Bi-Weekly Report

February 12, 2021

Managed Care Benefits from Administration Change

Biden Aims to Strengthen the ACA; 'Medicare for All' Passage Unlikely

Bottom Line

After a prosperous Obama administration, the Managed Care industry dealt with significant policy uncertainty and volatility during the Trump administration. Republicans advocated for repealing and replacing the ACA, while Progressives championed 'Medicare for All'. Enrollment slowed, health plans changed, and the existence of private insurance was threatened.

The Biden administration represents a big change for the Managed Care industry. Biden intends to strengthen the ACA, which was passed during his vice presidency. In addition, Democrats control Congress, which we view as positive for the ACA rather than negative. The policy headwinds from the last four years should ease, and the policy uncertainty discount should lower.

Main Points

▶ **Trump Administration Created Uncertainty & Weakened Affordable Care Act**

- The Trump administration used government agencies and executive actions to weaken the ACA. The result was lower ACA and Medicaid enrollment growth compared to the Obama administration.

- Managed Care's relative performance vs the health care sector suffered due to policy volatility and uncertainty under the Trump administration.

▶ **Biden Administration Intent on Strengthening the Affordable Care Act**

- In our view, investors are overestimating Democrats' ability to push through 'Medicare for All'. Joe Biden campaigned on strengthening the ACA, and the party's congressional majority is narrow.

▶ **State Budget Shortfalls & Headline Volatility are Two Key Risks**

- Medicaid is counter-cyclical, meaning enrollment and spending rise during economic downturns. The risk is states modify managed care contracts in an effort to balance budgets.

- The risk is the ACA remains subject to policy uncertainty and 'Medicare for All' remains in the headlines. Under this scenario, Managed Care stocks would likely remain volatile.

▶ **Favor Managed Care Stocks; iShares' IHF Provides a Suitable ETF Alternative**

- We prefer to own individual managed care stocks to gain direct exposure to the Biden administration policy catalysts. As an alternative, iShares' IHF ETF offers 41% exposure to the Managed Care industry.

Report Summary

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Position Details

Position Type
U.S. Sector / Industry

Position ID
USEQ.2021-21

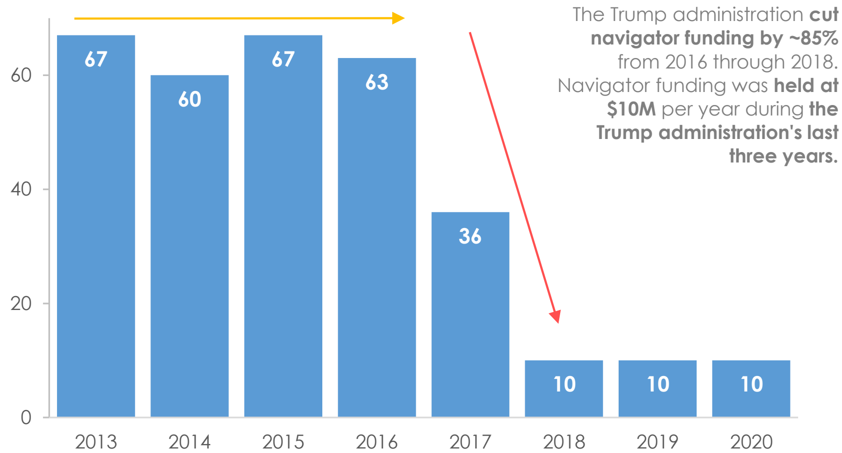
Ticker(s)
Stocks: ANTM, CI, CNC, HUM, MOH, UNH or ETF: IHF

Benchmark
S&P Health Care Sector (XLV)

