DO PRESIDENTIAL ELECTIONS AFFECT HEALTHCARE RETURNS?

REGIONS
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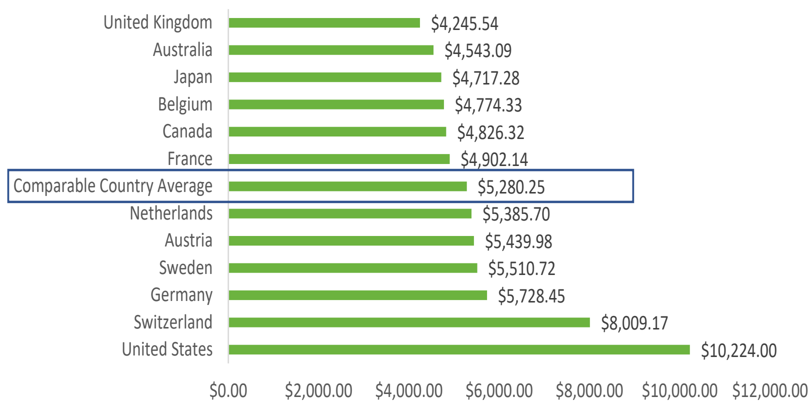
Healthcare is the second largest sector of the S&P 500. It is considered a defensive sector due to its predictability of earnings and high dividends (large cap pharmaceuticals) as well as a growth sector due to high growth biotech companies. Over the past 40 years, healthcare in the U.S. has become increasingly expensive and an area of focus in Washington. Therefore, in this report, we look at returns and valuations of the sector around presidential elections.

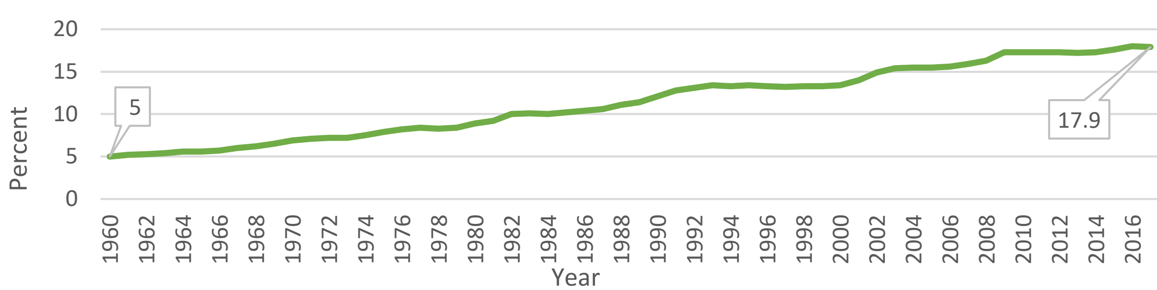
According to the Centers for Medicare and Medicaid Services (CMS), healthcare spending in 2017 was $3.5 trillion or $10,224 per capita. This is almost twice the average spending of all developed nations (Figure 1). A recent study, which compared healthcare costs between the U.S. and other developed countries, found that utilization of healthcare services was similar among all these countries. Main factors contributing to higher costs in the U.S. were higher prices for medical services, including hospitalization and doctor visits and higher pharmaceutical costs.

Figure 1: Health Expenditure Per Capita, 2017 (U.S. Dollars)[1]



Healthcare as a percent of GDP has risen from 5% in 1960 to 17.9% in 2017 (Figure 2). Rising costs and an aging population is expected to increase this to almost 20% by 2020. So, it is not surprising that healthcare has become a significant concern and a major topic for political debate during presidential elections.

Figure 2: National Health Expenditures as a Percent of GDP[2]



Investment Returns

Looking at returns between 1990-2018 period, we see that, on average, the sector has outperformed the broad market during election years as well as non-election years (Figure 3). It has outperformed during both Republican and Democratic presidents (Figure 4).

