Healthcare Sector
About the Index

Companies primary business in the healthcare sector include health care equipment and supplies, health care providers and services, biotechnology, and pharmaceuticals.
Industry Breakdown

1. Pharmaceuticals 50.60%
2. Health Care Providers & Services 20.00%
3. Health Care Equipment & Supplies 13.81%
4. Biotechnology 12.68%
5. Life Sciences Tools & Services 1.98%
6. Electronic Equipment & Instruments 0.93%
Third largest sector (Tech, Consumer discretionary)
Holdings and Weightings

Healthcare index has 52 holdings

Top holdings:
- Johnson & Johnson 12.61%
- Pfizer 11.71%
- Merck 8.63%
- Abbott Laboratories 5.84%
- Unitedhealth 4.16%
Portfolio Stats

- P/E Ratio 12.6
- P/B Ratio 2.70
- Median Market Cap 13.61B
- Beta 1.00
10k investment in Healthcare sector
Macroeconomic Factors

Government Spending

- Accounts for 12% of GDP
- 53% of health expenditure is through public funds
- Increased unemployment decreases tax revenue
- Austerity measures force decreased spending in the sector
- Hurts biotech companies but helps generic brands
Regulatory Uncertainty

- The Patient Protection and Affordable Care Act
  - 32 million more Americans will have coverage
  - Could lead to increased M&A

- Patent Cliff
  - Helps generic brands
  - Could hurt earnings of name brands
  - Reduces costs
Demographics

- Increase percentage of the population over 65
- Lower ratio of workers to retirees
- Long-term care industry
Industries can be classified by industrial life cycle and business cycle reaction.

Healthcare sector compose of 3 subsectors:
1. Pharmaceuticals, Biotechnology and Life Science
2. Healthcare Equipment and Services
3. Medtech (medical technology)

Each of above sectors react to business cycle differently.
Medtech Sector

- Growth in the medtech has slowed
- Fundamental drivers
  - From aging populations
  - Increasing needs for lifestyle medical procedures
- Suggest mature stage
  - Above market return through seeking new market in emerging market
  - But demand for medical technology products should be robust for years to come.
- Defensive feature
Pharma & Biotech Sector

- Biotech stocks behave differently than other healthcare stocks.
  - New Drug Approvals
  - Licensing
  - Access to Capital
  - Government policy
- Sector Defensive character, just individual stocks might be more cyclical than the other sectors in health care
Industry Life Cycle and Business Cycle

- Healthcare industry is in the mature stage of its life cycle
- Defensive stocks
- Consumers generally maintain health care spending during recessions, but don’t increase purchases during economic expansions.

Not all the firms in the industry are the same, and classification can change all the time.
Current Economy

- Weak economic recovery/Recession phase
- Health care industry is less economically sensitive to the phases of business cycle. Its profit are more likely to be stable than those in other sectors.
- Can engage in sector rotation strategy involving the movement of money from one industry sector to another in seeking alpha return.
During the last stages of an economic business cycle, just before a recession, it is best to buy health care stocks if you must invest in the stock market, because they are the least risky equity investments in a declining stock market.
Global diseases

- In 2008, 33.4 million people were living with HIV, and 2 million had died.

- Other global diseases affecting the healthcare sector worldwide are tuberculosis, malaria, and pneumonia.
Global Poverty

- Over 1 billion people do not have access to healthcare.

- Infectious diseases have long been associated with regions of poverty.
The health care sector is a major user of energy and a generator of waste.

To lessen the ecological impact, more and more hospitals and medical clinics are going “green.”
Recessions like the one in 2008 typically cause immediate loss of health care coverage to workers and their families.

