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## Time to buy Biotech

Every now and then comes a rare opportunity to buy a deeply unloved asset at a bargain basement price. The beaten-down biotech sector provides such an opportunity now – as it is trading at its greatest-ever discount to the market. Much of biotech’s underperformance is due to the following transient factors:

1. The sell-off in long-duration bonds: Ironically, though the market has downgraded biotech’s structural growth, it has still behaved like a long-duration sector that has tracked the sell-off in the 30-year T-bond. Hence, if the long-duration bond rallies, it will boost biotech stocks.
2. The focus on delivering a COVID-19 vaccine: While biotech was developing a COVID-19 vaccine, investors became enamored with the sector, but once the vaccine was delivered, investors fell out of love with the sector. Yet there is more to biotech than a provider of vaccines.
3. Regulatory concerns: In the US there has been some concern about the dilution of a biotech company’s intellectual property (IP) rights – known as March-In-Rights – if government funding or research has contributed to an innovation. In practice though, the sophistication of most innovations means that IP would remain with the innovator. There has also been concern about drug pricing reform, but as is normal in any negotiation, the opening extreme position is likely to get watered down.
4. A drought in M&A: The focus on COVID-19, plus the uncertainty around regulation, has led to a drought in the M&A activity that is usually the mechanism to crystallize value. Still, for long-term investors, value is value, whether it is crystallized or not. Furthermore, the drought in M&A cannot last forever.
5. A flood of IPOs: The more than 100 biotech IPOs in 2021 was double the usual rate, creating an oversupply and indigestion for specialist investors in the sector. But given the poor performance of the sector, the IPO flood is likely to recede through 2022-23 in a self-correction.

BCA’s Counterpoint team believes the underperformance in biotech has gone too far. The market is valuing US biotech at a record 40 percent discount to big-tech, and at its most unloved versus the broad market, when most of the headwinds it faces are transient. Therefore, the team recommends both a tactical and structural overweight of US biotech versus US technology.

