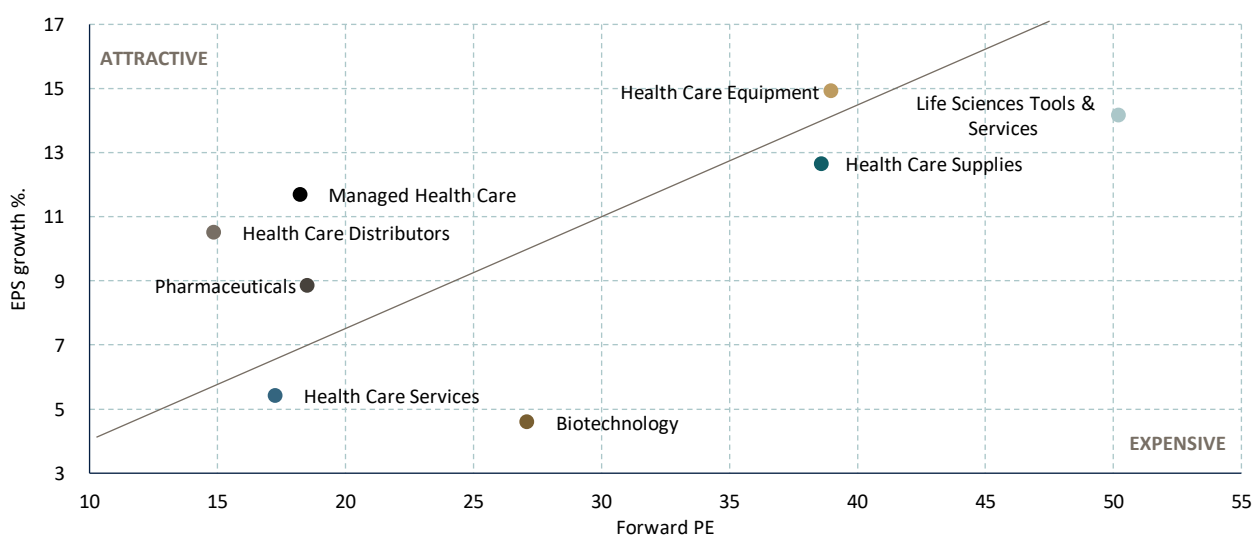




### "DOES THE HEALTHCARE SECTOR NEED A VACCINE? "

- ◆ The healthcare sector has chronically underperformed since 2015
- ◆ Yet it benefits from secular trends and pockets of strong growth ...
- ◆ ... such as the medical equipment sector and life science subcontractors
- ◆ Pharma is not left out and hope lies in the launch of new products

### CHART OF THE WEEK: "Differential valuation of healthcare sub-sectors



Source: Bloomberg, Atlantic Financial Group

### STOCK MARKET ANALYSIS

- ◆ The healthcare sector has chronically underperformed since 2015

The **healthcare sector has underperformed the market for over five years**, with few exceptions (see Fig 2), and is trading at a historic discount (see Fig 3). The healthcare market has suffered since the third quarter of 2015, when the **debate over drug pricing** began. More recently the **risk of removing intellectual property rights on covid-19 vaccines** has reignited fears that pharmaceutical companies will invest at a loss in research and development or experience margin pressure.



Yet the handling of the covid-19 pandemic had increased the sympathetic view of the pharmaceutical sector among politicians and the general public. The suggestion by the World Health Organisation (WHO) that laboratories should be obliged to make their covid-19 vaccine patents public in order to speed up vaccination in emerging countries has therefore created a new cold draught.

