

US Healthcare Theme Update

Q1 2026

In a Nutshell

Short-term volatility, long-term opportunity

Summary

The Healthcare sector marginally lagged the market in the first quarter (Q1) as investors took profits following its strong second half showing in 2025. Nervousness around the Trump Administration's approach to healthcare regulation returned to the front pages and M&A activity cooled from its frenetic end to 2025, which had benefited our previous holding in Polar Biotech so well.

The US-Iran conflict has led to a spike in bond yields and inflation expectations, but not a breakdown in the equity bull market. The defensive, 'bond like' characteristics of the Healthcare sector have been eschewed in favour of inflationary beneficiaries, such as Energy, amidst a generally resilient market backdrop for equities.

The Healthcare sector has always acted as a safe haven during periods of sustained market stress. If the ongoing market resilience gives way to an enduring, difficult period for risk assets, Healthcare will likely prove its worth once again.

Industry Developments

In Q1 2026, long-anticipated pricing reforms transitioned from policy debate to financial reality as the first negotiated 'maximum fair prices' for Medicare took effect in the US. However, the broader Healthcare sector absorbed this structural shift well, having largely priced in the margin compression during previous quarters.

Rather than retreating, global pharma is adapting its market access strategies, moving away from relying on the US as an indefinite high-price safe harbour. We are also seeing a pronounced geographic rebalancing, with underlying volume growth accelerating in Asian markets to help offset Western cost-containment.

In our Q4 update, we highlighted Polar Biotech manager, David Pinniger's caution that the brisk pace of 2025 deal-making had attached outsized M&A expectations to narrow Biotech leadership. We shared the view that the sector was vulnerable to hitting an "air pocket" of performance early in 2026 if further M&A did not satisfy these crowded expectations. This caution proved prescient.

Big Pharma's M&A strategy in the first quarter shifted decisively away from broad, expensive platform acquisitions. Instead, deal-making has become highly disciplined and asset-centric, focusing on targeted 'spin-out' transactions, next-generation delivery platforms (such as oral obesity drugs), and securing manufacturing capacity.

The fusion of AI and drug research keeps accelerating, moving beyond an initial hype cycle into definitive clinical testing. 2026 marks a pivotal year as the most advanced AI-designed drugs enter Phase III trials, which will serve as a definitive test of AI's ability to deliver efficacious therapies.

Big Pharma continues investing heavily in AI to help discover new drugs, improve sales, and reduce the need for acquisitions of Biotech companies. By leveraging their vast proprietary datasets to drive the wider ecosystem forward, industry incumbents are positioning themselves as indispensable utility engines that should drive Healthcare sector performance.

Schrodinger to offer Eli Lilly's AI drug discovery platform on its software

By Sneha S K

January 9, 2026 2:50 PM GMT · Updated January 9, 2026



Source: Reuters

Eli Lilly's January 2026 partnership with Schrodinger highlights the trend of AI adoption in the drug discovery and approval process

Performance

The Xtrackers US Healthcare ETF returned -3.5% (£ terms) through Q1, lagging a -1.4% decline in the Vanguard FTSE All World ETF.

The best performing holdings for the US Healthcare sector in Q1 2026 were Johnson & Johnson (pharma), Merck (pharma) and Gilead (biotech).

Stock	Q1 Contribution
JOHNSON & JOHNSON	1.81
MERCK	0.81
GILEAD SCIENCES	0.42
PFIZER	0.41
AMGEN	0.31

Source: Bloomberg

Johnson & Johnson (+21% in Q1) was the leading contributor in Q1 courtesy of a 'beat and raise' update as its oncology division delivered strong results

The worst performing holdings were Eli Lilly (pharma), Unitedhealth (health insurance) and Boston Scientific (med tech).

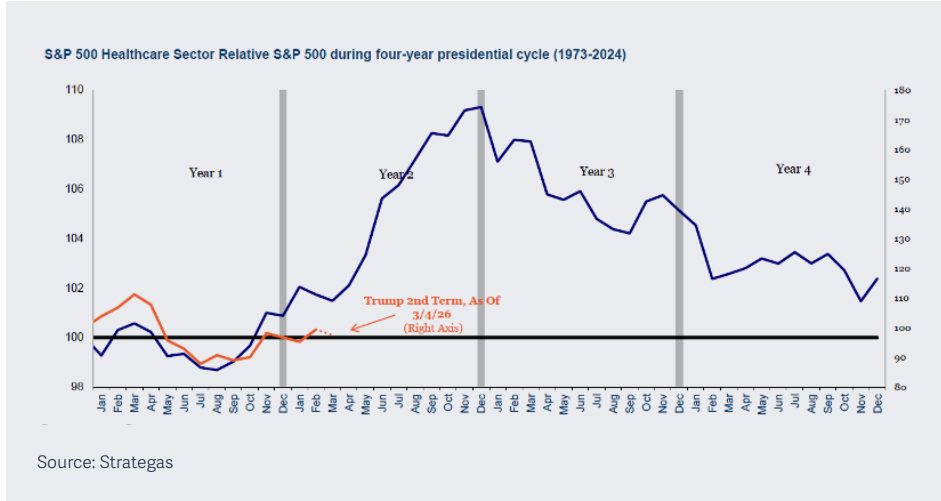
Stock	Q1 Contribution
ABBOTT LABS	-0.59
INTUITIVE SURGICAL	-0.6
BOSTON SCIENTIFIC	-0.81
UNITEDHEALTH	-0.83
ELI LILLY	-1.87

Source: Bloomberg

Eli Lilly (-13% in Q1) was the worst contributor in Q1 on profit taking (following a strong Q4) amidst market concerns that it's entering the price-sensitive phase of the obesity drug cycle

Sentiment towards Healthcare remains poor, as highlighted by a recent Bloomberg Opinion leader in March 2026; “An Erratic FDA Is a Threat to Innovation”. Weak sentiment, focused on political risk, has historically proven a positive contrarian signal.

