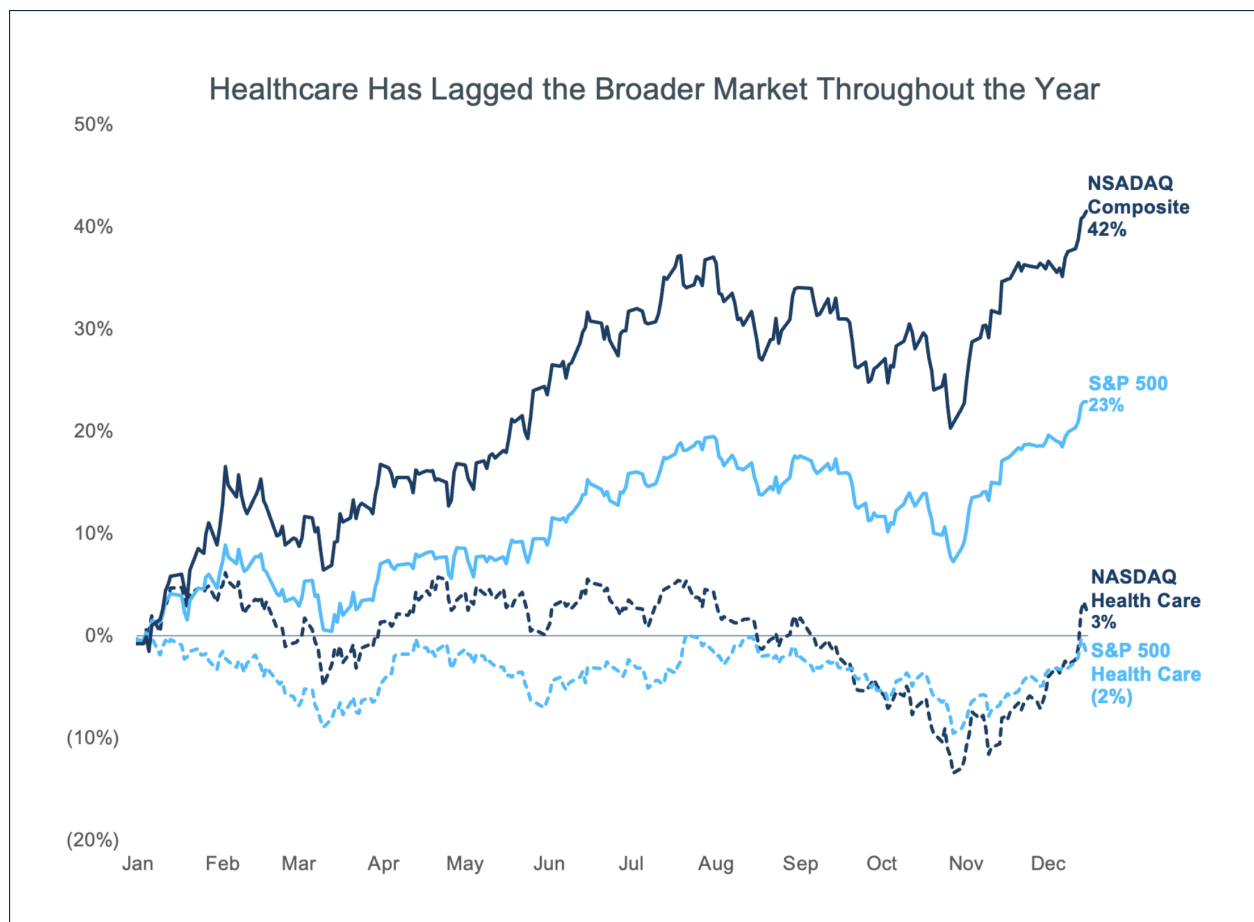


Turning the Page on a Challenging Year for Healthcare Equities and Looking Ahead to 2024

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2023 has been a roller coaster of a year for healthcare equities. A stronger-than-expected January faded throughout the balance of Q1. A sense of stability, and even some generalist engagement, around the end of the summer rolled into a bruising September pull-back that worsened in October. And, just as investors were ready to declare 2023 as one of the worst years in memory, November brought a rally that has put the sector indices within striking distance of ending the year in the black. And, along the way some turmoil among regional banks further added to the chaos.