Many countries have different health care strategies, whether it be universal or privatized healthcare.
Competitive Landscape

- Within US borders, the domestic focus has shifted towards maintaining and improving the medical device industry.
- The US produces 40% of the world’s medical equipment.
- Domestic manufacturing is the key to maintaining an export-driven economy.
- In the 1960’s, manufacturing accounted for 30% of the nation’s economy, it has dropped to 12%
Benefits of Domestic Manufacturing

- “Made in America” adds value and high-end R&D
- Product customization and specialization
- Creates jobs
- Lowers costs, eliminates issues that arise from off-shoring, such as decreased customer service levels
- Defends against counterfeit drugs, protects the nation’s $5.5 trillion in intellectual property
- Companies, such as Johnson & Johnson, have taken the steps to improve domestic manufacturing.
Global Competition

- Globalization positively affects the U.S. supply chain
- Competition from international and private label companies drive US healthcare towards innovation and lower costs
- Efficiency increased through global sourcing
- Importing logistics create risk, could affect the nations response to an epidemic
- The European regulatory process is favorable compared to the U.S. and recent economic downturn has lead companies overseas.
Historical Market Volatility
## S&P 500 GICS Sector Scorecard (9/21/12)

<table>
<thead>
<tr>
<th>Health Care</th>
<th>Index Value</th>
<th>% of 500 or Sector</th>
<th>Price Changes (%)</th>
<th>5-Year CAGR</th>
<th>Beta</th>
<th>Std. Dev.</th>
<th>12-Mo. Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biotechnology</td>
<td>1588.92</td>
<td>13.10</td>
<td>3.0</td>
<td>19.5</td>
<td>36.0</td>
<td>22.4</td>
<td>9.5</td>
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<tr>
<td>Health Care Distributors</td>
<td>330.81</td>
<td>3.12</td>
<td>0.8</td>
<td>(3.9)</td>
<td>5.3</td>
<td>7.9</td>
<td>3.4</td>
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<tr>
<td>Health Care Equipment</td>
<td>576.90</td>
<td>14.45</td>
<td>1.1</td>
<td>8.6</td>
<td>18.2</td>
<td>(2.2)</td>
<td>(0.5)</td>
</tr>
<tr>
<td>Health Care Facilities</td>
<td>182.23</td>
<td>0.14</td>
<td>7.3</td>
<td>26.4</td>
<td>20.5</td>
<td>(23.3)</td>
<td>10.4</td>
</tr>
<tr>
<td>Health Care Services</td>
<td>545.84</td>
<td>5.18</td>
<td>1.1</td>
<td>14.5</td>
<td>33.7</td>
<td>(7.8)</td>
<td>11.5</td>
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<tr>
<td>Health Care Supplies</td>
<td>123.93</td>
<td>0.34</td>
<td>(1.2)</td>
<td>(0.8)</td>
<td>6.3</td>
<td>2.4</td>
<td>(29.8)</td>
</tr>
<tr>
<td>Health Care Technology</td>
<td>170.19</td>
<td>0.72</td>
<td>3.4</td>
<td>(7.8)</td>
<td>21.6</td>
<td>29.3</td>
<td>8.6</td>
</tr>
<tr>
<td>Life Sciences Tools &amp; Services</td>
<td>171.94</td>
<td>3.52</td>
<td>(0.9)</td>
<td>9.8</td>
<td>24.4</td>
<td>(18.4)</td>
<td>4.0</td>
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<tr>
<td>Managed Health Care</td>
<td>484.85</td>
<td>7.98</td>
<td>1.8</td>
<td>(5.5)</td>
<td>2.2</td>
<td>32.9</td>
<td>(1.2)</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>378.62</td>
<td>51.44</td>
<td>2.0</td>
<td>7.0</td>
<td>12.2</td>
<td>13.4</td>
<td>1.9</td>
</tr>
</tbody>
</table>
Relevant Valuation Matrixes

- (P/E), (P/B)

- Index Calculation
  - Adapted from that of Milliman’s proprietary Health Cost Index (HCI)
  - Estimates the aggregate change in non-Medicare healthcare claim costs
  - Broadly used as one of the primary benchmarks in the healthcare industry

- Medical Consumer Price Index (CPI-Med)
  - Measures inflation at the retail, or consumer level of healthcare services
The S&P Healthcare Economic Indices and sub-indices were launched on October 21, 2010.

Seek to bring a new level of transparency into the healthcare market by providing a timely, consistent, third-party benchmark of the trend in U.S. healthcare costs.

Improves the ability to manage the long-term cost of health insurance programs.

Commercial/Composite/Hospital/Medicare/etc.
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