



# Health Care Sector Report

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Investment Management Program 2024 Spring Semester



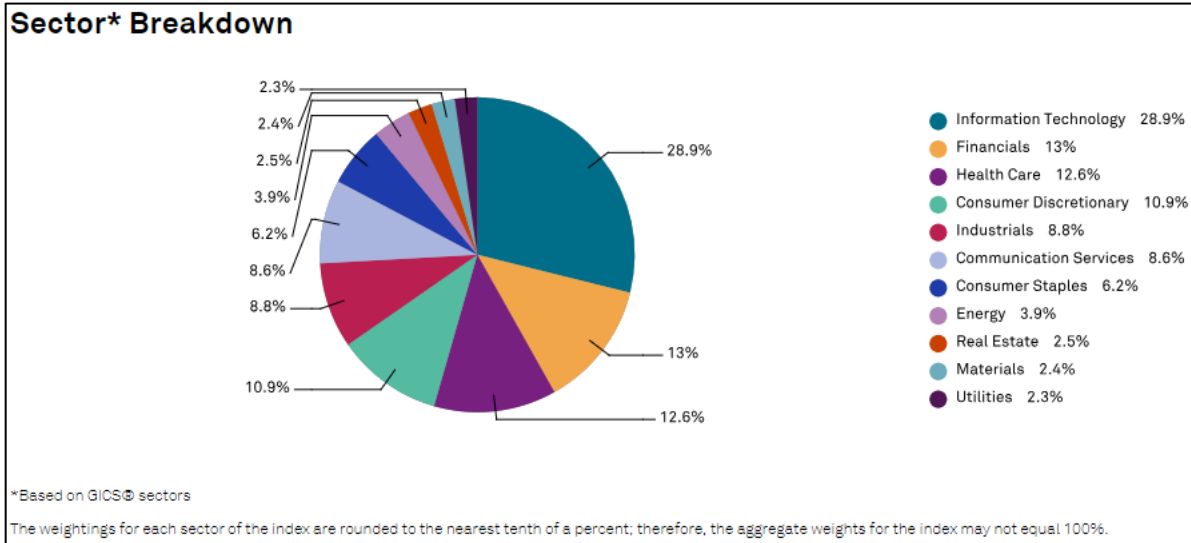
## Introduction

The healthcare sector of the S&P 500 index encompasses a diverse range of industries, including pharmaceuticals, biotechnology, medical devices, healthcare providers, and health insurance companies. Known for its innovation and research focus, the sector is heavily regulated and influenced by changes in healthcare policies. The aging population in many developed countries is a key driver of growth, as it increases demand for healthcare products and services. The sector is often considered defensive, as demand for healthcare remains relatively stable regardless of economic conditions. Many healthcare companies operate globally, providing them with opportunities for growth but also exposing them to currency fluctuations and geopolitical risks.

## Wisman Fund Current Holdings

AbbVie Inc. (ABBV), Cencora Inc. (COR), United Health Group Inc. (UNH), Veeva Systems Inc. (VEEV)

## Size and Comparison



As of December 29th, 2023, the health care sector accounts for 12.6% of the S&P 500 index's market capitalization (see the figure above), 64 different companies. The Wisman Fund weighs the health care sector at 16.3%. The total market capitalization of the materials sector is \$8.395 trillion.

## Historical Performance

### Historical Performance

Depending on index launch date, all charts below may include back-tested data.

\* Data has been re-based at 100



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This graph shows how similar the healthcare sector performance is to the S&P500 index. It reflects the stable nature of the sector as well.

### Composition of Health care Sector

The healthcare sector is made up of 5 different industries: healthcare equipment & supplies, healthcare providers & services, life sciences tools & services, biotechnology, and pharmaceuticals. The top ten weighted companies in the S&P 500 index are seen in the list below. These constituents make up over 55% of the health care sector. The Wisman Fund contains two of the top weighted stocks (UNH and ABBV).

