BostonPartners

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Entry Points Alert | Check Up for Healthcare Stocks

Transcript

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The Case for Healthcare Stocks Amid Economic Uncertainty

Equity Analyst Andrew Hatem, CFA, discusses the potential of healthcare stocks in uncertain economic times and the rationale behind active management strategies in this sector.

Catalysts in Play | The consensus view is that the Federal Reserve is nearly done raising interest rates, and many investors want exposure to stocks that thrive at the end of a tightening cycle. However, it remains unclear if the economy is stable, slowing, or headed for recession.

Entry Points | Healthcare is a defensive growth sector that has performed relatively well in different environments, even when the stock market has grown only modestly or declined. Over the past three decades, the S&P 500 has returned 10% or less during 11 calendar years. In 10 of those 11 years, healthcare outperformed the broad market.

> **Historical Resilience |** The sector has demonstrated resilience, in part because healthcare spending has grown faster than GDP growth, even in periods of slow economic growth or recession.
>
> **Fundamentally Sound |** Healthcare companies typically score well on the fundamentals, with many enjoying good margins and strong cash flow. What's more, many businesses in the sector have used that cash flow wisely to create shareholder value.
>
> **Valuation Advantage |** While some stocks in the sector are too expensive and others may be value traps, there are plenty of inexpensively valued opportunities here, reinforcing what a promising environment this is for healthcare to outperform.

Active Strategy | Regardless of what the economy does in the near term, we think this sector is fertile ground for finding good stocks through active management. We see many attractive opportunities in healthcare, based on our "Three-Circle" stock selection process that factors in valuations, business fundamentals, and business momentum.

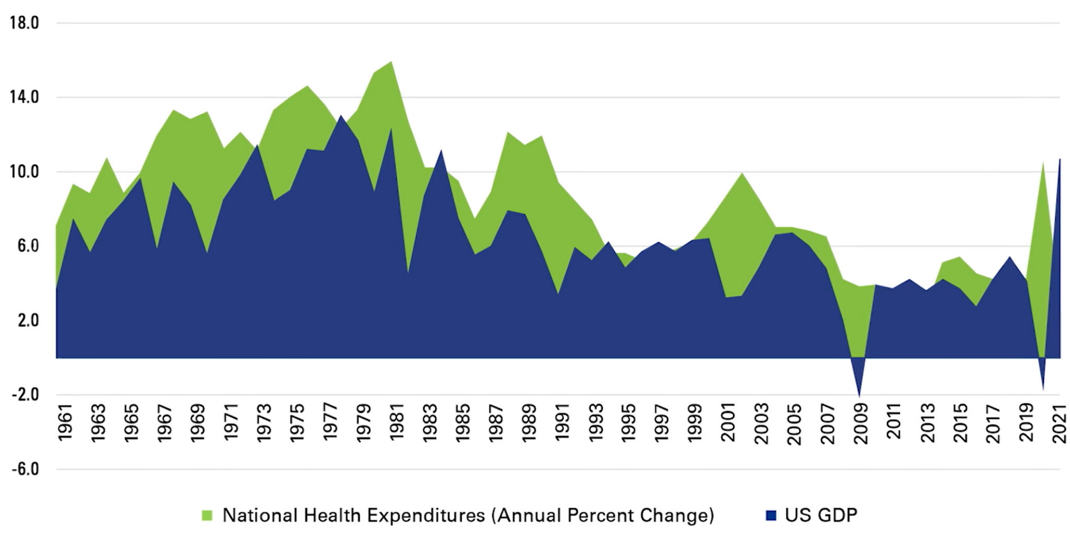
At Boston Partners, we look for a combination of strong business fundamentals, attractive valuation, and positive business momentum. To us, these are the three laws of investment physics. We believe our focus and unwavering discipline around these principles give us an analytic edge over competitors.

