

Making the News: BioTech Investments

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There is the news that you read, and then there is the news that you see. The news that you read might have been reasonably reliable ten years ago but more and more of the citizenry is finding broad-based media to be unreliable due to increasing inherent bias. The news you see is what is before you and what you can believe. Your former “trusted news” sources maybe can’t be so trusted anymore. Those who need reliable news information in their daily lives have had to adapt from “trusted news” to “news skepticism”. I can’t speak for others, but as an individual who consumes news as one component of many that goes into the investment decision-making process, I’ve had to change my news reading habits to include a much broader range of publications in recent years. It is no secret that more of us get our news online and that big tech (and big money) has come to dominate the distribution of that news. Further, the biggest distributors of information has been distilling itself down to fewer and fewer major publishing company owners, and therefore it is those owners of the distribution channel that can demand how news stories are presented to the public. Some have come to understand this, many more may not be as aware.

I remember a time in the back half of the last century and before the taking down of the Berlin Wall that the Soviet Union tried to control the information flow that those in Western Russia and Eastern Europe could obtain. The term at the time was “The Iron Curtain”, a reference to the silencing and filtering of outside news to the public at large. This was countered by a source known as “Radio Free Europe”, an effort to provide those same restricted populations with a free flow of supposedly “unbiased” information from the west. It is somewhat of a paradox, but today we have events that are occurring in the Western Hemisphere where big media appears to control narratives and information flow. Sometimes those news narratives favor one political party or the other. This is not lost on the free-flow of capital and it may be having some effect on global markets. It has been said that the stock market is so efficient that what is known has already been discounted. OK, maybe there is truth to that, but what if that which is “known” turns out to have been “propaganda”? Last month there was considerable news about the potential invasion by Russia into the borders of the Ukraine. Could we trust what we were being told? The popular media in North America has pushed the narrative that an invasion was imminent, yet

other news sources from Europe seemed to challenge the term “imminent”. In other news last month, the massive protest by Canadian truckers in Ottawa, Canada’s capital city, was viewed by many of the populace as an important passive event to bring to light the supposed “unfairness” of mandating a “proof-of-vaccination” in order to pass through the Canada-U.S. border. Yet some publications gave broad support for those making the rules. Time will tell how the public comes to view our modern mass media and whether or not they will be deemed to be the purveyors of truth or simply communist-like propagandists. Should it be the latter, look for more and more “underground” media distribution channels sooner than later.

The purpose for mentioning this is because the U.S. stock market appears to be focused more and more on the biggest stories coming from the nation’s largest news distributors in this New Year. When the news reports that a Russian invasion is moments away, more often than not there has been a sell-off of stocks and bonds. When it has been reported that an agreement may be close at hand, rebounds dominate the action. When it appeared the protests in Canada may be more harmful to the supply chain, markets would sell off. When the Canadian police arrived on the scene, stock market futures were up. And so it goes. As long-term investors, we should be doing our level best not to allow every news headlines throw us off the saddle from our well-rationalized longer term strategies. Rather, it is far more important **to stay focused on the big economic trends**, and to make minor adjustments as the evolving news events prove to have a more lasting impact than just a momentary headline.

Many socio-economic conditions that were dominating the landscape in 2020 and 2021 were continuing that domination coming into 2022. The Federal Reserve may have waited too long to throttle back the massive amounts of monetary stimulus and may have missed the most ideal time to start raising interest rates. Of course, that is an issue of debate. The consequence is still the same in that we have had too much money chasing too few goods and that has been driving up prices, creating product and service shortages. Politically, the shutting down of large swaths of the economy as a response to a new and unknown virus might have been an over-reaction that has put into motion a major reset of things we used to take for granted, like a “just-in-time-inventory” and expecting local stores to have a full inventory of goods on hand. We are waking up to a country and an economy that has changed for the first time in

a few decades, and as investors, that may have an impact on some of our assumptions and data going forward.

Based upon the above, I have maintained a strategy that can only be called “defensive”. More specifically, I would like to see lower than usual allocations to growth stocks, preferring instead to focus on those sectors that are more likely to benefit from (or at least hold up better) in an inflationary environment. So far in 2022, this strategy appears to be a very good one, but we got here while having to endure some under-performance in the back half of 2021.

