

## Editorial



**Dirk Steinhoff**  
Chief Investment Officer

With more than half of the year behind us, it has become clear that while equity valuations have overall still remained elevated and the macroeconomic landscape continues to be supportive, a healthy dose of caution has become essential. Over the last few months, we've seen

meltdowns in emerging markets, the highest oil prices since 2014 and an internal political crisis over immigration in Germany that heavily bruised Chancellor Merkel's European leadership status. Italy's new coalition government has also helped to reignite tensions over the immigration issue throughout the EU.

However, the topic that has dominated the headlines is the escalating global trade tensions. Focusing on China, the EU, Canada and Mexico, the tariffs that the US introduced and the retaliations that followed have sparked serious concerns over the impact of an all-out trade war. In this edition of the InSights, we'll take a closer look at the implications for investors and for the global economy at large.

We'll also review another important development, that we feel has not garnered the attention or coverage it deserves. Come September, the US market's sector classification system will undergo major changes, redrawing the lines for the Technology, Telecommunications and Consumer Discretionary sectors. With key

players like Facebook and Alphabet changing teams, the impact of the reclassification is set to be considerable, especially for sector-ETFs.

Overall, we remain cautiously optimistic for the coming months. At this stage, the current tariff levels are unlikely to inflict serious damage to the US or its trading partners, and much less so on a global scale. However, all relevant developments must be closely observed, as further escalations could rattle the markets and trigger an economic slowdown.

Finally, we are very happy to announce that Daniel Zurbrugg, BFI Infinity's CEO, will be visiting the US again from September 17th to the 21st with scheduled stops to include Florida, Tennessee, and New York. If you are curious to see if Daniel will be somewhere near you, let us know, and we'll see if arrangements could be made for a meeting.

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### In the Limelight: Sector reclassification

As key structural changes in the GICS classification system are scheduled to go into effect in September, we examine their impact on the sectors affected and on the corresponding ETFs.

### "America First": Trade war casualties and ripple effects

An in-depth look at the effects of the escalating trade tensions and their far-reaching economic, political and investing implications.

## CEO Corner

### Happy Birthday Switzerland – 727 Years of Excellence



Daniel Zurbrugg  
CEO BFI Infinity

On August 1<sup>st</sup>, our country celebrated its National Day and while most people that day were busy celebrating the event, it is important not to forget the rich history of the country and what led to the foundation of the Swiss Confederation in 1291. Back then, rep-

resentatives of the three founding cantons of Uri, Schwyz and Unterwalden came together and took an oath of confederation, pledging mutual support to defend themselves against the tyranny of the Habsburg empire. The main reason for coming together was the fight for freedom and security, something a lot of people take for granted these days.

History teaches us a lot of lessons and the history of Switzerland, spanning over 700 years, shows that the country and its people had to fight for freedom several times during that period. Following the foundation of the country in 1291, more cantons joined the Confederation. While Zurich was one of the early members, joining in 1351, Geneva was one of the last ones, becoming a member in 1815. Today, there are 26 member-cantons and four official languages in the country (German, French, Italian, Romansh). Switzerland remains a relatively small country, but the rich diversity of people and cultures present a great reminder that, far from a pipe dream, it is indeed possible to be successful, prosperous, and live in peace and freedom.

This is especially relevant today, in an increasingly globalized yet politically fractured world, where often topics like foreign cultures and immigration are seen as something negative or at least problematic. Switzerland today is much more than a home to native Swiss people. Today, people from all over the world live here and contribute to the continued success of our country. That is particularly impor-

tant for a small country like ours, that has almost no natural resources and is heavily dependent on a service-based economy and international trade.

Given its relatively small domestic market, the country has no other choice but to embrace the opportunity of globalization and compete at an international level. Often people think of chocolate, cheese, mountains, watches and banks when they think of Switzerland. While all of this is still important, today's economy is strongly diversified and all kinds of Swiss products and services are exported to the whole world. On the other hand, more and more people are visiting Switzerland every year to enjoy the natural beauty of our country and to learn more about the rich history we have.

The reason I bring this up is to show our readers that our country is successful because of diversity and international trade. Our long history of freedom has made our country one of the most stable and secure places in the world and has provided a conducive environment for businesses to operate and to succeed in. While we are proud of our history, we can't ignore that the world is changing. The lessons of the past teach us how to embrace change and the opportunities it brings, rather than trying to resist it and risk being left behind.