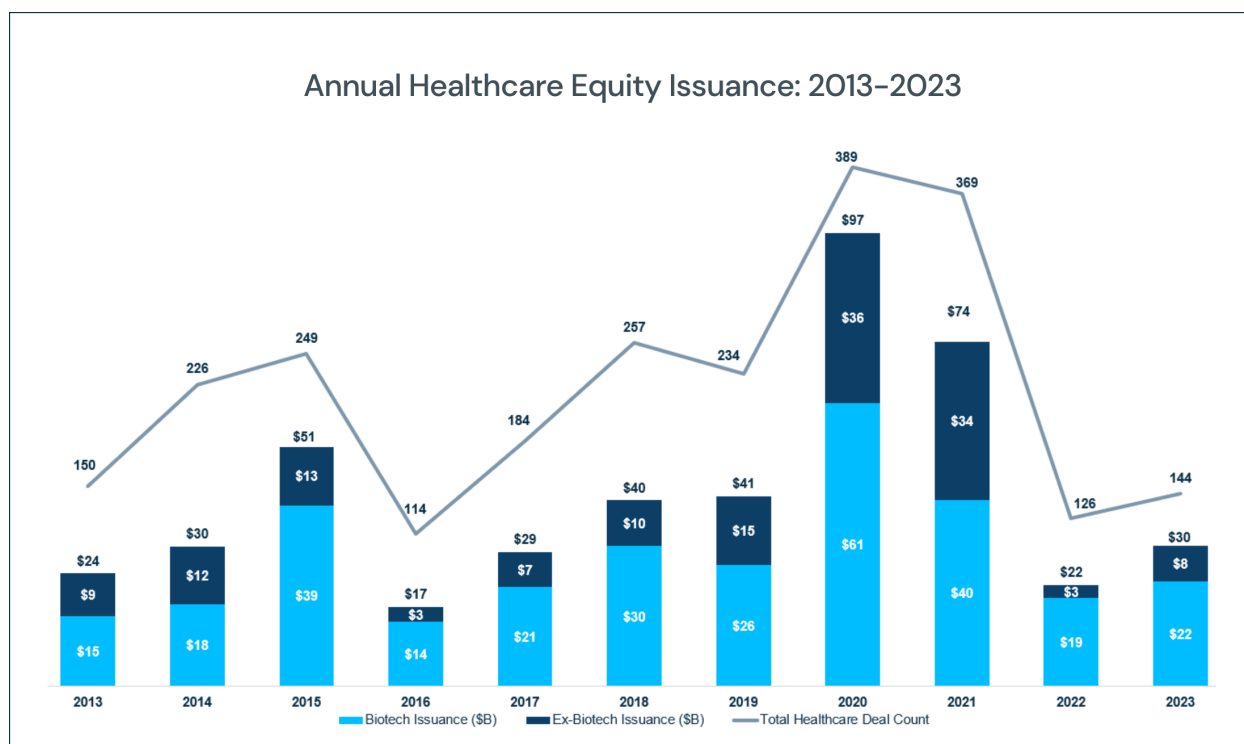


Source: Bloomberg. Note: Current data as of 12/15/2023.

While each sub-sector has faced its own unique challenges, a few common themes emerged:

- **It's tough to buck the macro:** Healthcare is thought to be a defensive sector in times of economic uncertainty, but the rate environment and the fragile prospects for a soft landing proved to be a sector-wide headwind that was impossible to ignore.
- **Haves and have-nots:** Across the board, we're seeing a flight to "quality", though that means different things for different subsectors.
- **Renewed focus on capital efficiency and discipline:** There is widespread acknowledgment that at least some of the pain inflicted was a necessary and healthy recalibration of valuations and budgets. Business models that can only work in the most constructive capital market environments are being changed or being punished.

Despite the sector's underperformance, healthcare capital formation increased relative to last year. Aggregate deal value was up across biotech and non-biotech alike, with the re-emergence of some larger deals that had been missing throughout 2022. The \$30B raised this year represents a 39% increase vs last year, and only 9% less than the 2013-2019 (pre-covid) average.



