

Market commentary, March 18, 2020

Experts expect a quick recovery from the healthcare sector

The healthcare sector has weathered the stock-market sell-off in relatively good form. From a fundamental perspective, the sector offers growth opportunities that are fairly resistant to economic downturns and it is likely to excel in a market rebound. Bellevue Asset Management's portfolio managers give a current snapshot of the situation and an initial forecast of future developments in this paper.

The stark fall in stock prices triggered by the coronavirus pandemic has put financial markets into a state of shock. Information gaps make it hard at the present time to reliably gauge the effect of the Covid-19 disease on the global economy. Whether stock markets stabilize in the near term largely depends on how the rate of new infections can be slowed so that the treatment of patients is not seriously disrupted. This is particularly relevant in the USA.

Economic cycles have little impact on the healthcare sector

Historical data from the past decades shows that the healthcare sector has performed better during steep corrections on the stock market and has recovered more quickly than the broader market too. Stefan Blum, Lead Portfolio Manager of the BB Adamant Medtech & Services, points out that medical technology companies and healthcare services providers start to recover when the fundamental health of these companies can be evaluated after the initial shock has worn off. Demand for these companies' products and services is hardly sensitive to macroeconomic variables, which is a key attribute during a crisis, as are resilient profit margins and strong balance sheets with low debt and high cash flows.

So the expert sees his fund's portfolio as very well positioned to weather the current storm. Large cap companies account for more than 80% of the portfolio's investments, which gives the portfolio a defensive profile and deep liquidity. Fast-growing markets such as digital healthcare, which represents 30% of the portfolio, are hardly impacted by economic cycles. Revenues at many of the companies in the fund's portfolio are subscription-based and some will actually experience an upturn in business from the corona crisis. Blum singles out telehealth service providers Teladoc, Ping An Healthcare Technology, and One Medical (1Life Healthcare) given their ability to treat patients in a virtual setting.

For Christian Lach, Lead Portfolio Manager of the BB Adamant Biotech Fund, developers of antiviral agents are receiving more investor attention again because of the corona crisis. Innovation leaders in particular should profit. However, prolonged supply chain disruptions in the drug development industry could have a negative impact on developers whose drugs are produced in China or India. Western specialty pharmaceuticals companies are at the greatest risk here, especially if they need to raise funds now.

China already out of the woods

The picture in Asia is completely different. It appears that its pandemic is past its peak. "The manufacturing operations of China's healthcare companies are in the country and they have experience in confronting epidemics," says Oliver Kubli, the emerging market expert on our healthcare team and the portfolio manager of the BB Adamant Healthcare Asia Pacific Fund.

"These countries learned a lot of lessons from the Sars crisis, such as the importance of drawing up emergency and safety protocols, so they were better prepared for this corona pandemic." Chinese

companies produce many pharmaceutical intermediates and APIs and Oliver points out that their capacity utilization rates were already back up to 80-90% at the end of February. Oliver is also certain that the corona crisis has sent a clear signal to the political leaders in Beijing that their "Made in China" approach to delivering healthcare to the country's vast population is a top priority. In-country research and development, especially in the biotechnology and technology platforms, will likely receive even more resources without relying on foreign know-how. The long-term, structural trends, such as modernization of the Chinese healthcare system, are fully intact. The companies that stand to benefit the most from this crisis are Internet healthcare companies like Alibaba Healthcare and Ping An Healthcare which have successfully set up entire healthcare ecosystems over the past ten years. New regulatory measures now permit doctors to issue online prescriptions for drugs and they can be filled and shipped online too. The BB Adamant Asia Pacific Healthcare Fund has weathered the current crisis relatively well so far. Oliver recently added defensive positions in Japanese pharmaceutical companies to the fund's portfolio and he increased the weighting of other companies that have made considerable progress in battling virus infections.

Companies linked in some way or another to combating the coronavirus pandemic account for 28.5% of the fund's portfolio that Christian Lach manages. Most of them are drug developers but the portfolio also includes diagnostics specialists and providers of clinical trial services. They are eight companies in all, the biotech giants Gilead Sciences and Regeneron being the biggest positions. Lach believes Gilead's remdesivir is the drug most likely to be approved first to treat coronavirus. Like the flu drug Tamiflu, remdesivir is an antiviral medication that stops viruses from replicating. Tamiflu was also developed by Gilead but is marketed by Roche and earns billions every year when flu season comes around. Expressed in scientific terms, remdesivir is an RNA polymerase inhibitor. Protease inhibitors used to treat HIV or hepatitis are also being tested to see if they are effective against coronavirus. This is the drug class to which Kaletra belongs, a lopinavir-ritonavir combination approved for treating HIV/AIDS which is now being tested by biopharmaceutical company AbbVie as a treatment for Covid-19. The biotech firm Alnylam is focusing on the gene level with its RNA interference platform, in partnership with Vir Biotechnology, an antibody therapeutics company. Positive scenarios assume that remdesivir could be approved in the fall. Great hopes also rest on drugs to control the excessive immune response that occurs in severe cases. These include Regeneron's antibody sarilumab and Chugai's tocilizumab. The hope here is to prevent lung damage in order to boost the chances of recovery.

Vaccines take effect one step earlier by preventing infection via the respiratory tract. The aim of vaccination is to provide permanent protection through active immunization by teaching the body to produce its own substances to fight disease, or achieve protection for a finite period of time (passive immunity). The various approaches range from antibodies and immunoglobulins for passive immunity to RNA vaccines and conventional vaccines for active protection. Common to them all is the fact that clinical trials have only just begun or will begin shortly. Approvals will take at least another 12 to 18 months. Moderna Therapeutics, Regeneron and Wuxi Biologics are the frontrunners, among others.

Considering the persisting high market volatility, the investment vehicles such as BB Adamant's fund products offer the best risk/reward profiles for entering the market. Sector valuations for the biotech sector and in emerging markets are currently at historical lows.

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Bellevue Asset Management

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