions<sup>4</sup>**



## Long-term secular demand drivers

Regardless of the global economic cycle, the healthcare sector should continue to experience growing demand over the longer term. Underpinned by multiple secular trends, including aging populations, major advances in Cancer and Cardiovascular medicine and massive increases in healthcare expenditure. Not surprisingly, despite these favorable developments, profound unmet medical needs still exist today.

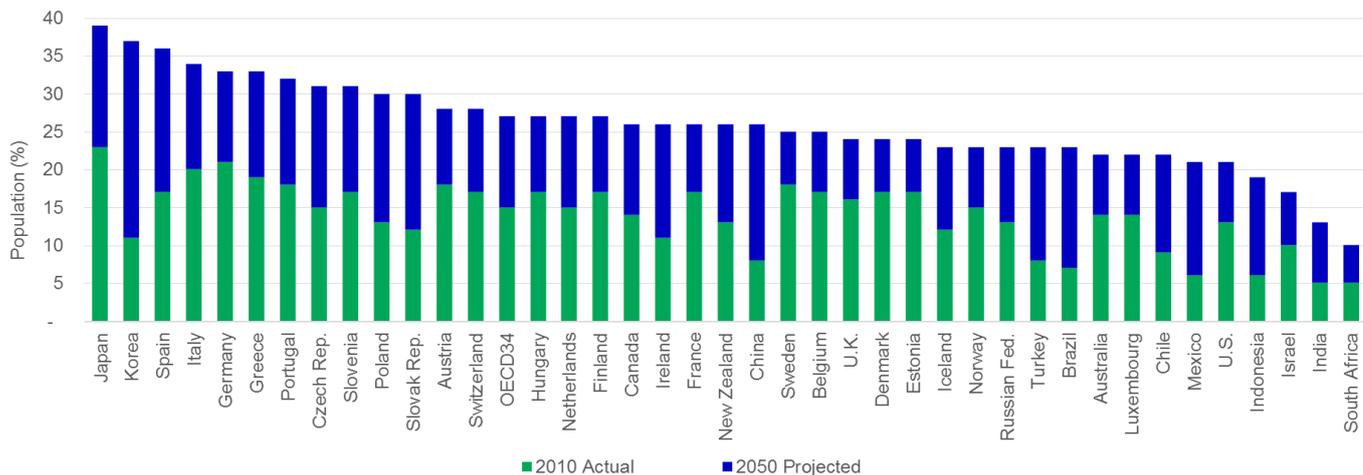
## Aging populations is an unremitting global phenomenon

In the US, aggregate life expectancy (at the time of birth) increased by some seven years to a median of 78 from 1970-2016<sup>5</sup>. The centenarian population in the US has approximately tripled in the past 40 years and is anticipated to nearly double again by 2030<sup>6</sup>.

This expansion in the US is consistent with that observed in other developed and emerging economies. Indeed, the trend is even more pronounced in other countries such as Japan, where nearly 40% of the population is projected to be 65 or older by 2050 (Chart 3).

These advances in human longevity appear closely correlated to advances in disease prevention (smoking cessation), improved treatment options (surgical/interventional procedures) and advanced therapeutic options (biopharmaceuticals).

**Chart 3: Population aged 65 years and older by OECD countries<sup>7</sup>**



<sup>4</sup> Source: Morningstar Direct, as of 2009. Indices returns in US dollar.

<sup>5</sup> Source: NCHS, National Vital Statistics System, Mortality. 7 May 2019.

<sup>6</sup> Source: Census Bureau, 2020-2030 estimates; 2017 National Population Projections Tables.

<sup>7</sup> OECD Historical Population Data and Projections Database, as of 2013.

## Two leading causes of death in the developed world – significant mortality improvements

With advanced biopharmaceutical treatments, such as monoclonal antibodies and cellular therapies, five different fatal Blood Cancers have now become defacto chronic manageable diseases. Selected Solid Tumor Cancers have also seen advances in mortality (but only in a minority of afflicted patients) via Immuno-Oncology agents which utilise the human immune system to help fight the disease, and Tyrosine Kinase Inhibitors which block certain proteins found at high levels in various cancer cells.

Important breakthroughs in Cardiovascular Disease include the widespread adoption of drugs and improved surgical interventions. For example, Statins are used extensively to lower cholesterol levels in patients. In addition, Beta Blockers and ACE Inhibitors are helping to reduce high blood pressure and mitigate the symptoms of congestive heart failure.

On the interventional side, Transcatheter Aortic Valve Replacements (TAVR), afford a minimally invasive surgical correction of defective aortic valves. New advancements in Stroke Thrombectomy (an endovascular procedure to remove blood clots from the brain) have also driven dramatic improvements in the morbidity and mortality of stroke patients.

However, persistent risk factors associated with Type-2 Diabetes and Obesity may mitigate these recent gains. In particular, Type-2 Diabetes remains an important risk factor for cardiovascular disease and blindness. Current treatment standards are inadequate and will typically increase a patient's weight, which can lead to obesity and further exacerbate these risks. Obesity itself is a leading cause of major joint-replacement. Recent data also suggests a correlation between obesity and various cancers.

