ADVISOR PERSPECTIVES

Should Investors Avoid US Healthcare Stocks in an Election Year?

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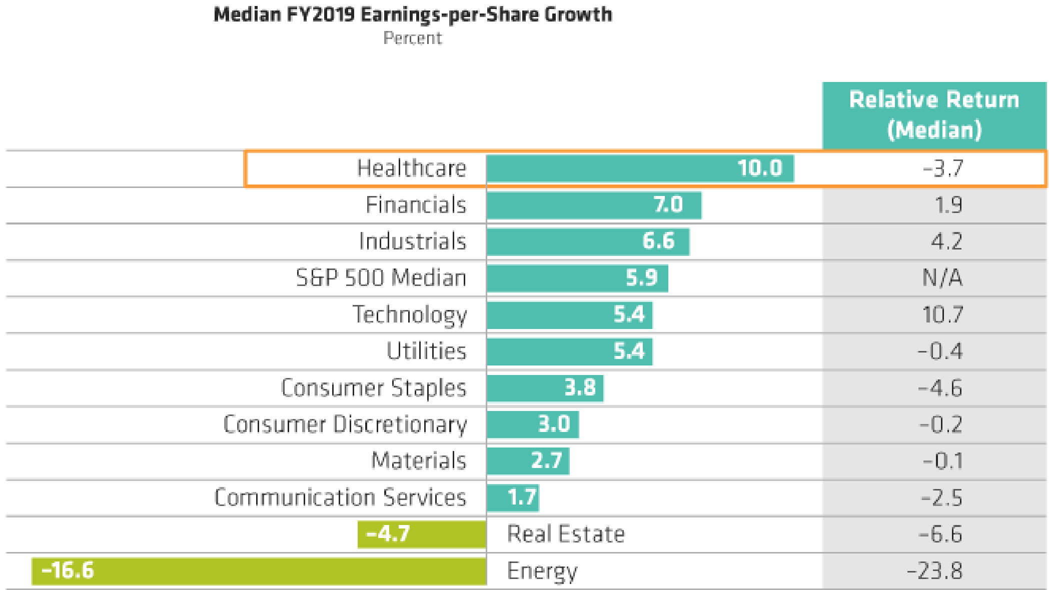
US healthcare is always a political hot potato, and volatility is expected to rise as the November elections approach. But investors can find good opportunities in the sector in companies with strong long-term business drivers that are relatively immune to political noise.

Many investors are wary of US healthcare stocks during an election year. Several Democratic presidential hopefuls have proposed a single-payer insurance system (Medicare for All) to replace existing private insurance. Drug pricing is another political minefield, with both Republicans and Democrats voicing concerns about rampant healthcare cost inflation.

Healthcare stocks are already under pressure because of US election concerns. While the median return for US healthcare companies in 2019 was 27%, the sector underperformed the S&P 500 by 3.7% despite strong earnings revisions (*Display*).