Fig. 2 - Absolute and relative performance

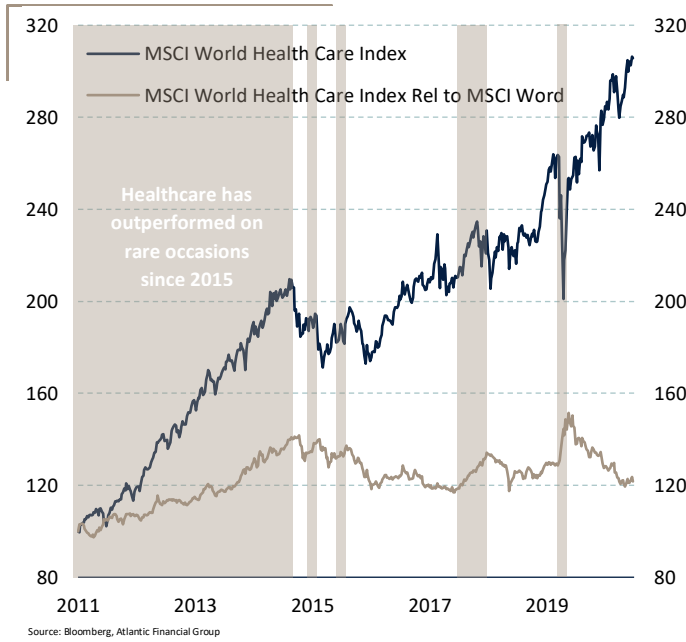
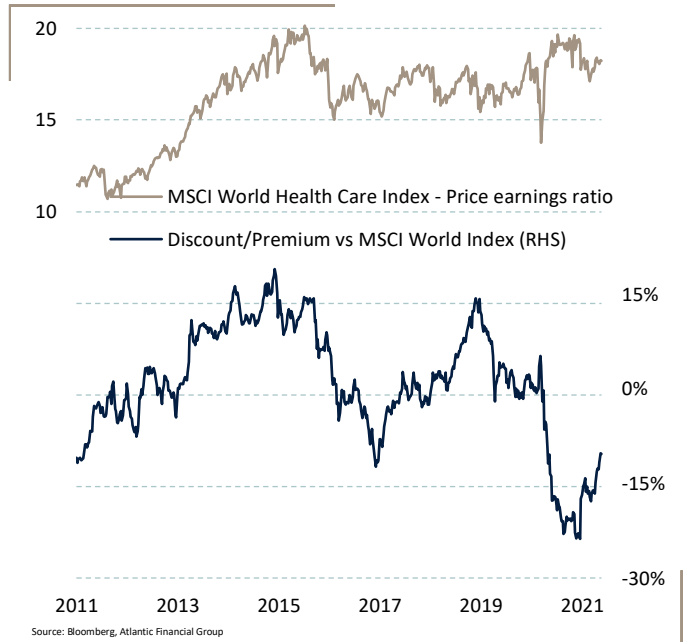


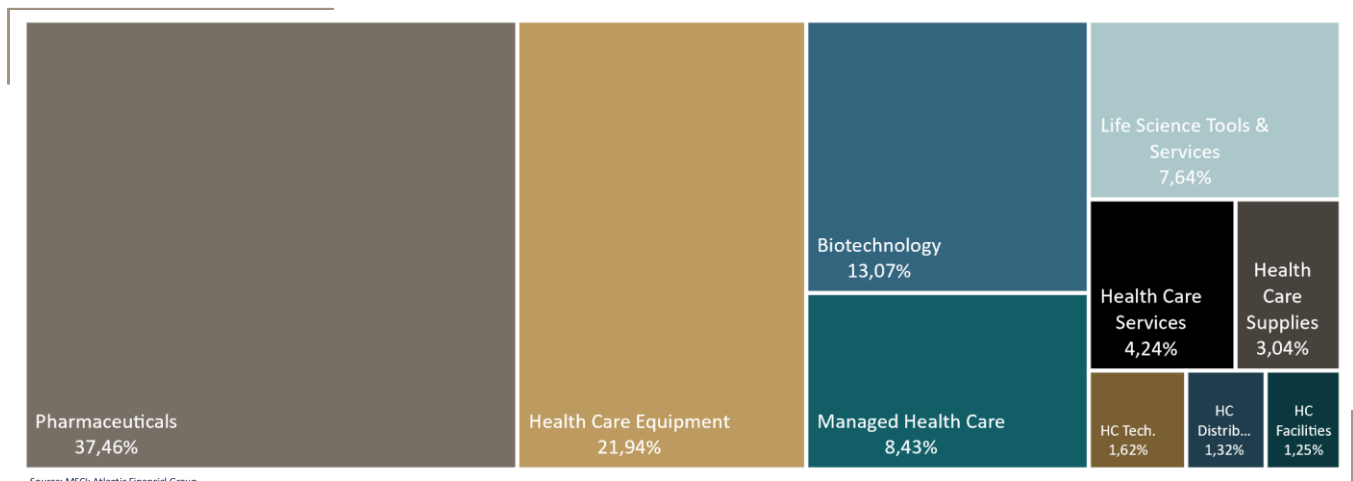
Fig. 3 - Historical and relative valuation ratio