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Figure 3: Average Returns 1990-2018[3]

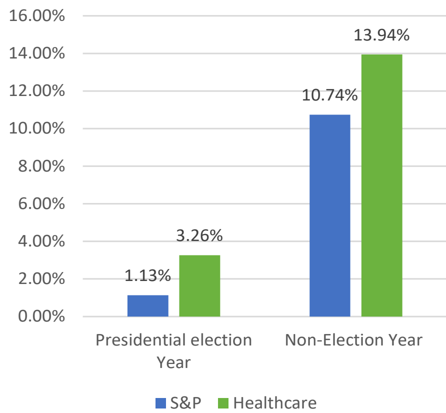
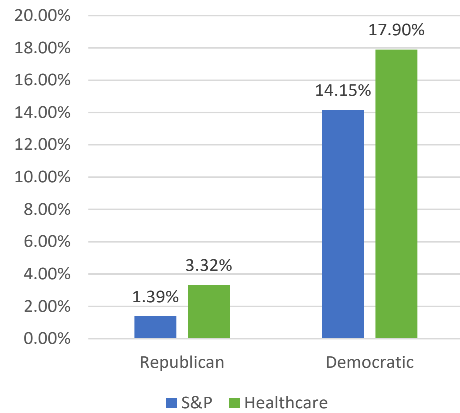


Figure 4: Average Returns 1990-2018[3]



Looking over the presidential cycle, on average, the healthcare sector has outperformed during the election year, the second (election year +2) and third year (election year +3) of the presidency, with the greatest outperformance in the second year (election year +2, Table 1).

Table 1: Average Returns over Presidential Cycle, 1990-2018[3]

	Election Year	*Election Year+1*	*Election Year+2*	*Election Year+3*
S&P	1.15%	14.36%	3.34%	15.59%
Healthcare	3.26%	14.06%	10.15%	18.16%

We can also look at election years when healthcare was a major issue. During the 1992 election year, then candidate Bill Clinton, introduced universal healthcare during his campaign. Right after the election, in January 1993, President Clinton created a task force for national healthcare reform. However, the plan was declared dead by August 1994. The healthcare sector underperformed the broad market in 1992 and 1993 and outperformed in 1994 and 1995 (Table 2).

Table 2: Returns during 1992-1995[3]

	Election year, 1992	*Election year +1, 1993*	*Election year +2, 1994*	*Election year +3, 1995*
S&P	4.46%	7.06%	-1.24%	34.11%
Healthcare	-18.08%	-10.98%	10.23%	54.50%

In 2008, then candidate Barrack Obama campaigned for universal health coverage. On March 23, 2010, President Obama signed The Affordable Care Act (ACA) into law. The healthcare sector outperformed in 2008 and underperformed in 2009 and 2010. The 2008 outperformance was probably due to the broad market sell-off as the result of the financial crisis (Table 3). By 2011, the uncertainty of reform related changes had dissipated. It was clear that the ACA would provide access to healthcare to about 22 million previously uninsured people. This would increase demand for healthcare services as well as pharmaceuticals and medical devices. This was probably a large factor for the sector outperformance in 2011.

Table 3: Returns during 2008-2011[3]

	Election year, 2008	*Election year +1, 2009*	*Election year +2, 2010*	*Election year +3, 2011*
S&P	-38.49%	23.45%	12.78%	0%
Healthcare	-24.48%	17.07%	0.71%	10.18%

Healthcare was the third most important issue amongst likely voters in the 2016 elections. Nominees from both the parties campaigned to reduce healthcare costs with proposals to repeal and replace the Affordable Care Act and to lower drug prices by various government interventions. As a result, the sector underperformed in 2016. In 2018, no major healthcare headlines persisted over the entire year. Also, S&P sold off in the second half of 2018 due to slowing earnings growth while healthcare outperformed due to its defensive characteristics. So far in 2019, there have been several issues affecting healthcare. The opioid epidemic, debate on drug rebates and alleged price fixing by generic pharmaceuticals are some recent healthcare headlines. Also, some of the Democratic party presidential candidates have put forth proposals for "Medicare for All". Thus, it is not surprising that, so far in 2019, healthcare has underperformed (Table 4). We expect healthcare to remain an important issue in the 2020 presidential election. As the election rhetoric picks up in late 2019 and 2020, we expect healthcare to continue to underperform.

