The Post-Pandemic Opportunity for Biotech

Ryan O. Issakainen, CFA | Senior Vice President | ETF Strategist

As large swaths of the US economy were being shuttered earlier this year to help mitigate the fallout from the coronavirus (COVID-19) pandemic, the biotechnology industry unleashed its capacity for innovation, creating new methods for testing, therapeutic treatments, and vaccines for COVID-19. Progress in these areas has been achieved at an unprecedented pace, and numerous clinical trials are currently ongoing. As the economy reopens, many are depending on the success of newly created therapeutics and vaccines to save lives and avoid future lockdowns. Indeed, the last few months have demonstrated the critical importance of a robust biotechnology industry.

As an investment theme, biotechnology has also worked relatively well during the crisis; the NYSE Arca Biotechnology Index reached a new all-time high in June. Nonetheless, we believe the industry's best days may still lie ahead. In our view, the events of the past few months help to improve the long-term outlook for these stocks, which may benefit from more efficient regulation, industry consolidation, and a rehabilitated public image.

Regulatory Efficiency

In the Fall of 2019, the FDA introduced a plan to make substantial investments modernizing its technical infrastructure to more efficiently process data.[1] But the COVID-19 crisis has further stimulated improvements in regulatory efficiency, representing one of the most important long-term consequences of the crisis for biotechnology companies, in our view. The urgency of the crisis forced regulators to reevaluate potentially outdated methods and consider new ways to streamline clinical trials. In the years ahead, these adaptations may enable biotechnology and other health care companies to bring new products to market more quickly, improving outcomes for both patients and shareholders. In a speech given earlier this month, FDA Commissioner Stephen Hahn, M.D. stated,

"To the extent that innovations and adaptations we implemented during the pandemic crisis worked and would be appropriate to implement outside of a pandemic situation, we will incorporate them into standard FDA procedures. And to the extent that we identified unnecessary barriers, we will remove them. This is one of my top priorities. Permanent change, where needed, will take place..." [2]

Industry Consolidation

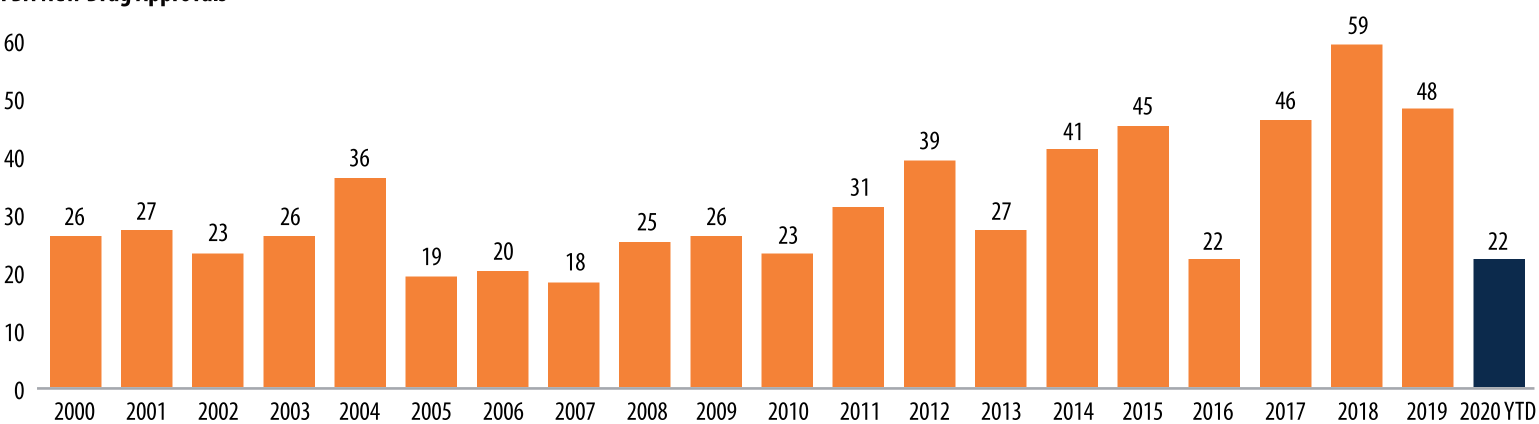
Another potential byproduct of the COVID-19 pandemic may be an increase in industry consolidation, which has historically been an important contributor to biotech stock returns. Over the past several months, numerous companies have entered into new partnerships, seeking to accelerate innovation and leverage one another's strengths. As they discover the benefits of these synergies, some may choose to make them more permanent via mergers & acquisitions. While near-term liquidity needs could delay certain deals from being proposed, several large health care companies have ample cash to consider such transactions, in our opinion. The ten largest pharmaceutical and biotech companies in the S&P 500 held an average of $10.7 billion in cash on their balance sheets, as of 6/9/20.

Improved Public Opinion

According to a Gallup poll conducted last summer[3], Americans viewed the pharmaceutical industry more poorly than any other industry. In our view, this made the sector a relatively easy target for politicians from both parties—especially during an election year—and raised concerns about potential price controls. However, considering the work that biotechnology and pharmaceutical companies are doing to address the COVID-19 crisis, more recent polling suggests public opinion has begun to shift. A Harris poll from April showed that 40% of respondents had a more positive view of the pharmaceutical industry than they did before the pandemic began.[4] Over the past couple months, hopeful news coverage related to potential COVID-19 vaccines and therapeutics has likely continued to bolster public opinion. As the public's admiration for biotechnology and pharmaceutical companies grows, we believe politicians may choose to focus on other issues than drug prices, reducing the near-term risk of price controls.

Of course, these issues are secondary to the most important driver of long-term returns for biotechnology stocks, namely, the cutting-edge, life-saving products they are developing, including areas such as immuno-oncology and gene therapy. And, as biotech companies have embraced the power of cloud computing, AI learning, and big data analytics to enhance research & development capabilities, innovation has accelerated. Despite the COVID-19 crisis, the FDA approved 22 new drugs during the first 5 months of 2020 (none of which were COVID-19-related).[5] For context, this total is roughly 50% higher than the previous five-year average (14.4 new drug approvals) at this point in the calendar year. In our view, accelerating innovation, supported by more efficient regulation, a more positive public image, and the potential for increased industry consolidation provides a compelling long-term case for biotechnology stocks.

FDA New Drug Approvals



Source: FDA. For illustrative purposes only.

[1]Source: FDA. *"FDA's Technology Modernization Action Plan (TMAP)"*
[2]Source: FDA. *"Remarks by Commissioner Stephen Hahn M.D. - The COVID-19 Pandemic - Finding Solutions, applying lessons learned"*
[3]Source: Gallup. *"Big Pharma Sinks to the Bottom of U.S. Industry Rankings"*
[4]Source: Fierce Pharma. *"Pharma's reputations has soared during COVID-19 pandemic, poll finds"*
[5]Source: FDA. *"Novel Drug Approvals for 2020"*