Research Portal →

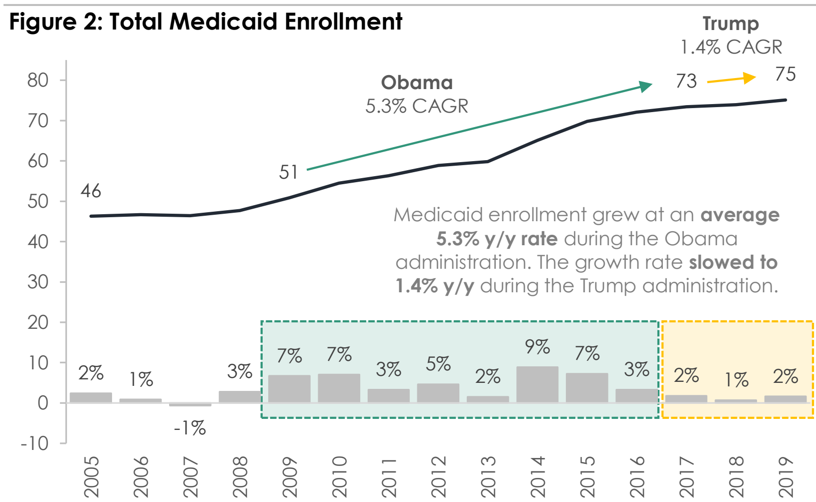
Trump Administration Actions Slow Enrollment

Figure 1: Total CMS Navigator Grants by Year



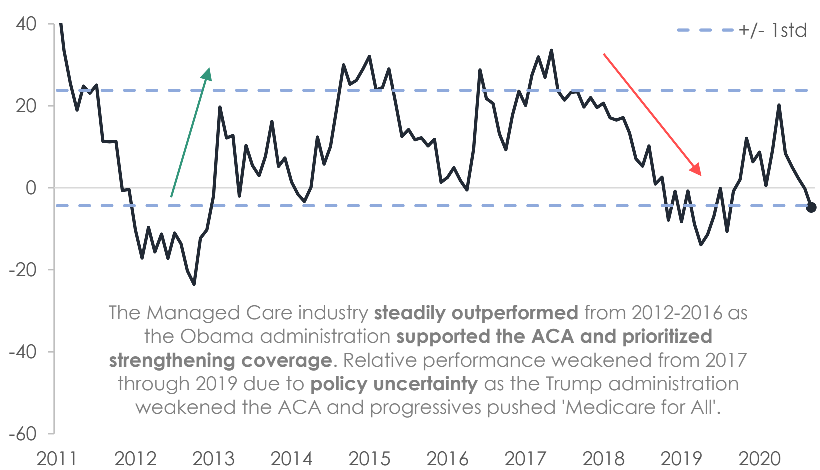
Source: MarketDesk Research, Centers for Medicaid & Medicare Services

Figure 2: Total Medicaid Enrollment



Source: MarketDesk Research, Centers for Medicaid & Medicare Services

Figure 3: Managed Care's Rolling Y/Y Relative Return vs Health Care



Source: MarketDesk Research

Trump Administration Cuts Navigator Funding by 85% From 2016 to 2018 …

- Figure 1 charts CMS's navigator funding. The Obama administration launched the navigator program in 2013 to provide outreach, education, and enrollment assistance to consumers eligible for ACA and Medicaid coverage.
- Navigator funding ranged between $60 million and $67 million during the Obama administration. The Trump administration cut navigator funding by 43% in 2017 and an additional 72% in 2018. The Trump administration held annual navigator funding steady at $10 million in both 2019 and 2020. The result was a 50% drop in the number of navigator organizations, with some states and cities not served by the navigator program.

Medicaid Enrollment Slowed During the Trump Administration …

- Figure 2 charts both total Medicaid enrollment and y/y growth from 2005 through 2019. Medicaid enrollment spiked during the Obama administration after the ACA expanded Medicaid eligibility.
- The Trump administration initially sought to repeal and replace the ACA. After multiple unsuccessful attempts, the administration turned to government agencies and executive actions to weaken the ACA. The policies, which included cutting navigator funding and granting innovation waivers, resulted in lower Medicaid enrollment during the Trump administration.

