



MARKETS IN FOCUS | Election 2020

Healthcare:

Finding Opportunity in Any Outcome

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Healthcare may be the most interesting opportunity right now

By Matt Orton, CFA

The outcome of the 2020 presidential election will have implications across all market sectors, but perhaps none is getting as much attention as healthcare. President Donald Trump vows to repeal the Affordable Care Act (ACA) while former Vice President Joe Biden pledges to strengthen and expand it should he win. Some Democratic politicians have called for reforms such as Medicare for All that would massively upend the healthcare status quo, although Biden's proposals appear more moderate. This uncertainty has many investors hesitating when it comes to healthcare, but in fact healthcare may present an opportunity.

Healthcare is nearly 20% of gross domestic product (GDP) and spending is growing at 4.6% per annum. The weight of healthcare in market indices is increasing. Healthcare represents a massive amount of the money spent in the United States, politics aside.

It is true that certain parts of the healthcare sector face some political risk. With a Democratic sweep of the White House and Senate, the most extreme outcomes likely would occur only if the filibuster is eliminated. The outcome that has the market most worried is the creation of a "Medicare for All" system, which would necessitate an overhaul of the private insurance market and change how hospitals and providers deliver care. More probable is the plan Biden is currently advocating – which includes a "public option" on the current ACA exchanges. While hospitals and managed care don't favor that, they could live with it. Either way, there will be a need to

drive cost savings to pay for these plans, which is where the diversity of the healthcare sector comes into play.

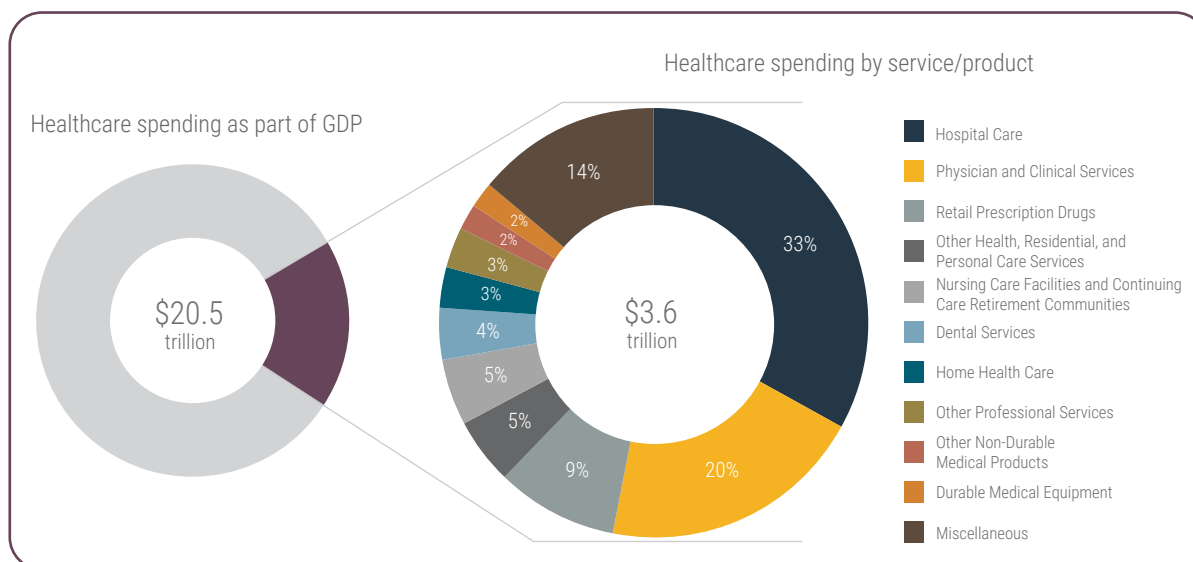
In a divided government with a Biden presidency, changes would likely be the result of regulatory action, with a likely rollback of many changes the Trump administration made to Medicaid, ACA plans, and short-term limited medical plans. A divided government with a Trump presidency would likely maintain the status quo with attempts to eliminate the ACA.

Problem solvers in the healthcare space

Regardless of the election outcome, important trends in the healthcare space will create investment opportunities going forward. Companies that will succeed regardless of the party in power are those that seek efficiencies to reduce costs. The only way to "solve" healthcare is to find efficiency, and that is an area of big investable opportunity going forward.

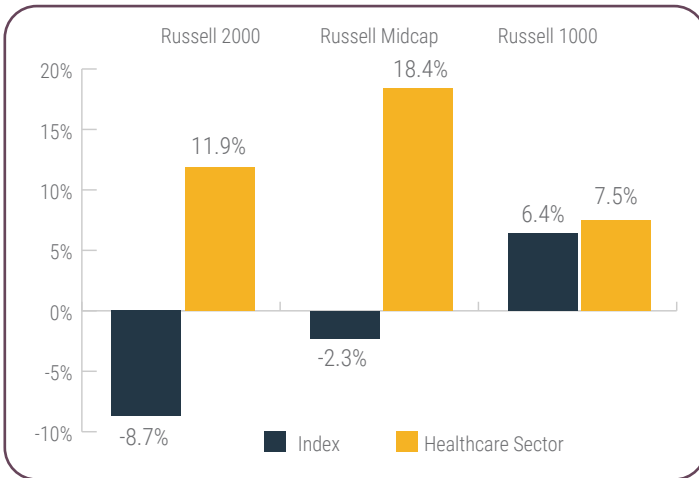
For the first time in U.S. history, the incentives of healthcare's three most important stakeholders – patients, providers, and payers – are finally aligning, with a focus on patient outcomes that are clinically better and help consumers navigate a complex system. As a result, companies and industries that are levered toward providing better outcomes will likely be the winners in healthcare and should be insulated from political crosshairs.

