



Investment Perspectives

Unlocking Potential Investment Opportunities in the Healthcare Sector

Lord Abbett investment professionals discuss three key reasons why the healthcare sector may offer a compelling long-term investment opportunity.



*Brian Foerster, CFA
Co-Head of Product
Management*



*Melanie Coffin, CFA
Investment Strategist*

Summary

- Shifting demographics and substantial gains in the efficiency of research and development (R&D) create a favorable backdrop for supply and demand.
- Historically, lower return correlation to the broad stock market may mean attractive diversification benefits, while higher return dispersion within the sector suggests selectivity may provide a better alpha opportunity.
- We believe a global focus on health and well-being and other long-term secular growth themes that came to the forefront following the COVID-19 pandemic will provide a strong tailwind for the sector in the years ahead.

The healthcare industry stands at the intersection of critical societal needs, economic growth, and technological advancement and will be a significant area for both investment and innovation over the next decade.

Since the original sequencing of the human genome in 2000 and the collapse in the cost of sequencing over the last 20+ years—from a few hundred million dollars to less than 500 dollars per sequence today—we have already had a glimpse at how powerful new technologies have become. In cell therapy, gene sequencing, and gene editing, we are seeing new drug development with remarkable precision in targeting deadly and debilitating mutations; in immunotherapy, we see tremendous successes in drugs enabling the body to fight cancers and other diseases far more effectively; and in medical diagnostics and devices, we are seeing a revolution in surgical precision and life-improving products.

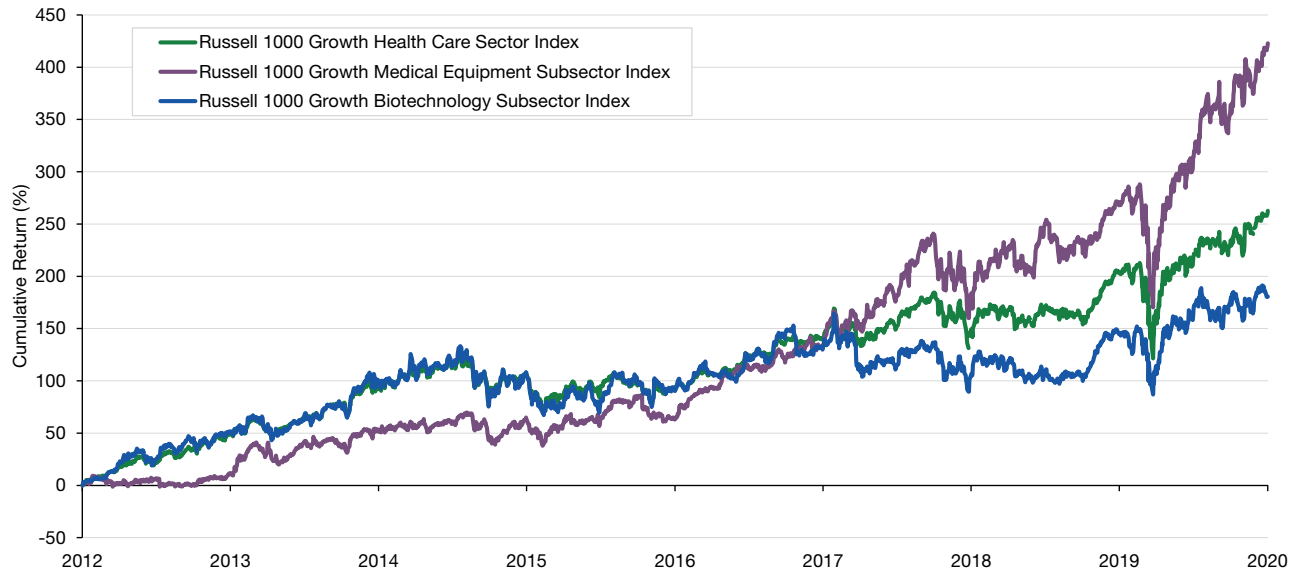
Not all of these technologies were directly related to the human genome sequencing, but their contemporaneous development over the last two decades has given investors—and humanity—hope that we are ushering in an era of wellness and longevity.

