

Market commentary of August 18, 2022

## Asia's rapidly expanding healthcare market

Healthcare stocks across Asia were not spared from the recent market turmoil. This sell-off coupled with unabated top-line growth has brought valuations to historic lows and created very attractive entry points for investors.

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The healthcare market in emerging Asian economies is a giant growth market. The region accounts for 60% of the world's population. There are more than 3 billion people in China, India and Indonesia alone. Meanwhile the middle class continues to grow relative to the total population. This means growing purchasing power and clearly stronger demand for goods and services from consumer and leisure-related industries and, of course, from the healthcare industry too.

An additional development under way in the healthcare sector is worthy of special mention: Asia populations are also steadily graying. Within approximately one generation, by about 2050, about one billion people in the region will be older than 60, and about half of them will be in China alone.

### Major reforms in the Asian healthcare sector

Against this backdrop, access to high-quality healthcare products and services that ordinary citizens can afford is critical. Government policy will, of course, shape the future development and modernization of national healthcare systems. Emerging Asian countries have been particularly active in pursuing sweeping healthcare reforms, in order to keep up with exploding demand.

Sector growth forecasts are correspondingly attractive. We expect the healthcare industry in Asian emerging markets to grow twice as fast as the respective gross national products over the next few years.

### Excessive correction in China

Turning to China, Beijing announced one of its first major healthcare reforms in 2015 when it introduced mandatory bioequivalence testing of generics, among other measures. Three years later, the first government tenders and centralized procurement processes for generics were introduced. Such action was initially greeted with uncertainty by investors. For patients, however, it has improved the quality, access and affordability of healthcare goods and services.

The recent correction, and not only in healthcare but across the Chinese stock market, can be traced to a mix of foreign policy tension (US-China confrontations), the Ukraine war, and Chinese public policy decisions. The latter include a stringent zero-COVID policy that has raised some eyebrows and a sweeping regulatory crackdown on technology companies among others.

What is often overlooked with these issues is that, unlike most countries in the West, inflation is not a concern in China and therefore its government is in a better position to support the economy through accommodative monetary and fiscal policies. What is particularly important when it comes to healthcare is that government action is squarely focused on modernizing the entire system, at every level of the value chain. Supporting research and development activities is absolutely vital in order to satisfy the tremendous demand with domestically developed products and services over the medium to long term.

A standout example of the progress being made by China's homegrown healthcare industry is Legend Biotech. Together with its partner Johnson & Johnson, it presented efficacy data from a personalized cell therapy trial in patients with multiple myeloma, the second most common type of blood cancer, that is in a class of its own. The cell therapy was approved by the US FDA at the end of February 2022.

Despite the occasionally brutal stock market sell-offs, Chinese healthcare stocks have outperformed the US stock market by more than 1 000 percent over the past 18 years.

#### Allocation to Chinese names increased

About 40% of the Bellevue Asia Pacific Healthcare Fund (ISIN B-USD LU1587984847) is currently invested in China. Its China allocation has been steadily increased during recent weeks in view of very attractive valuations, encouraging discussions with executives from several companies and the easing of the lockdown in Shanghai. The outlook on the pandemic front has also clearly improved.

The fund's Japan weighting is likewise about 40%, with a focus on globally active companies that are world leaders in their target markets and that have impressive innovative skills. Examples here are the pharmaceutical companies Daiichi Sankyo and Takeda or the medtech companies Olympus and Terumo. The portfolio is rounded out with a selection of Indian, Korean, Australian and Thai stocks. Half of the portfolio is therefore ideal for investing in emerging Asian countries that are making great strides in modernizing their healthcare systems and the other half offers access to highly innovative healthcare players in the region's developed countries.

Asian healthcare companies continued to report very solid quarterly results even during the recent sell-off, so valuations have fallen to very attractive levels, especially for Chinese stocks. The average PEG ratio for the fund's Chinese investments, which is based on mid-term EPS estimates, is currently at 0.8, which is lower than it has ever been since the fund's conception. This corresponds to a discount of just over 20% versus the historical average. The portfolio's overall PEG ratio is 1.4. The average estimated sales growth of all portfolio companies for the coming years is also highly attractive at 24.1% p.a.

The historically low valuation combined with still intact fast top-line growth offers investors with a mid- to long-term investment horizon extremely attractive entry points.

#### Author

Oliver Kubli has been Managing Director, Head Portfolio Management Healthcare Funds & Mandates since 2015. Previously, he worked as Senior Portfolio Manager at Zürcher Kantonalbank and was a member of the Executive Board and Head Portfolio Management at Adamant Biomedical Investment AG. He completed his studies in business administration at the Zurich University of Applied Sciences in Winterthur and is a CFA charterholder.

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