Market Insights & PM Commentary – Q4 2022

After strong calendar-year performance in 2021, markets experienced significant volatility throughout 2022. A surge in inflation was seen globally largely due to a mix of binding supply constraints and excessive demand, excess liquidity, and a tightening labor market. As such, interest rates began to rise over the course of year. All of these factors led to market volatility, and a sharp rotation out of high growth and expensive quality sectors, and into value oriented securities such as resources, financials and staples. Most recently in the US, easing inflation did not alter the Fed's resolve to keep raising rates as chairman Powell delivered the much expected 50 basis point increase in the fed funds in December. While there was little change in the accompanying statement's language, the central bank did modify its expectations for the coming year, with the median projection for the Fed funds rate to reach 5.1% by the end of 2023 vs. the previous expectation of 4.6%. The Fed continues to acknowledge that economic growth and employment will suffer from higher rates, but is determined to moderate demand so that it can better match supply and bring inflation back to its 2% target. This has resulted in prospects for the global economy continuing to dim with central banks committed to winning the battle against inflation.

Q4 2022 was characterized by both volatile stretches and rebounds. All global GICS sectors experienced positive absolute returns except for the consumer discretionary sector, with health care ranking 5th out of 11 global sectors. However in December, markets sold-off and in this environment, Health Care was a top sector. Health Care has traditionally served as a defensive equity sector. Whereas many sectors slow-down in recessions, stable and mature health care businesses are better positioned to hedge against rising inflation and interest rates, and slowing economic growth. In recessions, people still need drugs, the prevalence of disease stays fairly constant, and long-term secular growth trends from rising health care spending and aging populations remain regardless of where we are in the economic cycle. As a result, health care has historically protected throughout market dislocations. Therefore, holding a health-care portfolio should be an important consideration for investors in this type of market environment.

Given these developments, the Renaissance Global Health Care Fund Class F experienced a positive absolute return, but underperformed its benchmark over 3-months. It also outperformed the Global Category Average throughout the quarter. A few high conviction names had some idiosyncratic developments throughout the quarter, but we believe these high-quality businesses that generate significant free cash flow will outperform over the long-term.

After a period of elevated turnover after Lead Portfolio Manager, Michal Marszal took over management of the Fund in September, portfolio turnover was in-line with long-term expected activity. There were two new buys and two outright liquidations from the portfolio. Ascendis was eliminated following clinical readout which somewhat diminished the market potential for the product in the near to medium term. Its base business appears relatively priced in and the pipeline lacks meaningful near term catalysts. Instead, we initiated a position in Praxis, which has an attractive pipeline and assets in neuroscience which will have multiple data read-outs throughout 2023. We also eliminated Sarepta from the portfolio as the stock reached a full valuation. We opted to use the funds to initiate a position in Mersana. The company has an attractive setup heading into 2023 with multiple catalysts, most notably the Phase 3 readout of its lead asset in ovarian cancer.

Our thoughts on our positions

Many businesses continued their upward trajectory throughout the most recent quarter. Intuitive Surgical and Sanofi were both top contributors over 3-months. Intuitive Surgical develops, manufactures, and markets robotic products designed to improve clinical outcomes of patients. The company announced better than expected 3rd quarter results. Prior to the quarterly announcement, the market had significant concerns around procedural volumes related to its robotic platform. These were later alleviated with much better than expected results. It also experienced strong launches from its additional platforms and devices that supported top-line growth. Another top contributor to Fund performance was Sanofi, which is a multinational pharmaceutical company. Previously in 2022, there was an unexpected emergence of a legal liability due to one of its legacy consumer products. In addition, there were setbacks related to a few late stage pipeline assets. However in Q4, the market identified that the pipeline setbacks were not as meaningful as previously believed, and the legal liabilities would not have a significant impact on the company. Both these developments contributed to the company's strong performance throughout the quarter.

