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Healthcare stocks poised for a comeback in 2022

More and more people are receiving better and more effective treatment thanks to modern medicines and medical devices. Alone in the United States, the world's largest healthcare market, 50 novel drugs were approved during 2021. The positive multi-year trend for new drug approvals is thus still intact. In contrast to the operational advancements and attractive commercial potential of many companies in the healthcare sector, investors reaped slim returns on their healthcare investments last year. This means now is a perfect time to take a good look at what the future holds in store for healthcare.

Biotech labs are still the hotbeds of innovation

In 2021, investor attention in the biotech sector was clearly focused on Moderna and Biontech, two mRNA vaccine manufacturers. All this attention did not help the Nasdaq Biotech Index much in terms of annual performance because it lagged well behind the broader market despite the biotech industry's stronger growth momentum and all the new products it brought to the market, sustaining the strong new approvals trend from previous years. This discrepancy between commercial success and a sub-par performance means the biotech sector is increasingly attractive compared to the valuations of the total market and other subsectors within the healthcare industry. What could change market sentiment and attract buyers to the biotech sector again?

An important argument here is the patent cliff that drug makers, big pharma in particular, are facing in the coming years. We therefore expect a surge in M&A activity this year, which, in combination with the very attractive valuations and double-digit growth rates of biotech companies, is likely to lead to a sector rerating. In addition, many of the novel therapeutic approaches in recent years have emerged from the laboratories of biotech companies. The sector's rapid and successful solutions to overcome the pandemic were developed with breathtaking speed and are a testament to biotech's cutting-edge innovation. These solutions have the potential for use in other areas, too. Biotech companies are using mRNA to develop new vaccines against infectious diseases and cancer, with clinical trials already ongoing and topline results expected later this year.

Among established heavyweights, companies like Vertex Pharma and Biogen are working to rejuvenate their existing range of growth drivers with new products from their R&D pipelines. Any news of groundbreaking clinical successes from these industry veterans could lead to a positive shift in sentiment towards the biotech sector as a whole. The Alzheimer's disease pipeline promises excitement this year. Expected clinical and regulatory updates notably include the final Biogen/Eisai data on their early-stage Alzheimer's disease candidate, an antibody targeting beta-amyloid protein deposits in the brain. Eli Lilly is expected to report data from its Phase III donanemab trial, with Roche and Morphosys possibly reporting Phase III data on gantenerumab in the second half of the year.

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In oncology, numerous trial results are anticipated for the class of antibody-drug conjugates (ADCs) and bispecific antibodies in 2022. With its efforts to expand the use of its cancer drug Trodelvy beyond triple-negative breast cancer (TNBC), Gilead will see competition from AstraZeneca/Daiichi Sankyo, who presented encouraging data on an early-stage pipeline candidate last December. The two companies are also looking into treating patients with HER2-low breast cancer with their already approved Enhertu ADC. In addition, Genmab is to give updates on its lymphoma/blood cancer programs and present Xencor proof-of-concept data for its bispecific technology.

Pharmaceutical companies – banks in disguise

At first glance, the NYSE Arca Pharmaceutical Index's annual return of 24.2% for 2021 looks pretty good. However, that double-digit return can largely be traced to the strong performance of just a handful of pharma companies, Pfizer and Eli Lilly for instance. Looking at valuation metrics such as enterprise value to EBITDA, one sees that the index is trading at a discount of about 25% to the S&P 500. At the same time numerous factors suggest that pharma companies will be able to better navigate the general environment in 2022 than companies in other industries. Interference from political corners, in the form of government price controls, for instance, are no longer in sight after the Biden administration failed to get its "Build Back Better" plan through both houses of Congress. Prolonged high inflation will not hurt pharmaceutical companies much either, thanks to their strong pricing power.