Table 4: Returns during 2016-2019[3]

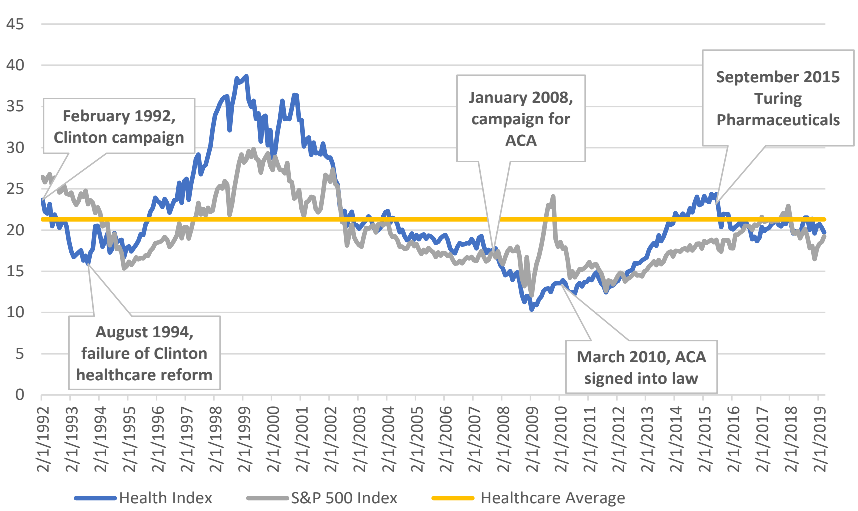
	Election year, 2016	*Election year +1, 2017*	*Election year +2, 2018*	*Election year +3, 2019**
S&P	9.54%	19.42%	-6.42%	12.98%
Healthcare	-4.36%	20.0%	4.69%	1.43%

*As of May 15, 2019

Valuations

Healthcare is considered both a defensive sector and as well as a growth sector. Therefore, on average, it trades at a premium to the broad market. Over the 1990-2018 time frame, the healthcare sector has traded at an average P/E of 21.3, an 8% premium to the broad market. During periods of uncertainty, when healthcare has underperformed, valuations have come down (Figure 5, Table 5). During the sell-off in 1992-August 1994, valuations were at a 10% discount to the S&P. During the 2008-2010 underperformance, valuations were at a 27% discount to the S&P. This wide gap was in part due to the spike in S&P P/E during the post-recession recovery.

Figure 5: Healthcare vs. S&P 500 Trailing P/E 1992-2019[4]



In 2015, healthcare was one of the best performing sectors and traded at a 46% premium to the broad market. In September 2015, there were media reports about Turing Pharmaceuticals, a small pharmaceutical company, which had overnight, raised the price of one of its drugs by 5000%. The drug, Daraprim, an off-patent lifesaving drug, is used to treat parasitic infections in AIDS and cancer patients. This news resulted in an outcry over drug pricing and started a sell-off in healthcare which then carried over to the election year 2016. During this period, healthcare valuations gave up the 46% premium and were in line with S&P. However, in all three periods, once the uncertainty was removed, the sector significantly outperformed the broad market and valuations improved.

Table 5: Healthcare and S&P Trailing P/E[4]

	Healthcare P/E	*S&P P/E*	*% change from S&P*
Feb 1992-Aug 1994	19.2	21.1	-9.6%
Jan 2008-Dec 2010	8.4	11.5	-26.5%
Jan 2015-Aug 2015	23.7	16.2	46%
Sept 2015- Dec 2017	20.5	20.2	1.2%

Summary

Over the past 40 years, healthcare in the U.S. has become increasingly expensive. Healthcare as a percent of the GDP has risen from 5% in 1960 to 17.9% in 2017. Healthcare costs in the U.S. are almost twice the average costs amongst developed nations. As a result, healthcare is a significant concern and has become a major point of debate during presidential elections.

During the 1990-2018 period, the healthcare sector has, on average, outperformed the broad market during election years as well as non-election years. However, during election years, when healthcare is a significant campaign issue, it has underperformed due to uncertainty over any proposed reforms and has traded at low valuations. However, once the uncertainty is eliminated, it has outperformed the broad market. We expect healthcare to once again be at the forefront during the 2020 presidential elections. Investing in the sector during the upcoming 2020 election, when it is likely to remain undervalued, may provide a good investment opportunity.

[1]Source: OECD iLibrary
[2]Source: Centers for Medicare & Medicaid Services
[3]Source: Strategas
[4]Source: Bloomberg

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