



Reiterating OW on Healthcare

Healthcare is 15.3% of US GDP (22.4% of PCE). The largest piece of this is healthcare services as rendered by healthcare professionals, hospitals and other facilities. The smaller but even faster growing part of Healthcare is drugs, devices and equipment. As is typical for the S&P 500, the Health Care sector is more exposed to manufacturing products than delivering services. We believe growth in healthcare products will stay strong owing to an aging population and increasing efforts to treat conditions with drugs and maximize the productivity of scarce healthcare labor with as many tools and conveniences as conceivable. We believe S&P 500 Biotech, Pharma, Devices, Equipment, Supplies, Tech and Tools sit in the sweet spot of these trends. We remain cautious on Managed Care and other HC services and facilities.

Given superior growth, the sector normally trades at a 10% premium to the S&P, so the current discount is rare. We see nearly 4pts of PE upside as we believe the sector should trade at 18-20x fwd PE or ~20x trailing, if the 10yr Treasury yield doesn't significantly exceed 3%. Currently, HC is trading at a 15.5-16x fwd PE, below S&P's 16.7x.

HC trailing PE is already as undemanding at it was in 1993 during the worst of the Hillary Care sell-off back then as a 13-14 PE with 6-7% 10yr Tsy yields is more demanding than a 14-15 trailing PE with 2-2.5% 10yr Tsy yields. So valuations are similar or even less demanding now than during the bottom of the 1993 sell-off. Moreover in 1993, Democrats held a Congress majority and when Republicans took it in 1994, Hillary Care stopped. Today, Republicans control Congress.

We expect 6%+ sales growth and ~7% EPS growth from S&P Healthcare next year, and it has best sales and EPS estimates revision trends of any major sector. We also like its low cyclicality and strong balance sheets. As the biggest and fastest growing part of US GDP and household consumption, HC remains our most favored sector.

Figure 28: S&P Healthcare Trailing PE as low as during worst of Hillary Care sell-off in 1993



Source: Clarif/Compustat, Deutsche Bank

Figure 29: 10yr Treasury yields 6-7% in 1993 sell-off vs. 2-2.5% today



Source: Bloomberg Finance LP, Deutsche Bank