

December 6th, 2013

Dear clients and colleagues,

We attended a few conferences this week in NYC. Companies in general were cautiously optimistic and still see Emerging Markets as their biggest opportunity for growth.

This week, we want to discuss the upcoming challenges and risks for the US posed by the aging population and rising healthcare costs.

Baby boomers in the US are getting old. Since 2010 every day, 10 000 people in the US will turn 65 and that will remain true for the next 20 years.

Not surprising, the older we get the more healthcare we use, especially after 70 years of age. The main diseases are diabetes, heart issues, arthritis and cancer. This trend is already a few years old in Japan and Europe and we are seeing the effect on the deficits of those countries.

For the US what does it mean? Healthcare costs will almost double between now and 2020 to more than US\$5 Trillion. Today, the US spends 17.2% of GDP or around \$8 500 per capital on healthcare, more than any nation in the World (see graph).

The current share of these cost by Federal Government through Medicare (over 65) and Medicaid (low income) is around one-third of that and expected to grow faster than the total growth, especially with the Affordable Care Act (Obamacare).

We do not agree with the projections of the Budget Office for growth of 2-3% per year. When Medicare was established in the US in 1966, the cost of the program was \$3 Billion. Projections for 1990 were for \$12 Billion. The actual cost in 1990 was \$107 Billion.

Rising Healthcare Costs in our opinion is the biggest risk for the US economy in the next 5 years.

Today's discussions about the deficit and the federal debt do not consider what is coming. In the current fight over the budget, President Obama said his budget would cut the deficit by \$2 Trillion over 10 years. We forecast that rising healthcare costs will make this target impossible. So we foresee years of political fighting in Washington with the uncertainty it brings.

The growth of health care spending cannot exceed economic growth indefinitely. But people will still spend an increasingly higher proportion of their income for healthcare, depressing consumption of other goods and services.

Taxes will go up as the federal government and States will have to pay more.

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Payers, individuals, government, insurers, will put pressure on providers to reduce costs and increase efficiency.

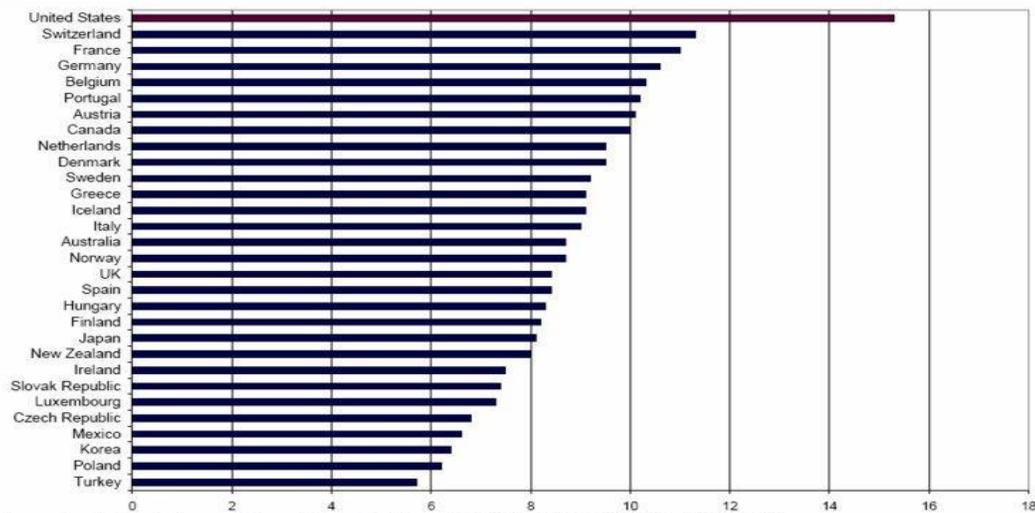
So, although healthcare seems to be an attractive investment opportunity because of the growth, the status quo will be challenged and winners are not obvious.

Large pharmaceutical and medical technology companies will be challenged to reduce costs, which will impact revenues.

Companies depending on Medicare and Medicaid will see their ability to profit greatly reduced. It has been forecasted that more than 70% of the companies providing home care, hospices and other services funded by those programs may be insolvent in 5 years.

We see a lot of opportunities in smaller companies which are bringing innovative technologies to improve outcomes and reduce costs.

Healthcare Spending as % GDP



Source: Organization for Economic Cooperation and Development, OECD Health Data, 2008 (Paris: OECD, 2008).
 Note: For countries not reporting 2006 data, data from previous years is substituted.

The problem is not unique to the US, but as we have written above, the US already spends the highest share of its GDP on healthcare.

Have a nice weekend.

The Global Alpha team

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