

The next big thing — biotechnology

Many markets have broken down and are trading in bear market territory. Even former high flyers like oil and Middle Eastern equities have reversed direction.

Amidst the market turbulence, a bull market continues for biotechnology. Despite a bumpy ride, it is still on an uptrend.

The Amex Biotechnology index has yet to break below its long-term trend line and has closed above its year 2,000 high, the last time when biotech was in a bubble together with the dotcoms (see chart).

Despite the market volatility of late, the biotech index continues to exhibit bull market characteristics. It is still trading above its 200-day moving average and its Relative Strength Index, a measure of price momentum, has turned positive after a slow 1Q.

Biotechs are poised to regain market leadership as seen in 1999. Technically, when this happens, a strong surge in biotech can be expected (Fig 3). It is encouraging to note that this is not a case where biotechs decline less than the market. In fact, on a year-to-date basis, biotechs are up 10.9%, compared with the 12.4% decline in the S&P 500 (as at Aug 16, 2008).

One can conclude that biotechs are still in a bull mode, have the potential for strong gains, and are likely to do so until proven otherwise.

First wave of M&As

There are also compelling fundamental reasons to invest in biotechs. The pharmaceutical industry is facing the prospect of key drug patents expiring within the next few years. That could mean a significant decline in earnings as the drugs turn generic. This is the reason for the recently announced acquisition bids by Roche for Genentech at US\$43.7 billion (\$61.74 billion) and Bristol Myer Squibb for

ImClone at US\$4.5 billion.

According to industry observers, these deals might represent the first wave of M&As between pharmaceutical and biotech companies, which could last for years. For the pharmaceutical industry, merging with biotechnology companies makes good business sense. It addresses one of the chief criticisms levied against the industry, which is its thinning pipelines of new products. For example, Roche relies on Genentech's stable of blockbuster drugs such as Rituxan, which has US\$2.5 billion in global sales in 2007, Avastin and Herceptin.



BY SIMON LIEW |

Acquiring biotechnology companies brings state-of-the-art R&D and promising pipelines in-house. A biotechnology product line tends to have a more complex molecular structure that makes it harder to reproduce, hence fending off competition from generic drug producers. Buying biotechnology firms with leading products and a strong R&D department is one way to sustain and diversify revenues when generic competition kicks in.

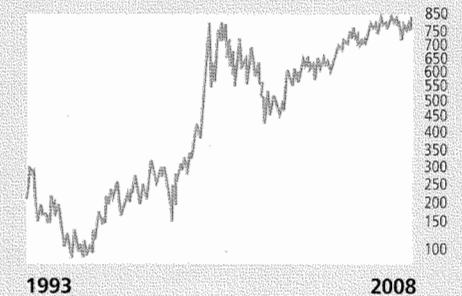
On the other hand, biotechnology firms benefit from the pharmaceutical industry's deep pockets, seasoned sales relationships within the medical community, and well-established experience in dealing with drug regulatory agencies around the globe.

Tectonic shifts

News of ImClone and Genentech buyouts will likely cause tectonic shifts in the pharma/biotech landscape. Other pharmaceutical companies with weak product lines would have to consider biotechnology companies as acquisition targets. This in turn raises the valuation of other biotech companies.

Momentum investors like hedge funds are also likely to get into the act. Now that commodities are trending southwards, they need to look for a new investment target. Biotech fits the bill with its supe-

Biotechnology Index-Amex



rior technical characteristics, positive price momentum and M&A potential. The flow of money can shift from commodities in biotechs.

The good news for investors is that investing in biotech has yet to be hyped up by the media. The constant focus on economic woes and credit crisis means that the biotech bull is likely to be in its infancy. Wall Street's marketing machine, which in the past has been pushing commodity related products, has yet to catch on to this trend.

Currently, only one unit trust, available to Singapore retail investors, has a biotech focus. Interestingly, the Franklin FTF Biotechnology Discovery fund is one of the few funds that is positive on a year-to-date basis, up 7.6%. Alternatively, investors can invest via biotechnology exchange-traded funds listed in the US markets.

Biotech investing has always been risky. By some calculations, the average return in biotech bull markets is 566% over 2.6 years, while the average loss is 46% over two years. Therefore, just like medicine, always seek professional advice before you buy. **E**

Simon Liew is an investment strategist at local independent financial advisory firm Frontier Wealth Management