Source: Factset. Bloomberg, Press Releases. Current data as of 12/15/23.
 Note: Includes transactions >\$30mm deal size. Excludes RDOs and PIPEs.

Pockets of Optimism Amidst a Sea of Pain in Biopharma

From many perspectives, it was a productive year for the biotech sub-sector. Issuance was up in aggregate, M&A deals were happening, and there were streaks of positive clinical and regulatory events. However, throughout much of the year, it felt as though the default sentiment was negative and the bar was extremely high to reach “escape velocity.”

On most days, the answer to the question, “Why is the XBI moving [in either direction]?” was, directly or indirectly, “the Fed.” There is no denying the impact that the historically rapid rate-hiking cycle has had on the sector. While there are some direct impacts to DCFs in terms of the present value of distant-future earnings, most of the impact boiled down to sentiment around when generalists may feel safe, let alone compelled, to wade back into a sector with low liquidity and risks aplenty. Regulatory concerns from the FTC and the impact of the IRA also added some unwelcome nuance.



Source: Bloomberg. Note: Data as of 6/15-12/15.

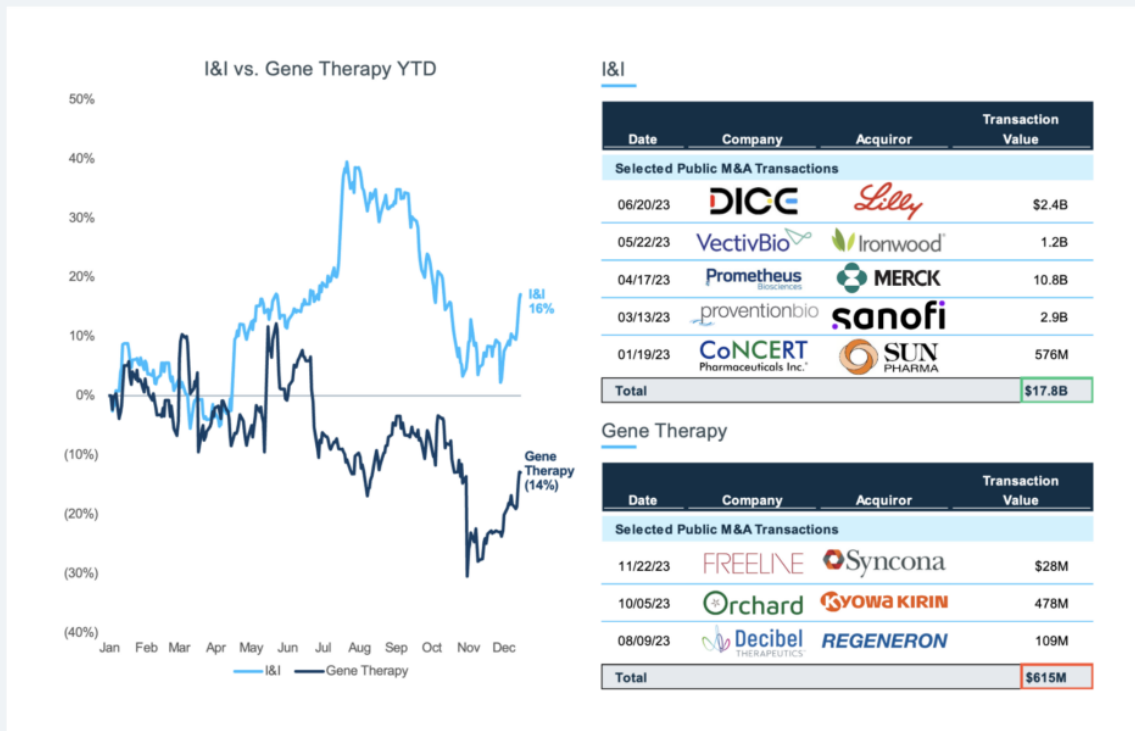
(1) The iShares 20+ Year Treasury Bond ETF seeks to track the investment results of an index composed of U.S. Treasury bonds with remaining maturities greater than twenty years.

