

## FORCES SHAPING THE GLOBAL HEALTH-CARE INDUSTRY

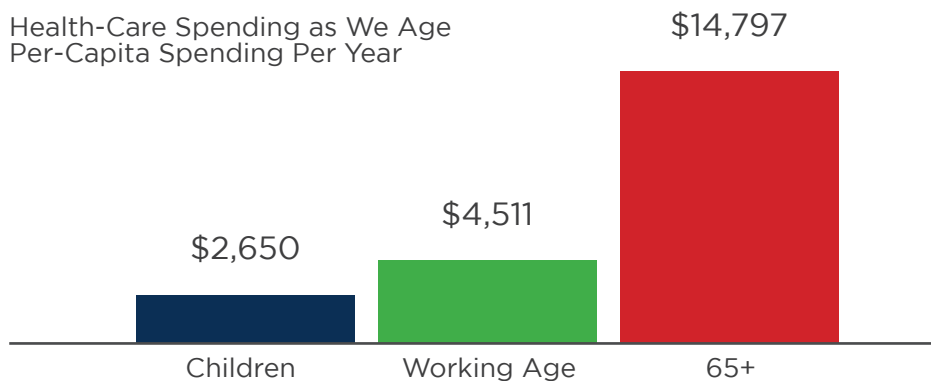
The health-care industry is undergoing many changes, from government reforms to ground breaking drug development. The three main drivers of the Healthcare sector are: the aging population in the developed world, the growing middle class in emerging markets, and scientific innovation. At WT Wealth Management we have an overweight on the sector and continue to allocate investor dollars to healthcare ETFs.

### AGING POPULATION IN THE DEVELOPED WORLD

A recent United Nations report stated that the percentage of people in developed countries over age 65 will rise from 17% today to 24% by 2035. Aging populations put significant pressures on health-care systems. According to the National Institutes of Health, in the U.S. approximately half of lifetime health-care spending occurs after age 65 (Figure 1). For the health-care industry, this means two things: More people will seek more (and more expensive) health-care services, so demand and volumes will rise, but the strain on public spending will likely necessitate cost controls throughout the industry. Private-sector health-care companies will need to implement efficiencies, create scale, and maintain market power in order to succeed.

FIGURE 1

Health-Care Spending as We Age  
Per-Capita Spending Per Year



Data is from 2004 and includes public spending. Children: 0-18; Working Age 19-64; 65+: Age 65 and older.  
Source: Center for Medicare and Medicaid Services

### GROWING MIDDLE CLASS IN THE DEVELOPING WORLD

Another important and largely positive trend for the health-care industry is the globalization of services across Emerging Markets. Higher health-care spending is strongly linked to income level: According to the World Health Organization, high-income countries spend an annual average of more than \$3,000 per capita on health care, compared to just \$30 per capita in low-income countries. Across Emerging Markets, the middle class is growing, and we expect those consumers to drive volume growth in therapeutic drugs and medical services by 10% a year for the next several years. China will be a particularly important factor. The Brookings Institution estimates that China's middle class will increase from approximately 10% of the population in 2009 to over 70% by 2030.

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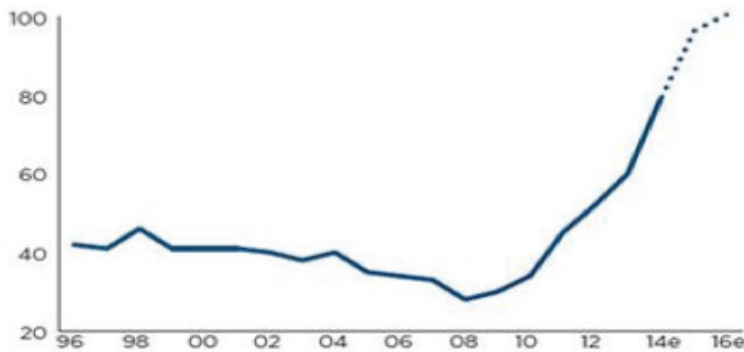


## SCIENTIFIC INNOVATION AND DRUG DISCOVERY

After years of low research and development during the global recession productivity and concerns about patent expirations, the pace of innovation in the biopharmaceutical industry has picked up sharply, with new, approved drugs entering the market at an accelerating rate (Figure 2). This highly productive R&D cycle could lead to substantial value creation and be a major tailwind for the industry.