Policy Related Headwinds Cause Managed Care to Underperform …

- Figure 3 charts managed care's relative performance against the broad health care sector. Managed care outperformed on a relative basis during the second half of the Obama administration. The industry's volatility increased during the Trump administration and relative performance was weaker.
- We attribute managed care's performance headwinds to attempts to weaken the ACA (refer to Figures 1 & 2) and concerns about 'Medicare for All' (e.g., eliminating private health insurance option). The performance headwinds continued in January 2021 after Democrats won both Georgia Senate runoff elections. There is a concern Democrats will pass 'Medicare for All' with control of Congress and the White House.

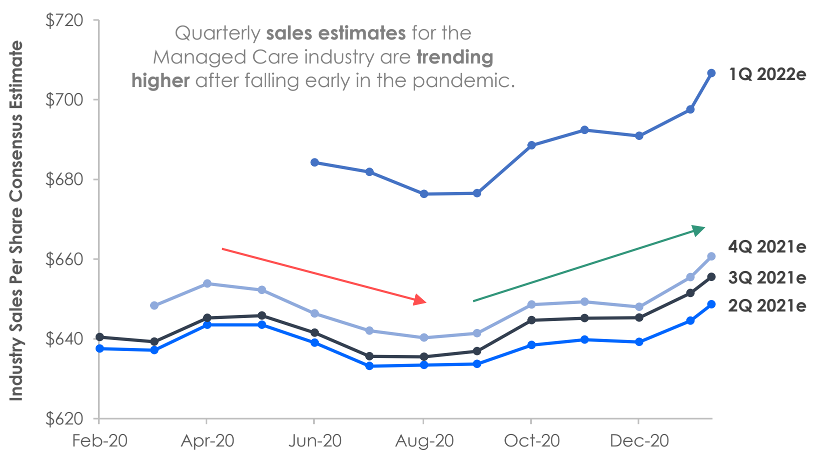
Biden Administration Actions & Valuation Discount

Figure 4: Potential Biden Administration Actions to Strengthen ACA

Complete	Category	Biden Administration Action	Potential Impact on Managed Care
✔	Enrollment	Reopen enrollment period, which Trump administration cut in half	↑ Enrollment – Another Opportunity to Sign Up
	Advertising	Increase navigator funding to provide outreach & enrollment assistance	↑ Enrollment – Simplifies the Process & Provides Additional Outreach
	Subsidy	Expand subsidy eligibility to include higher income level households	↑ Enrollment Increases Affordability
	Waivers	Reverse Trump's waivers letting states waive certain ACA rules	↑ Enrollment Strengthens Coverage

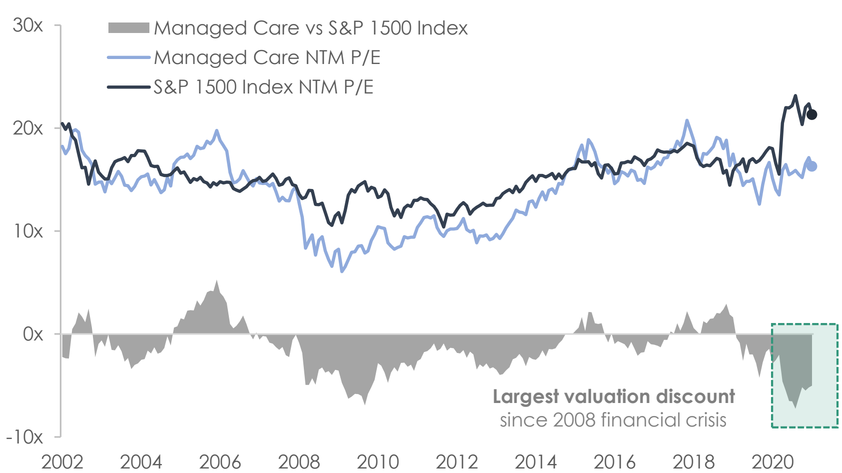
Source: MarketDesk Research

Figure 5: Managed Care Industry Consensus Sales Estimates



Source: MarketDesk Research

Figure 6: Managed Care NTM P/E vs S&P 500



Source: MarketDesk Research

Democratic Control of Congress is Positive for Managed Care …

- Joe Biden campaigned on bolstering the ACA and reversing the Trump administration's policies that were designed to weaken it. The table in Figure 4 lists the actions the Biden administration is considering to strengthen the ACA.

