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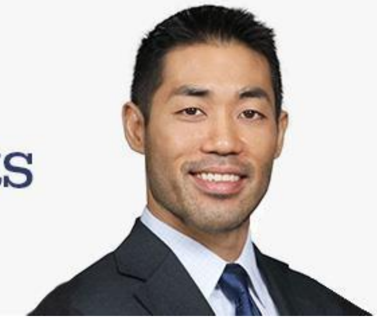
RBA Quick Insights



April 26th, 2019

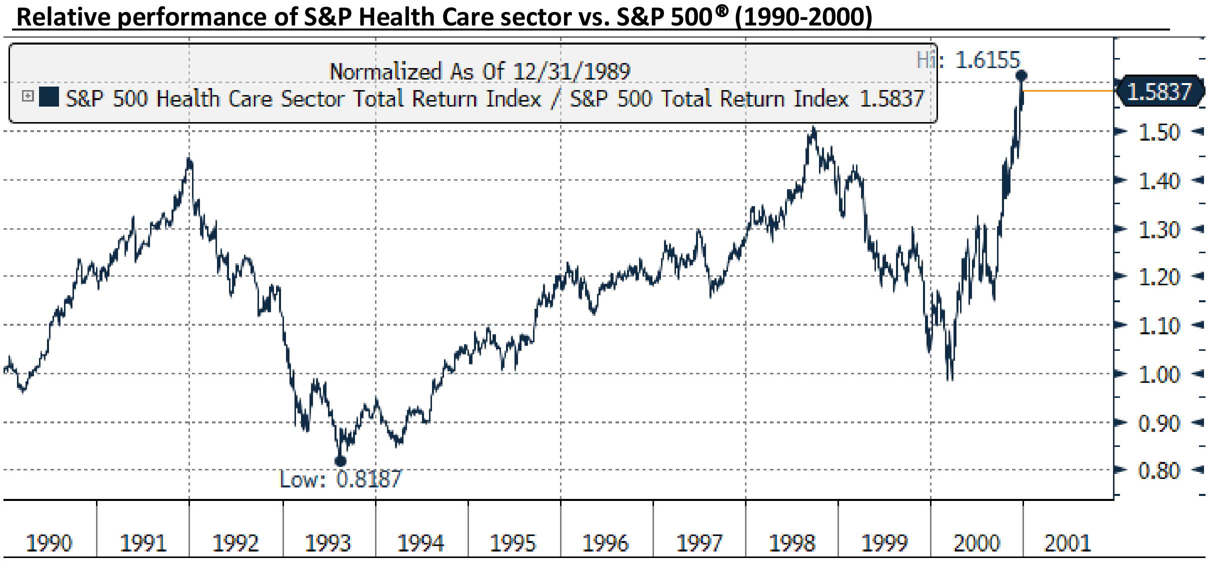
Health Care For All?

Profits — not politics — drive performance. Health Care tends to be a lightning rod for political criticism due to the eternal debate of whether companies should be maximizing profits at the expense of sick people. At RBA, our job is not to focus on what *should be*, but instead to focus on what *will be* and what that ultimately means for investment returns. The key determinant of that is profits.

We were asked yesterday whether the growing discussion around "Medicare For All" changes our view on Health Care stocks. The email went on to reference the underperformance of Health Care stocks during the Clinton Health Care Reform proposals in 1993. While the potential for policy changes did weigh on Health Care stocks immediately after Bill Clinton was elected president, this was only part of the story. The reality is that Health Care stocks were underperforming well before the 1992 election, and for reasons that had little to do with politics.

There were two distinct periods of Health Care underperformance during the 1990s: 1992-1993 and 1999 (see chart). It is no coincidence that in both periods, profit growth was rapidly recovering (following the early 1990s recession and the Asian & Russian Financial Crises). As profit growth accelerates, defensive sectors such as Health Care tend to underperform while cyclical sectors tend to outperform. That is not the story today. Profit growth is slowing and that has historically been a great time to own Health Care stocks. Another key difference is valuation: in 1992, the sector traded at a premium to the market, whereas it now trades at a discount. Ultimately, the summer of 1993 turned out to be one of the best buying opportunities ever for the sector (it went on to outperform the S&P 500® by over 200 percentage points over the next nine years).

Relative performance of S&P Health Care sector vs. S&P 500® (1990-2000)



Source: Richard Bernstein Advisors LLC, Bloomberg, Standard & Poor's

This is not to say that this won't be an issue that gets increasing focus as the election season nears, but the recent market reaction seems a bit disproportionate to us relative to the likelihood of a meaningful drag on Health Care profits. The analogy with Clinton's Health Care proposal assumes that Bernie Sanders (or like-minded candidate) wins the election, which is currently not the most likely scenario. Even if he were to win, Medicare For All is certainly not a foregone conclusion, particularly against the backdrop of heightened political polarization, a ballooning deficit and looming entitlement overhang. In the end, the Clinton proposal eventually died in Congress, and thus had little impact on profits.

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