Up 300pc in five years: 'This investment story is still intact'

Fund focus: It has been the strongest performing fund open to UK investors, turning £10,000 into £38,200 since 2011. What next?

The search for tomorrow's cures have been driving profits for investors Photo: Alamy

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Veteran investors will remember the first boom in biotechnology shares in the late Nineties. Prices crashed and brave backers vowed never to go there again.

But biotech is hard to ignore given the incredible gains of the past decade, driven by an ageing population and demands for better health care. Leading the charge has been the **Biotech Growth investment trust**. It has been run by Geoffrey Hsu of OrbiMed Capital since 2005. He also runs the**Worldwide Healthcare Trust**.

At its peak in July, Biotech Growth's returns equated to more than 20pc a year over a decade. Even after falling hard since then, the five-year return still stands at 282pc, turning £1,000 into £3,820.

Have biotech shares become overvalued?

There are some pockets of overpriced stocks in emerging biotech but big biotech still has compelling valuations.

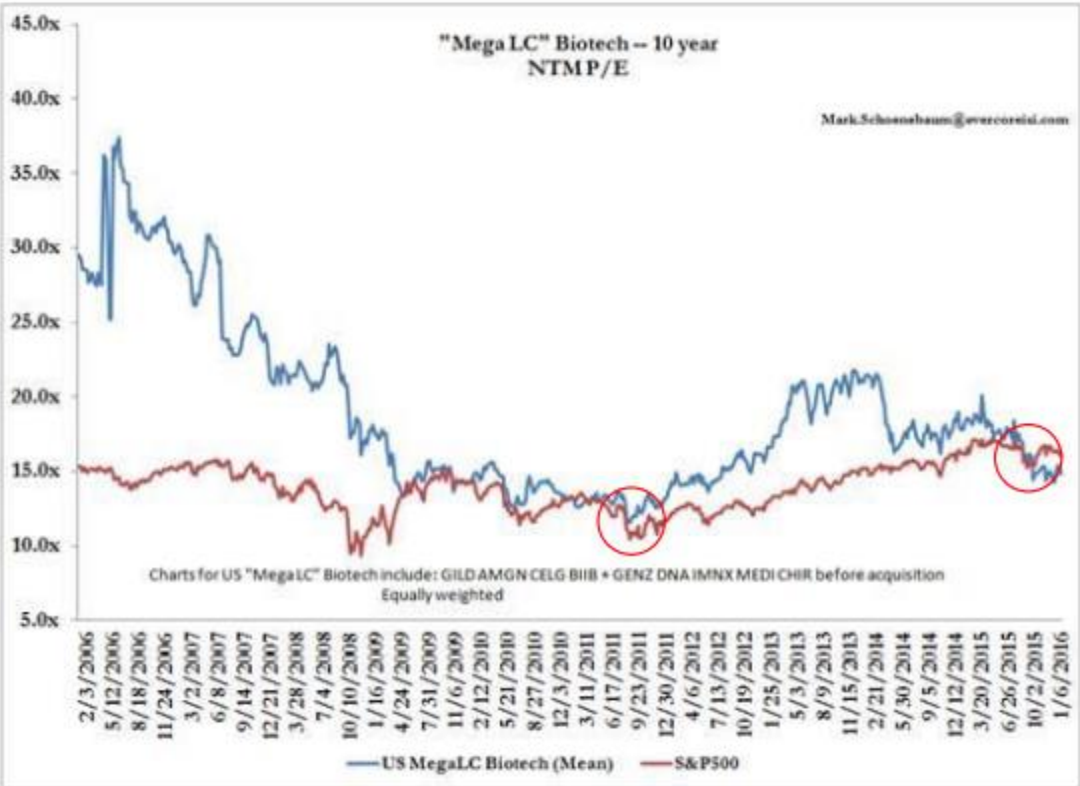
The sell-off we have seen since the start of the year really can’t be justified. It’s to do with the slowdown in China and the falling oil price. Biotech has no exposure to any of that.

Our chart (see below) shows that previously when the big biotechs have been cheaper, on price-to-earnings ratios, than the S&P 500 index it has turned out to be a good time to buy, which is the case now.

We believe the possibility of mergers provides a “valuation floor” for biotech. Single-product companies valued at $5bn to $10bn are in the sweet spot. We saw in 2015 that companies were still being bought at huge premiums of up to 140pc.

Biotech p/e ratio below S&P p/e: Historically a bullish signal

P/e ratios explained



Biotech valuation chart: Biotech P/Es below S&P P/Es: Historically a Bullish Signal

But prices were hit by Hillary Clinton’s comments. Are you worried?

