



# Healthcare: the sector where innovation is flourishing under the radar

Global Equity insights from **The Future Quality Finders**

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## Key Takeaways



- The healthcare sector is benefiting from rapid innovation, fuelled by a significant jump in COVID-led funding.
- The breakthroughs achieved during the pandemic are only just being realised, and further innovation will be fuelled by artificial intelligence (AI).
- Innovation is just one part of the investment puzzle; our Future Quality approach seeks to find companies that not only deliver solutions to the world's many healthcare challenges but also offer sustainable growth and returns.

## **"Innovation is the future delivered".**

### **-Jorge Barba**

As investors with a Future Quality ethos, our aim is to keep our portfolios ahead of the pack over the long term by seeing further and envisioning the investment opportunities of tomorrow. In short, we seek to invest in not only what is, but what will be.

In practical terms, this means monitoring the pulse of change, following the impacts of structural and demographic developments and staying alert to innovation. In recent times, the exciting and disruptive innovations surrounding AI have captured market attention. But if you look beyond the headlines, innovation is transforming other sectors by delivering new solutions to the world's most pressing requirements. Healthcare is a sector undergoing profound change so why aren't investors more excited about these innovative opportunities?

## Rapid innovation

The pace of innovation in healthcare is rapid. Just last year, the US Food and Drug Administration (FDA) approved 55 novel drugs, the second-highest figure in the last 30 years and a nearly 50% increase compared to 2022<sup>1</sup>. New healthcare models are being developed all the time and AI will likely take a major role in healthcare in the fullness of time.

The healthcare sector is particularly well-placed to offer solutions to the very pressing demographic challenges faced by society over the coming decades, such as ageing populations and the accompanying rise in chronic disease that will place a huge financial burden on governments worldwide.

In our view, investors' apparent indifference towards healthcare as an investment opportunity could stem from several reasons. Firstly, it is a technical and complex area with investors arguably needing both medical and technological knowledge to successfully seek out those companies on a path to leadership while avoiding those whose advantages are fading. Secondly, it could be argued that investors' disregard for the sector has been skewed by short-term considerations. 2023 was a challenging year for some healthcare subsectors as the COVID-driven inventory build-up for medical supplies was abruptly unwound and negatively impacted reported earnings.

## COVID supercharged healthcare investment

But in our view, those focusing on the COVID hangover are missing the bigger picture of the pandemic's positive long-term impact on the sector in terms of innovation and scientific advancement. In reality, the enormous amount of funding that flowed into healthcare innovation during the pandemic, alongside the unusual permission to move fast and break things—an adage that is normally reserved for the technology rather than the more risk-averse healthcare sector—ushered through significant healthcare developments in a matter of months that would have taken decades to achieve in normal times.

These rapid, but impactful, achievements included the development of COVID vaccines (Messenger RNA technology in particular), the building out of manufacturing capacity to make them available to the world and providing the cold-chain storage that made possible the transportation conditions required by some of these vaccines. Then as new strains evolved, the industry responded with the faster identification of these mutations and, thanks to the ongoing development of genomics databases, the industry was able to quickly recognise which new parts of the virus needed to be attacked by the vaccines to ensure efficacy.

Not only did these COVID-inspired innovations help make a tragic situation far less tragic than it could otherwise have been, but these accelerated scientific advances underpin massive healthcare changes that will unfold over the coming years and decades. For example, Messenger RNA technology is still in its infancy, but as well as being applicable for COVID-type viruses it is also being used to develop potential cancer vaccines. Gene therapies, and some of the more personalised medicines now being trialled, can provide medical professionals with a better understanding of why some people respond to certain medicines differently and more positively than others.

