Kieger – Thoughts from the Street

JPM HC Conference 2019

Zurich, January 15, 2019

Healthcare equity markets in 2019: More challenging macro backdrop, of strong company fundamentals and M&A as joker

We attended the 37th annual J.P. Morgan Healthcare Conference 2019 from January 7th to 10th in San Francisco.

Each January healthcare managements and healthcare investors around the world are looking to San Francisco to form their view of the coming 12 months. Anecdotally this year's conference was slightly less attended, however, from our point of view the hallways and presentation sessions seemed as congested as always.

The investment year 2018 was eventful and not lacking of ups and downs. In the end Healthcare handily outperformed the market by 11.2% (MSCI World Healthcare NT vs. MSCI World NT) and finished the year as the best performing sector. Within the space the performance variations were huge with LS Tools & Services returning 11.7% while HC Technology decreased by 6.8%.

After attending dozens of company presentations and talking to management teams and fellow investors at the conference we expect 2019 to remain volatile. Broader topics across most sessions included the flowing:

More challenging macro backdrop

While the industry growth drivers for Healthcare (aging population, raise of chronic disease, innovation and emerging markets) are still very much intact, the general macro environment seems to have become more difficult compared to past years.

- *Healthcare specific political pressures:* 1) Renewed discussion of drug pricing and the burden that rising drug prices puts on patients and payors. 2) Possibility for the introduction of single payor system in the US. 3) Resurface of the Obamacare repeal and replace debate. While we believe that there are no political majority for meaningful changes, all three topics can lead to headline risks and equity market volatility.
- *Current stage in the economic cycle:* Nearly all management teams were asked how their companies would perform in a recession. For us this is an additional sign that we might be at a later stage of the cycle. Most managements confirmed our own findings of a comparably low correlation of changes in GDP growth to changes in Healthcare sales growth. In fact it is possible that in a recessionary environment Healthcare once again could be perceived as safe haven. However, even if Healthcare stocks outperform relatively, they might still be negatively impacted on an absolute basis.

Surprisingly, the current government shut down (could impact M&A deal and product approvals) and the ongoing trade tensions with China were merly minor topics during the conference. The latter might be explained by the fact that we attended mostly Medtech and Healthcare Services presentations which generally have less exposure to China. In any case both, the shut down and China tensions, would support our view of a more challenging macro environment.

Strong company fundamentals

Company fundamentals was an area where commentarys and preannouncements were mostly very upbeat. Many Medtech companies talked about having the strongest product pipeline ever. It is therefore not surprising that 2 of the 3 biggest pure play Medtech companies preanounced organic sales growth of above 7% and seemed confident that they are able to sustain this rate in the coming years. Not too long ago 4% organic growth seemed the norm for mature Medtech companies. The reason behind this growth is innovation that opened up big, completely new markets (for example transcatheter heart valve replacement and surgical robotics) or expanded existing markets fundamentally (for example diabetes care with continued glucose measurement and hybrid closed loop pumping systems).
Also management teams of Healthcare Services companies were mostly bullish and seemed confident in their business prospects.

M&A

Before the conference started Bristol-Myers Squibb announced its intention to buy Celgene in an USD 80 bn transaction and three days later Eli Lilly offered USD 8bn for Loxo Oncology. Due to the generally strong balance sheets we see M&A as Joker that could strike across all subsectors of healthcare.

Bottom line

The combination of strong company fundamentals and a more challenging macro environment could lead to more volatility ahead. Compared to other sectors this setting might benefit Healthcare in relative terms. When it comes to individual stock performances we think the environment leads to greater performance dispersion and the opportunity for active portfolio management to add value.

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