The haves and have-nots dynamic played out in a few different ways within biotech:

- Late-stage clinical data and commercial companies have been favored over early data sets and pre-clinical companies.
- Obesity, inflammation & immunology (“I&I”) and central nervous system (“CNS”) companies have attracted strong interest while oncology and genetic medicine remain challenging.
- Strength of balance sheets and shareholder rosters are being closely scrutinized.

Case Study: Haves & Have Not

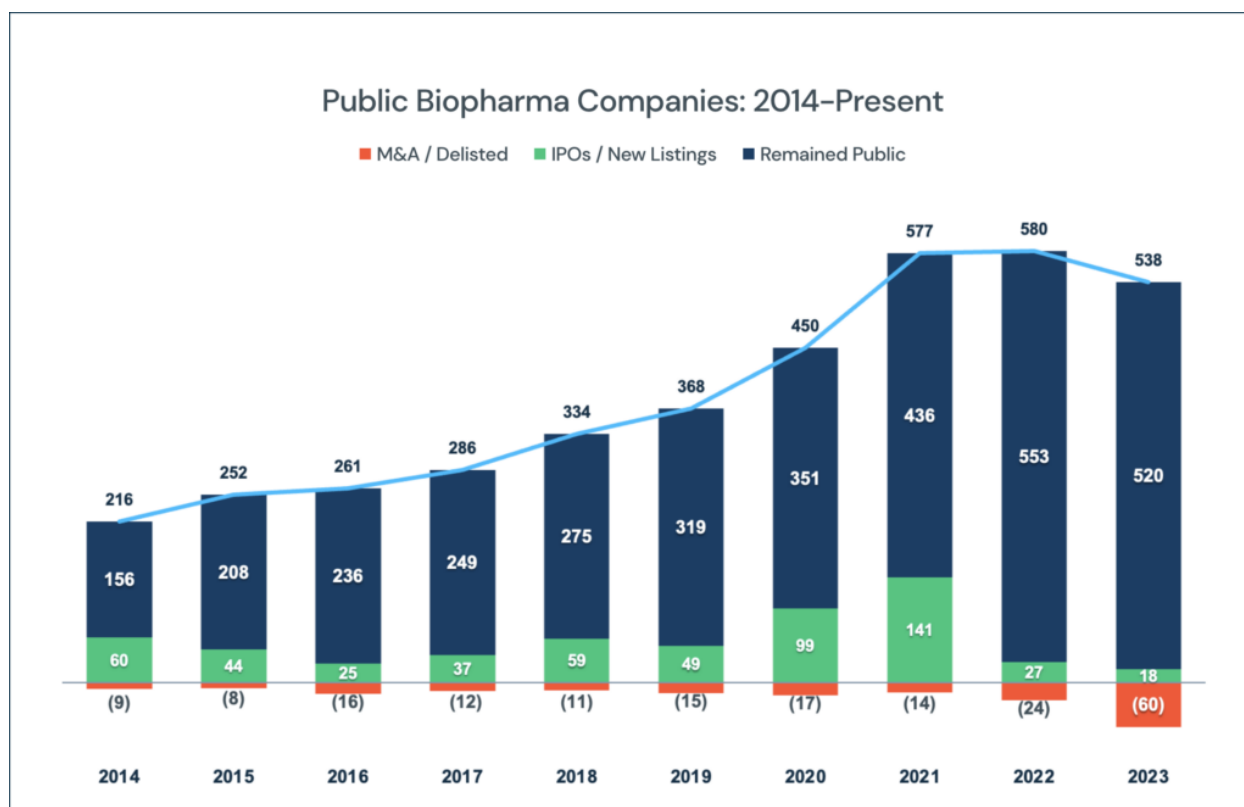
SMID-Cap M&A has propelled strong performance in I&I, while gene therapy has failed to generate returns.



Source: Bloomberg and press releases. Note: Current data as of 12/15/23.

With investors crowding into a small number of common themes and companies, everyone else has been forced to reckon with the challenging financing environment. Shareholders are demanding that companies do everything possible to bring spend under control and maximize the value of every dollar. Announced workforce reductions were up over 50% compared to last year, and each passing quarter brought portfolio rationalizations, discontinuations and strategic alternative processes.

And, for the first time in at least 10 years, the year will end with fewer public biotechs than when it began.



