GLOBAL MARKETS AND ECONOMY

Global Healthcare: The Times They Are A-Changin'

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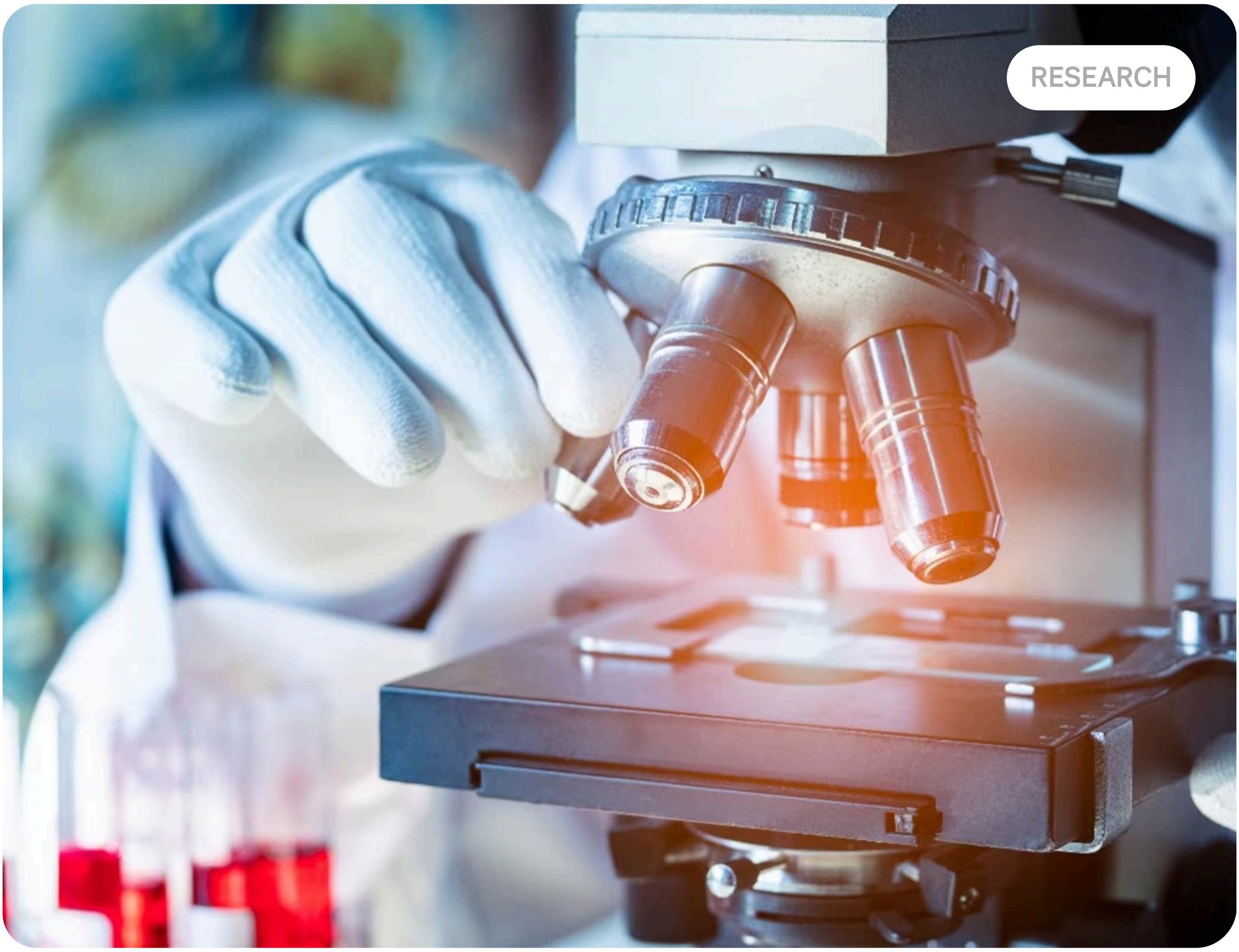

KEY TAKEAWAYS

- After a long period of underperformance for healthcare, Citi Research sees 2026 as a year marked by greater optimism.
- Among factors acting as headwinds for healthcare in 2025 were tariffs, China policy considerations, politics, interest rates and inflation.
- Healthcare industry trends will be a focus of our annual Global Healthcare Conference, to be held in Miami Dec. 2-4.

