Health Care Sector Report

Total Revenue (Bil)	Market Cap (Bil)	Number of Companies	Total Employees	Sector Price/Fair Value	Universe Price/Fair Value
2,030 USD	4,110 USD	133	3,733,028	0.90	1.05

Sector Update

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Sector Update as of 28 September 2015.
Pricing data through 30 September 2015.
Ratings updated as of 30 September 2015.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Industry Price/Fair Value is the median value of the companies covered by the Morningstar Equity Analysts.

- The recent market pullback has pushed the valuation of the healthcare sector to slightly undervalued from slightly overvalued valued, with the group trading close to 5% below our fair value estimates in aggregate with some stocks looking significantly undervalued, including Amgen AMGN, Allergan AGN and Elekta EKTA B.

- Despite global macro concerns about slowing growth, we expect overall health-care utilization to remain largely stable given the inelastic nature of health care.

- Adding to health-care valuations (especially smaller potential health-care targets), mergers and acquisitions continue at a rapid pace, as large conglomerates are looking for growth avenues and opportunities to cut costs, partially through lowering taxes.

- Strong drug launches and excellent clinical data in specialty-care areas, such as oncology, is increasing the productivity of drug and biotech companies.

We believe the recent overall market pull back has created some opportunities for healthcare companies. The valuation of the health-care sector now is slightly below our fair value estimates in aggregate and we see several undervalued stocks across the different industries. As has been the case for several quarters, we believe the current environment for health care continues to lend itself to a stock-pickers' market rather than a focus on industries.

After the recent market pull back on concerns of slowing growth from China and several other regions outside the U.S., we believe the downward pressure on health-care stocks is overdone. With the majority of health-care companies selling inelastic goods and services, we expect demand to remain strong for these products. Further, the majority of health-care companies derive most of their profits from developed markets, which should post more stable growth relative to emerging markets.

Within health-care, companies are continuing to acquire and merge to increase their growth potential through creating scale, cutting costs, and focusing on key strategic areas. Further, the persistent low interest rates are also fueling the M&A trends, because cheap capital is available to fund acquisitions. Beyond the heavy prevalence of M&A in the drug space, with large drug firms acquiring Hospira, Salix, and Pharmacyclics, we are seeing further consolidation in health-care services. UnitedHealth's UNH acquisition of Catamaran and Aetna's acquisition of Humana show the increasing importance of gaining scale advantages.

Turning to a core element of moats with innovation in health care, drug companies continue to shift their focus toward specialty-care areas such as oncology. We expect the shift to increase drug-development productivity and strengthen the moats for drug companies, since these areas of development carry strong drug pricing, a more accommodating stance from regulatory agencies, and steep launch trajectories. While some of these specialty indications have smaller patient populations than primary care areas, the strong pricing power can easily turn the drugs into blockbusters. In oncology, recent approvals carry price tags over $100,000 per year, opening the door to major market opportunities even in the less prevalent cancers.