This ebullience was reflected in the strong performance of healthcare stocks that focus on innovation, e.g., life sciences, biotechnology, medical devices, etc., particularly from 2013–2020. It culminated in the tremendous performance during the COVID-19-related lockdowns, when the combined effects of secular growth stocks leading the market during that time and the successes seen in rapid vaccine development attracted strong investment returns, as shown in Figure 1.



Figure 1. A Prolonged Period of Strong Healthcare Sector Returns

Cumulative returns of the Russell 1000® Growth Health Care Sector Index, Russell 1000® Growth Medical Equipment Subsector Index, and the Russell 1000® Growth Biotechnology Subsector Index, December 31, 2012-December 31, 2020



Source: Bloomberg. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees and expenses, and are not available for direct investment. Please see past performance of indexes on the last page. **Past performance is no guarantee of future results.**

Then came inflation and sharply higher interest rates, and today, we look back at 30+ months of repricing as secular growth stocks deflated, and we've seen variations of bear markets, depending on the subindustry.

And so, as investors stay bunkered in perceived low-risk investments and cash, we look at the healthcare space and note that from a fundamental and secular perspective, the only thing that has changed from the bull market of 2020 to now is that these areas look even more impressive, attractive from an investment standpoint, and ripe for active managers to identify the potential winners. In this paper, we identify three key reasons why we believe this is so:

1. Powerful healthcare sector supply and demand dynamics.
2. High-return dispersion and diversification benefits.
3. Clear themes for long-term secular growth and sustainability.

Supply-and-Demand Dynamics Look Favorable

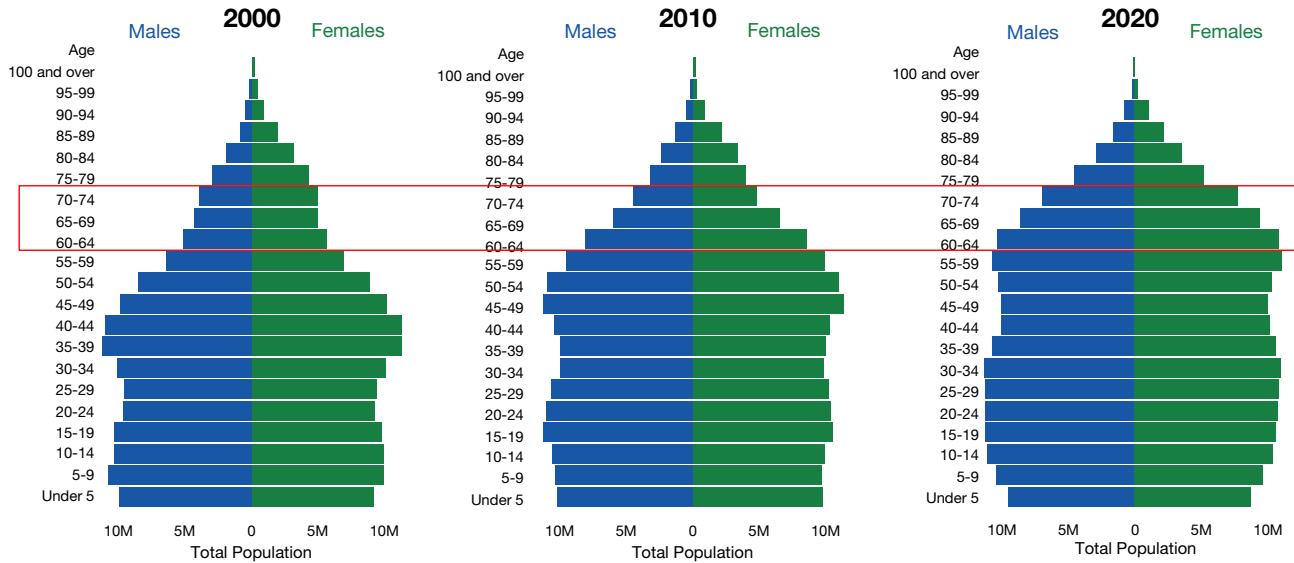
In assessing the attractiveness of the healthcare sector, we think it is important to consider both the components of, and the interplay between, supply-and-demand-side dynamics. The demand-side dynamics are more widely accepted and understood—with the two common themes being global investment in healthcare and an aging population. We continue to see an increase in national healthcare expenditure as a percentage of total GDP. In fact, it is predicted that the proportion of spend on healthcare relative to GDP in the U.S. will be as high as nearly 20% by 2028, according to data compiled by the Centers for Medicare and Medicaid Services.¹

