# Is it time to buy healthcare?

**Macro fears seem to have crimped valuations, despite the sector's long-term growth prospects...**

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The Armenian oil magnate Calouste Gulbenkian was, when confronted with points others believed would hurt his business, fond of issuing a simple retort; "The dogs bark, the caravan moves on."

It might be easy to dismiss this as flippancy, but given he survived close to 70 years in the oil industry and died the world's wealthiest man, it's probably fair to assume he had a good idea of what mattered and what didn't.

Whether or not we're quite as astute as Gulbenkian is up for debate, but his favourite retort does come to mind when looking at many listed healthcare companies today. Over the past 18 months, we've seen many firms in the sector see substantial drawdowns, albeit after a period of stronger performance that started following the onset of the pandemic.

Some investment trusts that invest in the healthcare industry have managed to weather this storm better than others. However, the average share price total returns for the AIC's Biotechnology and Healthcare as a whole were negative for the 12 months to 26/04/2023.

**Bellevue Healthcare's (BBH)** returns at that time were slightly down in NAV terms, with a fall of 1.7%. The trust's shares fell further, with a 6.4% drawdown on a total return basis. As that suggests, the trust has seen its discount widen substantially as a result.

Having traded at a 6% premium in May of last year, something that enabled the trust to issue new equity, the trust's shares are now sitting at a nearly 8% discount to NAV. This is among the lowest levels the trust's shares have traded at relative to NAV since launch. It is also far below the five-year discount average of 0.2%.

It is easy to see how the events of the last 18 months have made investors feel uneasy. The war in Europe and the highest levels of inflation we've seen since the 1970s do not make for the most relaxing of backdrops in which to invest.

But on a macro level; it is hard to see what has changed for the healthcare sector. Reports in January that China's population is declining for the first time in decades were another reminder that the world is getting older. Readers will know that this is not a new trend.

In 2017, the United Nations published a report noting that the global population of people over 60 had risen to 962m – up from 382m in 1980. The World Health Organisation believes this dynamic is likely to result in a substantial change in the world's demographics over the next 25 years, with the proportion of people over 60 almost doubling from 12% in 2015 to 22% by 2050.

We can see the impact this is having on healthcare spending. For example, in the UK, total spending on healthcare rose from £78.9bn in 2000 to £222.7bn in 2019, or 5.6% on average annually. GDP rose from £1.62trn to £2.24trn, equivalent to 1.7% per year, over the same period.

More than 80% of that spending normally comes from the state, and a similar picture is evident across the world. As readers can likely infer, this has the potential to create a circular problem. More GDP growth is needed to fund rising healthcare costs. But the lack of spending in other parts of the economy, as well as higher taxes needed to fund those increasing healthcare costs, arguably crimp that growth.

This plays into one of the key themes we see in the BBH portfolio, namely that there are innovative companies attempting to address this problem by providing new solutions to existing healthcare problems.

It also partly explains the company's recent performance, as these are the sorts of companies that have attracted more investor concern over the past 18 months. Partly that's because of valuations, but it's also due to fears that earlier stage firms won't be able to raise money or make it to profitability.

There are a couple of points that should allay fears here. One is that BBH managers John Major and Brett Darke have repeatedly noted that, even if the discount rate used to value portfolio companies were to rise markedly, they would still think they were fairly valued.

Those are not just idle words, as they have been adding to the portfolio as well as to existing positions over the past 18 months. Both managers have also made substantial additions to their own holdings in BBH during that time.

And in the first quarter of this year, two companies in the portfolio raised money via equity issuance rather than debt. In both instances, the two issuances were oversubscribed, a sign that plenty of institutional investors still believe these companies offer the potential for long-term returns.

That doesn't mean it's going to be smooth sailing and that we won't see further volatility in the near term. But the secular trends described above combined with the managers' stock picking abilities make it plausible we'll see returns smooth out over the long-term. Or, as Gulbenkian might have it, the dogs bark, the caravan moves on.

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