

Opportunities in Healthcare?

The market's discounting of the healthcare sector in 2023 was likely be rooted in a few concerns: 1) a hangover from higher utilization of healthcare during the Covid-19 pandemic; 2) concerns about regulatory or governmental changes in healthcare coverage (given that 2024 is an election year); or 3) something else. #1 and #2 are factors that we believe the market has recognized regularly for some time. We think that factor #3, however, has been the emergence of GLP-1 agonists ("GLP-1s").

This has been great for the manufacturers of GLP-1s, but it has sent healthcare investors running for the exits for almost any non-GLP-related healthcare company.

For the uninitiated, GLP-1s are a class of drug that include the brand names Ozempic, Wegovy, Mounjaro and others. The main indication for this class of drugs is weight loss, however, research to date has also indicated effectiveness controlling blood sugar, combatting heart disease and slowing kidney failure. We, too, are excited about the prospects of GLP-1s, and we wish we had been so astute as to purchase the stocks of the manufacturers of these drugs before they hit the market.

The results of these studies have been impressive, but the valuations of these companies are now dear. Even as we think that GLP-1s will change the medical landscape, we also believe that the indiscriminate selling across the sector was unwarranted.

First, while the weight loss and health results of this class of drugs are meaningful, users who stop taking the drugs gain back weight and lose the benefits of the drug. Further, compliance with prescriptions wasn't perfect even during clinical trials, in part because of side effects and because the drug is an injectable.

Additionally, the cost-benefit of GLP-1s as an ongoing treatment might be higher than other one-time treatments, such as gastric bypass, and therefore, it may not end up being the standard of care in all cases. Finally, and critically, we wonder if the market has made some dubious assumptions about the effects GLP-1s will have on certain segments of healthcare.

For instance, assuming that the population benefits from wholesale weight loss, is that going to result in fewer knee replacements (less weight on joints)

or more knee replacements (more active individuals)? We are not sure the answers are perfectly clear.

The market has already voted, but we question some of its conclusions. We think the dislocation created opportunity in a few companies, specifically a hospital operator, a health insurer and an orthopedic medical device company, all for which we feel the market priced far worse outcomes than warranted. If the worst cases come to pass, we surmise that they'll be ok investments. If events turn out better than assumed, the returns could be quite attractive.

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