Ticker	Name	Sector Weight	Mkt. Cap
LLY	Eli Lilly & Co.	11.26%	\$731.19 B
UNH	Unitedhealth Group Inc.	8.93%	\$487.68 B
JNJ	Johnson & Johnson	7.08%	\$389.84 B
MRK	Merck & Co Inc.	6.01%	\$328.03 B
ABBV	AbbVie Inc.	5.72%	\$314.59 B
TMO	Thermo Fisher Scientific	3.97%	\$218.19 B
ABT	Abbott Laboratories	3.79%	\$207.29 B
DHR	Danaher Corp	3.05%	\$186.77 B
PFE	Pfizer Inc	2.85%	\$156.76 B
AMGN	Amgen Inc	2.80%	\$154.98 B

## Overall, Price Returns

As of December 29th, 2023, 1-year returns for the healthcare sector in the S&P 500 saw growth at 1.99%, from December 29<sup>th</sup>, 2022. Whereas the S&P 500 saw a staggering 24.23% increase over the past year. The healthcare sector in the Wisman Fund accounts for 14.29% of the portfolio and has provided an overall weighted 1-year return of 0.93%. The graph below shows the overall up to date performance over the past year. This illustrates the underperformance of the sector in terms of 1-year returns compared to the S&P 500 index. (^GSPC is the S&P 500 index ticker symbol, ^SP500-35 is the healthcare sector ticker symbol)



### S&P 500 YTD Returns

The health care sector did underperform the S&P500 index last year, but this is to be expected when being compared to a larger collection of stocks. The health sector did have a poor performance in 2023, but projections and the first two months of 2024 already are foreshadowing a much stronger year. The table to the right reflects the healthcare sector's poor performance in 2023.

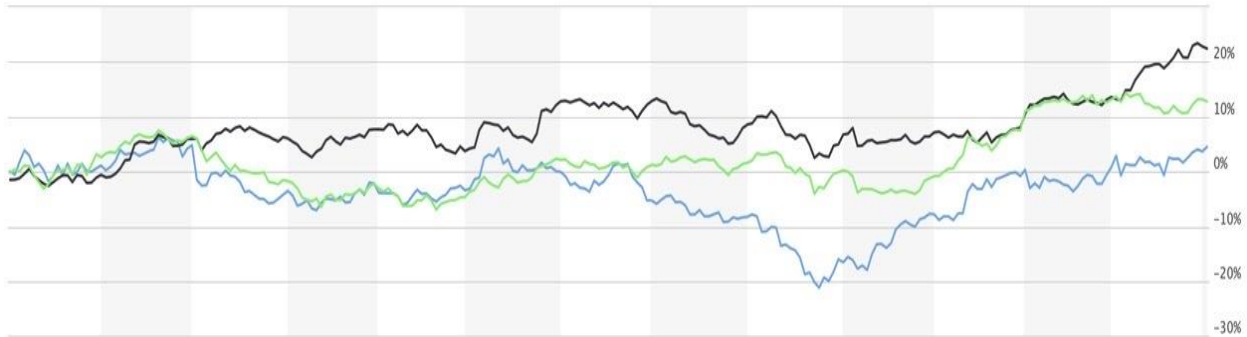
S&P 500 RETURN YTD 2023	
12/31/2023	Price
	RETURN
Energy	-4.80%
Materials	10.23%
Industrials	16.04%
Consumer Discretionary	41.04%
Consumer Staples	-2.16%
Health Care	0.30%
Financials	9.94%
Information Technology	56.39%
Communication Services	54.36%
Utilities	-10.20%
Real Estate	8.27%
<b>S&amp;P 500</b>	<b>24.23%</b>

### The Wisman Fund

The securities from the healthcare sector in the Wisman fund provided weighted 1-year returns (for the entire fund) as follows: ABBV= -0.11%, COR = 0.64%, UNH=-0.07%, and VEEV=0.47%. The graph on the right shows the 1-year fluctuations and growth for the current holdings.



## Industry Returns



A few industries are represented in the figure above as black is pharmaceuticals, green is biotechnology, and blue is life sciences.

These graphics above and to the right, depict the importance of the pharmaceutical industry to the healthcare sector. In summary, the pharmaceutical industry plays a crucial role in the healthcare sector due to its role in developing, manufacturing, and distributing drugs and medications. The public relies on pharmaceuticals which are essential for treating and preventing diseases, improving quality of life, and extending life expectancy. The industry's innovation is critical for addressing new and existing health challenges. An important industry to focus on is the biotechnology industry. This industry is on the rise as biotechnology companies are at the forefront of cutting-edge research, including gene therapy, personalized medicine, and immunotherapy. Their innovative approaches have the potential to revolutionize healthcare by offering more targeted and effective treatments.



