THE DRIVE YOU DEMAND

U ACCESS (IRL) NEXTHERA UCITS

Quarterly Comment | Q2 2019

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

Markets

- Global equity markets were up +3.23% during the second quarter of 2019 and stand at +15.90% YTD, as measured by the MSCI AC World Daily TR Net Index. After a very strong first quarter, Q2 was more volatile with two main elements influencing markets: trade war rhetoric, which initially escalated and then dampened further to the G20 meeting, and central banks, which have been intensifying their dovish stance, signalling possible rate cuts. In short, the market has been willing to ignore the weaker economic data in the hope that central bank stimulus will help avoid a recession.
- Developed Markets (DM) performed strongly in Q2, outperforming global markets on aggregate, with the notable exception of Japan. The S&P 500 TR ended the quarter up +4.30%, while the MSCI Europe gained +4.48%. In terms of styles, growth was once again the winner during Q2, while value and small cap underperformed global markets. Looking at sectors, Financials and IT were the strongest contributors. On the other hand, Energy was the laggard.
- Emerging Market (EM) equities were flattish during this second quarter of the year, with the MSCI EM TR Index being up +0.12%. As US interest rates decrease, a better environment for this asset class could emerge.
- Volatility increased slightly during Q2 but remained at a low level as of June-end (15.08) compared to the last nine months. It briefly topped the 20 mark during the month of May but came back down in June as markets rallied.
- After a very strong Q1, oil contracted somewhat between April and June (-2.78%). Q2 saw a revival in the price of Gold, as weak economic data increased fears of an economic downturn and demand for safe haven assets.
- Markets have been pricing in Fed rate cuts and the potential for further ECB quantitative easing (QE), all of which should be supportive of DM government bonds. However, and although global equities rebounded sharply in June and are off a very good start YTD, there are still a few headwinds that seem to be overlooked by markets so far, among which: (i) the on-going US-China geopolitical tension, (ii) slowing manufacturing data, (iii) early signs of a faltering American consumer, and (iv) a “whatever it takes” monetary policy easing that might not be sufficient to reverse the on-going global slowdown, all this leaving investors overly cautious at this juncture.
- In that context, we believe expanding asymmetric exposure through alternative solutions ahead of rising volatility prospects is a smart asset allocation move today. We are convinced that one efficient way to improve the risk-return profile of a traditional long-only equity portfolio is to favour Long/Short sector specialists like U Access (IRL) NEXTHERA UCITS. Indeed, this strategy is today characterised by significant innovation and regulatory changes, which should provide many long and short investment opportunities in the healthcare area.

UNION BANCAIRE PRIVÉE

Performance Review

- U Access (IRL) NEXTHERA UCITS returned -1.04% in the second quarter of the year, bringing the YTD performance to +13.10% (Class C USD, net of fees). Over Q2, the Fund was able to outperform the NASDAQ Biotech TR Index (large cap biotech) which posted -2.40%, and it slightly underperformed the NYSE ARCA Pharma Index (large cap pharmas) which was down -0.67%.
- On a relative basis, we were particularly pleased with the behaviour of the portfolio during the two difficult months of April and May for the therapeutics sector, outlining once again the ability of the strategy to preserve capital on the downside and to capture some of the market upside seen afterwards in June.
- The portfolio’s top performer over the quarter was a long position in uniQure, as it was reported by Reuters on June 16th that the company was “exploring options including a sale amid interest from other pharmaceutical companies looking to expand in gene therapy.” This position in uniQure was acquired late in Q1 after Roche announced its intention to acquire Spark Therapeutics, a close competitor of uniQure. This investment was consistent with the manager’s constructive view on gene therapy, as well as with his long-held view regarding consolidation in the mid-cap biotechnology space, particularly among exciting novel technologies such as this.
- The second top performer was a short basket of biotechnology stocks, which made gains primarily during the very difficult April and May for therapeutics stocks. This pronounced decline in therapeutics stocks during those two months was caused by political rhetoric from a number of Democratic US presidential candidates regarding the possibility of “Medicare for All”, a trend that reversed in June as this fear abated and a number of candidates softened their rhetoric and the possibility seemed to recede.
- The third top gainer was a long position in Coherus Biosciences, a developer of biosimilar drugs that is currently launching Udenyca, a biosimilar version of Amgen’s Neulasta. The investment team has been tracking the launch closely and invested in the company when the due diligence suggested that the launch could substantially exceed sell-side expectations.
- On the negative side, the portfolio’s worst performer was a long position in Mylan, which declined after the company posted Q1 revenue and earnings that missed expectations. Free cash flow was negatively impacted by a build-up in accounts receivable from new product launches; these lower cash flows created concern that, as with all of the levered companies in the generics and specialty pharma group, the company would not be able to de-lever according to its stated goals.
- Another detractor was a long position in Heron Therapeutics, which declined after the FDA gave the company a “complete response” letter for lead pipeline drug HRTX-011, a novel formulation of bupivacaine for use in post-surgical anaesthesia that the investment team believes had a high chance of approval based on the drug’s demonstrated ability to reduce opioid usage in the post-operative setting.
- A long position in Immunomedics contributed negatively as well, as sentiment was somewhat negatively affected when the company entered a licensing transaction in late April with Everest Medicines, a Chinese company, in which Immunomedics received $60 million upfront plus additional milestones and royalties in exchange for rights to the drug in select Asian markets, including China. While the company had been discussing the possibility of an Asian out-licensing transaction for some time, the consummation of it likely signalled the lack of a near-term takeout. In addition, in late April the company announced that its Chief Medical Officer was leaving the company.