They are also sitting on huge piles of cash thanks to their steady and strong revenue flows. Pfizer, for example, has long held a large amount of cash, and it is growing more and more by the sales of its COVID-19 vaccine and, more recently, its Paxlovid COVID-19 pill. Other pharmaceutical companies such as Johnson & Johnson, Novartis and GlaxoSmithKline should raise considerable cash from the planned spin-offs of certain business activities. Distributing these billions to shareholders in the form of dividends is one option for them. For generalist investors in particular, high dividend payouts are a key argument for buying pharma shares. Big pharma is also likely to invest large sums of money in collaborations and take advantage of the currently low valuations in the biotech space to make acquisitions.

Medical technology sector benefits from catch-up effects

Increasing global life expectancy, growing prosperity, and innovations in devices and medical instruments are ultimately setting the groundwork for long-term structural growth in the medtech sector with the aim of making healthcare better and more efficient. We expect growth rates of 5-6%, which is significantly higher than the projected world economic growth rate, and profitability should also continue to improve.

The biggest breakthrough innovations in terms of market-ready products and technologies have been in diabetes treatment, minimally invasive heart valve replacement/repair, neurostimulation for nerve disorders, and surgical robotics. One prime example is Dexcom, a US company specializing in diabetes management technology and a leading supplier of devices for real-time glucose monitoring using digital data analysis. A new generation of this product group is poised for launch this year.

Especially in the US, service providers and insurers stand to benefit from the high growth potential arising from the vertical integration of healthcare providers, the growing number of US residents with health insurance, and efficiency gains resulting from lower administrative costs thanks to increasing digitization. On top of that, equipment orders and medical treatments for non-life-threatening illnesses that were postponed due to the coronavirus pandemic are likely to pick up steam. These factors add up to stable, non-cyclical growth rates which are solidifying the medical technology sector's role and reputation as one of the most stable and defensive sectors in the eyes of the investment community.

Digital health is underestimated

As in many other areas of work and everyday life, sensors, cloud data storage and artificial intelligence are gaining ground in healthcare. Disruptive technologies are improving treatment and boosting efficiency, for example through digital analysis of patient data. In the field of digital health, small and medium-sized companies are setting the tone. After its strong performance in the previous year, a widespread rotation into large caps in 2021 led to steep declines in the share prices of some niche digital health players.

The strong fundamentals of the fast-growing digital health sector are still intact. Most digital health companies were able to sustain their growth momentum at the top and bottom line during the past year. Consequently, the valuations of digital health stocks are now 40% lower than they were as recently as January 2021. If the recently observed rotation back into small cap healthcare stocks continues, digital health is poised to make an impressive comeback. Bearing in mind that healthcare still has one of the lowest digital penetration rates of any industry, the long-term outlook for this subsegment of the healthcare sector remains attractive.

In summary, there are a wide range of arguments for buying the healthcare sector, covering a range of different time horizons. Biotech and digital health stocks tend to be more volatile but their underlying growth rates are high. Pharma, on the other hand, can be viewed as a defensive hedge in times of inflationary pressure, and medical technology will benefit from pent-up demand in the post-pandemic era. For investors who would rather not invest in one particular subsector, the Bellevue Healthcare Strategy Fund and the Bellevue Sustainable Healthcare Fund are good alternatives. Both funds invest in all subsectors of the global healthcare industry and boast very successful 15-year track records.

An overview of Bellevue Healthcare Strategies

Bellevue Healthcare Strategy
Bellevue Sustainable Healthcare
Bellevue Biotech
Bellevue Medtech & Services
Bellevue Digital Health
Bellevue Asia Pacific Healthcare
Bellevue Emerging Markets Healthcare

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Bellevue – Excellence in Specialty Investments

Bellevue is a specialized asset manager listed on the SIX Swiss Exchange with core competencies covering healthcare strategies, entrepreneur strategies, alternative and traditional investment strategies. Established in 1993, Bellevue, a House of Investment Ideas staffed by 100 professionals, generates attractive investment returns and creates value added for clients and shareholders alike. Bellevue managed assets of CHF 12.8 bn as at December 31, 2021.