One of the drivers for the increase in spend on healthcare is the shift in demographics. In the U.S., as the baby boomer cohort ages, we continue to see a decade-over-decade shift in the population, where a larger percentage of the population is 60 years old or older. As seen in Figure 2, the portion of the population above 60 years old has increased significantly in the U.S. over the last twenty years.



Figure 2. Over-60 Segment of the Population Has Increased

Historical U.S. Census population data by age cohort for 2000, 2010, and 2020.



Source: U.S. Census Bureau, Census 2000 Summary File 1, Census 2010 Summary File 1, and Census 2020 Census Demographic and Housing Characteristics File. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

On a global scale, the World Health Organization (WHO) estimates that between 2015 and 2050, the population of the world that is over 60 years old will nearly double—from 12% to 22%.² Demographic trends coupled with increased longevity will then directly lead to an increase in healthcare consumption. In the U.S. alone, the cohort of people aged 50 years or older spent \$7.1 trillion in 2021, and that is expected to rise to \$13.2 trillion by 2032, with a significant portion of that spend likely directed to healthcare needs.³

And while the above demand dynamics are certainly noteworthy, it is equally important to consider supply-side dynamics, such as new drug development and research and development (R&D) intensity. R&D, after all, is the critical lifeblood of drug discovery, and as we’ve noted throughout many papers focused on innovation, it historically has been chronically mispriced in stocks.

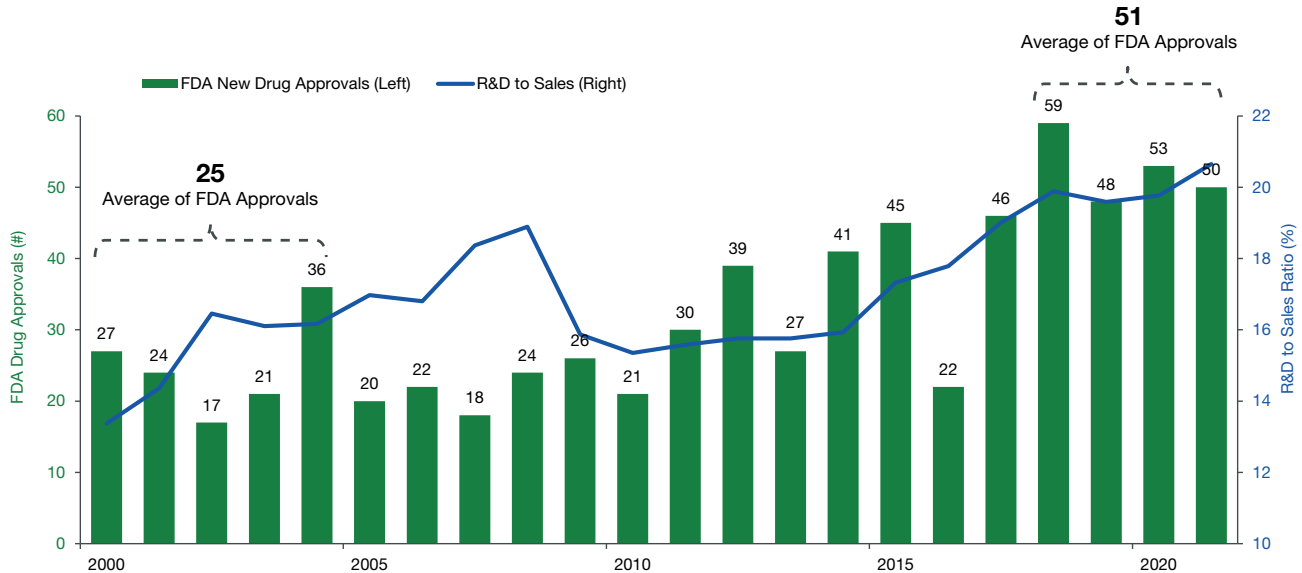
Looking at healthcare overall, we continue to see an emphasis on R&D intensity, which we define as research and development investment relative to sales. Twenty years ago, companies spent roughly 15% on R&D relative to sales, and that number has grown to north of 20%, as shown in Figure 3.