Healthcare Returns Lagged Despite Strong Fundamental Performance
S&P 500 Sectors

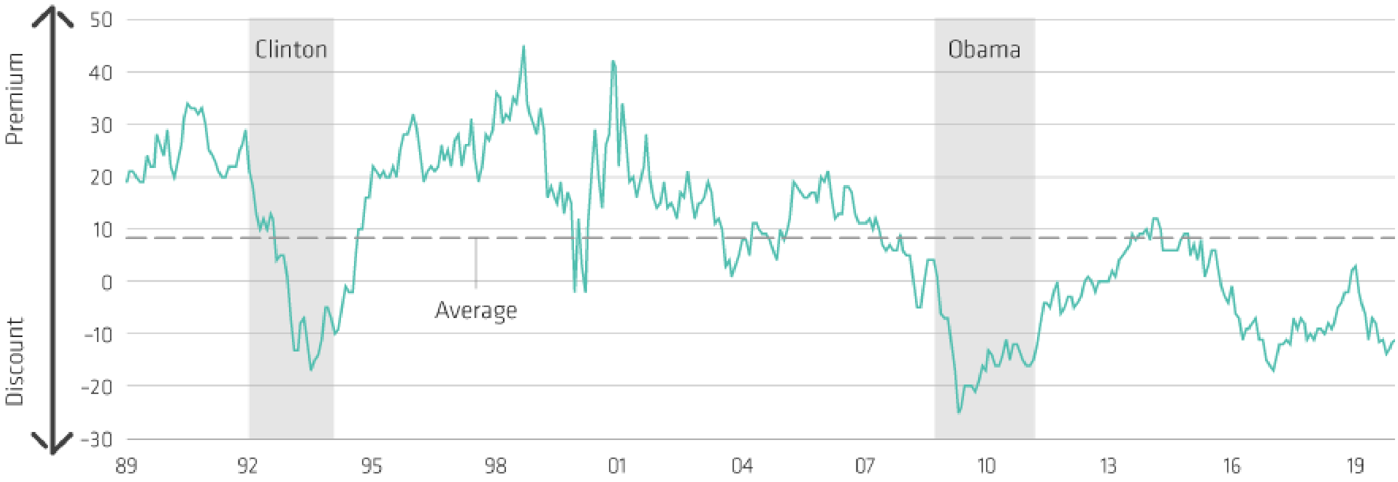


Past performance does not guarantee future results.
Universe comprises companies in the S&P 500 Index
As of December 31, 2019
Source: S&P 500 and AllianceBernstein (AB)

Current valuations reflect political fears. The US healthcare sector traded at a price/forward earnings ratio of 16.1 at the end of 2019, an 11% discount to the S&P 500 (*Display*). That's somewhere between the two last trough valuations, which were also driven by political concerns related to public insurance proposals by the Obama and Clinton administrations. At the same time, select healthcare companies have strong profitability and attractive growth prospects, in our view.

Low Relative Valuations Reflect Political Fears

US Healthcare Stocks Price/Forward Earnings* vs. S&P 500 (Percent)



Past performance does not guarantee future results.

Universe comprises companies in the S&P 500 Index.

*Based on estimated earnings for the next 12 months

As of December 31, 2019

Source: S&P and AllianceBernstein (AB)

So, what should investors do? Avoiding the sector means forgoing exciting opportunities with strong long-term potential. But healthcare positions may also expose investors to a bumpy ride this year.

Identifying Resilient Healthcare Themes

We think there are good ways to invest in US healthcare stocks with confidence—even in an election year. The key is to focus on companies that operate in a virtuous ecosystem. In other words, find companies that deliver products or services that are beneficial to customers, improve efficiency of the overall healthcare system, and are profitable to produce. Some attractive areas include:

- **Gene Sequencing**—The medical industry is making rapid advances in genetic data use. Tools that isolate and analyze genes are being applied to a growing number of research, consumer and clinical applications. Long-term demand for these tools is unlikely to be derailed by any political scenario. Illumina, the market leader in gene sequencing tools, has a competitive advantage that should stand the test of time, in our view.
- **Animal Health**—Companies that supply products for pets and livestock are part of the healthcare sector, but their businesses aren't really vulnerable to the same political risks. Zoetis is a case in point. Back in 2015, the company's shares tumbled along with the pharmaceutical industry's after Hillary Clinton tweeted her intention to impose price controls on prescription drugs if she was elected. Yet Zoetis is largely immune to the drug pricing debate. And the company has a solid business model, focused on improving profitability by reducing manufacturing costs, while pressing ahead with R&D that can augment returns.
- **Technological Progress**—The digital revolution is reshaping healthcare. Companies that help improve productivity and digitize clinical trial data can make a big difference. Veeva Systems is a healthcare software company doing just that. And given the heavy regulation of the industry, Veeva has a competitive moat to protect it from potential challengers.
- **Diversified Healthcare**—This might seem risky amid proposals for an insurance overhaul. However, we believe the proposals aren't feasible, given the likelihood that they would trigger job losses and erode the quality of care. At the same time, some healthcare groups have resilient business models. For example, UnitedHealth Group (UNH)—which does provide insurance—has a diversified set of products and services, including a data-driven focus on generating insights that can improve healthcare delivery. The company has improved profitability significantly since the last two elections, and UNH's contributions to longer-term solutions that could improve the US healthcare system's efficiency renders its business relatively resistant to political pressures, in our view.

These are just a few examples of healthcare segments that have long-term staying power, in our view. Medical devices, robotic surgery and biotech companies are other areas where we believe investors can find opportunities in healthcare by focusing on business models without trying to predict scientific breakthroughs.

Of course, even companies that are relatively immune to politics will probably experience share-price volatility along with the sector as elections draw near. However, many healthcare companies have underlying businesses that simply aren't affected by political issues. So, although their stocks may get shaken along with the sector, active managers can exploit the volatility to buy into companies that can ride out the elections and emerge as long-term winners.

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