As we approach the fourth quarter of 2013, the Medical Services Industry has picked up steam through much of the year. It now sits within the top-25 of the *Value Line* rankings.

The Obama Administration has tailored the forthcoming Affordable Care Act (large-scale implementation starts in 2014) to boost transparency and vastly increase the number of Americans that have healthcare coverage. Critics have come out in droves, but the end result from an investment standpoint is that a vast majority of people have cycled into this sector looking to cash in on the positives that this new legislation is expected to bring.

For sure, some sectors will get a bigger boost than others; however, at the moment basically all of the stocks in our coverage stand at a higher price point then they were three months ago.

As far as the industry goes, utilization is at near record lows at the moment. Patients are putting off most nonemergency procedures in order to wait until 2014 when the landscape will be much rosier, and probably much cheaper. Still, as has been the case for many years, reimbursement rates will need to be monitored closely. Medicare Advantage plans are tabbed for a decrease, and the effects of this decision are already reverberating through the field. Needless to say, there are a lot of moving parts at this juncture, but the end result should be an overwhelming net positive.

HMOs Making Moves

Utilization has been low of late, and earnings have risen in tandem. The noticeable acquisition of late was *Aetna* picking up Coventry for $7.3 billion. Adding lives before an expected uptick in volumes should pay dividends in the near term.

When details on the Affordable Care Act were first released, the health maintenance organizations put up the biggest stink. Placing spending floors on individual accounts has the potential to wreak havoc on their medical loss ratio, and subsequent earnings levels. Presently, the cream of the crop, like *Aetna* and *UnitedHealth Group*, have shown why they are the industry leaders and are well into the adjustment period that needs to be incurred to alter their business models. Other entities may struggle, but the general belief is that their is still plenty of profit to go around.

Even though the outlook is getting brighter, there are still serious concerns about Medicare Advantage platforms. The government is in cost-cutting mode, and reimbursements here will likely be under the ax in 2014. We recommend keeping an eye on the companies that have elevated exposure here.

Hospital Consolidation Trend

Hospitals should be the primary beneficiary of the reform that is set to go into effect next year. With that, getting bed counts higher to meet the increased demand has become priority number one. Those with the financial capabilities to cash in on this strategy should jump to the head of the class. *Tenet Healthcare* and *Community Health* have both made moves to do just that.

Tenet purchased Vanguard Health Systems for $4.3 billion in the summer. *Community* has inked a deal valued at $3.9 billion to buy smaller rival *Health Management Associates*. That company's rural footprint adds another layer to *Community's* base and will have it enviously positioned when millions of more Americans have health insurance beginning in 2014.

INDUSTRY TIMELINESS: 21 (of 97)

Duopoly Deals With Competition

The laboratory testing field is dominated by its top two players, dubbed the duopoly, *Quest Diagnostics* and *Laboratory Corporation of America*. Both concerns have seen their once stellar growth rates taper off, as potential patients are eschewing trips to the doctor's office until what most experts believe will be an uptick in volumes in 2014 to coincide with the launch of the Affordable Care Act. Getting patients into doctor's offices will result in more testing, which should raise all boats.

At the same time, as more and more hospitals snatch up physician groups, a greater portion of the testing is being kept in house and thus not being shipped out to labs. We do not believe this is a long-term concern, as we envision this consolidation trend will fade when the reform is fully enacted. Still, it is darkening an already dim period for the duopoly.

Once volumes pick up, however, we expect these two companies to bounce back quickly. New, high-profit (esoteric) screens for areas like cancer and cardiovascular disease should be in high demand, and once again get growth rates for both revenues and earnings back on track.

Conclusion

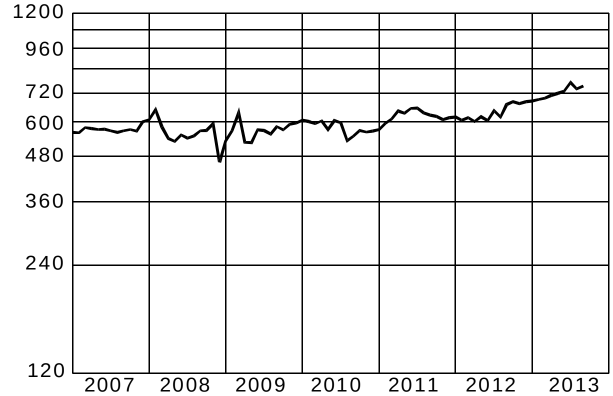
The Medical Services Industry is charging hard as we head to the close of 2013. Bright futures abound for many companies in our Survey. On that note, there are several plays for momentum investors, and some that should appeal to those with a longer-term bent. The road may get bumpy at times, as this level of reform is basically unprecedented in this field, but the cream always rises to the top.

We highly recommend that subscribers examine each of the following pages before deciding which investment vehicle provides their portfolio with the cleanest bill of health.

Erik M. Manning

Medical Services

RELATIVE STRENGTH (Ratio of Industry to Value Line Comp.)



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