Figure 1: Healthcare spending by service/product



Source: Healthcare data as 2018 from the Centers for Medicare & Medicaid Services (CMS): <https://www.cms.gov/files/document/highlights.pdf>

Figure 2: Healthcare has outperformed YTD across market capitalizations



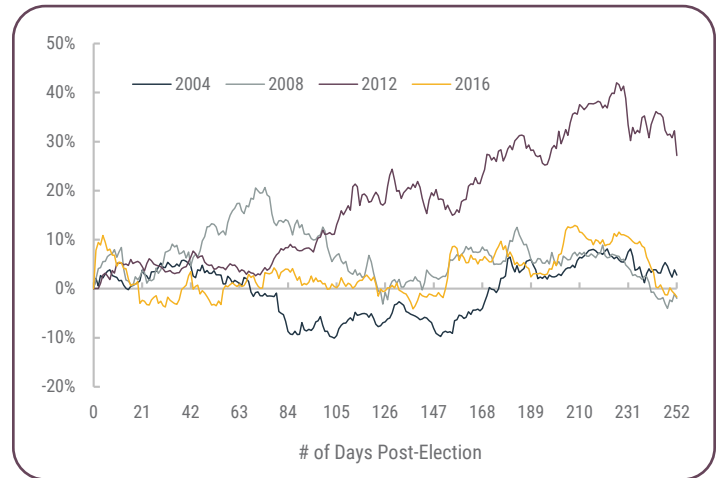
Source: Bloomberg, as of 9/30/2020

For example: Companies that digitize medical records and provide systems to share them between medical providers are improving efficiency and cutting costs. Services like telemedicine are improving efficiency, cutting costs, and increasing patient convenience. An increasingly aging population presents an entry point for medical device manufacturers and drug company suppliers focused on patient solutions for chronic diseases such as heart disease, diabetes, and obesity. Inconsistent pricing for elective surgeries also offers healthcare companies a chance to innovate.

Consider knee replacement surgery: If you ask five different hospitals what it costs, you'll get five answers. What if a company offered to compare pricing for this elective surgery and provide the best option? That's efficiency. Patients able to more easily compare their options would likely drive cost savings for their insurance providers. We shouldn't underestimate the impact of patient empowerment.

COVID-19 has also changed things for the healthcare sector. Medical device companies and hospitals were initially hit hard because elective procedures were canceled. Now those procedures are being scheduled again. The work-from-home environment is also more forgiving as patients can recover without missing work. Joint replacements and plastic surgery are two areas that can benefit as employees are no longer worried about having to miss being in the

Figure 3: Biotech outperformance vs. the S&P 500 after elections



Source: Bloomberg, as of 9/30/2020

office or seeing their colleagues immediately after having work done. This may result in an increased willingness for elective procedures and could provide a tailwinds going forward.

Biotechnology is another area that could provide opportunities. As shown in Fig. 3, biotech outperformance does not appear correlated to one party or the other winning the White House. Biotech doesn't appear to be influenced so much by politics as it is by idiosyncratic factors affecting individual stocks. The pandemic has helped to cast biotechnology and pharmaceutical companies in a more positive light. Over 150 vaccine candidates are in development, with 33 now in clinical trials, and seven that have advanced to Phase 3. Public sentiment toward these companies has improved markedly, and political appetite to get a vaccine is outweighing the desire to regulate.

Record low interest rates and a surge in activity from venture capital and private equity have also helped fuel investor demand for biotechnology across market capitalizations. This doesn't mean that political risk has disappeared – recall that Trump promised at the start of his presidency to lower drug prices – but it does mean that the ability and political desire to disrupt the space is likely muted in the shorter term.

THE BOTTOM LINE

The 2020 presidential election does pose risks to the healthcare sector. However, healthcare companies focused on long-term goals of improving efficiency and reducing costs should be able to grow and thrive regardless of who holds the White House. The growth of the sector and the percentage of healthcare as GDP present a huge opportunity for investors, who should not be dissuaded by potential volatility. Active management can assist in locating high-quality healthcare companies with solid fundamentals in this sometimes overwhelming sector.



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Matt Orton is a Vice President and Director of Portfolio Specialists at Carillon Tower Advisers. He specifically works with the Growth Team of Eagle Asset Management and leadership team at ClariVest Asset Management. He also provides U.S. market commentary, strategy, and analysis for clients.

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