Even though stocks can (and do) go down in price, we hold them more for the long-term benefits in a portfolio than for short-term cash needs. More specifically, we should always have some exposure to stocks to some extent, but that doesn’t mean we can run wild and just buy whatever is fashionable at the moment, a strategy much embraced by some on Wall Street and more generally by those with little to no lasting investment experience. I have always believed that the best way to build wealth through stock ownership is to buy stocks (and stock sectors) when they are out of favor with the masses and when you can get them at (or near) fire sale prices. You are rarely going to be able to buy them at the ultimate lows, but that is never the objective. We simply want to know that we got them at what would seem to be very exceptional values based upon the history that we know of. I call this “Planting the Seed for the Potential of the Next Great Return”. *[Of course, no one can predict what will happen next in any market.]* For the past seven years, there was time to own gold and silver miners at historically low valuations, and although that is a longer than usual time to ‘plant the seed’, I have always believed that our eventual returns will be multiples of our original investment somewhere in the not-too-distant future. In the fall of 2020, there was an exceptional opportunity to buy into hydrocarbon-based equities (oil and gas producers and processors); the planting of that seed gave almost immediate reward and gratification, and most of us still own them. Last year that sector was the best performer of the S&P500 Index. Today, I believe the Biotech sector may be a consideration.

For many reasons, the Life Science and Biotechnology sector of the market has fallen from grace among institutional investors, large investors, and speculators alike. In fact, valuations in this category have fallen to among the lowest levels witnessed in over twenty years. There are reasons, but none of those appear (to me) to be

permanent. I strongly suspect that an improvement could take place before this year is out. Let me share some information, but let's first define what Biotech is -- Within the Life Science industry there are companies that seek to develop new compounds that address unique and challenging issues affecting human health such as immunology and genomics, and then there are companies that manufacture these compounds, others distribute them, and still others prescribe and manage them. Biotech is the first of these; they are at the front end of this process.

Within publically-traded stocks, this category of equities is well known to be the most volatile. You need to know that if you do decide to go into this space, you are acknowledging that the component stocks can go way up and way down. Further, not all companies achieve their end goals, and nearly all of them must raise significant amounts of working capital so that can result in frequent stock dilution as well as occasional business plan terminations. Over the course of recent history (about 50 years), this sector has been amongst the highest performing. The biggest challenge to small investors is whether to target just a few individual stocks or alternatively, buy into a larger basket of them.

At this particular stage, many biotech stocks are trading well below their long-term business value while some are even priced below the value of the cash on their balance sheet, so this may be an opportunity to enter at unusually low prices (and by definition, valuations). Part of the reason for this can be attributed to the desire by more and more venture capitalists to focus on pre-IPO opportunities, but that also means buying into companies that may not have even begun their product development. The process of getting a compound from "proof of concept" to final FDA Approval can be both extensive and expensive and in many cases can be up to a decade and beyond. Stifel has analysts that cover this sector.

By the way, the current lower valuation on many stocks in this sector would make sense if the long-term growth potential has collapsed, but that is not currently the case. In fact, it may be quite the opposite. There are several events, both science-related as well as within the political hierarchy that may be about to benefit the industry in meaningful ways. It often takes courage to buy stocks that are down significantly in price, and this is a sector where 60% to 80% declines are not uncommon at all. However, this is a sector that has a history of beating the S&P 500

by following periods of significant underperformance, and this latest one appears to be more severe than most.

There is one other important consideration. The pharma industry is sitting on way more cash than at most points in the past. Sometimes it makes more sense for big pharma to buy new and novel compounds from others than to develop them internally. Future mergers or acquisitions could change the landscape quickly. This is not a sector for the faint of heart, but at this particular point in time, I believe this should be given a good hard look. Let me close by saying that my earlier comments above of potential distrust of the news media could apply to the life science stocks too. Great stories of a cure for cancer or Alzheimer's or other life-threatening conditions are easy ones to spin. They can also create passionate responses. This is an area of the market that can be quite promotional in nature and there is a history of past stock swindles that have occurred in this space. Forewarned is forearmed; you will definitely want to be sure to trust your sources!

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Typical February weather at Stifel