

INDUSTRY TIMELINESS: 74 (of 97)

After a sharp selloff in December, the Drug Industry rebounded nicely during the first quarter of 2019. A relatively solid Q4 earnings season, coupled with easing macroeconomic tensions were key catalysts, helping to offset soft 2019 guidance from a few of the bigger players and lingering political scrutiny related to drug pricing. In our view, the Fed's abrupt pivot on interest rates also provided significant support to recent equity market improvement.

All told, the XPH ETF, which tracks the performance of the broader pharmaceutical industry, has increased roughly 12% in value since January 1st, compared to a 10% uptick in the Dow Jones Industrial Average and a 13% gain on the S&P 500. According to our Timeliness Ranking System, the Drug Industry boasts a few attractive options for year-ahead relative price performance, but the sector as a whole is currently expected to lag in 2019.

Patent Losses

Branded drug companies are gearing up for another wave of high-profile patent expirations in 2019. Some notable assets expected to face increased generic competition include Pfizer's nerve pain medication *Lyrica*, GlaxoSmithKline's respiratory drug *Advair*, and Roche's cancer treatment *Rituxan*, among several others. Meantime, the world's best-selling drug *Humira* (made by *AbbVie*) lost exclusivity in several key overseas markets in the fourth quarter, resulting in significant erosion in its cornerstone rheumatoid arthritis franchise (roughly 60% of total revenue). Management anticipates a 26%-27% pullback in international *Humira* sales in 2019, which would equate to a loss of about \$3 billion.

Drug Pricing

Drug pricing continues to be among the most hotly-debated topics on Capitol Hill. With healthcare costs soaring to uncomfortable and seemingly unstable levels, large pharma has been faced with intense political pressure to alter their respective pricing practices. Thus far, the industry has been reluctant to make meaningful concessions. Swiss drugmaker *Novartis* was recently in the news due to the approval of its \$88,000 a year multiple sclerosis drug *Mayzent*. Indianapolis-based *Eli Lilly* also found itself in the crosshairs for hiking the price of its widely used insulin *Humalog*.

Cannabis Gaining Traction

In our last issue, we introduced several new companies operating in the cannabis space including *Canopy Growth*, *Aurora Cannabis*, and *Tilray*. The first mentioned is the current leader in terms of sales and market capitalization, but the industry is still in its early stages of development and all three could potentially yield attractive long-term gains. The opening of the Canadian recreational market in October was a real game changer, helping to fuel strong fourth-quarter sales growth and increased 2019 projections. In 2019, the focus increasingly shifts to U.S. markets, where the pro-legalization movement appears to be gaining steam. Indeed, ten states currently allow recreational sales of cannabis and 33 have legalized it for medicinal use.

Opioid Crisis

Opioid concerns have heated up in early 2019 on reports that privately-held Purdue Pharma was considering bankruptcy to resolve its outstanding cases. The maker of *Oxycontin* has been hard by opioid-related lawsuits that accuse the drugmaker of aggressively marketing the painkiller and fueling a drug epidemic that caused widespread death. Given the potential cost of litigation, Purdue's long-term sustainability has been called into question. It recently reached a historic \$270 million settlement with the state of Oklahoma.

The heat on Purdue has cast a shadow on other drugmakers who previously marketed and sold opioids, including *Endo International*. The company pulled its *OPANA ER* product from market in 2017 at the request of the FDA, but it still faces a tidal wave of pending lawsuits. *Endo's* stock has significantly underperformed since early March, right around the time that the Purdue news broke.

Dividends

The Drug Industry has developed a reputation of paying consistent and relatively generous dividends to its shareholders, specifically within the large pharma space. Several of these equities also maintain strong scores for Safety and Price Stability, which enhances investment appeal for those seeking to reduce risk within their portfolios.

Conclusion

Based on our Timeliness Ranking System, the Drug Industry has declined in recent months, losing six spots since our January report and currently ranks in the bottom third of sectors under *Value Line's* coverage (74th out of 97) in terms of year-ahead relative price performance. As a result, the majority of the equities herein are pegged to either track or underperform the broader market in 2019, but there are a few standouts including *AstraZeneca*, *Eli Lilly* and *Merck*, all of which garner our Highest rank (1). *Zoetis* is another appealing option for investors seeking a pure play in the increasingly attractive animal health segment.

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