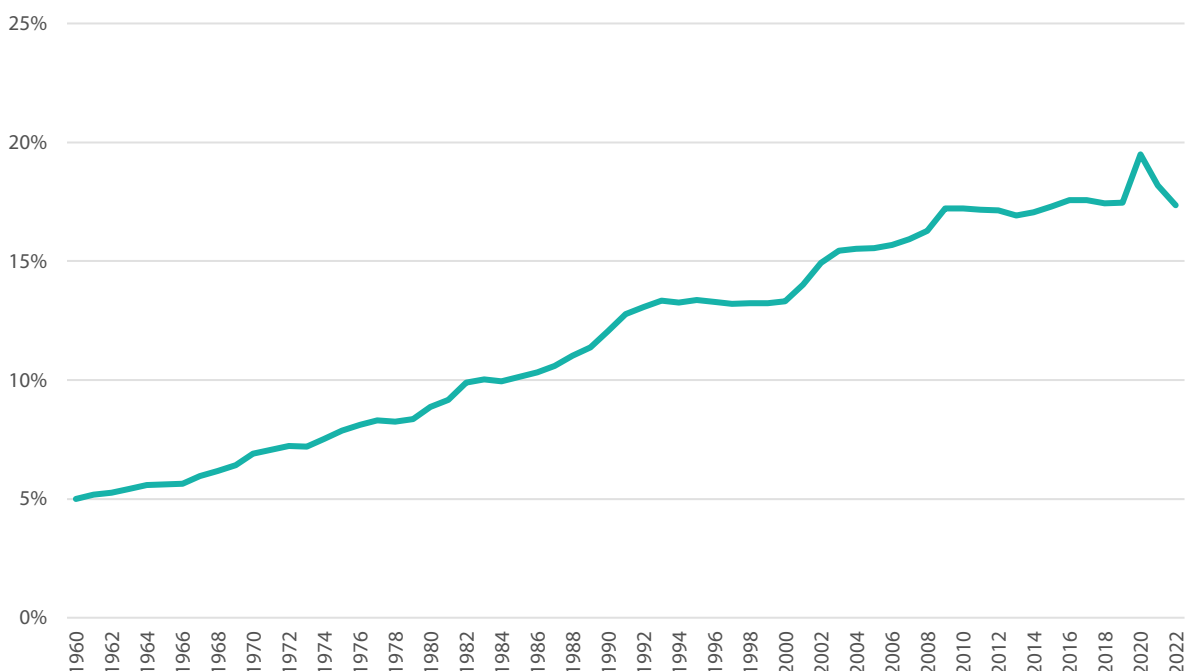
## AI-driven transformation and cost efficiency

We are also just at the emergence of witnessing the impacts AI and digital pathology will have on the sector. AI is already being harnessed to deliver better diagnostic imaging and treatment recommendations, the earlier detection of diseases such as cancer, as well as the faster identification of molecules that could lead to the development of even more new medicines. And the application of AI within healthcare is only beginning so the scope for future transformation is high.

An area of interest for us is companies that harness the power of data and AI-driven data management to demonstrate how their offering represents good value for money. In the realm of in-patient rehabilitation, US-based **Encompass Health Corporation** is a strong example of how a company can use data to present itself as a solution rather than a problem to healthcare payers. In-patient rehabilitation facilities look after patients who have suffered from a stroke or other acute healthcare episodes; having invested heavily in IT over the last decade, these facilities are now able to capture data to demonstrate that they can achieve much better health outcomes at a lower cost for the payer (i.e. governments) than other sources of care. In our view, more informed debate between facilitators and government payers could be a key differentiator of growth going forward as cost becomes ever more critical.

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<sup>1</sup> <https://www.technologynetworks.com/drug-discovery/news/2023-saw-second-highest-number-of-drug-approvals-in-30-years-382685>

**Chart 1: US healthcare spending as a percentage of Gross Domestic Product (GDP)**

Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group; U.S. Department of Commerce, Bureau of Economic Analysis; and U.S. Bureau of the Census. Data as of year-end 2022.

## Stock selection is key

While our conviction about the opportunities in healthcare is strong, our constructive view on the healthcare sector is very much built from the bottom up. While staying attuned to healthcare advances, we also aim to find companies within these areas of innovation that can meet our Future Quality criteria of being efficient with capital and attaining and sustaining rewarding returns. Right now, we see plentiful potential for above-average growth in areas such as life sciences tools, healthcare distributors and equipment suppliers. And with the right stocks, we believe the healthcare theme will benefit from a long and productive lifespan.

For more information on our global equity investment process, please download Nikko AM's new investment guide: [\*Seeing Further in Changing Times\*](#).

**If you have any questions on this report, please contact:**

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