The continued emphasis on R&D spend combined with technological advancements, which have improved the efficacy of that R&D expense, have contributed to an acceleration in the rate of new drug approvals over the last decade.



Figure 3. Improved R&D Efficiency Led to Increased New Drug Approvals

Annual Food and Drug Administration (FDA) new drug approvals and R&D to sales ratio, December 31, 1999-December 31, 2020



Source: U.S. Food and Drug Administration and Empirical Research Partners. Data as of 12/31/2020. R&D to Sales Ratio based on aggregate data for large cap pharmaceutical and biotechnology stocks. For illustrative purposes only.

Beyond an improvement in the efficacy of R&D, we expect the emergence of generative artificial intelligence (AI) to usher in a transformative era in healthcare. Generative AI is poised to revolutionize many facets of the healthcare industry, including accelerated drug discovery, improved clinical trials, enhanced remote monitoring, streamlined administrative tasks, among other use cases. As generative AI continues to advance, its integration into healthcare may promote not only greater efficiency, but also improved patient outcomes.

Greater Return Dispersion and Lower Correlation to the Broad Equity Market

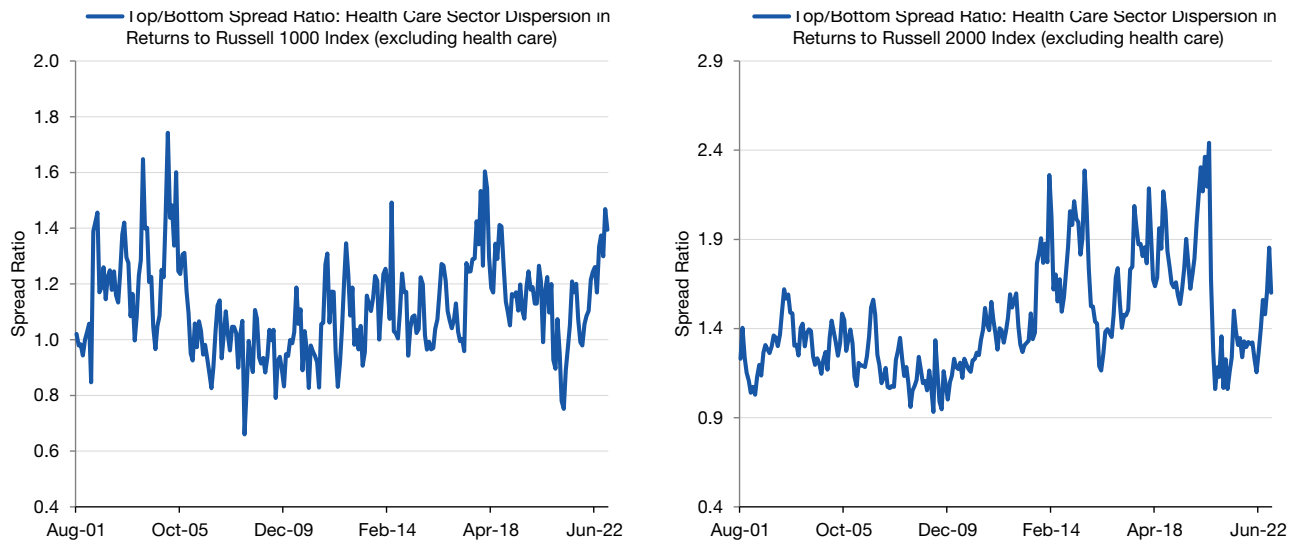
From an asset allocation standpoint, investors tend to seek out areas of the market that exhibit lower correlation and higher dispersion, as this creates an attractive opportunity for an active manager to drive alpha. Within the healthcare sector, we have historically seen a wider dispersion between winners and losers than the broader market. We measured dispersion by assessing the return differential between the top and bottom quintiles using forward six-month returns. Using this methodology, we can assess the spread between the dispersion of the healthcare sector and the dispersion of the broader market excluding the healthcare sector.