**The healthcare sector weight in Indices remains noteworthy** (13% of the S&P and Euro Stoxx; 12.3% of the MSCI world) and cannot be ignored by portfolio managers given the benefits it brings in terms of diversification and lower volatility. In addition, **the sector has greater financial flexibility thanks to healthy balance sheets and good free cash flow generation.**

The **Big Pharma and MedTech** sub-sectors **together account for over 50% of the MSCI Healthcare Index** and influence the sector's visibly attractive valuation, while the more expensive biotech sector accounts for only 13% of the index (see Fig 4).

Fig. 4 - MSCI Healthcare, segmentation by sub-sector (%)





### ◆ The sector benefits from secular trends and pockets of strong growth...

**The ageing population, the increase in chronic diseases and the more affluent middle class in emerging countries** will continue to be strong growth drivers for the sector. The wealthier a population becomes, the more they want access to good healthcare.

Other growth drivers include **improved access to medicines in emerging markets**. China has recently become the second largest market for medicines, worth \$130 billion compared to the US, which is worth around \$350 billion. **Healthcare spending in China will continue to grow at a steady pace, driven by the Chinese economy's rapid growth, increasing disposable income per capita, its ageing population and the government's support for improved healthcare access.** Healthcare expenditure in China in 2018 was RMB 5.9 trillion (\$ 830 billion) and is expected to reach RMB 9.4 trillion in 2023, or \$ 1.3 trillion (see Fig 5).

Fig. 5 - Healthcare expenditure in China (RMB bn)

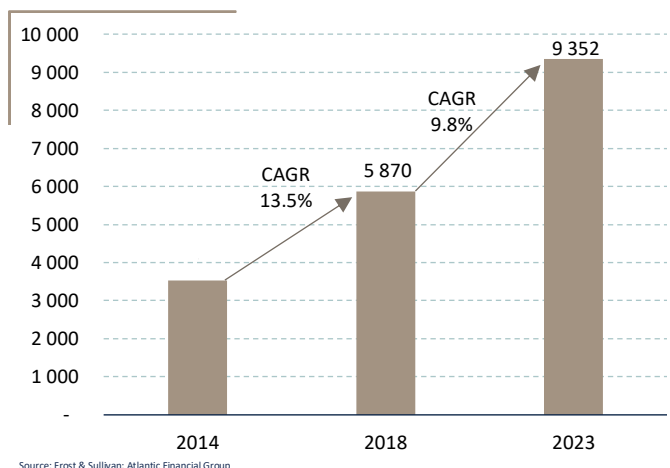
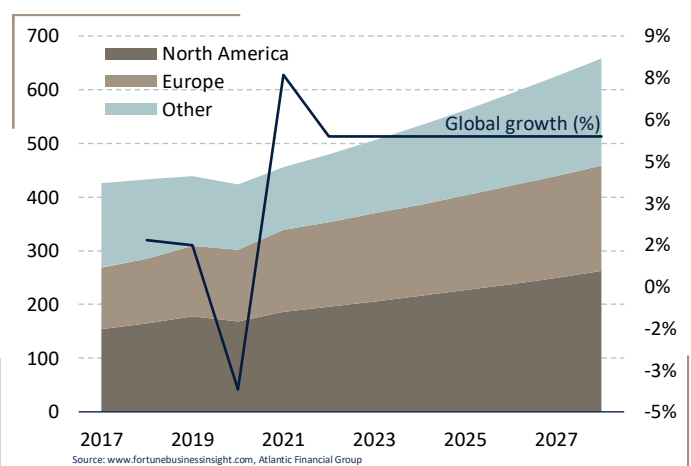