Portfolio Activity

- U Access (IRL) NEXTHERA UCITS focuses on therapeutics solely, and more specifically on pharma and biotech companies. Four segments make up the investment universe: (i) Large cap pharma companies with low multiple, high dividend paying, and strong revenue growth; (ii) Revenue generating biotech companies that would be accretive on day 1 for an acquirer and would be under the radar and not discounted for M&A; (iii) Clinically de-risked biotech companies which are innovative M&A target companies post Phase 3 about to commercialise their drugs; and (iv) Highly innovative companies which have passed the proof of concept (Phase 2) and are going through pivotal trial (Phase 3) with a high likelihood of clinical success, although their individual allocation in the overall portfolio would remain limited.
- Since the beginning of the year and the management of the portfolio under Rael Mazansky, several changes in portfolio construction and hedging strategies were implemented in order to improve performance and risk management. These improvements include (i) the use of carefully selected single-stock shorts as a hedging strategy rather than simply shorting ETFs, and (ii) a material reduction in gross and net exposures at portfolio level. These changes proved successful in April and May, especially the short book implementation which contributed a strong 6% of P&L during these two months.
- Over H1 2019, the U Access (IRL) NEXTHERA UCITS portfolio has been positioned to benefit from the ongoing wave of innovation that is driving substantial improvements in clinical outcomes for patients. The strategy is then heavily invested in novel technologies, with several investments in gene therapy companies that are generating exciting results in a host of previously intractable and devastating diseases.
- Consistent with the investment team’s view that consolidation of mid-cap biotechnology companies by large pharma is a highly likely sector theme due to many reasons (i.e. lack of pricing power, need for growth, failure to innovate and repatriation of overseas cash to the US), there have been several significant transactions that occurred since the beginning of the year. The most important deals included: Eli Lilly / Loxo Oncology, Johnson & Johnson / MeiraGTx, Roche / Spark Therapeutics, Biogen / Nightstar Therapeutics, Pfizer / Vivet Therapeutics, Pfizer / Array Biopharma, and Abbvie / Allergan.
- In that context, the portfolio held a long position in Allergan at the time of its proposed acquisition by Abbvie, as the investment team’s view of consolidation also extends to the need for larger companies to consolidate in order to reduce excess R&D and sales capacity and to regain lost pricing power through more sizable portfolios. In addition, while the strategy was not a holder of any of the four biotechnology targets mentioned above (i.e. Loxo, Spark, Nightstar or Array), it did benefit from a core position in Audentes Therapeutics, a gene therapy company whose shares had become depressed in December and which rebounded strongly in the following months as the above transactions provided a reminder once again of the high strategic value of gene therapy companies. Finally, U Access (IRL) NEXTHERA UCITS took advantage of the rumoured strategic interest in uniQure, as described in the previous section.
- At the end of June, the portfolio was built around 28 positions, 18 longs and 10 shorts. Biotech has been the largest subsector allocation during Q2, while the US and Europe remained the highest regional exposures. The portfolio maintained an average net exposure of 35% during the quarter.

Outlook & Positioning

- As we look ahead to the second half of 2019, the team's bullish view in therapeutics remains intact. The opportunity for value creation in the mid-cap therapeutics sector is meaningful given the high degree of innovation taking place, the translation of this innovation into tangible advances in patient care and disease outcomes, regulators' increasing openness to innovation, the willingness of payors around the world to reimburse these novel treatments once approved, and the aforementioned need at larger pharma companies to access these novel technologies and medications.
- The recent spate of gene therapy M&A has confirmed the need and likelihood for broad consolidation within many mid-cap biotech companies. The long portfolio in then positioned, as before, in those stocks where attractive fundamentals on a stand-alone basis are seen, and where the potential for M&A is high given the business development priorities of larger companies.
- Equally important is the investment teams' vigilance to the hedging strategies put in place in order to navigate market choppiness, while continuing to identify compelling risk reward opportunities in biopharma.