Figure 4 shows the spread between the large cap healthcare sector versus the Russell 1000® Index, excluding healthcare, on the left panel, and the small cap healthcare sector versus the Russell 2000® Index, excluding healthcare, on the right panel. Values greater than one imply that the dispersion is larger for healthcare than the broader market. A ratio of 2 implies that the dispersion between winners and losers in the healthcare sector is twice that of the rest of the index. Importantly, while the dispersion within the healthcare sector is notably higher than the broader market, there is a significant pickup in the difference of the spread as you go down in market capitalization.



Figure 4. Wider Spreads in Top and Bottom Return Dispersion Suggest Active Management May Drive Alpha

Monthly spread ratio between the large cap healthcare sector versus the Russell 1000® Index (left) and the small cap healthcare sector versus the Russell 2000® Index (right), August 2001-December 2022



Source: Bloomberg, FTSE Russell, and Lord Abbett. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees and expenses, and are not available for direct investment. Please see past performance of indexes on the last page. **Past performance is no guarantee of future results.**

This suggests that there is an opportunity to outperform with a team that has a specialized focus and expertise to adequately assess the industry dynamics, regulatory backdrop, total addressable market, and likelihood of success, among other factors.

For those seeking the benefits of diversification, it is also important to consider the correlation of an asset class or sector relative to the broader market. Figure 5 shows the healthcare sector has historically exhibited lower correlation to the broader market, as measured by the MSCI ACWI Index.

From January 1991 through August 2023, the sector's correlation of 0.22 was lower than all ten sectors. The healthcare sector is expansive—including a range of industries from pharmaceuticals to biotechnology. Given the complexion of the sector, the healthcare space offers industries with different return profiles and thus varying correlations relative to the broader market.

For example, we tend to see areas with more current profitability and earnings stability, such as healthcare equipment or larger-capitalization pharmaceutical companies, exhibit more defensive characteristics, while areas like biotechnology tend to be in favor during more risk-on periods. And so, not only can the healthcare sector potentially be an attractive diversifier from an asset allocation perspective, but also the varying industries provide active managers with the opportunity to adapt flexibly based on the market environment.

**Figure 5. Healthcare Stocks Historically Have Exhibited Lower Return Correlation to the Broad Equity Market**

Return correlation between the MSCI ACWI (All Country World Index) and other industry sectors, January 1991-August 2023

	MSCI ACWI
MSCI ACWI Index	1.00
Communication Services	0.26
Consumer Discretionary	0.34
Consumer Staples	0.23
Energy	0.42
Financials	0.31
Health Care	0.22
Industrials	0.35
Information Technology	0.31
Materials	0.34
Real Estate	0.34
Utilities	0.27

Source: Bloomberg and MSCI. Sectors represent the S&P 500® sector breakdown. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees and expenses, and are not available for direct investment. Please see past performance of indexes on the last page. **Past performance is no guarantee of future results.**

Clear Themes for a Long-Term Secular Growth Opportunity and Sustainability

The third key reason why we believe innovative areas of healthcare is a compelling investment theme for the long term is its sustainable growth outlook. As revolutionary medical technologies gain greater scale and acceptance, its reach will have a massive impact on the global populations, both rich and poor. As a result, capital allocations to drugs, therapies, devices, diagnostics, and making healthcare more affordable are almost inevitable from both the private and public sector. This global trend is also fueled by support from the United Nations, which has dedicated one of its Sustainable Development Goals to ensuring healthy lives and promoting well-being.

