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Poplar Forest Analyst Insights

In this edition of Analyst Insights, Steve Burlingame updates us on COVID vaccine developments, key trends in the Healthcare sector, and what he looks for when evaluating investment opportunities.

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Q What are your latest views on the outlook for COVID vaccines and therapies?

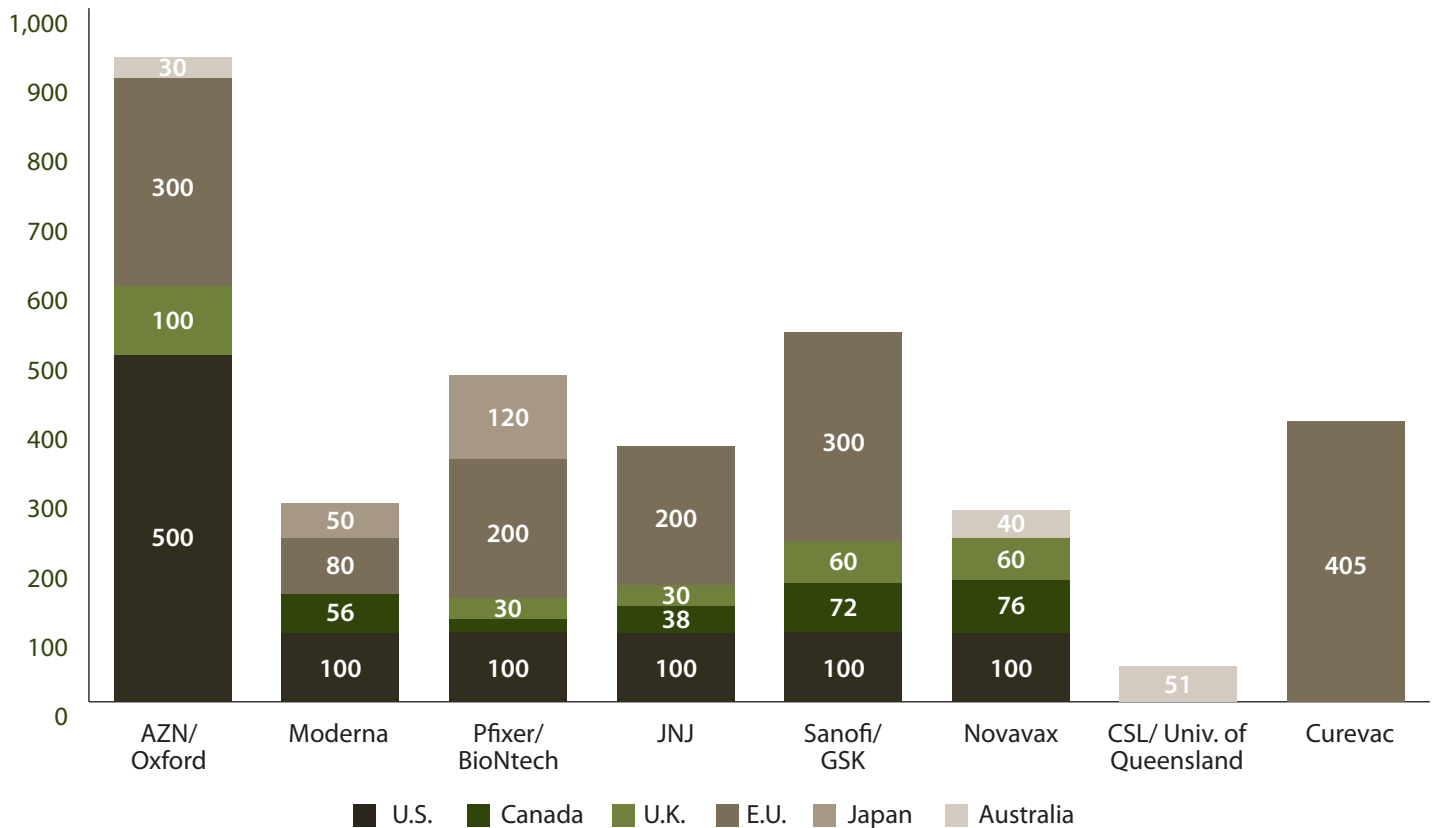
We view the recent announcements of $\geq 90\%$ efficacy from the three leading vaccine programs as a near best case outcome. It's a great example of human ingenuity delivering a big win for society. Very importantly, there have been no reports of meaningful side effects in the trials run by Pfizer-BioNTech, Moderna, or AstraZeneca-Oxford. While we still need to see the full efficacy and safety data, I believe at least two of these vaccines, and potentially all three, will receive emergency use authorizations in the U.S. and Europe in the coming weeks and months. Front-line healthcare workers, certain government employees, and high risk populations may have access to the Pfizer-BioNTech and Moderna vaccines before year end. As a result, I think it is reasonable to now expect that a majority of the adults in America that want to get vaccinated will have access to a vaccine by the summer of 2021. If there aren't any meaningful supply or logistical hiccups, the implication would be that the risk of infection, hospitalization, and death from COVID would dramatically decline during the second half of 2021. Since the stock market is a medium for pricing the future, we have now shifted our business analysis to assume that, by this time next year, the coronavirus pandemic is largely in the rear view mirrors of the U.S., Europe, and parts of Asia.

