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HEALTH CARE



- An in-depth look at the global Health Care sector investment universe, including pharma, equipment, biotechnology, managed care, and more
- Tips and tools for security analysis and portfolio management
- A useful guide for investing in any market condition

Foreword by *New York Times* bestselling author Ken Fisher

Fisher Investments on Health Care

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with

**Michael Kelly and
Andrew S. Teufel**



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Foreword

Fisher Investments on Health Care is the eighth in a series of investing guides from Fisher Investments Press—the first-ever imprint from a money manager. While reading the entire series would be a worthwhile endeavor for serious students of capital markets—covering the full breadth of capital market analysis—each book can stand on its own in its area. This book (and the series) presents a usable, top-down strategy for analyzing standard investing sectors (Energy, Materials, Consumer Staples, Industrials, etc.) as well as other investing regions and categories. This book is on Health Care—currently about 8 percent of total world stocks (as measured by the MSCI All Country index).

When folks hear “Health Care,” they probably think pharmaceuticals and insurers. And that’s right—but the sector also covers equipment makers, hospitals, biotechnology, distributors, services, supplies, technology, and life sciences. It may seem stodgy, but there’s massive, non-stop, life-saving innovation going on in drugs and equipment, and also many Health Care sub-industries.

Thanks to major US legislation passed in 2010, Health Care is certain to be a hot and often controversial topic for many years to come. That legislation (and any later legislation to change, repeal, clarify, or what-have-you 2010’s legislation) will impact Health Care firms in ways legislators couldn’t have possibly imagined—and certainly aren’t fully fathomable at this time. But the job of a Health Care analyst isn’t to decide whether legislation is good or bad, or to debate how the sector *should* be regulated. Instead, it is to always rationally assess the existing landscape, whether it’s likely to change, and how that likely impacts demand (and alternatively supply) for Health Care stocks.

Plus, Health Care is no stranger to legislation! Think of all the regulation aimed at pharmaceutical firms, insurers, medical device makers, hospitals, and so on. And Health Care firms are frequently targets for lawsuits. Nothing new about that! Understanding how regulatory and legal matters impact the sector and its industries is vital to making better forecasts. This book shows you how and provides a fundamental framework.

Don't let regulation scare you off. Health Care plays a vital portfolio role—it's a classically defensive sector. When times are tough, folks still take aspirin and need hips replaced. But when times are flush, you generally don't double up on insulin or heart medication. Hence, investors see Health Care as a refuge—it tends to do better than the market during bear markets while lagging in the sizzling times. In an overly simple sense, Health Care can be thought of in just that way—a great thing to own when other forms of defensive stocks beat the market, but not so great when defensive stocks lag in general. But Health Care has certainly had periods when it outperformed during a bull market—as it did in the late 1990s! It is fairly defensive, but innovation can be a tremendous driver too. This book explains the disparate drivers for Health Care's many industries, and how to know if the sector as a whole (and underlying industries) is likely to out- or underperform—no matter the market conditions.

And it's wrong to think Health Care is inherently less risky just because it's overall more defensive than sectors like Consumer Discretionary, Energy, or Materials. Or that Health Care should get better or worse returns over the long term. Over the long term, finance theory says all equity categories should net pretty similar returns when properly accounted for—though traveling drastically different paths over the short to intermediate term. Ultimately, given enough time, newly created supply or the destruction of existing supply tends to equalize categories. In the nearer term, demand tends to drive stock prices, but longer term (what may seem for most like an eternity but really isn't), supply swamps demand for that category. (For a more detailed discussion on the general process of how supply is almost all powerful in affecting stock prices in the very long term,

see my 2007 John Wiley book *The Only Three Questions That Count*, pages 240–250.) That’s why a good portfolio is broadly diversified, and why this book (and the entire series) can help you learn to be a better investor.

Don’t expect to find any “get rich quick” ideas or hot stock tips in this book. Such a thing doesn’t exist—someone telling you otherwise is selling you something unhealthy. Rather, this book provides a workable, repeatable framework for increasing the likelihood of finding profitable opportunities in the Health Care sector. And the good news is the investing methodology presented here works for all investing sectors and the broader market. This methodology should serve you not only this year or next, but the whole of your investing career. So good luck and enjoy the journey.

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Best Sellers,
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to Riches, and
The Only Three Questions That
Count

Preface

The *Fisher Investments On* series is designed to provide individual investors, students, and aspiring investment professionals the tools necessary to understand and analyze investment opportunities, primarily for investing in global stocks.

Within the framework of a “top-down” investment method (more on that in Chapter 7), each guide is an easily accessible primer to economic sectors, regions, or other components of the global stock market. While this guide is specifically on Health Care, the basic investment methodology is applicable for analyzing any global sector, regardless of the current macroeconomic environment.