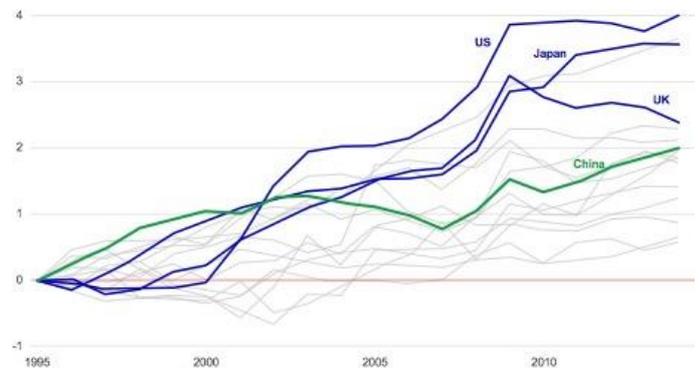
## Improved clinical outcomes have come at a cost

As advanced treatments and therapeutic options are driving improvements in health and extending life expectancy worldwide, it is not surprising that

healthcare expenditure has increased dramatically in recent years. An aging population is also contributing to continued budgetary pressures, as older patients require additional treatments and procedures.

US government healthcare outlays are expected to double over the next 10 years, rising from 6% of GDP to 8% over this time<sup>8</sup>. Global healthcare expenditure is projected to increase at an annual rate of 5.4% between 2017 to 2022, from approximately US\$7.7 trillion to US\$10.1 trillion<sup>9</sup>.

### Chart 4: Change in healthcare spend as a share of GDP since 1995 (pp)<sup>10</sup>



## Profound unmet medical needs still remain

We continue to see profound unmet medical needs in three main categories: Central Nervous System disorders (CNS), metabolic syndrome/obesity, and rare/orphan disorders.

For example, no disease-modifying treatment options currently exist for the most serious CNS disorders (Alzheimer's Disease, Huntington's, Parkinson's, etc.), and current treatment options for major psychiatric disorders (major depression/schizophrenia) remain suboptimal. Direct treatment costs in the US for Alzheimer's Disease alone are now approaching \$300 billion, and if a disease-modifying treatment is not identified they may surpass \$1 trillion per year by 2050<sup>11</sup>.

<sup>8</sup>Source: Congressional Budget Office (CBO), January 2019

<sup>9</sup>Source: World Industry Outlook, Healthcare and Pharmaceuticals; the Economic Intelligence Unit, September 2018.

<sup>10</sup>World Health Organization, 2014. Financial Times 7 November 2017.

<sup>11</sup>Source: Alzheimer's Association of America, 2018 AD Facts & Figures.

Metabolic syndrome, which is consistent with sedentary lifestyles and a western diet, continues to rise in developed nations. As mentioned earlier, obesity remains an established risk factor for serious cardiovascular disease and is now also linked to multiple cancers and osteoarthritis/joint replacements. Encouragingly, improved treatment options for obesity and metabolic syndrome are prevalent in current biopharmaceutical pipelines. We will continue to monitor these developments closely.

Finally, the medical community has identified approximately 7,000 rare/orphan diseases. Among these are conditions such as hemophilia, sickle cell disease, and lysosomal storage disorders. Approximately 80% of rare diseases are genetic in origin, with more than 450 new medicines/gene therapies in development today. We are also assessing this situation, as treatment options exist for only 5% of afflicted patients.

### **An experienced team with deep corporate and investment industry expertise**

Our Global Healthcare strategy boasts a team of three investment professionals with deep knowledge of the healthcare industry, as well as a dedicated client portfolio manager. Lead portfolio manager Steven Slaughter has over 30 years of healthcare experience. Throughout his career, Mr. Slaughter has directed healthcare investments as a portfolio manager and senior investment analyst. In addition, he has held various corporate roles with leading healthcare companies, including Johnson & Johnson, Abbott Laboratories, and Elan Pharmaceuticals. This combination of buy-side

investment experience coupled with direct corporate industry experience, has helped inform Mr. Slaughter and his team to fully understand the broader healthcare landscape, and in turn, has aided their investment decision-making process.

### **Guiding principles drive a differentiated investment approach**

The global healthcare team utilises a differentiated investment philosophy. This approach is rooted in the corporate business development methodology that underpins the merger and acquisition activities deployed by leading industry participants. The team believes that consistent outperformance can be achieved by investing in healthcare companies that:

- Seek to address unmet medical needs
- Pursue underappreciated market opportunities
- Demonstrate an ability to bend the healthcare cost curve

These three criteria constitute the guiding principles by which the team seeks to deploy capital.

Fundamental research and intrinsic valuation drive the investment process, from idea generation through portfolio construction. The team has developed an information advantage, particularly in forecasting revenues, by combining fundamental research with an understanding of corresponding scientific research and medical advances. Fixated on the importance of stock selection, the team has built a diversified portfolio of healthcare companies that meet its guiding principles while ensuring active positions are aligned with the strength of conviction, intrinsic valuation, and relevant risk mitigation.

## Investment Considerations

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