In a new Super-Sector Analysis from Citi Research, Joanne Wuensch and a team of analysts discuss the reasons they're optimistic about the healthcare sector heading into 2026 despite headwinds that have long weighed on earnings and stock-price performance. While healthcare subsectors have seen divergent performance, the analysts believe momentum will continue to build, and that Citi's annual Global Healthcare Conference, held in Miami on Dec. 2-4, will provide an opportunity to dig into trends.

The S&P 500 has been relatively volatile in 2025, with sectors impacted by artificial intelligence driving most of the returns since early April's Liberation Day unveiling of U.S. tariffs. While the S&P had risen 13% year to date at publication time, the healthcare sector had returned just 3%. That figure masks sub-sector variability, however: The Biotech index was up 16% year to date, Pharma up 4%, Healthcare Equipment up 4%, Life Science Tools down 4%, Healthcare Supplies down 21%, and Managed Care down 25%.

It's also worth noting that the overall sector has performed better since late September, when greater clarity about pharma tariffs arrived and the impacts of Most Favored Nation (MFN) drug-pricing policies proved relatively benign. This autumn rebound has helped Healthcare move from S&P 500 laggard to near the middle of the pack in terms of year-to-date performance, though that performance is far behind standouts such as Communications Services and Information Technology. Furthermore, the healthcare sector's weighting in the S&P 500 now stands at just ~9.1%, its lowest level since 1994; just two and a half years ago its weighting was ~16%.

Noteworthy subsector trends

U.S. Pharmaceuticals and Biotech

As the third quarter came to a close, the Street saw healthcare policy overhangs diminish, with pharma tariff threats largely mitigated and newfound clarity about MFN policies. That was a welcome change after a year marked by persistent headlines on healthcare policy, which combined with technology's continued momentum to keep investors at bay. But looking forward, we see optimism on a return to fundamentals.

On the policy side, we see investor concerns about pharma tariffs as mostly resolved, with most large Biopharma names having made commitments to large-scale manufacturing and R&D investments in the U.S., exempting them from targeted levies. Our recent investor conversations highlight renewed interest in the sector.

Mergers and acquisitions have also helped fuel a sense of optimism. Total M&A value in the second half of 2025 already exceeds what we saw in the second half of 2024, with activity focused on Biopharma's increasing need to fill the clinical pipeline. Oncology and Immunology & Inflation remain spaces with significant growth potential, with growing total addressable markets. The shift in M&A toward cardiometabolic and central nervous system names is an acknowledgment of arguably even faster growth spaces, with massive addressable populations and potential for innovation.

U.S. SMID Cap Biotech

FDA Commissioner Martin Makary is advancing a new approval pathway to increase efficiencies for rare disease drugs, which we think will lower hurdles and compress timelines to market. We think these new regulations could spur companies to shift greater attention to rare diseases and/or intensify efforts to identify relevant biomarkers.
More generally, we think additional wide-ranging commentary emerging from the new FDA should help convince both the industry and investors that collaboration and common purpose will make positive outcomes more likely and reduce regulatory friction.

U.S. MedTech

Despite solid fundamentals, the persistent theme for 2025 in MedTech has been "tariffs." But trends turned at the end of August. Throughout it all, the trade association AdvaMed pushed the White House to exempt devices from tariffs, while several large-caps emphasized their commitment to increasing manufacturing in the U.S. to reduce tariff impacts. Then September came, raising questions about the fate of Section 232 tariffs. Looking ahead, we are encouraged by the improving clarity and continue to appreciate companies that are transparent in their tariff/Section 232 communications and expectations.

