Biotech Innovations Remain at Forefront

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The first quarter of 2021 was challenging for investors in biotechnology, but Franklin Equity Group Portfolio Managers Evan McCulloch, Wendy Lam and Akiva Felt believe the second half of the year will likely bring welcome tailwinds for the industry. They offer an update on investment opportunities they see, and why they believe biotech companies will remain at the forefront through the pandemic period and beyond.

The first quarter of 2021 was challenging for the biotechnology industry, as the selloff in March represented a sharp reversal from record highs in February. As the pace of vaccinations has picked up worldwide, investors turned their focus to reopening and an economic rebound, rotating out of biotech and into cyclicals, financials, energy, and the COVID-19 recovery trade. Furthermore, a string of high-profile clinical trial failures and regulatory disappointments, as well as a resurgence in drug-pricing policy discussions, did little to sustain momentum in the sector.

Heading into the second quarter, our strategy remained unchanged despite the market volatility of the past few months. As always, we continue to concentrate our investments in biotechnology companies whose products are best-in-class, first-in-class, or only-in-class, and address diseases with significant unmet medical need delivering clinical value to patients, physicians and payors. Furthermore, we are mindful of valuation, as well as quality of management and financial position in the current environment.

Headwinds and Tailwinds

While the sector has remained relatively resilient throughout the pandemic, we expect a full recovery in the latter half of this year, as operations that were disrupted return to normal. Several commercial-stage companies struggled with new drug launches during the pandemic, while earlier-stage companies saw some disruption in starting new clinical trials or maintaining the pace of enrollment in existing trials. As vaccinations have enabled a gradual reopening in many parts of the world, clinical development and commercial sales have started to recover. Lastly, most of the developmental-stage companies we invest in rely on capital markets to finance their business models. Fortunately, after a short COVID-19-induced pause, the biotech financing window has been wide open for several months.

The recent discussion on drug pricing reform renewed investors’ concerns, exacerbating the selloff in March. While we support policy changes that improve the affordability of health care, we continue to believe that it will be challenging to implement any legislation that dramatically alters the current economics of the biopharmaceutical business model. On one hand, the combination of the new US presidential administration under Joe Biden and the Democrat-controlled US Congress could increase the chance of passing Democrat-sponsored prescription drug price legislation over the next four years. However, drug pricing was not a major policy focus for Biden’s campaign, and drug pricing discussions will likely continue to take a back seat to the pandemic response, in our view.

Merger-and-acquisition (M&A) activity remains a key driver for the sector, just as we saw in early 2021. We expect to see more consolidation given the robust stream of innovation flowing from numerous small- and mid-capitalization biotechnology companies, coupled with weakening product pipelines and strong financial positions at the larger biopharmaceutical companies.

While this is most definitely a challenging time for the biotech and pharma industries, the economy and all regions of the world, we are optimistic that we will find a solution to the pandemic. We now have at least four—and potentially several more—vaccines that are highly effective at preventing infection. These vaccines are already being administered globally, and as manufacturers continue to expand their production capacity over the next few months, we are hopeful that there will be a sufficient number of doses to meet demand. For this reason, our positive long-term view of the sector remains unchanged as we see this disruption as temporary.

Over the longer term, we are excited about the tremendous amount of innovation taking place. We are particularly enthusiastic about the recent advancements made in the areas of gene therapy and gene editing, immuno-oncology and precision oncology. We are encouraged by novel mechanisms to address diseases with high unmet medical need, including Alzheimer’s disease, other neurodegenerative diseases, and autoimmune disorders.

We also see opportunities at the other end of the “prevalence spectrum” in addressing rare diseases. What we are seeing in background processes is also encouraging to us, as many novel discovery tools are being used behind the scenes to enable faster drug discovery and development.

What Are the Risks?

All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. The technology industry can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants as well as general economic conditions. Investments in fast-growing industries, including the technology and health care sectors (which have historically been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement or regulatory approval for new drugs and medical instruments.

There is no assurance that any estimate, forecast or projection will be realized.

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