Unfortunately, the outlook for the rest of the world isn't as optimistic. Given the temperature requirements and specialized cold-chain infrastructure required by the Pfizer-BioNTech and Moderna vaccines, I don't view them as viable solutions for inoculating populations in emerging markets. Accordingly, it probably won't be until sometime

in 2022-2023 that a majority of the global adult population has access to a vaccine. If the easier-to-handle vaccines being developed in China and Russia are found to reliably produce efficacy greater than or equal to 80-90%, then emerging market vaccination timelines would shorten. As the chart on page 2 highlights, an approval of the AstraZeneca-Oxford vaccine would meaningfully increase the available vaccine supply in the first half of 2021. For this reason, I view the performance of the AstraZeneca-Oxford program as a throttle of sorts on how quickly adults in developed markets can get vaccinated in 2021. AstraZeneca explored a variety of doses in their Phase 3 trials and, based on the recently released interim data, only one arm of the AstraZeneca trial appears to have shown efficacy in the 90% range. Regulatory authorities in the U.S. and Europe may require another trial of this dosing regimen prior to approval which would slow the pace of inoculations during the first half of 2021.

Thankfully, scientists are making a lot of progress with COVID therapeutics, and I would expect the case fatality rate for the virus to further decline. For instance, one of our portfolio companies, Merck (MRK), recently acquired a private company, Oncolmmune, which has a very promising single dose treatment for COVID patients with severe infections. A recent interim analysis of the ongoing Phase 3 trial of this fusion protein therapy, known as CD24Fc, showed a 60% higher probability of improvement in a patient's clinical status than placebo and a 50% reduction in the risk of death or respiratory failure.¹ Given all the research underway, I would expect more highly effective therapies to emerge in 2021-2022 that would help reduce the risks of infection for those without access to a vaccine.

Chart:
Vaccine Supply Agreements – Initial # Doses (announced)



Source: Evercore ISI as of 11/25/20

Q Steve, what do you see as the key tailwinds and headwinds for the Healthcare sector?

I view the Healthcare sector as benefitting from two primary tailwinds. The first tailwind is demographics which reflects the fact that the number of baby boomers entering the 65+ age range is growing about 3 percent a year and much faster than overall population growth. These older adults tend to consume significantly more healthcare services than younger parts of the population, and thus will drive healthcare demand and spending higher in the years to come.

The second tailwind for the sector is innovation. The development of a highly effective COVID-19 vaccine in under 12 months showcases the sector’s technological prowess. For context, it used to take over 10 years to develop a new, highly effective vaccine. The innovation trend that we’re seeing in the biopharma and the medical device industries is much broader than vaccines. It stems from advances in gene sequencing, gene editing, new computing technologies, robotics, and 3D printing which are all leading to much deeper insights into how diseases and the human body

work. The Food and Drug Administration (FDA) in the U.S. and regulatory authorities in Europe have generally taken an accommodative stance to approving these innovative new therapies and products. The net effect of this upcycle in sector innovation is lots of new products and growth opportunities for many of our portfolio companies.

