CIO expects strong growth for the healthcare sector. (UBS)

UBS CIO upgrades healthcare to Most Preferred

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This month, the UBS Chief Investment Office (CIO) thinks the backdrop for US equities remains supportive driven by healthy economic growth, moderating inflation, a Fed that's pivoting to rate cuts, and a strong surge in AI investment. Healthcare in particular has seen faster earnings growth relative to the other defensive sectors, which is why CIO has upgraded it from Neutral to Most Preferred.

Eric Potoker, US Healthcare Equity Strategist with CIO, spoke with UBS On-Air's Dan Cassidy to explain the reasoning behind upgrade. **Click here** to listen to his commentary and read highlights below:

The equity strategy team views healthcare as the most attractive among the defensive sub-sectors, and overall that Most Preferred view of healthcare serves to balance other Most Preferred sectors, which are the pro-cyclicals technology and industrials. Specific to healthcare, we've seen a general improvement of the sector end markets through 2023 and an acceleration of earnings growth through the sector broadly.

Unlike last year, there is little in the way of a "post-pandemic hangover" to slow growth in 2024. In 2023, there were a number of large companies that saw growth slow, or even go negative, because they were no longer benefiting from the same magnitude of COVID tailwinds. That's been normalized for 2024, which allows the healthcare sector to generate faster earnings growth on both an absolute and relative basis.

CIO has three preferred sub-sectors of US healthcare.

1. **Medtech/medical devices.** This continues to be a structurally strong end-market, and this year we expect to see even better growth and a lot of that is procedure volumes, some of which is pent-up post-pandemic demand, and

some of it is due to new products that are coming to market and adding to growth. We think this sub-sector will continue to show strong growth and think certain parts of the sector will accelerate in 2024 and beyond.

2. **Life sciences tools.** This sector in particular suffered from a COVID-19 hangover in 2023 and should benefit from a normalization of what we see in recovering end-markets. The sector struggled last year with weakness in small-cap biotech funding availability and large biopharma companies bringing down their inventory levels from pandemic peaks. We think the inventory correction is mostly finished and there has been a decent recovery so far this year in biotech access to capital.
3. **Managed care sector.** This group has struggled due to higher medical utilization, which we do think is transitory in terms of how it will impact margins. We also think that by the second half of the year, some of that pressure will moderate and that these companies will be able to show margins and earnings that are consistent with guidance. Given where valuations are, we think MCOs are at an attractive entry point for managed care.

CIO is still Neutral on large bio-pharma. Obesity drug therapies dominate pharma. There's a significant divergence of valuations within the sector between the “haves” and the “have nots” that centers on obesity drugs, and there are only a couple of players with an effective, marketed obesity drug. While there are some attractive valuations that represent value, CIO sees looming pressure from many large products losing patent protection over next three years.

Take a deeper dive:

- Read the report **CIO View: US equity sectors** 22 February 2024.
- Listen to the podcast **US healthcare—Sector update and outlook** 13 March 2024.