- In our view, investors are overestimating Democrats' ability to pass 'Medicare for All'. Joe Biden campaigned on strengthening the ACA, and the party's congressional majority is tight. Instead, we believe the Democrats' first step will be to increase enrollment using a combination of the actions listed in Figure 4. A decrease in policy volatility and increased enrollment would be welcomed by managed care executives.

Sales Estimates Trending Higher After Falling During the Pandemic …

- Figure 5 tracks quarterly sales estimates for the Managed Care industry over the past 1 year period. The sales estimate history shows the downward revisions early in the pandemic, which troughed around September 2020 before steadily trending higher into 2021.

- We attribute Managed Care's upward sales estimate revision to the change in presidential administration. The Trump administration enacted policies designed to weaken the ACA (**Figs 1 & 2**), while the Biden administration is committed to strengthening and expanding the ACA (**Fig 4**). After facing headwinds under Trump, we believe Managed Care will return to growth under Biden.

Managed Care Trades at Biggest NTM P/E Valuation Discount Since 2009 …

- Figure 6 compares the relative NTM P/E valuation gap between Managed Care and the S&P 1500. Managed Care trades at the biggest NTM P/E valuation discount since 2009.

- With markets trading near all-time highs and concerns about irrational exuberance, Managed Care's NTM P/E provides a margin of safety. In addition, the industry is defensive and not tied to the speculative activity occurring in corners of the stock market. We view Managed Care as attractive opportunity to lower portfolio beta in the months ahead.

State Budget Shortfalls & Headline Policy Volatility

Key Risks — State Budget Shortfalls & Headline Policy Volatility …

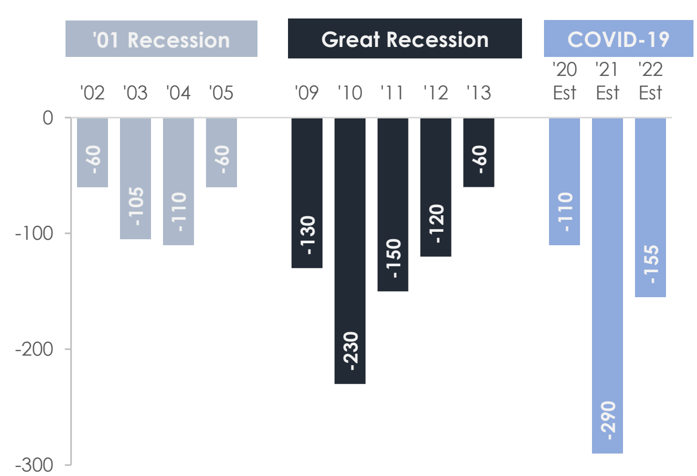
There are two primary risks to a tactical Managed Care position. Stressed state and local government budgets could cause reimbursement and coverage cuts. At the Federal level, progressives in the Democratic party continue to push for a single-payer healthcare system. Headline 'Medicare for All' risk could make managed care stocks more volatile.

#1 State Budget Shortfalls & Federal Funding: Medicaid is jointly funded by the federal and state governments. The funding mixture ranges from $1 in federal funds for every $1 in state funds to 90% funding for select services and populations. States sign multi-year contracts with managed care organizations (MCOs) and administer the program in accordance with federal guidelines. The contracts usually give states flexibility to renegotiate rates, impose risk corridors, and restructure contracts.

