



THE DRIVE YOU DEMAND

# U ACCESS (IRL) NEXThERA UCITS

Quarterly Comment | Q3 2019

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

## Markets

- ◆ Global equity markets were up +1.11% during the third quarter of 2019 and now stand at +17.18% YTD, as measured by the MSCI AC World Daily TR Net Index. After a difficult summer for risk assets, investors returned from their holidays in a bullish mood and drove equities higher in September, leaving global equities broadly flat for the quarter. The quarter was marked by a continued slowdown in the global economic data, offset by further monetary easing from the U.S. and Europe.
- ◆ Developed Markets (DM) performed positively in Q3, outperforming global markets on aggregate. The Japanese Topix was up +3.4%, the MSCI Europe gained +2.5%, while the S&P 500 TR ended the quarter up +1.7%. In terms of styles, REITs saw the strongest gain, growth and value were in line with the market, while small cap underperformed. Looking at sectors, utilities and IT were the strongest contributors, while energy and healthcare were laggards.
- ◆ Emerging Market (EM) equities were negative during the third quarter of the year, with the MSCI EM TR Index being down -1.9%. Slowing global economic data put pressure on EM, particularly in countries relying on Chinese growth.
- ◆ Volatility increased slightly during Q3, ending the quarter at 16.2, right around the average of this year. It briefly spiked to almost 25 early August as equities dropped but subsequently moderated as markets normalised.
- ◆ Oil dropped during Q3 (-7.5%), despite a sudden increase in September further to an attack on a large refinery in Saudi Arabia. However, the initial fears related to supply disruptions rapidly abated and macro-economic factors, including slowing growth, took over.
- ◆ Overall, the global economy faces several binary and highly unpredictable risks, including trade war, a possible no-deal Brexit, as well as tensions in the Middle East. The other uncertainty regards how companies will respond to slowing growth and profits and their possible impact on jobs. Until we have more clarity on the answers to these questions, we continue to believe that investors should favour alternative risk-reward profiles, which should protect against negative economic or geopolitical risk while allowing for participation in upside potential. More specifically, we think that an asymmetric equity exposure should prove valuable in the months to come, with stock selection alpha from long and short investment opportunities being increasingly beneficial. On the fixed income side, with long-term rates at multi-year lows and tight credit spreads, alternative sources of yields to generate steady income in portfolios should also be preferred.
- ◆ U Access (IRL) NEXThERA UCITS is a strategy that seizes long and short opportunities in healthcare, a sector characterised by significant innovation and regulatory changes that affect business models.



UNION BANCAIRE PRIVÉE



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*Performance Review*

- ◆ U Access (IRL) NEXTERA UCITS returned -13.26% in the third quarter of the year, bringing the YTD performance to -1.89% (Class C USD, net of fees).
- ◆ It was a difficult quarter for therapeutics investing overall, as the U.S. presidential election cycle moved into full swing with televised debates among the field of Democratic candidates. Several leading candidates including Elizabeth Warren and Bernie Sanders advocated for radical changes to the drug pricing system in the United States.
- ◆ The portfolio's worst performer was a long position in Sarepta Therapeutics, which declined after the company failed to secure FDA approval for one of its pipeline drugs to treat Duchenne muscular dystrophy. The downside in the stock after this event was substantially greater than the investment team anticipated based on valuation and modelling work ahead of time.
- ◆ Another detractor was a long position in Insmed Inc., which declined in August after reporting its second quarter results relating to the launch of its recently approved drug Arikayce. These results came in ahead of sell-side expectations, generally matched buy side expectations that were even higher, and the company raised its revenue guidance for the year. But nevertheless the stock declined substantially as investors worried instead about the growth outlook for the company for the remainder of the year.
- ◆ A long position in Audentes Therapeutics contributed negatively as well, as sentiment was somewhat negatively affected across the gene therapy sector after Novartis, which had acquired a leading gene therapy company last year (AveXis), was called out by the FDA for having submitted falsified animal data in connection with its regulatory application for approval of Zolgensma. This event had a chilling effect on investors' enthusiasm for many gene therapy companies.
- ◆ On the positive side, the portfolio's top performer and second top performer over the quarter were (i) a short position in a custom basket of biotechnology stocks, and (ii) a short position in the Nasdaq Biotechnology Index (NBI). As discussed in previous communications, the manager redesigned hedging practices at the beginning of the year in order to more closely match the factor attributes of the short hedges (i.e., beta, market capitalisation, liquidity) with those of the long investments, with the dual goals of better protecting downside during periods of subsector drawdown and providing alpha generation in the custom basket.
- ◆ The third top gainer was a short position in FibroGen, a biotechnology company which is developing a drug called Roxadustat for the treatment of anaemia, or low red blood cell counts, in patients with chronic kidney disease. Despite release of Phase III clinical trial results in May that revealed a number of efficacy and safety concerns – at which time the investment team also had a short position –, the stock rallied back in June and July, which caused the investment team to substantially increase the short position. This position performed well in August when the stock again declined.



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*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.
- ◆ Over the course of the year, 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 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 U.S.), 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, Abbvie / Allergan, Lundbeck / Alder Biopharmaceuticals, SOBI / DOVA Pharmaceuticals and UCB / Ra Pharmaceuticals.
- ◆ At the end of September, the portfolio was built around 20 positions, 13 longs and 7 shorts. Biotech has been the largest subsector allocation during Q3, while the U.S. and Europe remained the highest regional exposures. The portfolio maintained an average net exposure of 34% during the quarter.



## Outlook & Positioning

- ◆ As we look ahead to the remainder of 2019, the team's bullish view has moderated somewhat in light of the ongoing election cycle and potential for candidates' rhetoric to dampen enthusiasm for the sector – a repeat of events in 2015/2016. Nevertheless, 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.

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