Why a top-down method? Vast evidence shows high-level, or “macro,” investment decisions are ultimately more important portfolio performance drivers than individual stocks. In other words, before picking stocks, investors can benefit greatly by first deciding whether stocks are the best investment relative to other assets (like bonds or cash), and then choosing categories of stocks most likely to perform best on a forward-looking basis.

For example, a Tech sector stock picker in the mid to late 1990s probably saw his picks soar. But in 2000 to 2003, his picks were likely decimated. Was he just smarter in 1998 and 1999? Did his analysis turn bad somehow? Unlikely. What mattered most was stocks in general, and especially Tech stocks, did relatively great in the 1990s, but Tech crashed in 2000, and US stocks overall did lousy in the 2001 to 2002 bear market. In other words, a top-down perspective on the broader economy was key to navigating markets—stock picking just wasn’t as important.

Fisher Investments on Health Care will guide you in making top-down investment decisions specifically for the Health Care sector. It shows how to determine better times to invest in Health Care, what Health Care industries are likelier to do best, and how individual stocks can benefit in various environments. The global Health Care sector is complex, covering many industries and countries with unique characteristics. Using our framework, you will be better-equipped to identify their differences, spot opportunities, and avoid major pitfalls.

This book takes a global approach to Health Care investing. Most US investors typically invest the majority of their assets in domestic securities; they forget America is less than half of the world stock market by weight—over 50 percent of investment opportunities are outside our borders. While a larger proportion of the world's Health Care weight is based in the US, many companies derive a significant portion of profits overseas. Given the vast market landscape and diverse geographic operations, it's vital to have a global perspective when investing in Health Care today.

USING YOUR HEALTH CARE GUIDE

This guide is designed in three parts. Part I, Getting Started in Health Care, discusses vital sector basics including the history of major developments in Health Care. We'll also discuss sector-level drivers that ultimately influence stock prices.

Part II, Next Steps: Health Care Details, walks through the next step of sector analysis. We'll take you through the global Health Care sector investment universe and its diverse components. The Health Care sector itself presents 3 industry groups, 8 industries, and 16 sub-industries. Various firms are driven by enterprise spending, others by consumers, and some by infrastructure build-outs. Many are leveraged to combinations of these, yet others are leveraged to none. We will take you through the eight industries in detail, how they operate, and what drives profitability—to give you the tools to determine which industry will most likely outperform or underperform looking forward.

Part II also details many of the challenges Health Care firms face, including historical examples of how these challenges have been met and overcome. Moreover, we'll discuss certain products and manufacturing processes used today, as well as how they're advancing through new and emerging technologies.

Part III, *Thinking Like a Portfolio Manager*, delves into a top-down investment methodology and individual security analysis. You'll learn to ask important questions like: What are the most important elements to consider when analyzing semiconductor and PC firms? What are the greatest risks and red flags? This book gives you a five-step process to help differentiate firms so you can identify ones with a greater probability of outperforming. We'll also discuss a few investment strategies to help determine when and how to overweight specific industries within the sector.

Fisher Investments on Health Care won't give you a "silver bullet" for picking the right Health Care stocks. The fact is the "right" Health Care stocks will be different in different times and situations. Instead, this guide provides a framework for understanding the sector and its industries so that you can be dynamic and find information the market hasn't yet priced in. There won't be any stock recommendations, target prices, political stances, or even a suggestion whether now is a good time to be invested in the Health Care sector. The goal is to provide you with tools to make these decisions for yourself, now and in the future. Ultimately, our aim is to give you the framework for repeated, successful investing. Enjoy.

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GETTING STARTED IN HEALTH CARE

HEALTH CARE BASICS

Shane is having dinner with his wife Emily when he notices a strange numbness in his arm keeps him from picking up his fork. He tries to tell Emily, but numbness in his face slurs his speech. Worried, she immediately calls 911, and an ambulance arrives and rushes him to the nearest hospital. Doctors run various tests and determine plaque formation in his carotid artery is preventing adequate blood flow to his brain, causing a stroke. To treat Shane, doctors will perform a procedure called carotid angioplasty and stenting, where a small balloon will open the clogged carotid artery, and a stent (a thin, metal mesh tube) will be inserted to keep the artery open. Shane is moved and placed on a stainless steel table in a sanitized operating room. Doctors wash their hands, put on their scrubs and gloves, and use various tools and equipment to perform the procedure. Shane successfully recovers and heads to the local pharmacy to pick up his newly prescribed medicine. He later receives the bill and works with his insurance company to pay for the services rendered. Shane is thankful Emily recognized the early signs of a stroke.

This is more than a simple anecdote with a happy ending—it's an illustration of how Health Care products and services impact our