Wellington Global Health Care Equity Fund

WELLINGTON MANAGEMENT®

MARKET REVIEW

Global equities rose in August despite significant market volatility. Exacerbated by an abrupt unwinding of the Japanese yen carry trade, equities fell precipitously at the beginning of August amid an uptick in recession risks and fears of excessively restrictive monetary policy in the US. However, markets rebounded amid optimism that the US economy can achieve a soft landing. Federal Reserve Chair Jerome Powell cited an impending rate cut during his Jackson Hole symposium speech stating, "the time has come for policy to adjust." Against a backdrop of declining inflation and softening global economic growth, monetary policy easing gathered pace in August as the central banks of England, Sweden, New Zealand, and Mexico lowered interest rates. The Bank of Japan faces a higher bar to raise interest rates in October after its rate hike in July destabilized markets and caused a sharp spike in the yen. Global economic data was mixed, highlighted by broad signs of cooling inflation across the global, tepid growth in Europe hindered by weak manufacturing in Germany, and a softening US labor market. Geopolitical risks remained highly elevated; the war between Ukraine and Russia escalated after Ukrainian forces breached the Russian town of Kursk, while the humanitarian catastrophe in Gaza continues to destabilize the region.

The MSCI World Health Care NET returned 5.5% over the period. Within the index, all of the sectors rose over the month. Biopharma large cap and biopharma mid cap were the top performing sectors, while health care services and medical technology were the bottom performing sectors for the period.

FUND PERFORMANCE AND ATTRIBUTION

- The fund modestly underperformed the index for the month, however delivered overall positive returns.
- Sector allocation, a result of our bottom-up stock selection process, was the primary driver of relative underperformance. Allocation effect was driven by our out of benchmark allocation to biopharma small cap and underweight to biopharma large cap, but modestly offset by our underweight to medical technology. Stock selection however, contributed to returns. Strong selection in biopharma large cap and health care services was partially offset by selection in biopharma mid cap.
- At the issuer level, our top two relative contributors were not owning Pfizer and an out of benchmark allocation to Acadia Healthcare, while our top two relative detractors were out of benchmark allocations to Guardant Health and agilon health.
- Pfizer is a diversified large-cap biopharma company. Not owning the stock benefitted relative performance. Despite reporting a beat and raise second quarter earnings report, investors remain cautious on the company's ability to execute. Guardant Health is a SMID-cap genetic diagnostics company offering early cancer screening capabilities. The stock was weak in August after FDA approved the Shield blood test as a primary screening option for colorectal cancer but with a more cautious label than the street anticipated. Later in the month, a bearish sell-side report also weighed on the stock.

FUND POSITIONING AND OUTLOOK

Biopharma remains a rich environment for innovation. We are excited about developments among GLP-1 and next-generation metabolic medicines, ADCs for cancer treatment, and various modalities of genetic medicines. We remain selective in large-cap biopharma, avoiding companies with significant patent expirations and risk of future drug pricing pressure. US drug pricing remains a risk to watch, but the first round of Medicare negotiated prices released in August were generally favorable. Ultimately, we think the pricing risks are manageable and continue to find opportunities in companies with rich pipelines and strong track records of productive business development. A number of SMID-cap biopharma companies remain well positioned as sources of innovation and potential solutions to pipeline gaps for larger companies, and equity raises have created opportunities to add to high conviction names at attractive prices. Recent positive clinical readouts across therapeutic areas underscore the quality and breadth of the opportunity set today.

We believe medical technology innovation has never been stronger due to advancements in technology development, engineering capabilities and integrated informatics. Product cycles, procedure recovery, and biopharma innovation are creating investment opportunities. Areas of most interest to us now include interventional cardiology, life science tools, robotics, and diagnostics including liquid (blood) biopsy.

Health care services companies remain well-positioned to help solve the societal challenge of rising health care costs and to benefit from the ongoing transition from a fee-for-service to a fee-for-value care system. Higher utilization and rate pressures remain medium-term headwinds for Medicare Advantage but long-term opportunities remain robust. Providers should benefit from higher utilization and behavioral health companies have bipartisan political support in the US. Broadly, we favor companies focused on improving patient outcomes while reining in costs as well as scaled-based players with rising regional market share.

At the end of the period, our largest exposures were biopharma large cap and health care services and we were least exposed to biopharma small cap and biopharma mid cap. From a regional perspective, our largest exposures were North America and Developed Europe & Middle East ex UK and we were least exposed to Emerging Markets. We had no exposure to Developed Asia Pacific ex Japan.

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