Among other trends, we note that concerns regarding access to healthcare continue to build, including coverage for Medicaid patients, something that's already shaping healthcare delivery. AI is making inroads in MedTech; while there has been some industry pushback about how to best incorporate guardrails, MedTech seems broadly in sync with AI advancement. Medical-device companies are increasingly integrated AI into their products, with the FDA's AI-Enabled Medical Devices list documenting more than 1,200 such devices. We see AI as transformational, a technological boon to the industry and an ongoing catalyst as we head into 2026.

U.S. Life Sciences Tools & Diagnostics

"Uncertainty" has been the primary word referenced by most Life Sciences management teams since impacts from the new administration began to weigh on the Healthcare/Life Sciences sectors, with veteran researchers noting this as the most challenging funding backdrop they've experienced given that uncertainty as well as volatility.

As we move toward year-end 2025 and fiscal 2026, the biggest message we heard from management teams about what will improve demand and sentiment is initial views on the recent positive MFN developments, focus on the fiscal 2026 National Institutes of Health (NIH) budget changes, and global tariff rates. Besides the back and forth on the NIH budget, another factor to consider is the method of funds dispersal, as the Trump administration seems to want to shift toward multiyear grants rather than a single lump sum. As we move into year's end and more clarity is gained, we believe research customers will remain cautious and capital-conservative into fiscal 2026 in order to extend the longevity of funding.

Finishing on a positive note, exiting the third quarter the White House announced an agreement that will follow MFN pricing initiatives, lifting a significant overhang from Tools. Expectations are that the new pricing strategy will have a small percentage impact to the topline, coming in far better than investors have feared.

U.S. Healthcare Technology and Distribution

Our Healthcare Tech and Distribution coverage tends to be well insulated from political vagaries, but it isn't immune from the headline risk inherent in the Trump administration's policy prescriptions. This tends to manifest in two key areas: drug pricing policies (namely MFN and TrumpRx) and cuts to Medicaid/exchange subsidies.

The Trump administration has sought to lower branded drug prices most recently via MFN/TrumpRx. While implementation of these policies is uncertain, anything that pressures list prices would generally be a negative for distributors. Ultimately, we expect distributors to work with manufacturers to be fairly compensated on core distribution regardless of list prices, and to work with the government/payors to make sure their recently acquired community-provider assets aren't unfairly harmed by a reduction in reimbursement based on average sales price. The impact of TrumpRx is wholly dependent on if the website partners and/or integrates with existing discount programs or creates a competing channel.

The Congressional Budget Office estimates that Medicaid cuts and the potential exchange subsidy expiration will reduce Medicaid enrollment by ~7 million (a 9% reduction) and exchange enrollment by ~8 million (about a 36% reduction) by 2034. Such reductions stand as a slight headwind to our coverage.

China Healthcare

We're constructive on the long-term trend of China's rise as a global hub for biotech innovation. From 2020 through August 2025, for outlicensed molecules originating from China, total transaction consideration as a percentage of global jumped from 1% to 52% and the deal number increased from 4% of global deals to 19%. We see the most promising opportunities in innovative Chinese pharma and biotech companies that possess strong pipelines and are prime candidates for outlicensing deals with global multinational corporations.

Despite stock-price volatility caused by geopolitics, we expect the impact of tariffs and other potential U.S. policies to be minimal for China's pharma and biotech sectors, for several reasons. Outlicensing innovative Chinese molecules to U.S. companies isn't physical goods and so has no impact from tariffs. Upcoming patent cliffs and pricing pressure make it imperative for global drug makers to enrich their pipelines, with China assets becoming an important source. And finally, U.S. non-pharma companies could license early-stage assets to potentially outcompete restricted U.S. firms.

The speedy expansion of overseas businesses has been a key growth engine for domestic Medtech leaders. Given an established sales network and good-enough product quality, leading China Medtech players have continued to capture market share overseas.

Our new report, *Global Healthcare: The Times They Are A-Changin'*, offers our detailed analysis of themes across all subsectors. It's available in full to existing Citi Research clients here.

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