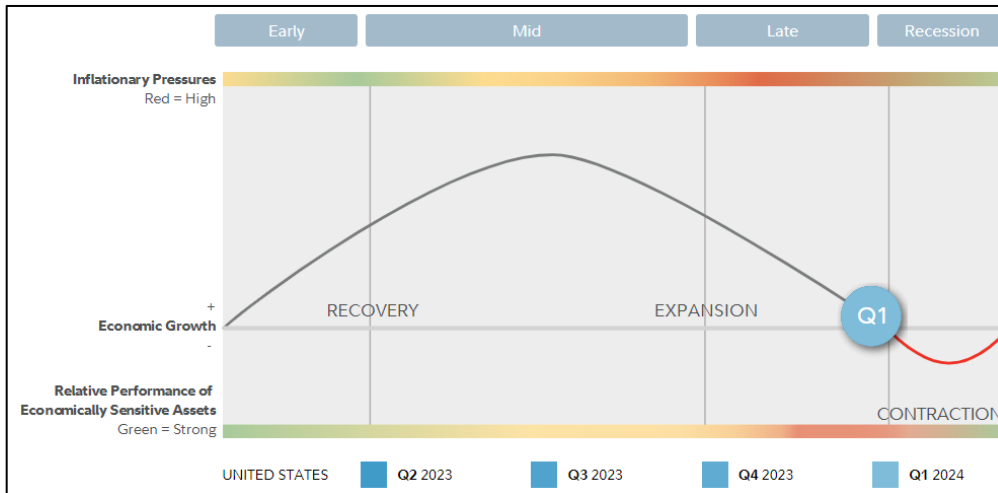
### *The Wisman Fund*

The Wisman fund contains companies from the providers and services (UNH, COR), pharmaceuticals (ABBV), and life sciences (VEEV) industries.

## Business Analysis

### *Economic Cycle*

Fidelity indicates that the US economy is in the very late expansion stage of the economic cycle, as seen in the graphic directly below.



The late expansion stage of the economic cycle represents a mature phase of economic growth where growth continues but at a slower pace. It is characterized by low unemployment, rising inflation, higher interest rates, potential stock market volatility, and a focus on preparing for the next economic downturn. These characterizations are addressed in the economic analysis section. Understanding this phase is essential for businesses, and investors to make informed decisions and navigate the economic landscape effectively.

### *Business Cycle*

As seen below, data for the performance of the healthcare sector is relatively neutral during late periods and very positive during recessions. Demand for health services remains strong even through economic downturns, as they are necessities. Additionally, pharmaceutical and biotechnology companies will continue to develop and innovate during poor economic conditions. As the economy progresses further towards a recession, the healthcare sector may appear even more favorable compared to alternative sectors.

<b>Sector</b>	<b><u>Early</u></b>	<b><u>Mid</u></b>	<b><u>Late</u></b>	<b><u>Recession</u></b>
Financials	+			-
Real Estate	+ +	-	+	- -
Cons. Disc.	+ +		- -	
Info Tech.	+	+	-	- -
Industrials	+ +			- -
Materials	+	- -		-
Cons. Stap.	- -	-	+	+ +
Health Care	- -			+ +
Energy	- -		+ +	- -
Comm. Serv.		+		-
Utilities	- -	-	+	+ +

### *Healthcare Sector in the Economy*

The healthcare sector is essential to the economy due to its role in providing vital medical services and products. It encompasses a wide range of industries, making it viable during almost any point of the business cycle.

Relationship with the Economy: A strong healthcare sector is crucial for maintaining the overall well-being of the population, which is a key driver of economic productivity, while reducing health care costs for businesses. Healthcare spending stimulates economic activity by creating jobs, driving demand for healthcare products and services, and fostering innovation.

### Product Segmentation:

- **Pharmaceuticals:** This category includes drugs and medications used for the prevention, treatment, and management of diseases and medical conditions. Pharmaceuticals can further be segmented into prescription and over-the-counter (OTC) drugs
- **Biotechnology:** Biotechnology products are derived from biological sources and include biologics, gene therapies, and cell therapies. These products often represent cutting-edge treatments for various diseases and conditions.
- **Medical Devices:** Medical devices encompass a wide range of products, including diagnostic equipment, surgical instruments, implants, and wearable devices. These products are essential for diagnosis, monitoring, and treatment in healthcare settings.
- **Healthcare Services:** Healthcare services include a broad range of services provided by healthcare professionals and facilities, such as hospitals, clinics, and nursing homes.

These services can include preventive care, diagnostic services, treatment, and rehabilitation.

