Diagnosis: Big opportunity in healthcare stocks

BlackRock

Expert insight from BlackRock Fundamental Equities

Healthcare is both one of life's necessities and also the lifeblood of equity portfolios – especially as investors seek resilience amid macroeconomic turbulence. Dr. Erin Xie answers the big questions facing healthcare investors today.

Dr. Erin Xie
Lead Portfolio Manager
BlackRock Health Sciences

What makes healthcare a compelling opportunity now, particularly amid high inflation and slowing economies?

The healthcare sector has a history of stability and outperformance during periods of both recession and inflation, as healthcare demand has remained stable regardless of macroeconomic conditions. Global healthcare earnings growth has been steady and above the market average historically. [See the chart below.] Over the past seven recessionary periods in the U.S., healthcare has outperformed the broader market by an average of 10 percent.[1] And the healthcare sector also has a history of resilience during inflationary periods. We view healthcare as a structural growth sector, driven by global aging trends.

Yet the sector goes beyond the defensive. We see opportunities to invest selectively in a variety of companies, ranging from large to small and from stable to innovative, and it is this prospect of diversification – as well as the global nature of the sector — that we believe makes healthcare a sector for all scenarios.

Should investors expect to pay up for this kind of opportunity?

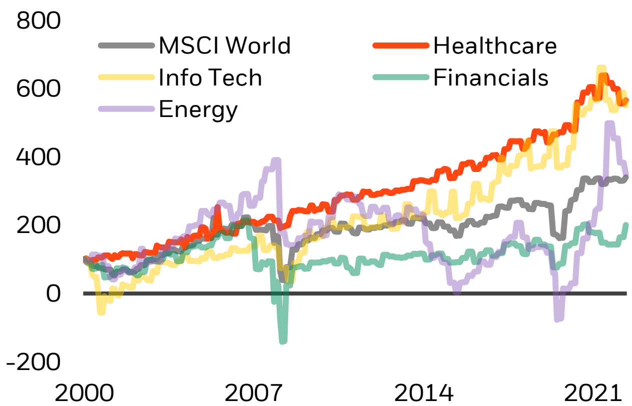
Healthcare stocks are not expensive today and, in fact, are priced below the broader market. Slowing economies call for the resilience that healthcare companies can offer, in our view. Yet the sector remains at a 10% discount to broad global equity markets compared to an average premium of 3% over the past two decades. [See the chart below.]

Many global economies are proving sturdier than feared as consumer spending holds up, meaning that recessions have mostly been avoided so far. Yet one reason that growth fears are rising is the inversion of bond market yield curves — when short-term yields are higher than long-term yields. This has historically been a signifier of recession.

We looked at Russell 1000 sector performance 24 months following prior yield curve inversions and saw good performance from healthcare. It is lagging so far in this cycle, which we believe makes for a more attractive entry point into a well-priced and recession-resilient sector.

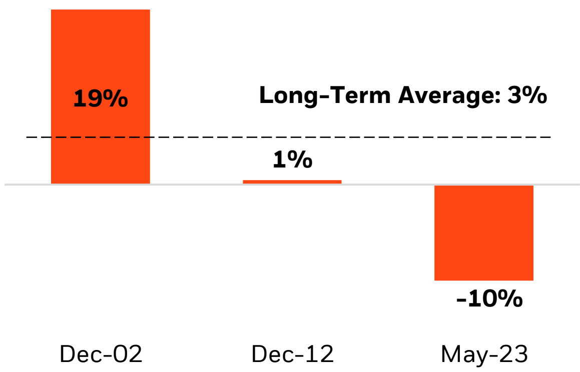
A history of resilience and growth

Global sector earnings growth, Dec. 2020 – April 2023



Healthcare at a discount to the market

MSCI World Healthcare valuations vs. MSCI World



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Sources: BlackRock, data from Bloomberg, as of May 2023. Left chart shows 12-month trailing earnings-per-share growth re-based to 100 for select sectors of the MSCI World Index. Right chart shows the MSCI World Healthcare valuations vs. the MSCI World, on an average year-ahead price-earnings basis.

[1] Source: State Street Global Advisors, November 2019

We shouldn't confuse "defensive," with "boring." What are some of the exciting areas of healthcare innovation you are monitoring?

