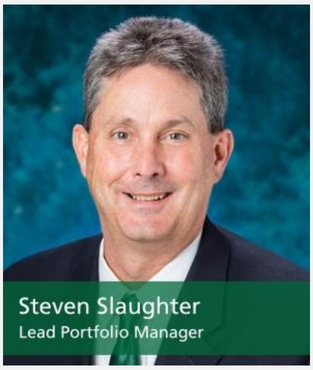
Manulife Asset Management

Investment Note

For distributors, professional/institutional investors
17 April 2019

Global Healthcare Strategy: New leadership delivers a healthier portfolio



Next month marks the first anniversary since Steven Slaughter became the Lead Portfolio Manager of Global Healthcare Strategy ("the Strategy"). With his differentiated investment philosophy, Slaughter set about trimming the portfolio's excess weight to create a more focused portfolio. This investment note reviews the team's new approach and highlights the resulting strong absolute and relative returns enjoyed over the past 12 months.

Slaughter believed that the Strategy had to be an accurate reflection of the new team's philosophy and processes. Consequently, the portfolio was altered throughout May and June 2018.

Deep roots

The team's differentiated investment philosophy is rooted in the same corporate business development approach that underpins the M&A activities deployed by leading healthcare industry participants. It is a mindset moulded by decades of corporate and investment experience.

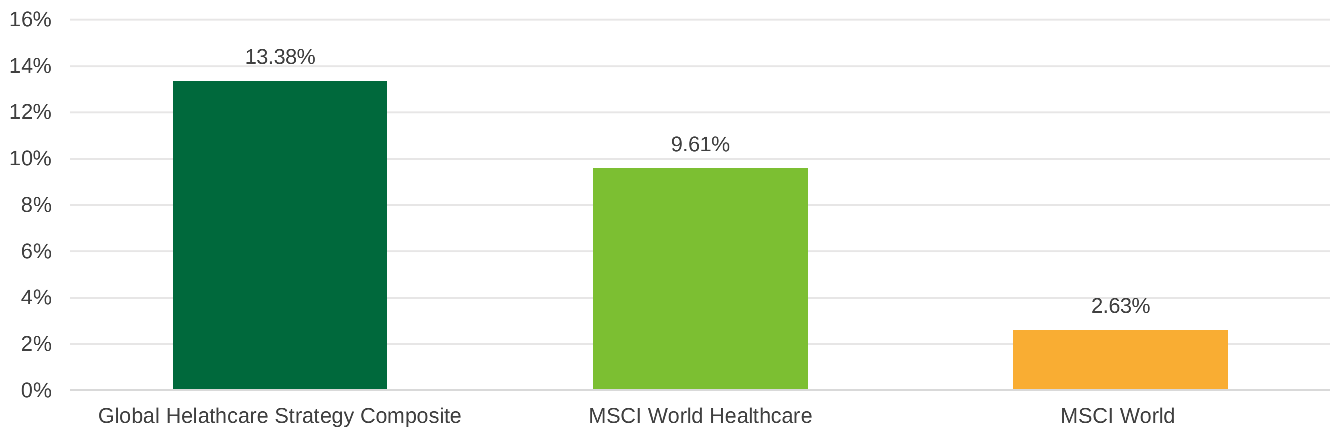
In particular, the team focuses on companies that address unmet medical needs, pursue underappreciated market opportunities, and demonstrate an ability to bend the healthcare cost curve.

Performance outpaces peers[1]

The Strategy has undoubtedly benefited from this new approach, rising by 13.4% in 9 months from June 2018 to March 2019. Over the same period, the benchmark (MSCI World Healthcare) was up by 9.6% (Chart 1). As Slaughter notes, "With our tight focus on stock selection, this is an opportune time to invest in the healthcare sector."

[1] Manulife Asset Management, as of 31 March 2019. Performance shown is the Global Healthcare Composite gross of fees. Past performance is not indicative of future results. Portfolio holdings and characteristics are subject to change at any time, may differ for a specific account and are not a recommendation or solicitation to buy/sell a security. The securities identified and described do not represent all of the securities purchased sold or recommended for the portfolio. It should not be assumed that an investment in these securities or sectors was or will be profitable. Composite inception date: June 2006.

