

MONEY MANAGERS LOOK PAST MIDTERM ELECTION UNCERTAINTY FOR LONGER-TERM GAINS ON U.S. HEALTH CARE

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Featuring Liam Schillaci, Portfolio Manager at Middlefield

U.S. health care stocks, which have struggled in recent years, appear to be on the road to recovery.

The S&P 500 health care sector, which includes pharmaceuticals, biotechnology firms, health insurers and medical equipment makers, has gained about 16 per cent this year, outpacing the 12-per-cent total return for the broader S&P 500 index.

Although the rally partly reflects investors rotating away from pricey technology stocks, some investment managers see other catalysts driving this defensive sector higher.

"We see potentially greater impact of artificial intelligence [AI] in drug discovery and drug design," says Michal Marszal, portfolio manager, equities, global health care, at CIBC Global Asset Management Inc. in Toronto.

The sector will also benefit from an aging population and steady demand for medical devices, says Mr. Marszal, who manages Renaissance Global Health Care Fund.

"I'm bullish shorter term – that is, over the next 12 to 18 months – and longer term because we have eliminated a lot of the risks," he says.

The sector surged 24 per cent in 2021 during the peak of the COVID-19 pandemic but then languished, partly because of excess inventories in medical equipment and drugs such as vaccines, he says.

There was a pickup in activity until the 2024 election of U.S. President Donald Trump, who threatened pharmaceutical tariffs and other policies that affected the health care sector negatively.

By late 2025, those threats were somewhat mitigated by the pharmaceutical industry doing deals with the Trump administration to build manufacturing plants in the U.S. There were also agreements with the health insurance and managed care industry, Mr. Marszal says.

With 60 per cent of his fund invested in biopharmaceuticals, he likes Switzerland-based Roche Holding AG (RHHBY -0.82%↓), a leader in oncology and neurology treatments with a pipeline of assets that he says should propel higher growth into the next decade.

He also owns Amgen Inc. (AMGN-Q +0.47%↑), whose clinical trials on its obesity drug will have pivotal data next year; Medtronic PLC (MDT-N +0.96%↓), an attractively valued medical-device maker, and UnitedHealth Group Inc. (UNH-N +0.45%↑), an insurer with improving fundamentals.

He bought some mid- and smaller-cap biotechs recently. They include Incyte Corp. (INCY-Q +0.46%↑), which specializes in blood disorders, and Praxis Precision Medicines Inc. (PRAX-Q +3.87%↑), which has a promising pipeline in neurology and epilepsy treatments.

The U.S. midterm elections on Nov. 3 could trigger sector volatility, he says, with the Democrats expected to win the House of Representatives and the Senate still a toss-up. "Still, there's low probability of major health care reforms on the horizon."

Liam Schillaci, portfolio manager at Middlefield Ltd. in Toronto, is also positive about the sector over the short and longer term, but says the midterm elections could impact health care.

"The midterms are a catalyst to both fundamentals and investor sentiment because the Democrats will push for more health care spending," says Mr. Schillaci, who co-manages Middlefield Health Care Dividend ETF (MHCD-T +0.39%↑).

The Democrats, who favour restoring the Affordable Care Act subsidies and reversing Medicaid cuts, could bargain with Republicans over terms of the cuts and changes, he adds.

The sector could continue benefiting from investors rotating from the AI trade, he says. "You're getting above-average growth for a market multiple, which is attractive. ... I expect double-digit earnings growth in 2027."

Health care, which accounted for 16 per cent of the S&P 500 during the pandemic-spending boom, makes up around 9 per cent of the index now, he adds. Biotechnology is the best performing subsector this year, with a gain of about 23 per cent despite a pullback on rising interest rate concerns.

Funding for biotechnology from venture capital and other sources increased sharply this year and that should drive spending in instruments used for drug discovery, he says. That's why he favours life-science tool firm Thermo Fisher Scientific Inc. (TMO-N +1.19%↑), which also offers other services.

The Middlefield ETF also holds Waters Corp. (WAT-N +2.13%↑), which makes testing instruments for pharmaceutical production. Analysis of obesity drugs has been a big demand driver, Mr. Schillaci adds.

He also likes health insurers, such as United Health and Humana Inc. (HUM-N +0.90%↑), as well as Eli Lilly and Co. (LLY-N +0.45%↑), which benefits from a rising demand for its obesity drug.

Paul MacDonald, president and co-chief investment officer at Harvest Portfolios Group Inc. in Oakville, Ont., is upbeat over the medium to long term on health care but wants to see how earnings fare in the short term.

"We see the health care sector as second to technology for earnings growth in 2027," says Mr. MacDonald, whose firm offers Harvest Healthcare Leaders Income ETF (HHL-T -0.07%↓) and Harvest Healthcare Leaders Enhanced Income ETF (HHLE-T +0.28%↑).

Among the firms reporting third-quarter results so far, "confidence is increasing in the shorter term that we're generally seeing a reacceleration in earnings," he says.

His long-term bull case is based on aging demographics, growing health care needs in developing countries and drug development and innovation, such as in robot-assisted surgeries.

Momentum in health care stocks became apparent in the summer, he says, when fund flows into U.S. health care ETFs turned positive after about two years of outflows.

Mr. MacDonald favours the undervalued medical services subsector and his top pick is Stryker Corp. (SYK-N +0.56%↑), whose products include robotic surgery, which is a "lever for growth."

Within large-cap biopharmaceuticals, he likes AbbVie Inc. (ABBV-N +0.11%↑). When its patent expired for its blockbuster Humira medication, two other drugs helped to reaccelerate growth, he notes.

Still, he says the sector is not without risks. With biopharma companies, there's uncertainty with clinical trials and the drugs' effectiveness.

"And you can't talk health care without talking about politics," Mr. MacDonald adds.

Past statements by independent Vermont Senator Bernie Sanders championing "Medicare for all" rattled insurers' stocks.

"But it's more of a headline risk than a fundamental risk," Mr. MacDonald says. "To effect policy change is very difficult."

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