

Talking Heads podcast with Jon Stephenson

Andy Craig: Hello and welcome to this week's BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in-depth insights and analysis through the lens of sustainability on the topics that really matter to investors. In this episode, we'll be discussing the state of play in healthcare equities. Healthcare is a field where technological innovation and scientific process are combining to create new opportunities, and discerning investors are seeking to identify and capitalise on the emerging trends.

I'm Andy Craig, Co-Head of the Investment Insights Centre, and I'm joined today by Jon Stephenson, who's Senior Portfolio Manager with the US Equity team at BNP Paribas Asset Management. Jon is responsible for the healthcare equity strategy. Welcome, Jon, and thank you for joining me today.

Jon Stephenson: Great [to be here].

AC: Healthcare underperformed between 2023 and 2025. Can you talk us through the factors that contributed to that?

JS: A number of factors [have] negatively impacted the healthcare sector over the last several years. It goes back to 2021, because biotech stocks, which had peaked in the post Covid economic recovery, continued to sell off for the next several years and didn't bottom until the announcement of the major [US import] tariffs in April 2025. So that remains a significant headwind for the healthcare sector overall.

Additionally, large cap biopharmaceutical stocks had been negatively impacted by the late 2022 passage and early 2023 implementation of the Inflation Reduction Act, or IRA. That's important because it represented the first time that US Medicare was able to directly negotiate drug prices for the largest and oldest biopharmaceutical products by drug spend, and that created a major headwind for large cap biopharmaceutical stocks. That's important because those stocks represent a huge proportion of total sector market capitalization.

In 2024, healthcare stocks had actually started rebounding on a relative basis in the first half of the year, but that added significantly as we got closer to the US fall election cycle because drug pricing concerns once again took centre stage. There was significant angst around the prospect of changes at Health and Human Services in the US and also the FDA (Food & Drug Administration), and those concerns remained overhanging well into 2025 as investors needed to live with this regime for a while to get some perspective on the actual impact.

AC: What's the outlook for healthcare in 2026?

JS: I believe the outlook has improved significantly because many of the headwinds that persisted throughout 2023 to 2025 have abated.

First, we have much greater clarity around drug pricing because in the fall and early winter of 2025, most of the big biopharmaceutical companies entered into 'most favoured nation' agreements with the US administration and the resulting deals were less onerous than many investors had feared.

This means that, in the US, there will be some marginal reductions in drug pricing, mostly through steeper discounts on Medicaid purchasing. Outside the US there is the prospect for potential improvements in drug pricing for future innovations.

As to the regulatory backdrop, concerns related to FDA dysfunction have not manifested nearly as significantly as feared. What's becoming clearer to investors is that, other than vaccines and some of the more controversial innovations such as gene therapy, most things at the Food & Drug Administration are running on time.

We've seen a continued pace of mergers and acquisitions activity, most notably with large cap biopharmaceuticals purchasing small and midcap biopharmaceutical companies to resolve pending patent cliffs. But we're also seeing M&A within the med tech space, with a handful of deals at the beginning of this year. Medical procedural volumes remain solid and that is a positive for med tech stocks, although the industry has not actually reflected that positive reality yet.

AC: What are some of the key factors and themes you see as likely to have an impact on healthcare equities this year?

JS: The outlook for the biopharma backdrop is looking much healthier, for a number of reasons, and that creates an environment that's much more investable.

Specifically, innovation trends remain strong. The funding backdrop [has] improved significantly over recent months and that gives companies the ability to deploy capital against their R&D initiatives and to hold on for better prices when they're negotiating with large cap biopharmaceutical companies on M&A. Additionally, despite some high-profile disappointments, the number of drug approvals remains fairly high by historical standards.

All of that means biopharmaceutical stocks are very investable. As I noted earlier, medical procedural volumes remain solid and that's important because there has been some fear among the investment community that [those] volumes – which had re accelerated coming out of Covid – would eventually decelerate. That has not happened, and I think there are secular reasons for that, including the ageing of the population.

I think M&A will continue to be a major driver for the sector because the patent cliffs within large cap biopharmaceutical remain and they have not adequately been resolved. So, there's going to have to be more capital deployed via M&A in that space and that's an important theme for this year.

As to the regulatory backdrop in the United States, the largest market for healthcare, I think there's the potential for some improvement on margins as there might be some shifts in the regulatory regime. The head of the biologics division of the Food and Drug Administration resigned recently and there's the potential for more changes, which I think will be viewed favourably by the investment community in this environment.

AC: Where do you see the greatest opportunities in healthcare?

JS: I continue to favour small and midcap biopharmaceutical companies and there's a number of reasons for that.

The cadence of innovation continues at a very high pace. I won't get into the details of types of innovations that we have, but the amount of drug targets being identified continues to rise and the number of ways in which we can address them continues to improve as well, all of which is really solid for the underlying fundamentals of that group.

As I noted earlier, patent cliffs for the large cap companies remain unresolved as it pertains to valuation. While we have had a lift off of the bottom on a valuation basis, the bottom being 2025, we actually remain somewhere in the lower half of historical valuations for small and mid-cap biopharmaceutical companies, so I remain positive there.

I'm also starting to see an emerging opportunity in medical technology because, despite strong underlying fundamentals, most notably solid procedural trends, decent reimbursement and a nice cadence of innovation, these stocks have been really beaten up.

We're seeing is a lot of opportunities particularly in the smaller and midcap end of the spectrum, but also in some of the larger cap medtech equities because fears of decelerating trends have not manifested. I don't think they will, and the businesses are generally healthy. Valuation is at historical lows and even in this pocket of the market, we're starting to see M&A pick up.

AC: Well, it does sound as if healthcare is poised to do well from here. Thank you very much for taking us through the environment and talking about the outlook, John.

JS: Great, you're welcome, thanks.