

# Doing More for Less: Opportunities in US Healthcare



## Healthcare Spending as a Share of US Economic Output Has Been Rising Steadily

Healthcare spending as a share of US economic output has been rising steadily over the last 50 years. Today, the US spends more on healthcare than any other developed country, 52% higher than the next highest spender<sup>1</sup>.

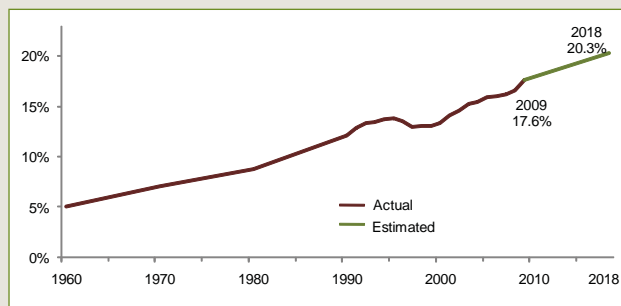
Drivers leading to these increased costs include an aging population, increased life expectancy, unhealthy lifestyles, treatment for the under- and uninsured, and administrative inefficiencies.

Rapid growth in healthcare costs over time is steadily consuming a larger part of this country's total gross domestic product (GDP). It remains to be seen if new government reform efforts will impact spending. Effective cost management is expected to be critical to making healthcare fiscally sustainable for the public and private sectors.

Companies that save the healthcare system money will play an important role in the Artio US Smallcap Strategy. We believe smallcap companies that have or are developing products and services that reduce costs while improving patient outcomes, efficiency, and quality of care are among the most compelling investment opportunities.

Following are four investment themes we have identified for 2010 and beyond.

## Growth of Healthcare Spending as a % of GDP 1960 - 2018



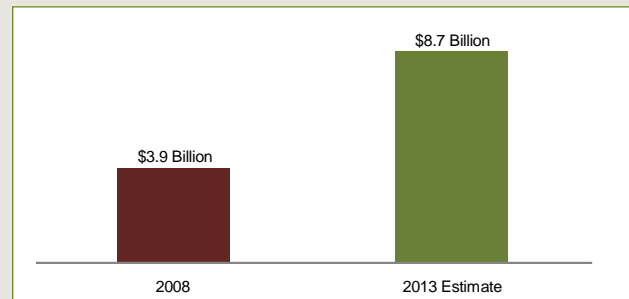
Sources: Rand Corporation, The Henry I. Kaiser Family Foundation, US Congressional Budget Office

## Diagnostics

Diagnostic testing represents less than 5% of healthcare spending but provides more than 80% of necessary information for treatment. As faster and more accurate diagnostic tests are developed, they are often accompanied by cost savings. It is cheaper to diagnose diseases earlier, prevent them entirely, if possible, and more quickly and accurately match the patient to the right course of treatment.

We see a unique opportunity for growth in molecular diagnostics. These tests aid in the detection, diagnosis and monitoring of diseases ranging from cancer to hospital-acquired infections. Of the \$40 billion diagnostics market, the nearly \$4 billion molecular segment is expected to more than double reaching almost \$9 billion by 2013<sup>2</sup>.

## The Molecular Diagnostic Testing Market is Estimated to More Than Double by 2013



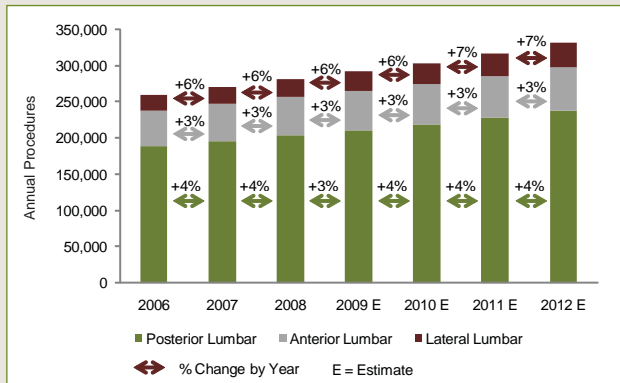
Sources: Cepheid, Scientia Advisors

## Medical Technology

Minimally invasive surgery benefits patients, providers, and payers alike. These approaches often have better patient outcomes and significantly lower costs as surgery and recovery time are reduced. It is anticipated that medical companies with innovative technologies can change the standard of care and take market share from larger competitors or those that rely on more traditional surgical techniques.