#### Macroeconomic Factors:

- **Healthcare Expenditure:** The overall health of the economy and government policies influence healthcare expenditure. Increased healthcare spending often correlates with economic growth and improved access to healthcare services.
- **Technological Advancements:** Technological advancements drive innovation in healthcare products and services, leading to improved patient outcomes and increased efficiency in healthcare delivery
- **Demographic Trends:** Aging populations and changing demographics impact healthcare needs and services by driving demand
- **Regulatory Environment:** Government regulations and policies, such as drug approval processes, reimbursement policies, and healthcare reforms, can significantly impact operations and profitability.
- **Globalization:** Globalization has increased access to healthcare products and services worldwide but also presents challenges such as different regulations and market competition.

### **SWOT Analysis: Healthcare Sector**

#### Strengths:

1. **Innovation and Research:** The healthcare sector is known for its continuous innovation and research, leading to the development of new drugs, treatments, and technologies.
2. **Defensive Nature:** Healthcare is considered a defensive sector, as demand for healthcare products and services tends to remain stable even during economic downturns.
3. **Aging Population:** The aging population in many countries is driving increased demand for healthcare services and products, providing a long-term growth driver for the sector.
4. **Global Market:** Many healthcare companies operate globally, providing them with opportunities for growth in international markets.

#### Weaknesses:

1. **Regulatory Environment:** The healthcare sector is heavily regulated, which can impact companies' operations and profitability. Changes in regulations can pose challenges for companies in the sector.
2. **High Costs:** Healthcare costs are often high, which can be a barrier to access for some individuals and can also impact companies' profitability.
3. **Technological Complexity:** The rapid pace of technological advancements in healthcare can be a challenge for companies to keep up with, requiring continuous investment in research and development.

## Opportunities:

1. **Technological Advancements:** Continued technological advancements present opportunities for the development of new healthcare products and services.
2. **Emerging Markets:** Growth opportunities exist in emerging markets, where there is increasing demand for healthcare services and products.
3. **Aging Population:** The aging population presents opportunities for healthcare companies to develop products and services tailored to the needs of older adults.

## Threats:

1. **Regulatory Changes:** Changes in regulations, such as healthcare reform or drug approval processes, can pose threats to companies in the sector.
2. **Competition:** The healthcare sector is highly competitive, with companies vying for market share and facing pressure to innovate and differentiate their products and services.
3. **Pandemics and Health Crises:** Events such as pandemics or health crises can disrupt the healthcare sector, leading to reduced demand for certain products and services.

## Economic Analysis

This economic analysis will consider important factors like PCE Inflation, Unemployment, the FED interest rate and monetary policy.

- *Inflation:* The PCE (Personal Consumption Expenditures) inflation rate is at 2.8%, which is above the Federal Reserve's target of 2%, but lower than the 3.3% projection. This indicates that there is currently elevated inflation in the economy. The FED acknowledges this and expresses its commitment to returning inflation to its 2% objective.
- *Unemployment:* The unemployment rate is at 3.8%. This suggests a very tight labor market with low levels of unemployment, which is typically associated with a strong job market.
- *Economic Activity:* The Federal Reserve indicates that economic activity has been expanding at a solid pace. This is a positive sign for the overall health of the economy, although it mentions that job gains have slowed in recent months. Despite this slowdown, the job market remains strong. 2023 percent change in GDP was well above the September projection.
- *Monetary Policy:* The Federal Reserve has decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. This suggests that the FED is holding interest rates steady at a relatively high level, likely to combat inflation. The Fed also mentions its commitment to reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, which is a part of its strategy to normalize its balance sheet.



- *Uncertainty:* The FED acknowledges uncertainty regarding the effects of tighter credit conditions on economic activity, hiring, and inflation. This uncertainty suggests that the central bank is closely monitoring economic developments and may adjust its monetary policy as needed.

The table below acknowledges changes, and projections in real GDP, unemployment, PCE inflation and core PCE inflation.