Fig. 6 - MedTech market expansion (\$bn)



Big Pharma is benefiting from these new markets opening up and from the rise of China. Other healthcare sub-sectors are showing even higher growth rates, including the medical equipment sector (MedTech) and the drug, generic and vaccine manufacturers or contract development and manufacturing organization (CDMO).

### ◆ Medical equipment sectors and subcontractors serving the life sciences

**The medical equipment market**, after slowing down -3.7% in 2020 due to covid-19, is **expected to rebound by 7.6% this year to \$455 billion. Its average growth is expected to be 5.4% between 2021 and 2028**, reaching a size of \$ 658 billion in 2028 (see Fig 6). The growth in 2021 reflects a catch-up effect after many non-essential medical procedures were postponed to avoid contagion risks.

The MedTech sector is benefiting from the **rise in chronic diseases** (e.g., hypertension, diabetes, and cardiovascular disease), linked to a more sedentary lifestyle. In addition, there is an **accelerating demand for ophthalmic and orthopaedic products**, linked to an ageing population. The sector is also benefiting from the **craze for monitoring devices such as fitness trackers** coupled with an app on smartphones. 21%



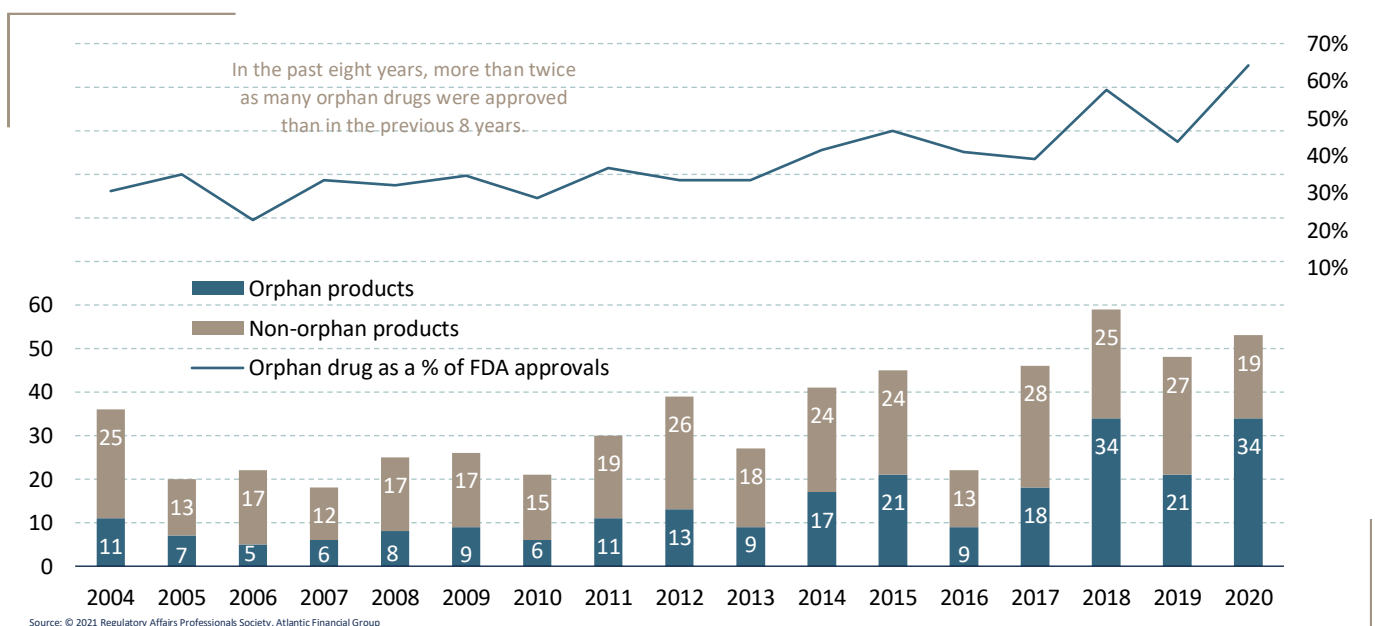
of Americans are said to own such a device, encouraged by their health insurance companies who want to reduce the health costs associated with chronic diseases.

