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## A promising outlook for the biotech sector

Judging by the market performance of biotech stocks, the past two years have been difficult for the biotech sector. Biotechnology indexes underperformed broader stock-market indexes. Now it looks like the tables are turning. Biotech stock prices have stabilized, and a comeback is possible.

From Dr. Lukas Leu, Portfolio Manager Bellevue Biotech Fund

The bearish market in biotech stocks probably bottomed out in mid-June 2022. After that low, the sector rebounded about 30% (mid-June to mid-August, as measured by the Nasdaq Biotech Index (NBI), but the upward momentum has weakened a bit in the meantime. Nevertheless, the sector outlook is positive, not only for the remainder of the current year, but also for the coming year. This is because many biotech companies are in fundamentally strong positions and very attractively valued to boot. Moreover, many groundbreaking innovations are in the pipeline and likely to drive market potential in the targeted disease areas.

### Attractive entry points

Another trigger is the growing pressure on pharma companies to launch new growth drivers. According to estimates by the US FDA, blockbuster drugs that currently generate more than USD 250 bn in annual sales will lose patent protection by the end of the decade. The overall earnings picture at many multinational pharma companies is often shaped by just a few blockbuster drugs. When they go off patent, it can put a big dent in a company's earnings profile. Consequently, drug manufacturers are always trying to come up with new technologies and drugs. Meanwhile small or mid-sized biotech companies that are not yet turning a profit because their revenues from drug products are still too low are trading at historically low levels, even after the recent, in some cases drastic, markdowns. That offers attractive entry points.

The widespread selling during the past twelve months was fueled by the greater discount investors were applying to future revenue streams as interest rates moved higher in the face of higher inflation. Despite the continued market volatility, we assume the biotech sector will be well-supported by the steady value it is generating in the healthcare space.

### Focus on mid-caps

The Bellevue Biotech (Lux) Fund is primarily invested in mid-sized biotech companies with strong innovation and growth momentum and that possess a number of positive triggers in expanding pipelines. The biotech sector's track record of innovation is still strong. Next-generation products and technologies are being introduced in various fields, for example in gene therapy. In other, already established technology areas such as RNA therapeutics, an initial focus on orphan diseases has quickly been expanded to include larger disease areas, and the resulting revenues could be significantly higher than initially projected.

A good example here is Biomarin, which recently received European marketing authorization for Roctavian, the first-ever gene therapy for treating severe hemophilia A. Or Alnylam, which published excellent clinical trial data for Patisiran in AATTR amyloidosis with cardiomyopathy and is likely to soon receive regulatory approval for the drug. This niche product could become a blockbuster. Even some mature and, especially, profitable large-cap biotech names offer good upside potential. Shares of Vertex

or global player Regeneron have already made nice gains this year, which brings stability to a biotech portfolio when markets are volatile or defensive plays are preferred.

### M&A activity on the rise

The latest acquisitions against the backdrop of the sector's enticingly low valuations could herald the start of a new wave of M&A activity and give the entire sector an additional boost. Pfizer has been on the acquisition path for a while now. Its most recent acquisition was in August, when it shelled out USD 5.4 bn for Global Blood Therapeutics, a US biotech company that is developing medicines for rare hematological diseases and a leader in the treatment of sickle cell anemia. This inherited disease changes the shape of red blood cells, so they look like a crescent moon, or sickle. Three months before that deal, Pfizer put the finishing touches on the largest transaction in the biotech industry so far this year. It spent USD 11.6 bn to acquire the US biotech company Biohaven, giving it ownership of Nurtec, a migraine pill with a novel mechanism of action.

Rising M&A activity coupled with a strong innovation pipeline should protect the sector from the general headwinds caused by rising interest rates. We believe the chances are good that large, cash-rich pharma companies will continue to beef up their R&D pipelines as 2022 draws to a close and going into 2023. We see several factors that could lead to an increase in acquisition activity. A large number of biotech companies have presented promising clinical data this year. Biotech companies have also been prominent on the new approvals front. The political environment is currently favorable for the biotech sector. The recently passed Inflation Reduction Act in Washington will not impose any price caps on innovative drugs in the US, the world's largest drug market. This fosters innovation and also whets Big Pharma's appetite for attractive biotech companies. Companies that have recently launched or are about to launch their first products on the basis of groundbreaking technologies will attract the most attention from buyers eager to quickly navigate a patent cliff. Looking at the transactions announced so far this year, oncology remains the most important therapeutic area for prospective buyers. Neurology is also an area where smaller biotech companies have made good clinical progress during the past few years pursuing new therapies for schizophrenia and depression.

### Outlook

A favorable regulatory environment and the growing number of clinical trial submissions at the FDA suggest that the number of new drug approvals will climb higher going forward. Innovation has been quite impressive; new breakthroughs are being developed and new products are getting to the market faster. Attractive stock valuations translate into good return potential. The biotech sector should be part of diversified investment portfolios anyway in view of its unique dynamics. Current stock prices are an invitation to open new positions in the biotech sector or top up existing positions.

Learn more

[Bellevue Biotech](#)

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