



**SECTORAL
ASSET MANAGEMENT**

US ELECTIONS OUTCOME TURNS HEADWIND INTO TAILWIND FOR HEALTHCARE

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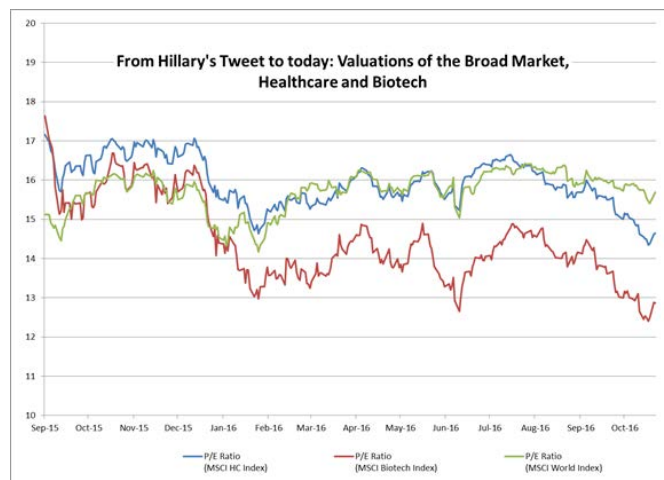


The most significant implication of the US Presidential election is that the recent underperformance of healthcare and the biopharma industry is likely over. The underperformance was sparked and fueled by fears the Democrats would harm the biopharma industry through new drug price regulation. Under the new administration, priorities shift to other areas and the issue of drug pricing gets demoted.

RECENT HEALTHCARE UNDERPERFORMANCE

The underperformance started in September 2015 after a tweet by Hillary Clinton expressing concerns about drug pricing in response to Turing Pharma's exorbitant price increases. This grew further with Bernie Sander's failed Presidential bid and his socialist healthcare reform message, Congressional focus on companies such as Valeant and Mylan, Hillary Clinton's campaign re-iteration of wanting to "control drug prices", and additional tweets from Bernie Sanders on Ariad's Iclusig and Lilly's Humalog prices.

During this time Healthcare's premium turned into a significant discount:



HEALTHCARE UNDER A TRUMP PRESIDENCY AND REPUBLICAN CAPITOL HILL

President-elect Trump campaigned to "Make America Great Again". The biopharma research industry, along with a few others (such as tech), is one of the industries where America is currently great. Almost 65% of the market cap of the global healthcare sector is domiciled in the US (with the second being Switzerland at 9%). In a study a few years ago, 118 out of 252 drugs approved (in the 10 years ending in 2007) were discovered in the US. It is unimaginable that a President Trump would act in a way that diminishes this greatness.

President-elect Trump, based upon his campaigning, will seemingly prioritize improving the economy, reforming taxation, immigration reform, and border security rather than tackle healthcare reform. Obviously, given the Democratic loses, the Clinton/Sanders/Warren healthcare reform initiatives are now dead.

SOME CONCLUSIONS CAN BE MADE ABOUT THE HEALTHCARE INDUSTRY BASED UPON PRESIDENT-ELECT TRUMP'S CAMPAIGN:

Generally, in discussions of healthcare President-elect Trump spoke of repealing and replacing Obamacare. What he means exactly is unclear given the far reaching nature of the Affordable Care Act ("Obamacare"), including the individual mandate, pre-existing conditions measures, healthcare exchanges, the biosimilar pathway, Medicaid expansion, the Independent Payment Advisory Board (IPAB), the Center for Medicare and Medicaid Innovation (CMMI) among others. It is probable that market-based mechanisms will spread and many bureaucratic oversight mechanisms (e.g. IPAB, CMMI)

will be scrapped. Destroying healthcare exchanges and reversing Medicaid expansion will likely prove problematic as this will adversely affect many of the citizens who just voted him into office. The greatest risks lie among the providers and potentially some Pharmacy Benefit Managers (PBMs) and managed care.

US drug pricing will continue as a theme but not as dominantly as it would have been under a Democrat government. The greatest beneficiaries are the biopharma industry. President-elect Trump has spoken of allowing drug importation and direct negotiation for CMS as methods of drug price control. Also, self-regulation (and self-control) in the industry with respect to price increases will likely grow.

M&A could re-ignite within the industry if ex-US cash stockpiles of pharmas (and large cap biotechs and medtechs) are repatriated, as President-elect Trump suggested during the campaign in the context of tax reform. The greatest beneficiaries are the small and mid-cap healthcare names.

Finally, the medtech industry, which became a "pricing-risk immune" safe haven in the election run up, will likely continue to be a source of funds as it continues to trade near all-time highs (19.2x ntm P/E relative to Healthcare's 14.6x ntm P/E).

As we have pointed out in the past (based upon historical S&P industry performance), healthcare is a sector that over the long run (26 years) has outperformed the broad markets. The last year or so has been difficult due in large part to the American political winds. Many of those winds have largely died down with the election of President-elect Trump.

The strong performance of healthcare following the election relative to the broad markets is likely the beginning of the re-rating of the sector.

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