Another sub-sector, which is currently experiencing **strong growth (~10%p.a.)**, is the **subcontracting or CDMO market, which is estimated to be worth around \$170 billion**. **Big pharma has the infrastructure to serve its own needs but is turning more to specialist CDMOs for efficiency and cost control**. The explosion of R&D projects due to covid, the need to mass-produce vaccines or drugs has been overtaken by many subcontractors who have not had the means or time to invest in production tools. CDMOs, such as Lonza in Switzerland, are taking full advantage of this booming demand.

#### ◆ Pharma is not left out and hope lies in the launch of new products

Big Pharma is focusing on R&D in the **most profitable areas of oncology, haematology, diabetes or cardiovascular diseases**. **Another sector that is perhaps even more profitable because of extended patent terms is rare diseases, which also benefits from a faster approval process and higher treatment prices**. This strategy allows them to bypass governments' efforts to contain drug price inflation. In 2020, the validation of "orphan" products represented 63% of approved drugs compared to only 29% in 2010 (see Fig. 7).

Fig. 7 - Annual validation of new drugs by the FDA



The erosion of drug sales prices with the arrival of generics and biosimilars has continued into 2020, but the pressure is expected to ease from 2021-2022 and slowly rebound in 2023-24. The last major patent expiry took place in 2017, when 18 blockbuster drugs went off patent. This represented an expected loss of sales of \$30 billion. No further patent losses of this magnitude are expected until at least 2025. In 2012, pharmaceutical market revenues fell by only 1%, while lost patents accounted for almost \$52 billion in



annualised revenues. The sensitivity of revenues to patent expiry appears to have a smoothed impact in general and supports the view that the sector offers good long-term visibility and low earnings volatility.

The **lifting of covid-19 vaccines patents should not have a significant financial impact on pharmaceutical companies**. Sales contracts have already been partially negotiated for the most important geographical areas, the US and Europe. The **real added value of these mRNA-based vaccines lies in the potential to develop future drugs against cancer or other chronic diseases**, the intellectual property rights of which should be maintained. Finally, before the pandemic, **90% of the global vaccine industry's revenues, or c. \$30 billion, were generated by GlaxoSmithKline, Pfizer, Sanofi and Merck. This amount remains minimal (~2.5%)** for an industry that generates over \$1.25 trillion in sales each year.

### Conclusion:

Political debates and campaign pledges to reduce healthcare costs continue to be a headwind to the healthcare sector, and especially for the **big pharmaceutical companies**. However, the valuation discount relative to the market is not justified, especially given the **quality of the balance sheets and their defensive characteristics**. **MedTech and CDMOs** appear pricier nonetheless feature **greater growth opportunities**. The healthcare sector is not immune to political risks, but rewards outweigh those risks while the pandemic has highlighted the **need to maintain a strong and efficient local R&D and manufacturing capacity**.





## RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2021 Year-to-Date (%)	2020 (%)	2019 (%)
<b>Equities</b>							
World (MSCI)	716.3	64.74	0.8%	2.9%	11.8%	16.9%	27.3%
USA (S&P 500)	4 230	60.41	0.6%	1.7%	13.3%	18.4%	31.5%
USA (Dow Jones)	34 756	62.63	0.7%	2.1%	14.5%	9.7%	25.3%
USA (Nasdaq)	13 814	56.68	0.5%	1.4%	7.5%	45.1%	36.7%
Euro Area (DJ EuroStoxx)	453.5	63.57	0.6%	5.1%	16.0%	0.8%	27.3%
UK (FTSE 100)	7 069	56.37	0.7%	2.5%	11.2%	-11.4%	17.2%
Switzerland (SMI)	11 571	69.51	1.3%	5.6%	11.1%	4.3%	30.2%
Japan (Nikkei)	29 019	52.55	-0.7%	0.4%	6.2%	18.3%	20.7%
Emerging (MSCI)	1 382	64.37	1.6%	3.7%	7.7%	18.8%	18.8%
Brasil (IBOVESPA)	130 126	76.01	3.6%	10.5%	9.3%	2.9%	31.6%
Russia (MOEX)	3 807	71.23	2.5%	8.4%	18.1%	14.8%	38.4%
India (SENSEX)	52 207	68.45	1.5%	8.2%	9.6%	17.2%	15.7%
China (CSI)	5 268	58.02	-0.6%	3.3%	1.7%	29.9%	39.2%
Energy (MSCI World)	187.3	70.41	5.5%	9.5%	32.1%	-27.7%	13.9%
Com. Serv. (MSCI World)	113.55	58.01	0.3%	1.3%	13.3%	24.2%	25.1%
Materials (MSCI World)	383.7	60.05	1.1%	3.8%	18.6%	21.6%	20.8%
Info. Tech. (MSCI World)	484.5	58.43	1.0%	2.2%	7.0%	46.2%	47.5%
Utilities (MSCI World)	154.8	47.73	-0.1%	0.3%	3.7%	4.8%	22.3%
Financials (MSCI World)	151.2	71.79	0.8%	5.9%	23.8%	-3.1%	24.1%
Cons. Staples (MSCI World)	282.4	69.68	1.0%	4.2%	6.7%	8.8%	22.4%
Health Care (MSCI World)	335.5	54.56	-0.6%	1.3%	6.4%	15.4%	23.3%
Cons. Discret. (MSCI World)	400.2	56.01	0.5%	0.7%	6.0%	37.0%	28.2%
Industrials (MSCI World)	329.9	63.89	0.6%	3.3%	14.9%	11.8%	27.2%
<b>Bonds (FTSE)</b>							
USA (7-10 Yr)	1.58%	60.35	0.4%	0.5%	-4.2%	9.3%	7.4%
Euro Area (7-10 Yr)	0.10%	58.15	0.2%	-0.1%	-2.3%	4.5%	6.7%
Germany (7-10 Yr)	-0.21%	54.84	0.2%	-0.3%	-3.1%	3.0%	3.0%
UK (7-10 Yr)	0.79%	52.80	0.0%	0.1%	-4.3%	5.4%	4.8%
Switzerland (7-10 Yr)	-0.14%	43.58	-0.1%	-0.5%	-1.8%	0.4%	2.0%
Japan (5-10 Yr)	0.08%	47.35	0.0%	0.0%	-0.3%	-0.1%	0.0%
Emerging (5-10 Yr)	4.29%	67.82	0.2%	0.8%	-2.0%	5.2%	13.3%
USA (IG Corp.)	2.11%	61.42	0.2%	0.5%	-2.6%	9.9%	14.5%
Euro Area (IG Corp.)	0.35%	59.97	0.2%	0.0%	-0.6%	2.8%	6.2%