Source: Bloomberg, Press Releases. Current data as of 12/08/23.

Note: Includes U.S. listed companies classified as biopharma by Bloomberg.

Other Healthcare Sub-Sectors Biding their Time

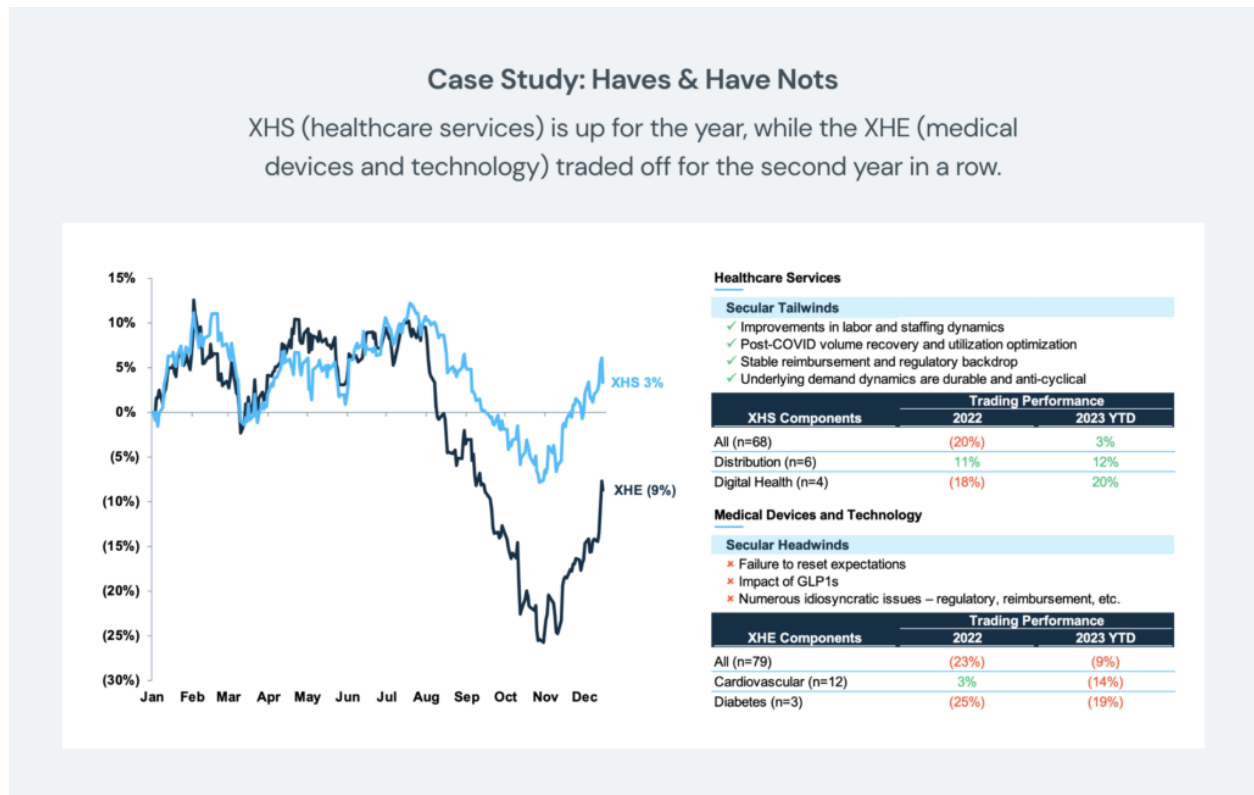
It was a similarly challenging year for much of the public healthcare universe beyond biotech. The S&P healthcare index has been below water for substantially the whole year as investors evaluate whether sentiment and valuations have sufficiently reset to reward strong execution.

The Fed's impact was felt as debt became more expensive at the same time equity valuations compressed, leaving nowhere to turn for cheap funding. Sponsor M&A activity has been dampened by the heightened cost of capital, and the spectre of a potential recession loomed large for much of the year.