Andy Hatem, Equity Analyst at Boston Partners

With the uncertainty in the financial markets, health care companies can offer investors defensive growth in their portfolios. Hi, my name is Annie Haytham and I invest in health care stocks here at Boston Partners. We think the health care sector is fertile ground for finding good stocks through active management, especially in a slowing or shrinking economic growth environment.

So far in 2023. We have a lot of investors right now who are comfortable betting that the Fed is done raising rates. And what they want to do is they want to buy growth stocks to play that end in the Fed rate cycle. However, it seems like these are still uncertain times. You have an economy that it's unclear if it's stable or if it's slowing down or even if it's going into a recession. You have an inverted yield curve, which is usually a sign of a looming recession. We've had some recent bank failures and typically in times like these. Health care is a defensive growth industry and it can usually do very well. If you go back historically and we have data readily accessible back to the sixties. Health care spending historically has grown at a multiple of GDP. But what that means is U.S. health care spending has grown faster than GDP. It's taken market share of GDP over time. What it also means is during downturns, there are periods when U.S. GDP is either shrinking or growing at very slow rates. Yet U.S. health care spending has continued to grow faster during those times. What that means from a stock market perspective is during periods where the U.S. market is growing slowly or declining, health care has done relatively well. We can go back 30 years and why pick 30 years? That's about the amount of time that Boston Partners has been in existence. So over that time period, we have had 11 periods where the U.S. stock market, the S&P 500, has grown 10% or less in any calendar year. Ten of those 11 years, the S&P 500 health care index has outperformed the U.S. stock market.

US GDP Growth vs. Health Spend Growth

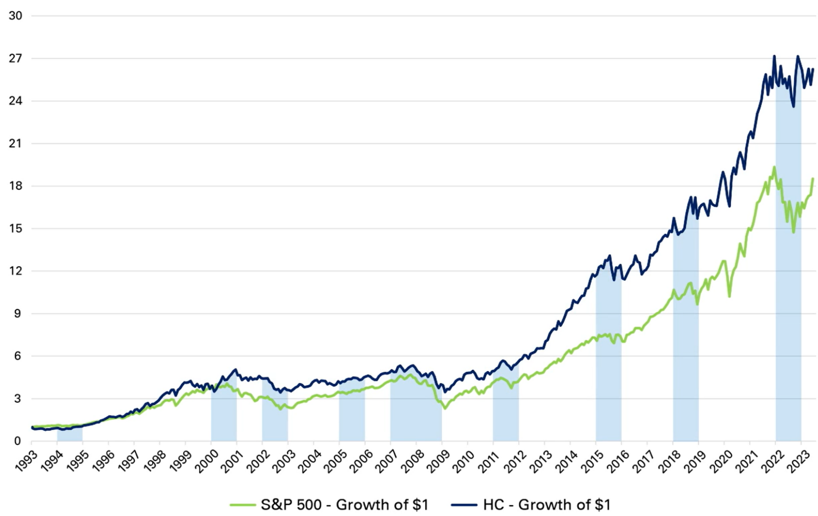


Data as of June 30, 2023. Source: CMS (Centers for Medicare & Medicaid).
Past performance is not an indication of future results. Please refer to the end of the document for other important disclosures.

How do we decide if something is reasonably valued? It's really a function of the research. And when you do all that research, you get a sense for how a business can grow over time. What you think the business prospects are, and then it gives you a sense of where you think future earnings and cash flow generation come back related to how they're currently generating cash flow in earnings. For example, Bristol-Myers Squibb back in 2015, Bristol-Myers was much more of a growth stock. It was very expensive relative to the rest of the pharma group. Since then, what have they done? In 2019 they bought a company called Celgene and Celgene brought with it a drug called REVLIMID, which was two thirds of revenues.

Celgene was very inexpensive on near-term earnings and the reason why is this drug would go generic in 2022 and a lot of people thought they imported a patent cliff problem. Since then the stock really hasn't moved much. But as we look at this stock, what we see, first of all is a good business. We see a company that has allocated capital over long periods of time reasonably well. They've been shareholder friendly and they are laying out a path for improving the momentum in the business. So as we look at it, it looks like it's a three cycle stock and it's a stock that we own today.