Following the COVID-19 pandemic, the societal impact of the healthcare space became increasingly more apparent as genomics research led to the development of COVID-19 vaccines. The global pandemic led many to recognize the importance of the healthcare sector as an area of the market well-positioned for sustainable long-term growth. The intersection of sustainability and healthcare presents active managers with the opportunity to identify the long-term winners in the healthcare sector. Within this sector, we have identified five sustainable, secular themes that we believe will present attractive opportunities for investors over the next decade:

- The development of drugs or medical equipment seeking the treatment of major diseases.
- The development of treatment for rare and orphan diseases.
- Investment in the research and/or the development of vaccines and medicines for communicable and non-communicable diseases primarily affecting developing countries.
- Affordability and accessibility of healthcare services and improving the efficiency of delivering such healthcare services.
- The pursuit of other healthcare and well-being objectives.

As the global economy continues to emphasize health and well-being, companies aligned with these five themes are likely to exhibit exceptional resilience, benefiting from reduced regulatory risks, alignment with sustainable global priorities, and an influx of capital directed toward these promising secular growth areas of the market. The healthcare industry's dual commitment to societal welfare and sustainable economic returns, as well as its capacity for continuous innovation, firmly establishes its enduring value within the investment landscape.



Key Takeaways

For investors that may be underallocated to healthcare stocks, there may be meaningful risk of lost opportunity over the coming decade, as this sector continues to become a more significant part of global GDP, and innovation within the sector continues to drive high organic growth.

Moreover, as the dispersion data in Figure 4 shows, it is critically important, in our opinion, to allocate to an active manager with expertise in innovation investing and the ability to navigate different market environments. And lastly, unlike some recent spates of euphoria such as in cryptocurrencies, COVID-19-era remote fitness, and meme stocks, the themes in innovative healthcare are underpinned by the secular forces of technological advances, capital allocations to sustainable companies, and accessibility. As investors begin to reassess their asset allocations and focus on long-term fundamentals, we believe capital is likely to return to areas within healthcare.

Past Performance of Indexes:

	Russell 1000 Growth Healthcare Index	Russell 1000 Growth Medical Equipment Subsector Index	Russell 1000 Growth Biotechnology Subsector Index	Russell 1000 Growth Index	Russell 2000 Index	MSCI ACWI Index
2022	-13.20	-21.04	-29.04	-29.14	-20.46	-19.80
2021	21.64	23.05	6.97	27.60	14.78	16.80
2020	17.69	41.48	12.25	38.49	19.34	14.34
2019	20.05	29.84	16.16	36.39	25.48	24.05
2018	3.01	22.13	-11.52	-1.51	-11.03	-11.18

NOTE: Past performance is not a reliable indicator or guarantee of future results.



Sources:

¹Centers for Medicare & Medicaid Services, NHE Historical Fact Sheet, 2021. <https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data/nhe-fact-sheet#:~:text=Projected%20NHE%2C%202022%2D2031%3A,to%2019.6%20percent%20in%202031.>

²World Health Organization, Ageing and Health, 1 October 2022, <https://www.who.int/news-room/fact-sheets/detail/ageing-and-health>

³AARP (American Association of Retired Persons), Oxford Economics, The Longevity Economy, prepared by Oxford Economics for AARP, 2013-2020, <https://www.aarp.org/content/dam/aarp/home-and-family/personal-technology/2013-10/Longevity-Economy-Generating-New-Growth-AARP.pdf>

Important Information

Equity Investing Risks

The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

Fixed-Income Investing Risks

The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price.