Percent															
Variable	Median <sup>1</sup>					Central Tendency <sup>2</sup>					Range <sup>3</sup>				
	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run
Change in real GDP	2.6	1.4	1.8	1.9	1.8	2.5-2.7	1.2-1.7	1.5-2.0	1.8-2.0	1.7-2.0	2.5-2.7	0.8-2.5	1.4-2.5	1.6-2.5	1.6-2.5
September projection	2.1	1.5	1.8	1.8	1.8	1.9-2.2	1.2-1.8	1.6-2.0	1.7-2.0	1.7-2.0	1.8-2.6	0.4-2.5	1.4-2.5	1.6-2.5	1.6-2.5
Unemployment rate	3.8	4.1	4.1	4.1	4.1	3.8	4.0-4.2	4.0-4.2	3.9-4.3	3.8-4.3	3.7-4.0	3.9-4.5	3.8-4.7	3.8-4.7	3.5-4.3
September projection	3.8	4.1	4.1	4.0	4.0	3.7-3.9	3.9-4.4	3.9-4.3	3.8-4.3	3.8-4.3	3.7-4.0	3.7-4.5	3.7-4.7	3.7-4.5	3.5-4.3
PCE inflation	2.8	2.4	2.1	2.0	2.0	2.7-2.9	2.2-2.5	2.0-2.2	2.0	2.0	2.7-3.2	2.1-2.7	2.0-2.5	2.0-2.3	2.0
September projection	3.3	2.5	2.2	2.0	2.0	3.2-3.4	2.3-2.7	2.0-2.3	2.0-2.2	2.0	3.1-3.8	2.1-3.5	2.0-2.9	2.0-2.7	2.0
Core PCE inflation <sup>4</sup>	3.2	2.4	2.2	2.0		3.2-3.3	2.4-2.7	2.0-2.2	2.0-2.1		3.2-3.7	2.3-3.0	2.0-2.6	2.0-2.3	
September projection	3.7	2.6	2.3	2.0		3.6-3.9	2.5-2.8	2.0-2.4	2.0-2.3		3.5-4.2	2.3-3.6	2.0-3.0	2.0-2.9	
Memo: Projected appropriate policy path															
Federal funds rate	5.4	4.6	3.6	2.9	2.5	5.4	4.4-4.9	3.1-3.9	2.5-3.1	2.5-3.0	5.4	3.9-5.4	2.4-5.4	2.4-4.9	2.4-3.8
September projection	5.6	5.1	3.9	2.9	2.5	5.4-5.6	4.6-5.4	3.4-4.9	2.5-4.1	2.5-3.3	5.4-5.6	4.4-6.1	2.6-5.6	2.4-4.9	2.4-3.8

## Financial Analysis

These financial fundamentals are used together to assess the financial health and performance of a company. Analysts often consider them alongside other metrics, industry benchmarks, and qualitative factors to form a comprehensive view of a company's financial situation and prospects. It's important to note that the interpretation of these metrics can vary depending on the industry, company size, and economic conditions, so they should be analyzed in context.

### *Financial fundamentals*

#### *Why these factors?*

- *ROE:* a financial ratio that shows how much net income a company generates per dollar of invested capital. It helps investors understand how efficiently a firm uses its money to generate profit.
- *EPS Growth Rate:* the net income generated in a given period as allocated to each common share outstanding.
- *ROA:* measures how efficient a company's management is in generating profit from their total assets on their balance sheet.
- *Profit Margin:* represents the portion of a company's sales revenue that it gets to keep as a profit, after subtracting all its costs.

	S&P 500	Healthcare Sector
ROE	23.24%	11.39%
EPS Growth Rate	3.2%	14.15%
ROA	4.44%	5.77%
Net Profit Margin	10.7%	2.39%

The S&P 500 outperforms the healthcare sector in terms of ROE and net profit margin. However, it lags behind in terms of ROA and EPS growth rate. This is likely due to how much revenue healthcare companies can generate in comparison to many other type of companies in the S&P500 index which would drag down its overall EPS growth rate.

### *Major Companies*

	Eli Lilly & Co (LLY)	UnitedHealth Group Inc	Johnson & Johnson
ROE	48.93%	26%	48.29%
EPS Growth Rate	13.10%	12.43%	26.52%
ROA	9.23%	8.62%	19.81%
Net Profit Margin	15.36%	6.02%	41.28%

These major companies in the S&P 500 index healthcare sector tend to outperform the market and the sector on every front. The top performers are Eli Lilly & Co (LLY), UnitedHealth Group Inc (UNH), and Johnson & Johnson (JNJ).

## **Valuation Analysis**

Valuation ratios, including metrics like the P/E ratio, P/B ratio, P/S ratio and DY play a crucial role in evaluating a company's worth. These ratios are evaluated in conjunction with other financial indicators, industry benchmarks, and qualitative factors to develop a comprehensive understanding of a company's financial standing and future potential.

### *Why these ratios?*

- *P/E*: a way to value a company by comparing the price of a stock to its earnings.
- *P/B*: measures the market's valuation of a company relative to its book value.
- *P/S*: an investment valuation ratio that shows a company's market capitalization divided by the company's sales for the previous 12 months.
- *DY*: a financial ratio that tells you the percentage of a company's share price that it pays out in dividends each year.