 Photo: Reuters

Hillary Clinton’s tweet in September [she promised to regulate drug prices] started off an intense media frenzy. The pharmaceuticals sector is easy to attack, to score political points.

We saw something similar in 2014 and prices fell. But even when the Democrats had the presidency and controlled Congress, they failed to get this through in 1993 and 2010.

The regulatory environment is favourable and should continue to improve. The US drugs regulator approved 45 new products in 2015, the most since 1996.

Will slower spending by governments on health care become a problem?

Europe is certainly becoming more cost-conscious. In Italy now they will only spend a set budget for each area, so once the money has run out on hepatitis C, that’s it. It’s a question for society to work out: how much do we want to spend on health care?

But the US [where most of the fund is invested] is an exception – 18pc of its economic output is spent on health care. It’s around 10pc in Europe.

The simple fact is that you’ve got an ageing population and more being spent on health care.

• Time to 'sell everything'? No, this is when 'hold everything' works

Where are the best opportunities?

One of the themes for 2016 will be the combining of different immunotherapies in tackling cancers, with the result being much better outcomes for patients. Companies in this area are very interesting. [The fund’s holdings in this part of the market include US-listed Advaxis and Incyte Corporation and Innate Pharma of France.] Immuno-oncology will be the next gold rush in biotech.

[Mr Hsu won’t talk about individual stocks but it is worth noting that his only British holding is **GW Pharmaceuticals,** a firm that distils marijuana to make a treatment for child epilepsy. Its share price has risen five-fold in three years, despite falling since the summer]

Biotech Growth investment trust vs Nasdaq Biotech index

Will the biotech boom continue?

Biotech has had a great run in the past five or 10 years. We believe that story is still intact. The appreciation of biotech stocks has been rational. It’s about fast-rising earnings and is supported by fundamental breakthroughs in science and clinical practice.

• I'm working on a 'buy list' for 2016 - one fund already stands out

Do you invest your own money in the fund?

For tax reasons it is difficult for a US citizen to invest in a UK fund. I wish I could given how well it has done.

Before becoming an investor, what did you want to do?

I studied chemistry at Harvard. I had wanted to do something in medicine to do with the brain. When I was really young, I wanted to be an astronaut.

Performance

	1 year	3 years	5 years
Growth	-19.5pc	99.7pc	281.9pc
Quartile	4	3	1

Key facts

Launch date	6/23/1997	Return year to date	-14.7pc
Return since launch	735.8pc	Current fund value	£394.8m

Top holdings

1. AMGEN INC	9.9pc	6. ALEXION PHARMACEUTICALS	7pc
2. BIOGEN INC	9.6pc	7. CELGENE CORP	5.9pc
3. INCYTE CORP	8.2pc	8. ONO PHARMACEUTICAL	4.2pc
3. REGENERON PHARMACEUTICALS	7.6pc	9. ILLUMINA INC	3.9pc
5. GILEAD SCIENCES INC	7.2pc	10. MYLAN NV	3.4pc

Source: FE Trustnet

How to buy the fund as cheaply as possible

The trust has a total cost (the "OCF" or "TER") of **1.2pc a year**, with performance fees applying. The investment shop through which you buy the fund will also levy a charge. Some will charge a percentage of the amount invested, others will apply a flat annual fee.
Our colour coded tables at **telegraph.co.uk/investing** will guide you to the cheapest fund shop for your circumstances.

• Tables: The cheapest and most expensive places to buy an Isa

Our view

First, full disclosure. I hold this fund. I invested in 2012 and have sold batches of shares twice. I had no choice. It had grown from a small holding in my Sipp to make up 15pc of it, which is far too much.

Advisers would recommend holding only a low, single-digit proportion, maybe 1pc or 2pc. For most, it's too risky. You may also already have exposure to biotech through other funds. The eight biggest holdings in the popular Woodford Patient Capital investment trust, for example, are in biotech and health care.

The cost is also far higher than you would pay on most funds, although at 1.2pc a year it is modest for such a specialist fund.

Biotech Growth is a well-run fund, operated by a highly specialised fund company, OrbiMed, and by a manager who understands the science. There is also the benefit of a discount mechanism that sees the trust buy its own shares if the discount – the difference between the value of the assets and the share price (currently 6.4pc) – exceeds 6pc.

One question is whether you want to take such a bold bet on such a narrow part of the economy; another is hard to answer: is biotech in a bubble?

Profits have, on some measures, grown fast enough to justify the surging prices, but who knows what hurdles may undermine future earnings growth?

Alternatives include the slightly less racy Worldwide Healthcare, also run by OrbiMed, or the often-tipped Axa Framlington Health fund. For a low-cost option, the L&G Global Health & Pharmaceutical index fund costs 0.31pc a year and has returned 123pc in five years.