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What Is the Market Outlook for U.S. Healthcare?

By Eric Nager, CRPS®

In an effort to keep our clients informed with differing outlooks, we have interviewed fund managers or members of the management team of funds we are currently employing in our portfolios. Previously, we spoke to a member of the First Eagle Global Fund for our June newsletter. This month, we spoke with Titania Hanrahan, Vice President and Lead Strategist for the BlackRock sector funds in healthcare and technology.

The BlackRock Health Sciences Opportunities Fund has been a key component of most of our portfolios for some time now, primarily because the healthcare sector is such a big driver of the U.S. economy. Roughly $1 in every $6 is spent on healthcare today, and this trend is likely to continue as the Baby Boomer generation retires from the workforce. The BlackRock fund has done well versus other funds of its type, landing in the top 10% of its peer funds, according to Morningstar, over the past fifteen years, and it has been managed by Erin Xie since 2003.

According to Ms. Hanrahan, the healthcare sector enters its most volatile phase within 18 months of each U.S. presidential election, and we are within that window now. Her feeling is that, regardless of the outcome, there will be an increased focus on drug pricing that will affect the industry. Broadly, there are three sectors within the industry. At the top are the manufacturers; in the middle are the distributors, wholesalers and pharma benefit managers (PBM); and then there are the insurers and pharmacies. Each political party has an approach to address price transparency.

Titania Hanrahan, Vice President and Lead Strategist of BlackRock

251-626-1140 • 29000 US Hwy 98. 203-B • Daphne, AL 36526 • southerncapitalservices.com

The proposed Republican approach seeks to address the current model of price negotiation among these industry levels that they see as too opaque, and therefore not a true open market. For example, customers do not have visibility to the discussion that goes into the markups for what a distributor might charge for a drug to CVS vs. Walgreens. The current administration feels that by making these transactions transparent, it will put downward pressure on pricing.

The Democratic approach is more targeted negotiation that will take one of two forms. One approach being discussed by the presidential candidates is Medicare for all, but Hanrahan does not see this as possible to achieve. The costs are estimated at $30 trillion to implement this, and she does not see the social or political will to raise taxes that much. More likely is Medicare for more, where the eligibility age is lowered somewhat.

The other Democratic approach is renegotiation with insurance providers of Medicare/Medicaid part B and D, where B is outpatient and D is for prescriptions. This renegotiation would force prices lower in those categories for the end users: individuals, clinics, and hospitals. (We did not discuss how it also might lower the reimbursement rates for healthcare professionals.)

With either the Republican or Democratic approach, BlackRock feels that the ultimate losers are those businesses in the middle, the distributors, wholesalers, and PBMs, who will be squeezed on price. Anticipating this, BlackRock has already exited positions of stocks for companies in those areas so that the fund does not have exposure to them. Instead, they favor stocks in the home health sector as well as app-based and telemedicine. The convenience element for these services is growing in appeal, and the technologies can also provide access to those in emerging markets around the world.

Currently, BlackRock Health Sciences Opportunities has about 83% of its investments in the developed Americas and 11% in what is called developed Europe. This represents a recent switch of about 3% of the portfolio from the Americas to Europe in order to mitigate some of the pre-election volatility. Hanrahan does not see Brexit as affecting the health sector significantly.

Since Hanrahan oversees the BlackRock technology sector fund also, I asked her how much, if any, overlap there is between biotechnology and technology. She said not much because biotech is focused on the biologic versus chemical baseline of drugs. Any overlap would be in the app-based technologies. As of now, BlackRock only has about 14% of the fund in biotech because it can take 12-15 years for the products to get to market. Instead, about 42% of the fund is in medical devices and supplies because they can get to market in 5 years.

Finally, I asked about the short term outlook for the rest of the year. Hanrahan said that the economy appears to be late in a bull, or up, cycle and that the healthcare sector tends to over-perform during that time. Even if we hit a downturn, the amount of money spent on healthcare makes it a defensive sector that retains the potential for good returns.

FINANCIAL FACT

More than 3 million Americans ages 60 and older owe more than $86 billion in unpaid student loans. To pay it off, they're turning to their Social Security benefits.

Source: CBS News