Less invasive lateral fusion surgery is one area which, we believe, is poised for continued growth. Lower back pain is the second most common reason for a visit to a physician<sup>3</sup>. With age, various changes can occur in the lower spine that cause chronic pain. Lateral spine fusion techniques currently represent only about 10% of the \$8.5 billion global market for spinal surgery but has been growing more rapidly than other techniques<sup>4</sup>.

## Minimally Invasive Lumbar Fusion Surgeries in US 2006 - 2012



Source: PearlDiver Inc.

## Generic Pharmaceuticals

Generic drugs offer the same safety and efficacy as brand names without the high costs associated with marketing, research and development. Smallcap generic manufacturers often focus on niche markets or products that are difficult to manufacture, creating a barrier to entry for other competitors.

Between 2009 and 2015, branded drugs that account for approximately \$120 billion in sales will see their patents expire creating significant additional opportunities for generic manufacturers<sup>5</sup>. The cost benefit of generics is clear: we believe they provide up to a 95% discount over their brand name equivalents.

### Cost Comparison: Brand Name vs. Generic Drugs for Common Ailments

Condition/Disease	Brand Name Drug Estimated Cost/Month	Generic Drug Estimated Cost/Month	% Discount
Heartburn	\$179	\$13	93%
High Blood Pressure	\$128	\$14	89%
Arthritis and Pain	\$135	\$30	78%
Depression	\$103	\$37	64%
High Cholesterol	\$95	\$37	61%

Source: Consumer Reports. For illustrative purposes only. Holdings in our US Smallcap Strategy may or may not have products which treat the above ailments.

## Home Health Services

Healthcare costs tend to rise exponentially with age. As a result, the growing elderly population (aging baby boomers) are expected to pose a major challenge for cost containment. With approximately 45 million current beneficiaries, Medicare spends roughly \$16 billion annually on home healthcare<sup>6</sup>. Over the next 20 years, the population of those 65 and older is expected to nearly double, resulting in more Medicare recipients qualifying for care. In the US, someone turns 65 every eight seconds<sup>7</sup>.

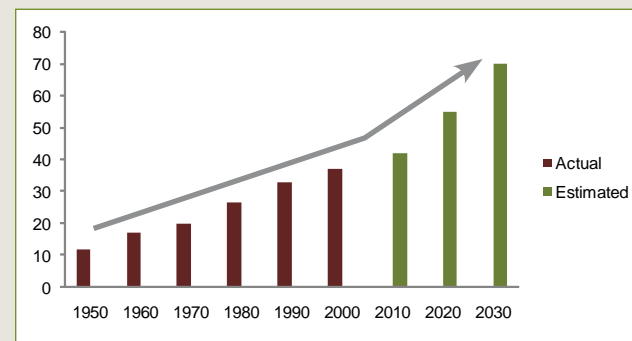
We believe home health companies should be long-term winners, as at-home treatment is significantly less expensive and is often more desirable.

### Cost Comparison: Home Health Services is a Cost-Effective Alternative

Cost of Home Health Services	Cost of Nursing Home	Cost of Hospital Stay
\$150/day	\$325/day	\$1500/day

Source: Almost Family

### The Growing Need for Long-Term Care: US 65+ Population Estimated to Nearly Double Over the Next 20 Years



Sources: US Bureau of the Census

All four of these investment themes have particular relevance in the smallcap arena. We believe each represents compelling investment potential over the long-term, given the growing need for cost reduction in the healthcare sector. We continue to explore these and other investment ideas related to healthcare trends in the Artio US Smallcap Fund.

### Artio US Smallcap Fund (JSCAX/JSCIX)

The Artio US Smallcap Fund employs a core approach with emphasis on intensive, bottom-up research by our team of sector analysts.

Our process seeks out companies that have long-term potential to change the behavior of consumers or capital spenders and can grow sales, earnings or use internally-generated free cash flow to grow organically.

Our diversified portfolio normally holds between 40 to 70 individual companies.

The team is comprised of five dedicated analysts who possess in-depth knowledge of the individual companies that make up the sectors and underlying industries they cover.

1. The Henry I. Kaiser Family Foundation. 2. Cepheid, Scientia Advisors, Frost & Sullivan. 3. Medicinenet. 4. PearlDiver Inc. 5. Morgan Stanley. 6. Almost Family. 7. PepsiCo

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