

SHINING A LIGHT ON..... AXA FRAMLINGTON BIOTECH FUND

At a glance

This fund is unlikely to appeal to all investors. It has the potential to deliver very strong returns but equally it can do the reverse. This means it is volatile and investing at the wrong time can deliver negative returns.

So if I am appearing negative why would anyone invest in the sector? There are certain sectors which have the potential to be drivers of the global economy going forward. This includes agriculture and biotech. There will be periods when these sectors are out of favour but over the long term they have the potential to deliver.

The first thing is that investors need to believe that this statement is correct and secondly if it is then the next question is why biotech? On a simplistic level, similar to Agriculture there is a demand. Demographics is the biggest demand. We are living longer and more importantly living longer in retirement, so this brings added demand for new innovative drugs. Obesity is a big problem (a third of the US population is obese and in the UK 10% of children are obese – Goldman Sachs Research, OECD 2012) and this brings with it diabetes, heart and liver disease etc and then the developing world is demanding a more westernised health care system.

If an investor believes that there is a greater demand for innovative drugs which responds to changing demographics then it makes sense to invest in those companies that are at the cutting edge of that technology. This in a nutshell is what this fund does. However investors need to understand this is a high risk fund, and will be volatile. For this reasons the concept may appeal but the risk less so! In this update we look to outline the style of management in more detail.

Who are the team behind the fund?

The fund is managed by Linden Thomson, she took over the management on 5 July 2012. She has 11 years' experience in the healthcare sector previously working at Clear River Capital and Goldman Sachs. She has a degree in Medical Microbiology.

Her co-manager is Mark Hargraves who joined AXA in 2000 and is lead manager across a number of products in European and global portfolios. They are supported by five regional specialists.

Fund highlights?

This sector has seen strong growth and this will attract investors who are searching for the highest returns. The danger is that just because something has happened in the past it may not happen in the future.

The challenge is that the price of many biotech names is towards the top end therefore one of the questions is whether this run can continue. Linden believes there might be a slight correction and is holding around 5% cash to take advantage of this, however she believes the long term fundamentals remain sound.

We discussed these fundamentals in more detail. In the past companies developed drugs which could be copied by others so there was little difference between the companies. Now this is changing with

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companies developing specialist drugs which are harder to copy and the focus is on new therapies which is changing everything.

Because these drugs are innovative it means that they can be sold at a premium. Gilead Sciences launched a Hepatitis Drug which now dominates this space. Treatment is quicker and more efficient, and although the upfront costs are higher the longer term costs are less. Unlike other companies it now has competition via AbbVie. This has forced the price down but in Linden's view the stock was cheap at 10 times earnings and the fund recently bought back into the stock. It is currently 8.85% of the fund.

Despite the high valuations the reason why Linden doesn't believe a full correction is due is because of the fundamentals. There is a forecast of 20 to 30% growth within the sector over the next two years. There are good reasons for this. We mentioned the demographic tailwinds (age, obesity, wealth) and more importantly there is a strong pipeline of innovation coming through.

This innovation is producing "first in class, best in class" products which will differentiate winners in the future. These companies can use premium pricing which delivers strong profit margins. Biogen is its highest holding and develops medicines focusing on neurodegenerative diseases, hematologic conditions and autoimmune diseases.

The tradable universe is 140 stocks and currently the fund holds 67 stocks. The top ten make up 55% of the fund, with the top 4 making up over 30% of the fund. All stocks are held with a three year time horizon in mind so turnover is fairly low.

Linden did say that high valuations are making it harder to find good opportunities, but these occur as was seen with Gilead. This fund is high risk, and investors are potentially being rewarded for this but it will be volatile and future returns are not guaranteed. Another risk is the manager, Linden has only been at the helm for the three years and this is her first role in managing a fund. We discussed the pressures of the wider group and clearly they are supportive of her, however the greater pressure to deliver is from Linden herself.

We talked about her background, she explained that she had a degree in Medical Microbiology and felt she had three options she could follow, none of which appealed to her. She ended up working for Goldman Sachs in their healthcare research team which enabled her to follow her passion for science. She believes this role enables her to use her science degree within an innovative environment and for her to see what others may miss.

In conclusion this is a well-managed fund but investors need to accept this is high risk and will be volatile. The valuations are high and the sector may correct, the manager believes this will be a minor correction but she may be wrong. It is also worth noting that although she has 11 years' experience in the sector she only has just under three years' experience as a manager. There are also other funds available which investors may wish to consider.

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Fund performance

Performance for the previous five years is shown below and since launch:

	2010	2011	2012	2013	2014	2015 (up to 28/02/2015)
AXA Framlington Biotech Fund	9.81%	7.60%	24.30%	63.65%	45.26%	12.44%

	1 Year	3 Years	5 Years	Since Launch
AXA Framlington Biotech Fund	36.83%	194.36%	275.29%	251.21%

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

This fund has a solid process but it is in a high risk and volatile sector. Although the returns may seem attractive investors need to consider the risk carefully before deciding to invest in the fund and it may not suit all investors.

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