S&P 500 Healthcare Index vs. S&P Index



Data as of June 30, 2023. Source: eVestment.

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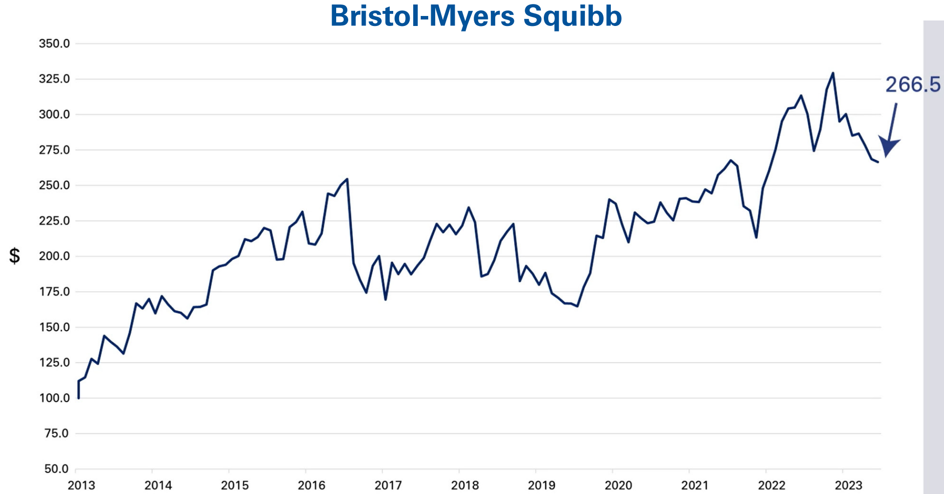
In general, we think there are many attractive stock opportunities in health care as we think of the three circle approach. Health care typically scores well on the fundamentals. These are good businesses. They have good margins, they have good cash flow, they have good returns. And there are many companies in health care that have done a very good job with their capital. And there are many companies in the health care industry that have used that cash flow to create lots of value for shareholders. As you move on to the business momentum, we've talked much about how health care companies can grow during tough economic times and how they've been able to grow very well over long periods of time, no matter what the economy is like. Finally, there are a lot of companies in health care right now which are inexpensively valued. There's always a handful that might be too expensive for us. There's always a handful that are so cheap and have really bad businesses and probably end up being value traps. However, when you take a step back and you do look at the economic indicators out there in the state of the economy, it seems like a lot of signs point to this being a great environment for health care stocks to outperform.

Bristol-Myers Squibb



Data as of June 30, 2023. Source: Factset. Chart shows the total return for BMY (div reinvested) from 1/1/2013-6/30/2023.

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Andrew G. Hatem, CFA | *Equity Analyst*

Mr. Hatem is an equity analyst with Boston Partners specializing in the U.S. healthcare sector of the equity market. He joined the firm in December 2017 from Adage Capital where he managed a long/short healthcare portfolio. Mr. Hatem began his career at Fidelity Management & Research Co., where he spent eighteen years in both an equity analyst and portfolio management role, and covered a variety of industries including consumer, financial services, industrials, and healthcare. While at Fidelity, he also managed the Select Air Transportation, the Select Defense and Aerospace, and the Select Medical Delivery Funds. Mr. Hatem holds a B.S. degree in marketing and english as well as an M.S. in finance from Boston College. He holds the Chartered Financial Analyst® designation. Mr. Hatem began his career in the investment industry in 1995.

Index Definitions

The S&P 500® Index is an unmanaged index of the common stocks of 500 widely held U.S. companies.

GDP: Gross Domestic Product

Equity Securities Risk: Equity securities are volatile and can decline significantly in response to broad market and economic conditions.

Growth Stocks Risk: Growth stocks may be more sensitive to market conditions than other equities as their prices strongly reflect future expectations.

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