Here too, haves and have-nots emerged as investors triaged which sub-sectors were sufficiently safe to wade back into:

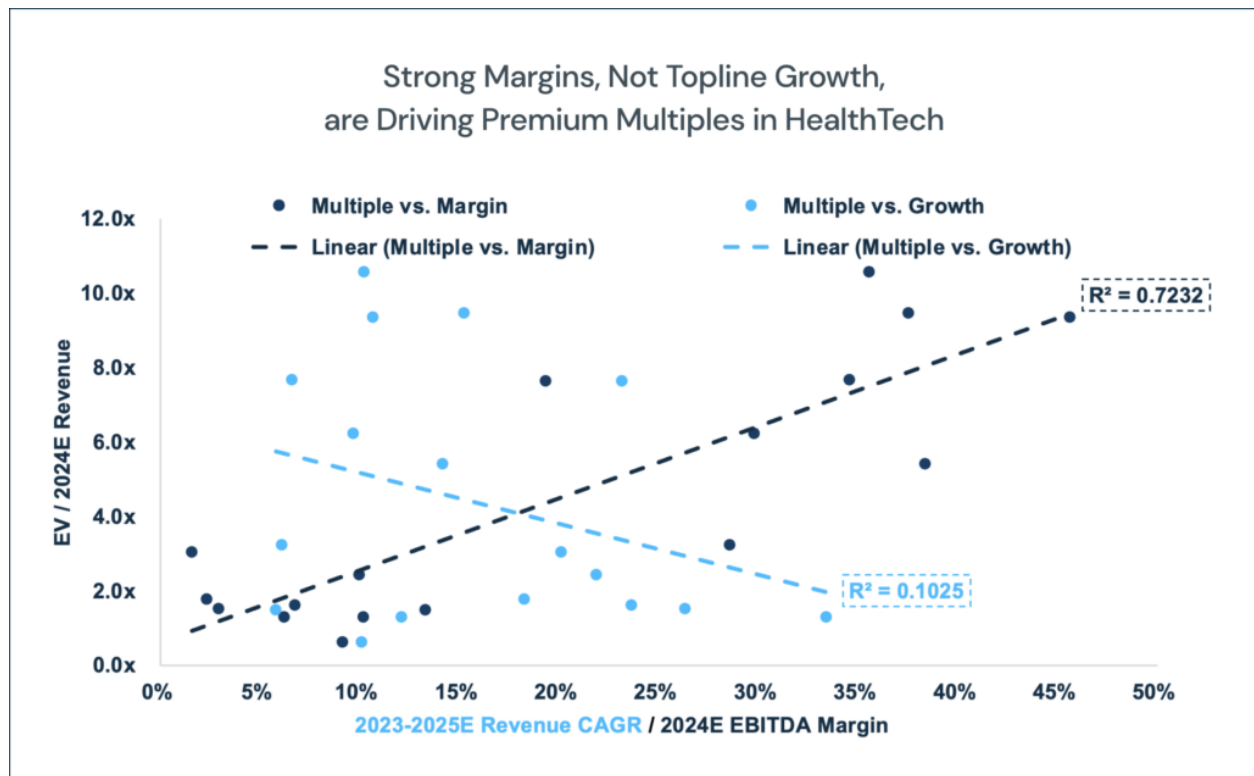
- The S&P Healthcare Services ETF (XHS) has stabilized after trading down significantly in 2022, with its digital health and distribution components among the strongest contributors.
- The S&P Healthcare Equipment ETF (XHE), on the other hand, has yet to find its footing, losing nearly a third of its value over the last two years, with cardiovascular and diabetes-

focused companies being hit disproportionately hard.