Medicaid is counter-cyclical, meaning enrollment and spending rise during economic downturns. Recessions, such as the current COVID-19 pandemic, increase stress on state and local government budgets. Declining economic activity translates into lower tax revenues, while rising unemployment and Medicaid populations mean higher expenses. Without increased federal funding, states are forced to respond by reducing benefits, tightening eligibility, or cutting provider payments.

The risk is states act on their ability to modify MCO contracts in an effort to cut expenses and balance their budgets. If states modify contracts, MCOs face the threat of lower revenues and decreased profit margins. While states will likely modify contracts, we view the risk of major restructurings or modifications as low. We believe the Biden administration and Democratic Congress will step in to increase federal funding to support the ACA during the pandemic.

Figure 7: Estimated COVID-19 State Budget Shortfalls ($Bn)



Source: MarketDesk Research

#2 Headline Policy Uncertainty: The ACA endured attacks from both Republicans and Progressives during the Trump administration. Republicans pushed to repeal and replace the ACA, while Progressives pushed 'Medicare for All'. The pressure from both sides weakened Managed Care's relative performance. **Figure 3** shows Managed Care's underperformance headed into the 2018 mid-terms.

'Medicare for All' remains a priority for the progressive wing of the Democratic party. There is also growing acceptance within the broader party, as highlighted by the attention the issue received during the 2020 Democratic primary. Democrats' control of Congress gives the Progressive wing a louder voice to push for single-payer healthcare.

The risk is the ACA remains subject to policy uncertainty and 'Medicare for All' remains in the headlines. Under this scenario, Managed Care stocks would likely remain volatile. While the ACA is likely to remain in the headlines, we view the probability of 'Medicare for All' passing as low given Democrats' narrow majority in Congress and Joe Biden's stated position of strengthening the ACA. In our view, the Managed Care industry should be subject to a lower 'policy uncertainty discount' under the Biden administration compared to the Trump administration.

Trade Implementation — Focus on Managed Care Stocks

This tactical Managed Care position is focused on gaining exposure to MCOs. The Biden administration already made clear its intention to strengthen the ACA. The actions listed in **Figure 4** are designed to increase enrollment and undo the Trump administration's efforts to weaken the ACA. A smaller uninsured population and expanded coverage are both positive for the health care sector. Within the health care sector, our preference is to gain exposure to the companies with contracts to manage the various state Medicaid programs.

In our view, the timeline for this tactical position is 6-12 months. The ultimate duration depends on how quickly the Biden administration works to implement its own healthcare policies and reverse the Trump administration's policies. Washington, D.C., moves at its own pace, and the change in presidential administrations and control of Congress will keep the city occupied in the coming months. In addition, the number of introduced bills generally spikes at the start of new Congresses as legislators jockey to prioritize their bills. This could result in significant 'Medicare for All' discourse during 1H21.

Refer to page 5 for individual stocks and an ETF.

Impacted Stocks & ETF

Figure 8: Selected Managed Care Stocks & ETF

Ticker	Company	6 Mo Return	Description
Managed Care Stocks			
ANTM	Anthem	6.9%	Provides life, hospital and medical insurance plans
CI	Cigna	15.4%	Provides health insurance services
CNC	Centene	-3.1%	Operates as a multi-line healthcare enterprise
HUM	Humana	-9.9%	Offers health insurance coverage and related services
MOH	Molina	8.9%	Provides health care services to persons eligible for Medicaid
UNH	UnitedHealth	4.5%	Provides hospital and medical service plans
ETF			
IHF	iShares U.S. Healthcare Providers ETF	17.5%	Offers ~41% exposure to the Managed Care industry; Remainder of exposure is split between Services (35%), Facilities (12%), Technology (11%), & Life Sciences (1%)

Source: MarketDesk Research. ***Note:*** *The benchmark for this tactical opportunity is the S&P Health Care Select Sector Index (XLV).*

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