Quarterly Healthcare Market Report

January 2025

HANetf & Westfield Capital Management
Harbor Health Care UCITS ETF
WELL
89 bps
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For Professional Clients Only. Capital at risk.
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This report was written by, and is the opinion of, Westfield Capital Management.
*This fund changed strategy on 12/09/2024

Health Care ETF Manager Review

Market in review

The fourth quarter of 2024 presented a complex landscape for the Health Care sector, reflecting broader market dynamics as well as idiosyncratic challenges and opportunities within the space. U.S. equity markets demonstrated resilience, with indices like the S&P 500 continuing to reach new highs, yet Health Care lagged, weighed down by persistent macroeconomic uncertainties and sector-specific headwinds. Deeply oversold conditions across many subsectors persisted, culminating in a 24-year low weighting for Health Care within the S&P 500.

A confluence of events and sentiment shifts has led to extreme levels of ETF outflows and a significant down-weighting of the sector as a percentage of the S&P. Many high-quality structural winners now trade at multiples not seen in the last decade. Additionally, biopharma assets across the cap chain made strides on the clinical and regulatory fronts but have not yet seen corresponding upward movement in market caps, with some experiencing meaningful declines. These dynamics set the stage for potential recovery in 2025, but for now, sentiment remains subdued as the sector grapples with ongoing challenges.

Quarter performance

From an industry perspective, underperformance was driven by relative weakness in small- and mid-cap biotechnology stocks, as well as a pronounced headwind from health care services. Conversely, positive contributions from medical technology and selective biopharma positions provided offsets.

Stock selection was additive to relative outperformance during the period but was outweighed by a common factor headwind. From a factor perspective, the portfolio's underweight exposure to Momentum and Earnings Yield and overweight exposure to leverage was a headwind to relative performance. This was partially offset by a tailwind from the portfolio's overweight exposure to volatility.

Contributors and detractors

Masimo Corporation, a leader in developing innovative noninvasive patient monitoring and sensor technology, was the largest contributor to relative results during the quarter, benefiting from strong operational execution and favorable investor sentiment, as well as a successful activist campaign that reconstituted the Board of Directors and ousted the long-time CEO. Westfield played an active role in this process, engaging with the Board of Directors and proxy advisors ISS and Glass Lewis to represent our investors' views.

The ETF benefitted from our significant underweight position to Eli Lilly throughout much of the fourth quarter. Eli Lilly's stock faced a downdraft following a third-quarter miss of investor expectations, driven in large part by stocking dynamics and growing competitive concerns from other pharma and biotech companies entering the obesity space. While we continue to view GLP-1 therapies as a transformative class, we remain cautious on the long-term valuation of Eli Lilly, as consensus models may underestimate challenges related to treatment persistency, pricing pressures, increased competition, and intellectual property risks. This positioning highlights our focus on risk-adjusted opportunities within the group.

Legend Biotech, a biopharmaceutical company specializing in innovative cell therapies for oncology, experienced significant price declines despite promising CAR-T pipeline developments. Despite the short-term underperformance, we remain confident in Legend's long-term market leadership and growth trajectory.

Leader in robotic-assisted minimally invasive surgery, Intuitive Surgical, Inc., also detracted from relative results due to our lack of exposure throughout the majority of the quarter. The company has a monopolistic position in the industry through their Da Vinci robotic surgery platform which increases the scale and efficiency of minimally invasive surgery. We had been out of the stock due to its elevated valuation but initiated a position in the ETF in December after meeting with management which gave us increased confidence in the potential upside to gross margins if the DV5 launch continues apace.

Buys and sells

During the quarter, we purchased Revolution Medicines, Inc., a development stage biotech company with promising drugs, in our opinion, targeted to address previously undruggable large markets such as pancreatic cancer.

During the quarter, we sold our position in biopharmaceutical developer Innoviva Inc. The stock had outperformed the broader sector year-to-date, and our thesis had played out so we felt it was no longer a best use of capital.

Industry overweights and underweight

The Biotechnology industry represents the Portfolio's largest overweight relative to the index as of 12/31/2024. Following a period of overcapitalization and investor euphoria that peaked in February 2021, we have seen a precipitous decline in valuations, all while many high-quality companies have made significant progress in the clinic and have dramatically improved intrinsic value. We also believe an unprecedented wave of merger activity could be on the horizon.

The Pharmaceuticals industry represents the portfolio's largest underweight as of 12/31/2024. We continue to believe that the industry includes many interesting opportunities, and the industry represents the third largest absolute weight in the portfolio at over 10%, however we remain underweight given our focus on risk-adjusted opportunities within the industry.

Macro Outlook

Despite what feels like a perpetual malaise toward the healthcare ecosystem, we are incrementally more constructive on the opportunity from both a relative and absolute standpoint. While there is some uncertainty surrounding the new administration's stance on the FDA, CMS, and HHS, we largely believe much of the status quo at these agencies will remain intact. Furthermore, the notion that a few individuals could drive meaningful disruption appears overblown. Key factors often cited by healthcare bulls—including innovation, value-based care, robust demographics, and M&A—remain strong potential drivers for equities, and perhaps even more so in the near term.

Regarding innovation, we are focused on long-duration assets that provide true advancements in treatment paradigms, adding value to all stakeholders. Within this subsector, we are finding opportunities across the development spectrum, including fully derisked and commercial-stage companies trading at significant discounts to intrinsic value in our opinion, which we expect to unlock in the coming year.

With the potential for a more lenient FTC backdrop, rising cash balances at larger pharma and biotech companies, and compelling valuations in biotech, we anticipate an uptick in M&A activity in 2025. We are also constructive on medical technology and equipment— a group likely insulated from political headwinds in 2025. As always, our hunt within the healthcare services space remains selective, but we see a few very compelling structural winners positioned well for multiple expansion in the coming year.

Additional sources available upon request.

Health Care ETF Details

Harbor Health Care UCITS ETF (WELL) aims to provide exposure to the secular growth and innovation of the U.S. healthcare system, while achieving alpha relative to the broader healthcare sector by investing in quality businesses with differentiated products, technologies, and services which meet the team's disciplined valuation criteria.

This includes disruptive themes such as targeted oncology, liquid biopsy, gene therapy, orphan diseases, and others that represent compelling long-term growth opportunities.

The Healthcare ETF is actively managed by the expert team at Westfield Capital Management.

Visit the WELL fund page for more information.

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