As we move towards the US mid-term elections, an expected grid-lock in Congress should be a tailwind for Healthcare, as it lowers policy risk. Healthcare typically outperforms in the second year of the Presidential cycle (particularly in the second half of the second year).



Healthcare has historically led the market during the second year of the US Presidential cycle as policy risk premiums dissipate in anticipation of Congressional gridlock

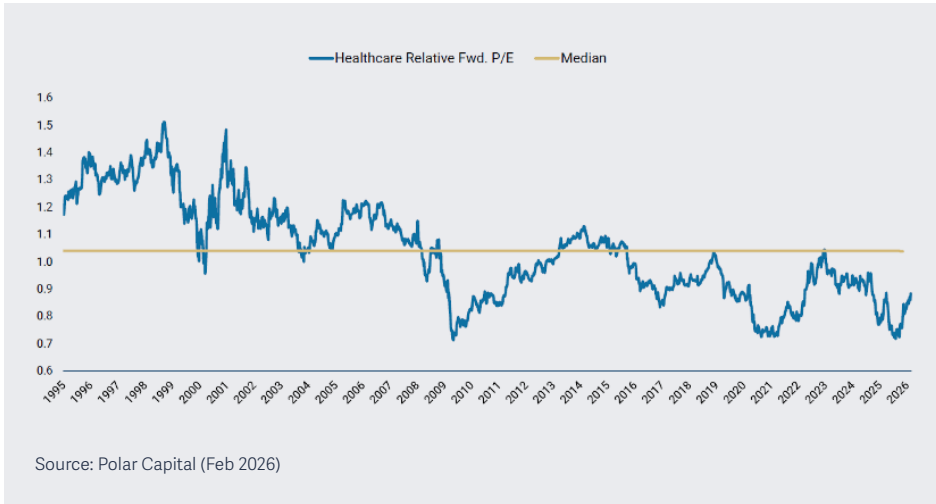
Valuation

The multi-year underperformance of Healthcare has depressed the sector’s valuation and weight in major indices, falling to multi-year lows – levels from which it previously outperformed significantly during the Dot Com crash.



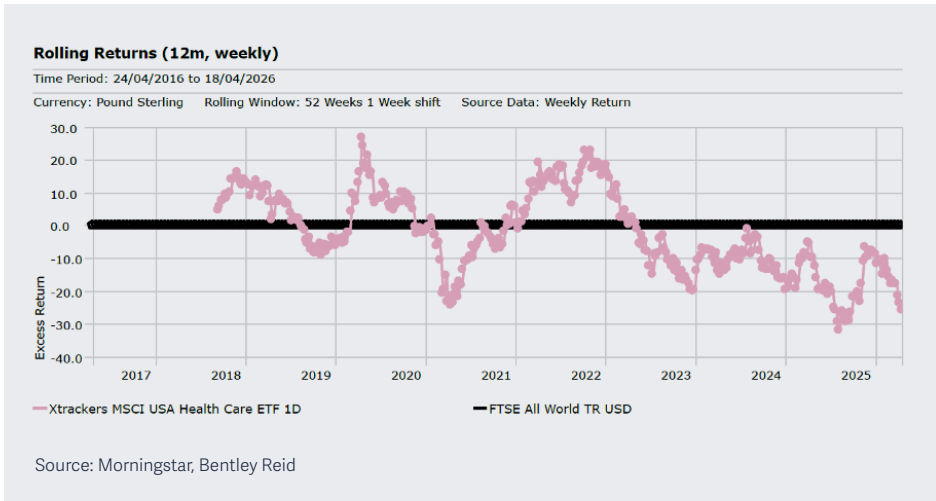
Healthcare’s weighting in the S&P 500 has fallen to levels last seen in 2000, from where it performed strongly

Healthcare’s current discount versus the market has been an excellent entry point in the past.



Healthcare’s relative price to earnings valuation is at a very attractive discount versus the market

One measure of the US Healthcare sector’s attraction is its 12-month rolling performance versus the FTSE All World. The chart below highlights the sector’s strong outperformance during bear markets, as in 2020 and 2022, and its underperformance during bull markets, as in 2021 and today.



Positioning

We access the US Healthcare theme via the Xtrackers MSCI USA Health Care ETF, the cheapest available US Healthcare index tracker (0.12% annual fee).

The fund invests in 62 companies listed in the United States. Top holdings in this market cap weighted index include Eli Lilly, Johnson & Johnson and Abbvie (at 31st March 2026).

Top 10 ETF constituents

Issuer	ISIN	Weight
ELI LILLY	US5324571083	13.28%
JOHNSON & JOHNSON	US4781601046	10.90%
ABBVIE INC	US00287Y1091	6.96%
MERCK & CO INC	US58933Y1055	5.59%
UNITEDHEALTH GROUP INC	US91324P1021	4.41%
AMGEN INC	US0311621009	3.53%
ABBOTT LABORATORIES	US0028241000	3.40%
THERMO FISHER SCIENTIFIC INC	US8835561023	3.35%
GILEAD SCIENCES INC	US3755581036	3.14%
INTUITIVE SURGICAL INC	US46120E6023	3.02%

Source: DWS

The fund invests in the Pharma, Biotech, Medical Technology and Healthcare Services sub-sectors that comprise the Healthcare sector

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