	S&P 500	Healthcare Sector
P/E	23.27	19.57
P/B	4.04	7.00
P/S	2.33	4.84
Dividend Yield	1.51%	2.10%

The healthcare sector has a higher P/B ratio and P/S ratio indicating that the sector may be overvalued as a whole. However, the healthcare sector offers a higher average dividend yield, implying a potentially better income generation for investors. Additionally, the healthcare sector has a lower P/E ratio which is a good sign.

### *Major Companies*

	Eli Lilly & Co (LLY)	UnitedHealth Group Inc (UNH)	Johnson & Johnson (JNJ)
P/E	132.68	33.72	31.12
P/B	68.03	21.49	5.67
P/S	20.37	3.49	4.87
Dividend Yield	0.61%	1.38%	2.94%

UNH and JNJ have good ratios in comparison to their sector and the S&P500 index. They may be slightly higher in some areas, but are still comparable. LLY's ratios are significantly higher in comparison, so although it is currently listed as near fair value, it may become overvalued in the future.

## **Current Holdings Trialing Returns**

### *Why Trailing Returns?*

Trailing returns on an absolute basis can give you an idea of how much an investment has grown on a nominal basis, which can be compared to the benchmark. Trailing returns relative to a benchmark can tell you if an investment has outperformed or underperformed the benchmark over the measured time horizon.

## AbbVie Inc. (ABBV)

### Trailing Returns Daily Monthly Quarterly



ABBV has had impressive performance by outperforming the industry and index over almost any notable period of time. Even after a rough 2023, its 1-year return of 21.01% still beats the industry due to its bounce back in early 2024.

## Cencora Inc. (COR)

### Trailing Returns Daily Monthly Quarterly



Similarly to ABBV, COR narrowly outperforms the industry and index at each relevant time period. COR continues to be a valuable stock in the healthcare sector.

## UnitedHealth Group Inc. (UNH)

### Trailing Returns Daily Monthly Quarterly



UNH is a dominant company in the healthcare sector. Its trailing returns do demonstrate this as UNH outperforms the industry and index over time. UNH has struggled recently which is why it underperforms in the 1-year, YTD, and 3-month categories. We expect UNH to bounce back and overperform in the long run.

*Veeva Systems Inc. (VEEV)*



VEEV is a relatively volatile company in comparison to our other healthcare holdings. With that being said, although there are times when it will underperform the industry and index, in the long run VEEV will recover as seen in the 10 and 5 year trailing returns. Additionally, its recent performance has been very impressive as seen with the 34.49% 1-year trailing return.

**Recommendation**

Based on the current market conditions and historical performance, we recommend the following actions regarding the Wisman Fund's allocation within the healthcare sector:

*Overweight Healthcare Sector:* Considering the defensive nature, economic outlook, historical data, current financial data, and the SWOT analysis, the healthcare sector should be **overweighted**. The weight of the materials sector in the S&P 500 Index as of December 29<sup>th</sup>, 2023, was 16.3%. It is currently weighted at 15%. It is recommended that the fund find a target weight between 16-17%. Overweighting this sector will help capitalize on what is projected to be a strong sector in 2024, especially with a looming recession and rate cuts.

*The Wisman Fund Current Holdings:*

	AbbVie Inc (ABBV)	Cencora Inc (COR)	United Health Group Inc (UNH)	Veeva Systems Inc (VEEV)
YTD Return	14.6%	15.4%	-0.6%	16.00%
Holding Return	61.2%	65.4%	234.5%	27.00%

Total Time Held	2 years and 4 months	2 years	18 years	3 months
Portfolio Weight	1.59%	2.01%	6.34%	3.84%
Sector Weight	10.84%	13.58%	49.75%	25.83%
Market Cap	\$314.59 B	\$47.28 B	\$487.66 B	\$35.69 B

The Wisman Fund holdings have all been productive over their respective holding periods. As seen in the YTD returns, the healthcare sector, and particularly our holdings, are off to a good start in early 2024 with the exception of UNH. It is expected that a struggling UNH in a struggling insurance industry will bounce back over time. Given the overweight decision, it would be in the IMP cohort's best interest to buy more of these securities or potentially buy another company set up to thrive in 2024 and beyond. The fund has benefitted from having these securities, so maintaining these positions would be in the IMP cohort's best interest.

## Sources

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