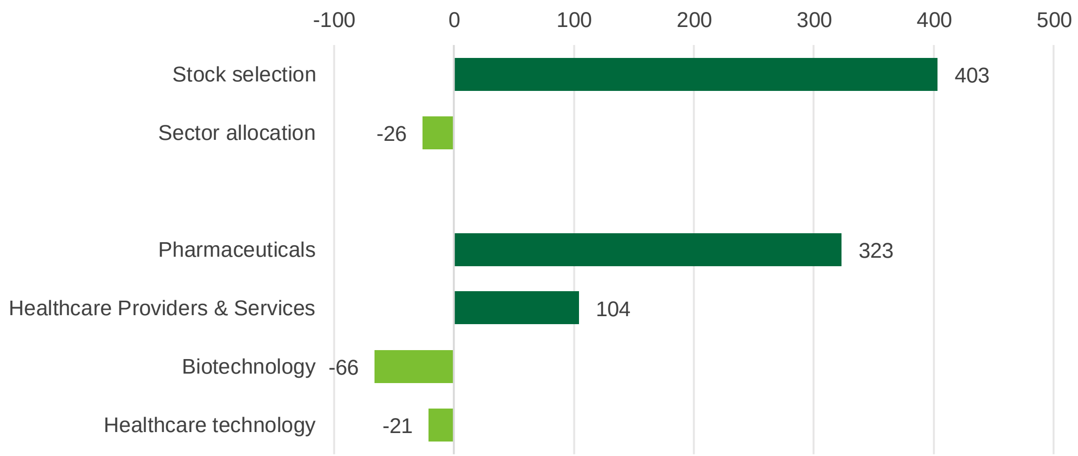
Chart 1: Strategy performance: 30 June 2018 to 31 March 2019[1]



Portfolio Review

Stock selection has been the primary driver of relative performance (Chart 2), particularly in the biopharmaceutical and healthcare providers & services sub-sectors:

Chart 2: Key contributors and detractors, 30 June 2018 to 31 March 2019[1]



i) Starting with biopharmaceutical companies, the team has successfully navigated the recent market volatility. This turmoil was driven by a combination of diverging fundamentals and the pressures being faced by market participants exposed to the US drug-pricing debate. In response, the team has been selective with its choice of higher-conviction names. Its focus has been on companies with best-in-class product portfolios and growing pipelines that can hold their formulary positions in an evolving US market. At the same time, the team has avoided or reduced its exposure to companies that are vulnerable to therapeutic substitution, exhibit weak emerging pipelines, or are reliant on excessive price increases to drive top-line growth.

ii) Regarding stock selection in healthcare providers & services, the team has concentrated on a select number of managed-care entities, which appear well positioned for continued growth – particularly those linked to the US Medicare Advantage and Managed Medicaid markets. Additionally, the team has targeted reasonably valued medical device and tools companies that have exposure to relatively higher growth segments, such as robotics, interventional stroke, mitral valve repair, mass spectrometry and continuous glucose monitoring.

Outlook

The healthcare sector has numerous investment opportunities offering attractive long-term return profiles, and the Strategy is well positioned to take advantage of this.

As previously mentioned, we believe that the recent volatility in the biopharmaceuticals sector has been induced by diverging fundamentals, as well as the recurring pressures exerted on market participants affected by the US drug pricing debate. However, we believe that the discussion is changing direction, with the specific changes to the Medicare drug programme warranting further research. We expect this noise to continue as we approach the US 2020 presidential election cycle.

The fundamentals within the healthcare equipment & supplies sub-sector remain attractive. That said, sustainable revenues and earnings are now more fully reflected in the risk-adjusted return profiles of many stocks.

Within the healthcare providers & services industry, certain healthcare supply-chain companies, such as pharmacy retailers and drug wholesalers, may see heightened pressures from the recent Medicare drug-pricing proposals.

As we approach the later stages of a 4+ year capital-markets financing window, M&A activity in the healthcare space appears to be accelerating. However, we expect this historic run of healthcare IPOs/secondary offerings to wane in the coming months. We believe that the portfolio is well positioned in this regard.

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