When you combine the aforementioned demographic tailwinds with accelerating innovation, it’s easy to conclude that healthcare spending can continue outgrowing the broader economy, despite the fact that it already represents about 18% of GDP. To counter persistent increases in healthcare costs, employers and insurance companies have been shifting more of the burden onto employees through higher co-pays and deductibles. As a result, the vast majority of Americans have seen their out-of-pocket healthcare costs steadily rise over the last ten years. With healthcare expenditures straining American checkbooks, it’s quite popular for politicians to advocate policy changes that might slow or reduce healthcare spending. Accordingly, I view the Healthcare sector’s primary headwind to be

adverse regulatory change. While there was some concern heading into the presidential election that a strong Democratic sweep could have led to meaningful healthcare reform, it's increasingly looking like we're going to have a divided government. Furthermore, President-elect Biden has made clear that he isn't interested in a radical shift to the sort of single-payer system that would have created significant revenue headwinds for the sector. I believe incremental policy change is now the most likely outcome for the next few years. History suggests that most healthcare companies will be able to navigate incremental policy changes fairly well.

To summarize, our view is that the Healthcare sector's two primary tailwinds around demographics and innovation will overwhelm what are likely to be modest regulatory headwinds. As a result, the Healthcare sector and, more importantly, many of the companies we own, are likely to continue growing at a faster rate than the broader economy.



Which parts of the Healthcare sector do you think offer the best combinations of value and growth?

The way we think about identifying healthcare investments is first to just appreciate that, regardless of whatever policy changes may happen in the Healthcare sector, there will be persistent pressures from employers, consumers, and government payers to lower healthcare costs. In light of this cost pressure, businesses that are only delivering marginal value to the system are unlikely to be good long-term investments. As a result, we limit ourselves to only those companies with clear and strong value propositions. To keep it simple, we focus our investments in companies that are either clearly saving lives, with innovative products and services, or that are clearly saving dollars through highly efficient business models.

On the saving lives front, we own Eli Lilly (LLY), a leading biopharmaceutical company. They have one of the strongest pipelines in the industry and just got an antibody therapy for treating COVID approved by the FDA. We also own Merck (MRK) which is benefitting from a significant new product cycle in cancer therapies—a few of which are doubling the 3-5 year survival rates for patients.

In terms of companies saving dollars for the healthcare system, we own CVS Health (CVS), which has a cost advantage in pharmacy and healthcare services. They are likely to play a key role in vaccinating the American population against Covid-19 in 2021. We also own AmerisourceBergen (ABC), which has a cost advantage in drug distribution. We have a robust shopping list and are closely monitoring a number of potential new investment candidates. In the past, we've been able to consistently identify companies that not only meet our standards for a strong value proposition but also offer the favorable combination of above-average growth potential priced at a below-average valuation. For this reason, we've been overweight the sector during the last few years. Currently, the Healthcare sector represents approximately 17% of the portfolio, which compares to about 14% of the S&P 500 and Russell 1000 Value Indices. If you were to combine all of our healthcare holdings into one company, we estimate that company would be capable of 10% EPS growth, which we would characterize as an above average long-term growth rate. Importantly, though, this above average growth potential is currently valued at a below average valuation which we believe creates a compelling risk vs. reward profile.

Let's Discuss

We'd love to continue the conversation. Please contact Patty Shields (pshields@poplarforestllc.com or **(626) 304-6045**) if you're interested in scheduling a call to discuss this or any other topic of interest.

Disclosures

Past performance does not guarantee future results.

Mutual fund investing involves risk. Principal loss is possible.

Earnings Growth is the annual rate of growth of earnings typically measured as Earnings Per Share Growth. **Earnings growth is not a measure of the Fund's future performance.**

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory prospectus and summary prospectus contain this and other important information and can be obtained by calling 1-877-522-8860 or by visiting www.poplarforestfunds.com. Read it carefully before investing.

Opinions expressed are subject to change at any time, are not guaranteed and should not be considered investment advice.

¹<https://www.merck.com/news/merck-to-acquire-oncoimmune/>

The S&P 500 Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. The Russell 1000 Value Index measures the performance of the Russell 1000's value segment, which is defined to include firms whose share prices have lower price/book ratios and lower expected long/term mean earnings growth rates. One cannot invest directly in an index.

The Partners Fund top ten equity holdings and their percentage weights as of 9/30/20: Advance Auto Parts 5.8%, AmerisourceBergen 5.0%, CVS Health 4.5%, International Business Machines 4.5%, Merck 4.4%, E*Trade Financial 4.2%, Equitable Holdings 4.1%, AT&T 4.1%, Nucor 4.1%, American International Group 4.0%. Composition of sector weightings and fund holdings are subject to change and are not recommendations to buy or sell any securities.

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