The credit quality of fixed-income securities in a portfolio is assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

This material may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

The views and opinions expressed are as of the date of publication, and do not necessarily represent the views of the firm as a whole. Any such views are subject to change at any time based upon market or other conditions and Lord Abbett disclaims any responsibility to update such views. Lord Abbett cannot be responsible for any direct or incidental loss incurred by applying any of the information offered.

This material is provided for general and educational purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument, or any Lord Abbett product or strategy. References to specific asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations or investment advice.

Please consult your investment professional for additional information concerning your specific situation.

Glossary & Index Definitions

Research and development (R&D) expenses are direct expenditures relating to a company's efforts to develop, design, and enhance its products, services, technologies, or processes.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Correlation is a statistic that measures the degree to which two securities move in relation to each other. A perfect positive correlation means that the correlation coefficient is exactly 1. This implies that as one security moves, either up or down, the other security moves in lockstep, in the same direction. A perfect negative correlation means that two assets move in opposite directions, while a zero correlation implies no relationship at all.

The MSCI ACWI (All Country World Index) is a free float-adjusted, market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

The S&P 500® is widely regarded as the best single gauge of large cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

The Russell 1000 Growth Healthcare Index consists of companies that manufacture healthcare equipment and supplies or provide healthcare-related services such as lab services, in-home medical care and healthcare facilities. The Healthcare Index also includes companies involved in research, development, and production of pharmaceuticals and biotechnology.

MSCI is a global provider of equity, fixed income, real estate indexes, multi-asset portfolio analysis tools, ESG and climate products.

This material is the copyright © 2023 of Lord, Abbett & Co. LLC. All Rights Reserved.

Important Information for U.S. Investors

Lord Abbett mutual funds are distributed by Lord Abbett Distributor LLC.

FOR MORE INFORMATION ON ANY LORD ABBETT FUNDS, CONTACT YOUR INVESTMENT PROFESSIONAL OR LORD ABBETT DISTRIBUTOR LLC AT 888-522-2388, OR VISIT US AT LORDABBETT.COM FOR A PROSPECTUS, WHICH CONTAINS IMPORTANT INFORMATION ABOUT A FUND'S INVESTMENT GOALS, SALES CHARGES, EXPENSES AND RISKS THAT AN INVESTOR SHOULD CONSIDER AND READ CAREFULLY BEFORE INVESTING.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product, or service may be appropriate for your circumstances.



LORD ABBETT®

Important Information for non-U.S. Investors

Note to Switzerland Investors: In Switzerland, the Representative is ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich, whilst the Paying Agent is Bank Vontobel Ltd., Gotthardstrasse 43, CH-8022 Zurich. The prospectus, the key information documents or the key investor information documents, the instrument of incorporation, as well as the annual and semi-annual reports may be obtained free of charge from the representative. In respect of the units offered in Switzerland, the place of performance is at the registered office of the representative. The place of jurisdiction shall be at the registered office of the representative or at the registered office or domicile of the investor.

Note to European Investors: This communication is issued in the United Kingdom and distributed throughout the European Union by Lord Abbett (Ireland) Limited, UK Branch and throughout the United Kingdom by Lord Abbett (UK) Ltd. Both Lord Abbett (Ireland) Limited, UK Branch and Lord Abbett (UK) Ltd are authorized and regulated by the Financial Conduct Authority.

Lord Abbett (Middle East) Limited is authorised and regulated by the Dubai Financial Services Authority ("DFSA"). The entire content of this document is subject to copyright with all rights reserved. This research and the information contained herein may not be reproduced, distributed or transmitted in any jurisdiction or to any other person or incorporated in any way into another document or other material without our prior written consent. This document is directed at Professional Clients and not Retail Clients. Any other persons in receipt of this document must not rely upon or otherwise act upon it. This document is provided for informational purposes only. Nothing in this document should be construed as a solicitation or offer, or recommendation, to acquire or dispose of any investment or to engage in any other transaction. Nothing contained in this document constitutes an investment, an offer to invest, legal, tax or other advice or guidance and should be disregarded when considering or making investment decisions.