Emerging (IG Corp.)	3.78%	63.48	0.0%	0.3%	0.3%	8.1%	13.1%
USA (HY Corp.)	4.01%	75.06	0.3%	0.3%	2.5%	7.1%	14.3%
Euro Area (HY Corp.)	2.80%	79.89	0.3%	0.5%	2.8%	2.3%	11.3%
Emerging (HY Corp.)	6.03%	69.55	0.2%	0.9%	0.9%	4.3%	11.5%
World (Convertibles)	442.2	55.63	-0.1%	0.7%	3.3%	38.8%	17.3%
USA (Convertibles)	590.5	53.61	-0.4%	0.4%	2.6%	54.5%	22.8%
Euro Area (Convertibles)	4 148	60.52	-0.1%	1.0%	0.8%	6.1%	7.6%
Switzerland (Convertibles)	186.4	49.13	0.0%	-0.1%	-0.2%	0.5%	2.4%
Japan (Convertibles)	198.7	52.33	-0.1%	-0.2%	2.2%	2.8%	2.6%
<b>Hedge Funds (Crédit Suisse)</b>							
Hedge Funds Indus.	708.5	76.84	n.a.	2.6%	5.5%	2.5%	9.3%
Distressed	#N/A N/A	74.47	n.a.	1.7%	8.0%	1.5%	1.4%
Event Driven	#N/A N/A	72.07	n.a.	1.9%	8.3%	3.1%	8.2%
Fixed Income	#N/A N/A	76.57	n.a.	1.2%	3.4%	2.2%	6.1%
Global Macro	#N/A N/A	77.30	n.a.	3.5%	6.4%	2.0%	10.4%
Long/Short	#N/A N/A	70.02	n.a.	3.1%	5.5%	3.6%	12.2%
CTA's	#N/A N/A	65.41	n.a.	2.7%	5.0%	-3.2%	9.0%
Market Neutral	#N/A N/A	52.76	n.a.	2.4%	3.3%	-0.1%	1.6%
Multi-Strategy	#N/A N/A	77.31	n.a.	2.2%	4.4%	1.4%	7.3%
<b>Volatility</b>							
VIX	16.42	42.84	-2.0%	-15.7%	-27.8%	65.1%	-45.8%
VSTOXX	17.38	43.80	1.2%	-23.9%	-25.6%	67.5%	-41.5%
<b>Commodities</b>							
Commodities (CRB)	551.3	n.a.	0.5%	3.1%	24.2%	10.5%	-1.9%
Gold (Troy Ounce)	1 884	58.31	-1.2%	2.9%	-0.8%	24.9%	18.3%
Oil (WTI, Barrel)	69.62	66.46	5.0%	6.0%	43.5%	-20.5%	34.5%
Oil (Brent, Barrel)	70.96	62.57	4.0%	2.5%	39.1%	-23.0%	24.9%
<b>Currencies (vs USD)</b>							
USD (Dollar Index)	90.220	48.23	0.2%	0.0%	0.3%	-6.7%	0.2%
EUR	1.2156	51.08	-0.6%	-0.1%	-0.5%	9.7%	-2.2%
JPY	109.51	47.19	0.1%	-0.8%	-5.7%	5.3%	0.9%
GBP	1.4117	52.28	-0.7%	1.0%	3.3%	2.8%	3.9%
AUD	0.7736	49.49	0.0%	-1.4%	0.5%	9.5%	-0.4%
CAD	1.2098	55.71	-0.3%	0.3%	5.2%	1.8%	5.0%
CHF	0.9004	53.83	-0.2%	0.0%	-1.7%	9.8%	1.4%
CNY	6.4015	58.76	-0.5%	0.5%	2.0%	6.7%	-1.2%
MXN	19.909	52.94	0.2%	0.0%	0.0%	-4.9%	3.8%
EM (Emerging Index)	1 752.2	70.94	0.0%	1.7%	1.9%	3.3%	3.1%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)



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