We are seeing some incredible developments in potential treatments for the world's most prevalent and fast-growing diseases, such as cancer, diabetes, Alzheimer's and obesity. Decades of genomics research are now paying off, leading to a deeper understanding of the root causes of diseases as well as a new wave of medicine.

New therapies for obesity and diabetes could add more than US$100 billion of revenue to the US$1.5 trillion prescription drug market, according to our analysis. These drugs have rapidly become some of the fastest-growing medications in the pharmaceutical space. Originally developed to treat diabetes, they have had the added benefit of promoting weight-loss.

Strong breakthroughs within oncology include the development of new antibody-drug conjugate treatments, with impressive clinical data emerging. And the mRNA technology that produced vaccines capable of combating COVID-19's evolving variants is now being repurposed to create potential treatments for cancer as well as diseases associated with aging.

We expect Alzheimer's to become more prevalent as the global population ages — the number of persons aged 80 years or over is projected to triple, from 143 million in 2019 to 426 million in 2050, according to the UN. New antibody treatments showed great promise in late-stage trials and we believe this will attract more investment to the area.

Diabetes is a major disease, impacting 10.5% of the global adult population. This is expected to rise to nearly 13% by 2045.[2] We see exciting new treatment options here, as well as new technology. Continuous glucose monitors enable patients to manage their diabetes via real-time glucose data feedback without having to endure painful finger pricks. These devices are getting smaller and more effective, and there is the near-term potential for diabetes data to be displayed on smart watches.

Can you expand on med-tech opportunities and explain how COVID-19 continues to influence the sector?

Innovation within the sector and adoption of new technologies has significantly increased since the COVID-19 pandemic. Innovation is particularly evident among diagnostics, robotics and minimally invasive surgery companies. Demand for devices has picked up as hospitals try to clear the backlog of procedures delayed during the pandemic — a process that is aided by an easing labor shortage. Yet we also see investment opportunities among healthcare providers who are seeking to innovate to gain greater efficiency and mitigate future labor supply problems. Robotic-assisted surgery volumes have already recovered to pre-COVID levels, and we see adoption accelerating.

Technological developments in minimally invasive procedures have advanced patient outcomes and present attractive investment opportunities. This tech enables smaller incisions and faster patient recovery times for neurosurgery, cancer surgery, endovascular and gynaecologic surgery, among others. We anticipate this market to grow over time.

What are the key risks to the sector?

Regulatory risk is always top of mind for healthcare investors, especially around U.S. election season. But we see muted risks here at the moment. A known entity seeking a second term, in this case President Biden, lends some stability that should benefit the sector.

Patent expiration is a risk to the recurrent revenues of drug companies. This is when competitors are legally allowed to copy a drug and introduce cheaper versions to the market. So we focus on those companies that have the financial muscle to invest in research and development and a strong track record of successful innovation, both internally — resulting in strong product pipelines — and by purchasing smaller companies that have developed proven new treatments.

This highlights the importance of selectivity when investing in healthcare. Earnings are driven by powerful, long-term demographic trends, but not all companies can capitalize. We believe a deep understanding of the science behind each company is key to unlocking investment insights and finding both resilience and growth.

Key numbers behind healthcare opportunities

10%
Average outperformance of healthcare sector during past recessions [3]

426m
Number of people expected to be over 80 by 2050 globally – triple the 2019 number [4]

10.5%
Proportion of adults globally with diabetes; expected to grow to nearly 13% by 2045 [2]

[2] Source: International Diabetes Federation, November 2021 [3] **The figures shown relate to past performance.** Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.There is no guarantee that the expectations stated above will come to pass. [4] Source: United Nations, June 2019

Fundamental Equities

Expert insight

People	Profound curiosity, deep conviction
Purpose	Active edge, sustainable outcomes
Perspective	Astute, diverse, panoramic
Performance	Long-term lens, risk-aware results

Risk warnings

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Important information

This material is prepared by BlackRock and is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of the date shown above and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by BlackRock, its officers, employees or agents. This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. This material is intended for information purposes only and does not constitute investment advice or an offer or solicitation to purchase or sell in any securities, BlackRock funds or any investment strategy nor shall any securities be offered or sold to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. Investment involves risks. Past performance is not an indication for the future performance.

In Singapore, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore.

In Hong Kong, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong.

BlackRock