**FIGURE 2**

Approved Innovative Drugs\*



\*Innovative drugs must have unique mechanisms of action and be first-in-class. Figures reflect actual number through 2013 and expected approvals from 2014-2016

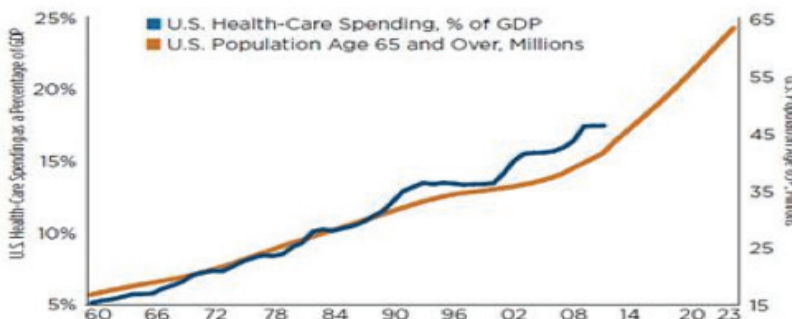
Source: Credit Suisse

## THE IMPACT OF U.S. HEALTH-CARE REFORM

Rising health-care costs have been increasing as a share of U.S. GDP and are likely to rise further as baby boomers age (Figure 3). In 2013, the U.S. government spent a total of \$3.5 trillion, of which approximately 17% went to Medicare and 8% to Medicaid. Those are massive numbers, and they represent key long-term risks to the U.S. economy and financial markets. The Congressional Budget Office projects the budget deficit will shrink to 2.6% by 2015 but then increase to 6.5% by 2038, and it expects spending on the major health-care programs to increase from 5.6% to 8.1% of GDP over the same period. The social costs of an expensive, inefficient health-care system are high as well. Although the U.S. spends more than any other developed country on health care our outcomes appear to be worse. The National Research Council has found that Americans of every age-except those over 80 years old-have higher mortality rates than other developed countries. 3 Finally, fully 15% of the country does not have health insurance. While the ultimate impact won't be known for years, The Patient Protection and Affordable Care Act (ACA) has three main objectives: expand health-insurance coverage, improve the quality of health care for consumers, and limit health-care costs. To fund increased access to insurance, the ACA decelerates the growth of Medicare payments, levies taxes on individuals, and imposes new fees on insurance, pharmaceutical, and medical-technology companies. While the ability of

**FIGURE 3**

The Inexorable Rise in Health-Care Spending



Source: Centers for Medicare and Medicaid Services

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WEALTHMANAGEMENT

ACA to control costs is still debatable, the law directly addresses access to coverage, with insurance exchanges and an expanded Medicaid program already reducing the number of uninsured Americans.

Many experts believe that the current fee-for-service system, in which hospitals and providers are paid for each test or service they provide, is partially responsible for the steep rise in medical costs, as providers are effectively incentivized to perform more tests and services, whether they are necessary or not. However, over the past several years we've seen a powerful trend developing as financial risk and cost-reduction incentives are shifted from payers (including health plans, employers, and government entities) to providers and consumers. We are optimistic that these shifts will keep costs down and move the system away from fee-for-service and toward a fee-for-value model.

The ACA accelerates these shifts in a number of ways. It encourages the formation of accountable care organizations (ACOs) that tie provider reimbursements to quality outcomes and cost-reduction efforts. It also penalizes hospitals for excessive re-admissions, expands Medicare and Medicaid anti-fraud and abuse programs, and imposes a 40% excise tax on sponsors of plans deemed overly generous in 2017 and beyond.

## CONCLUSION

Health care is exciting. The industry has become a significant global economic growth driver. Profound changes-including shifting global demographics, scientific innovation, and cost pressures-present challenges and opportunities for providers, consumers, policy makers, and investors. Rising demand, both from an aging U.S. population and larger Emerging Markets middle classes, is a positive for the industry, although consumers, businesses, and governments will push back as prices climb.

In the U.S., consumers will assume a greater share of health-care costs as public exchanges and individually purchased insurance plans supplant employer-sponsored group coverage. This more consumer-driven system will undoubtedly become more price sensitive. For investors, the ability to identify companies that can adapt to lower cost structures and higher volumes while still retaining pricing power will be key.

At WT Wealth Management we have been and our increasingly bullish on the Healthcare Sector. We believe this is a sector that every investor should have exposure to through the next decade.

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