

# Shifts within the Healthcare Sector in 2026

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With a 9.5%<sup>1</sup> weight, Healthcare is the fourth largest sector in the S&P 500. While it is typically considered a defensive sector, it is exposed to government oversight. As a result, within healthcare, different subsectors have different risk profiles. For example, pharmaceutical, biotechnology and medical device companies are subject to FDA approval of their drugs which is based on results of clinical trials. They are also subject to patent protection as well as the loss of this exclusivity. Managed care companies are subject to Medicare and Medicaid rates that are set yearly by the Centers for Medicare and Medicaid Services (CMS). Life Sciences Tools and Services are dependent on R&D spending by pharmaceutical and biotech companies as well as NIH research grants. In this piece, we are focusing on the pharmaceutical and managed care subsectors since these have had the greatest volatility this year.

## PHARMACEUTICALS

The pharmaceutical subsector is the largest within healthcare. While it is more growth oriented, growth is always company specific. Thus, a pharmaceutical company facing patent losses for its largest drug will likely see decelerating revenue and earnings growth before new products start to have significant revenue contribution. For example, Pfizer (PFE) is facing a major patent cliff between 2026-2030 when it is expected to lose patents for several of its blockbuster drugs which could result in loss of \$17-18 B revenue annually. As a result, revenue is expected to decline over that time period. On the other hand, Eli Lilly (LLY), which has drugs for the expanding weight loss market has seen above trend revenue growth (Table 1).

Table 1: Revenue (2026-2030 expected) CAGR (%) <sup>1</sup>	
Company	CAGR (expected)
LLY	9.2
BMJ	-4.8
PFE	-3.2
MRK	2
JNJ	4.8

Source: FactSet

Since 2024, obesity drugs have been one of the largest growth categories. According to WHO, over 1 billion people in the world are considered to be obese. Of these, about 11% could potentially be eligible for weight loss drugs. As a result, the market for these drugs could reach \$150B by 2035 from about \$15B in 2024<sup>2</sup>. This growth is due to increased access, new indications as well as newer generation drugs. These projections are based on assumptions regarding regulatory approvals, reimbursement coverage, pricing and patient adoption which are subject to change.

**Demand:** The U.S. is the largest market with an estimated 107MM or 42.7% of the adult population with obesity in 2023. This is expected to increase to 126MM or 46.9% of total adult population by 2035<sup>3</sup>. By June 2026, Medicare is expected to cover obesity drugs for patients with comorbidities like diabetes, cardiovascular disease, and sleep apnea<sup>4</sup>. Medicaid coverage varies by state, with some states covering weight loss and some covering it for comorbidities. Similarly, employer insurance coverage also varies by company size. The U.S. government has launched Balance, a new model which stands for Better Approaches to Lifestyle and Nutrition for Comprehensive Health, which will pay for obesity drugs for weight loss (without comorbidities) where the price and coverage of the drugs will be negotiated by CMS. This is expected to be available as early as July 1, 2026 for Medicare and January 1, 2027 for Medicaid.

**New Indications:** Obesity drugs have been approved for treatment of cardiovascular disease, chronic kidney disease, and sleep apnea. Currently these drugs are being studied for treatment of neurodegenerative diseases like Multiple Sclerosis, Alzheimer's, and Parkinson's. They are also being studied for treating addiction and fatty liver disease. If successful, these new indications could also expand market for obesity drugs.

*New Generation Drugs:* Current obesity drugs are incretin therapies which regulate secretion of insulin and have been developed primarily for treatment of Type 2 Diabetes (T2D). They are various combinations of glucagon like peptide (GLP) receptor inhibitors. Most of these are injectables. Recently, FDA approved an oral (GLP) developed by Novo Nordisk. LLY is currently conducting phase 3 trials for its oral GLP.

In hopes of achieving even more weight loss, trials are being conducted adding additional antagonists to GLPs. For example, LLY is testing Retatrutide, which is a triple hormone receptor antagonist (GLP, Glucagon and GIP) in phase 3 trials. Novo is testing CagriSema, a combination therapy of GLP and an Amylin antagonist. Amgen is developing MariTide, a triple combination (GLP, GIPR).

## MANAGED CARE

Managed Care Organizations (MCOs) typically offer health insurance plans in commercial markets like individual, group (employer), and government markets like Medicare Advantage and Medicaid managed. Of these, the Medicare Advantage plan has been the fastest growing segment and the main source of revenue growth<sup>5</sup>. In 2024, 54% of total Medicare enrollees were enrolled in MA plans<sup>6</sup>. The Congressional Budget Office expects this to grow to 64% by 2034<sup>7</sup>. While Medicare Advantage plans are administered by MCOs, the payment rate is set by the CMS and the Affordable care Act (ACA) mandates a medical loss ratio of 85%. CMS also administers a Star program for Medicare Advantage plans and allocates a 5% bonus on benchmark payments for plans with 4 or higher Star rating.

Table 2: Medicare Rate Increases <sup>8</sup>	
2023	8.5%
2024	3.5%
2025	3.7%
2026	5.06%
2027	0.09%

Source: <https://cboh.kenaninstitute.unc.edu/publication/what-are-medicare-advantagerates-and-why-do-they-matter/>

After significant rate increases over the past four years, CMS announced a near flat rate (0.09%) increase for 2027 (Table 2). Additionally, in order to reduce upcoding, it also proposed eliminating use of unlinked chart review records from risk calculations. The 2027 rates were significantly lower than consensus analysts' expectations of 4.9%<sup>9</sup> increase.

The Medical loss ratio (MLR) varies for different insurance plans. On average, in 2024, MLR for commercial plans was between 85-88% and 90% for Medicare Advantage<sup>9</sup>. Due to greater usage of specialized drugs, and increased utilization, MLRs for both commercial and Government plans have increased. MLR for commercial plans has increased from 86% in 2023 to 88% in 2024 for group plans and 87% in 2023 to 90% in 2024 for Medicare Advantage<sup>10</sup>.

The proposed 2027 Medicare rate along with rising MLRs are expected to have a negative effect on revenue growth and margins of MCOs. For example, United Health Group (UNH) is projecting a 2% loss of revenue in 2027. As a result, most managed care stocks have sold off and the managed care ETF, IHF, has underperformed the broad markets (-8.9% vs. -0.57%<sup>11</sup>, YTD).

As a result of the 2027 proposed Medicare rates, MCOs may have to reduce benefits and exit some markets and reassess risk pools. This is an overhang on the group.

## CONCLUSION

Given its defensive characteristics, the healthcare sector is currently outperforming the broad market (-0.12% vs. -1.1%<sup>12</sup>, YTD). Given the geopolitical uncertainty, we believe this outperformance could continue. Within the healthcare sector, we believe pharmaceutical and biotech companies with strong catalysts like new product launches along with minimal patent losses could contribute to the sectors' outperformance. We expect the managed care companies to remain under pressure due to rising costs and possible changes to their membership and thus risk pools.

Sources:

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