The top detractor from Fund performance was Revance which is a small-cap biotechnology company focused on innovative aesthetic and therapeutic offerings. The company's stock sold-off throughout Q4 2022 based on concerns related to slow product launches and their ability to compete against other large-cap names. However at the time of writing, early launch metrics have been very encouraging and the stock is the best YTD 2023 performer for the Global Health Care Fund. We believe the volatility associated with the stock will be short-lived. The stock continues to be the largest biotechnology weighting within the portfolio and has strong take-over potential going forward. We continue to have high conviction in the business. Roche Holding was a top detractor throughout the period. It is a global pharmaceutical and diagnostics company which has an attractive pipeline of developmental assets across multiple therapeutic categories. Roche has a robust R&D engine in drug development innovating across all areas of the market including small molecules to large molecules, gene and cell therapy, etc. Throughout the quarter, the company had a number of pipeline setbacks, notably in its the Alzheimer's disease research. Nevertheless, the company has a robust pipeline, mostly in mid-stage clinical trials. Roche is discounted the most out of the large pharmaceutical names while generating phenomenal free cash flow. It remains one of our high conviction names and is the 6th largest position in absolute weight at quarter-end.

Navigating a complex and potentially volatile 2023

In our portfolio positioning, we remain tilted towards defensive names. Given the market dislocation that has occurred, the potential for continued downside still remains for higher beta names or companies with long-date cashflows. As a result, we have sold many companies with higher volatility and beta profiles in favour of defensive high-quality names with greater visibility on cashflows and future prospects. The portfolio remains fairly concentrated, focusing on only the highest quality businesses within each sub-industry while also remaining quite diversified in all areas of health care. As of quarter-end, there were 25 names in the portfolio.

Within the health care sector, our mentality is selectivity and cautious optimism. We've been quite defensive throughout the year, but have become even more cautious throughout the past quarter. There was a significant rebound in higher growth health-care businesses throughout Q4 2022. Their valuations increased, so we subsequently reduced weighting in these smaller-cap names, and shifted into existing large-cap health care holdings based on the likelihood for additional volatility in 2023. Despite significant forward risks that are emerging both from a macroeconomic and geopolitical perspective, many health care names are quite defensive and can insulate investors throughout market volatility. We typically invest in companies with strong competitive advantages that can pass-on price increases to stakeholders, attributes that will typically do well in this market environment.

The portfolio has fairly balanced exposure across the three major health care sub-sectors in pharmaceuticals, medical technology, and health care services. Pharmaceuticals are quite defensive, and we expect an eventual rebound in biotechnology. Many large-cap pharmaceutical companies are accruing vast free cash flow that can eventually be used for acquisitions of biotechnology stocks. In medical technology, the sector as a whole has less of a favourable outlook in this market environment but we have been very selective and have sizeable exposure. The companies we do own such as Medtronic have extremely attractive valuations, purchasing them at multi-year lows. Health care services can be affected by inflation, however businesses like IQIVA and United Health are well-diversified and defensive. For example, IQIVA has exposure to the entire universe of pharmaceutical R&D which provides enhanced diversification and reduces idiosyncratic risks associated with the industry. All of this allows for very balanced exposure across all three health-care subsectors.

Focusing on the long-term

It is important to remain vigilant in this environment, and we have capitalized on market volatility by increasing our exposure to innovative high-quality businesses in large cap pharmaceuticals, defensive and diversified businesses, and industries with strong secular growth drivers. We believe this approach will continue serve investors well over the long-term. As per usual, we will continue our alpha generation focus that is driven through deep fundamental analysis underpinned by a capital preservation approach to risk management.

Fund name as at December 31, 2022	3 months	1 year	3 years	5 years	10 years	Since PM Inception (Sept 2022)
Renaissance Global Health Care Class F	7.71	-5.42	4.79	8.05	14.39	8.71
MSCI World/Health Care (Net)	11.57	1.46	10.36	11.94	15.53	12.45
Global Equity Category Average	7.41	-14.66	3.31	4.65	8.80	2.09

As at December 30, 2022 CAD Currency. Source: CIBC Asset Management, † Morningstar Direct. Fund returns are net of fees.

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