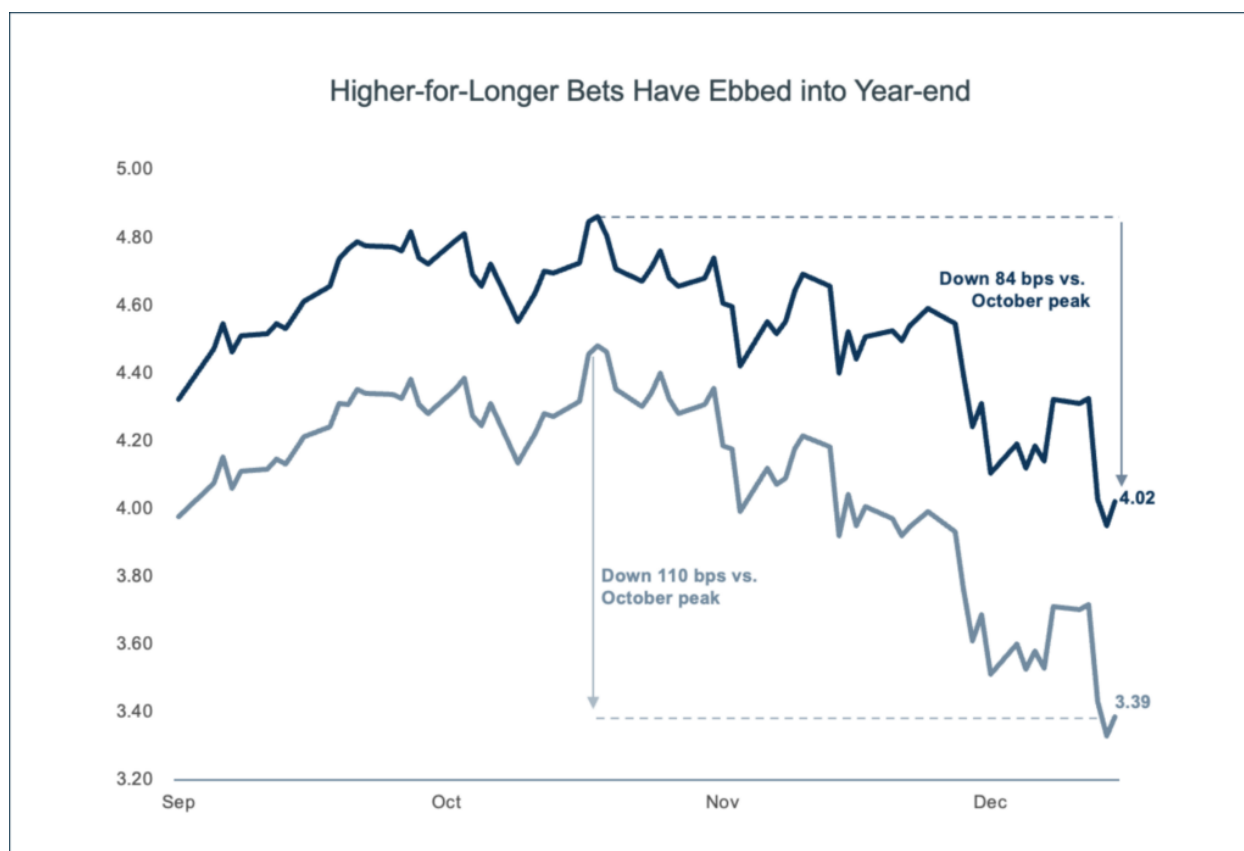
Source: Factset. Data as of 12/15/23.

And, the focus on profitability, or at least a roadmap thereto, has played out across the market. Growth-at-any-cost has fallen out of favor, and many of the high-flying growth stories of the bull market have been among the hardest hit.



Outlook for 2024

As we look forward, we're optimistic that declining rates, continued M&A, and reasonable valuations can make next year a productive one for the capital markets.



Source: Bloomberg. Note: Current data as of 12/15/2023.

With strong execution against more grounded business plans, we can once again restart the cycle of value creation and capital redeployment that fuels the sector. As the high watermarks of the COVID era fade from memory, more and more sellers will wade back into the market opportunistically. And, the number of high quality private companies that would make attractive public stocks has never been greater. We're aware of dozens of IPO candidates that are closely monitoring the market, and several have taken tangible steps to preserve the option to go public in the first half of next year. Investor interest in meeting these companies has been strong, with full testing-the-waters schedules and well-attended private company conferences, though it remains to be seen how that ultimately translates in terms of breadth of new investor participation.

Encouragingly, healthcare investors continue to raise large funds and actively evaluate new opportunities, which is a testament to the sector's resilience and its importance, to the economy and society as a whole.

We hope you find time to relax and recharge over the holiday season, and we look forward to helping you navigate the ever-changing healthcare landscape in 2024.

Cheers!

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