Switzerland's history, its strong economy and unmatched track record of political stability makes it the ideal place for our business, helping clients from around the world protect their wealth and access the most promising investment opportunities internationally. We see a bright future ahead for our country and its people, as we will continue to do what we have been doing for more than 700 years: protecting our freedom, remaining open-minded and respectful of other nations' histories, values and cultures, all while continually adapting and embracing the opportunities that the future will bring.

## In the Limelight

### Sector reclassification: Key challenges and opportunities for investors

by Dirk Steinhoff

With significant structural changes to the market's sector classification system set to go into effect after the close of business on September 28<sup>th</sup>, expectations of a shake up in the Telecommunications and the Information Technology sector are on the rise. What will the practical implications be for investors and for the market at large?

#### What is the GICS and why it matters

The Global Industry Classification Standard (GICS) is a sector classification system developed and maintained by MSCI and Standard & Poor's since 1999. About 95% of the world's equity market capitalization is classified under GICS. It organizes companies into 11 sectors, 24 industry groups, 68 industries and 157 sub-industries. This classification is applied to sector indices, which form the basis upon which the corresponding ETFs and mutual funds are built.

However, the world has changed a lot since 1999. In an effort to update the GICS system and make sure

it reflects the current realities of today's market, a number of changes will go into effect this coming September. While there will still be 11 sectors and 24 industry groups, the GICS structure will expand to 69 industries and 158 sub-industries. Selected companies will be reclassified, with Information Technology, Telecommunications and Consumer Discretionary being the affected sectors. The most impactful changes are set to take place in the Telecommunication Services sector, which will be significantly broadened in scope and renamed Communication Services.

#### (Tele)communication Services revamp

Today, we communicate, consume and share content in ways that would have been both impossible and largely unimaginable 20 years ago. Online communication channels have reshaped the global media and information landscape, while traditional communication and media platforms keep losing ground.



Source: State Street Global Advisors, S&P Dow Jones Indices, Beumont Capital Management, Bloomberg

Thus, a realignment is arguably long overdue. Currently, online media company Netflix is grouped under the Consumer Discretionary sector, together with retailer Macy's, Starbucks and Chipotle Mexican Grill. Facebook and Google parent, Alphabet, are currently grouped under the Information Technology sector, alongside Hewlett Packard and Xerox.

Once the changes go into effect, the new Communication Services sector will become a lot more relevant and better aligned with the sector's real-life landscape. It will include companies that enable communication and provide content through various types of platforms, thereby more accurately reflecting modern communication activities.

The sector will still include "traditional" telecommunication companies, such as AT&T, but it will also encompass heavyweights previously in the former Consumer Discretionary sector, such as Disney, Comcast and Netflix. It will also absorb "stock market darlings" like Facebook and Alphabet from their previous home in the top-performing Information Technology sector.

## Radical Sector Profile Changes

Overall, the GICS changes are set to have a decisive impact. According to a study by State Street, one of the largest ETF providers, the new Communication Services sector will represent around 10% of the S&P 500 Index market cap, a considerable jump

from the 1.8% weight of the old Telecommunication Services sector. It will also include 13 companies from the top 50% of returns in 2017. This represents a drastic shift for a sector that has hitherto included a large proportion of high-dividend stocks and has largely been viewed under a "value" lens, rather than a "growth" one.

Conversely, the Information Technology sector, which at the end of 2017 accounted for 26% of the S&P 500, could see its dominance shrink, as it is set to lose some of its most important constituents that have helped drive the impressive returns the sector has delivered, especially in the last few years.

## ETFs and the potential for increased volatility

ETFs, very popular vehicles to track indices, will be particularly affected by the GICS reclassification. Important changes and shifts lie ahead, especially for ETFs currently tracking the Telecommunications, IT and Consumer Discretionary sectors. Rearrangements in their underlying holdings will be necessary in order to align with the new sector classification.

As can be seen in the following chart, the ETF industry has been consistently breaking its own records in terms of assets under management, reaching a total of \$4.4 trillion by the end of September, 2017. More specifically, according to Thomson Reuters Lipper data, U.S. Science and Technology

## Growth of global ETFs, net assets in USD trillions



Source: Monringstar Direct, Ernst & Young

ETFs have \$78 billion in assets and many will have to sell their shares of Alphabet and Facebook to align with the newly-drawn sector lines. Telecom ETFs, with around \$4 billion in assets, will conversely have to buy shares of the new arrivals to the Communications Sector, while selling parts of their investments in current constituents.

Overall, these “realignment” trades that ETFs will need to make could create a surge in volume, as well as in volatility. While the potential to trigger higher volatility is not expected to hit stocks as hard as in February 2018, the fact remains that the investment shifts could be significant enough to cause some choppiness.

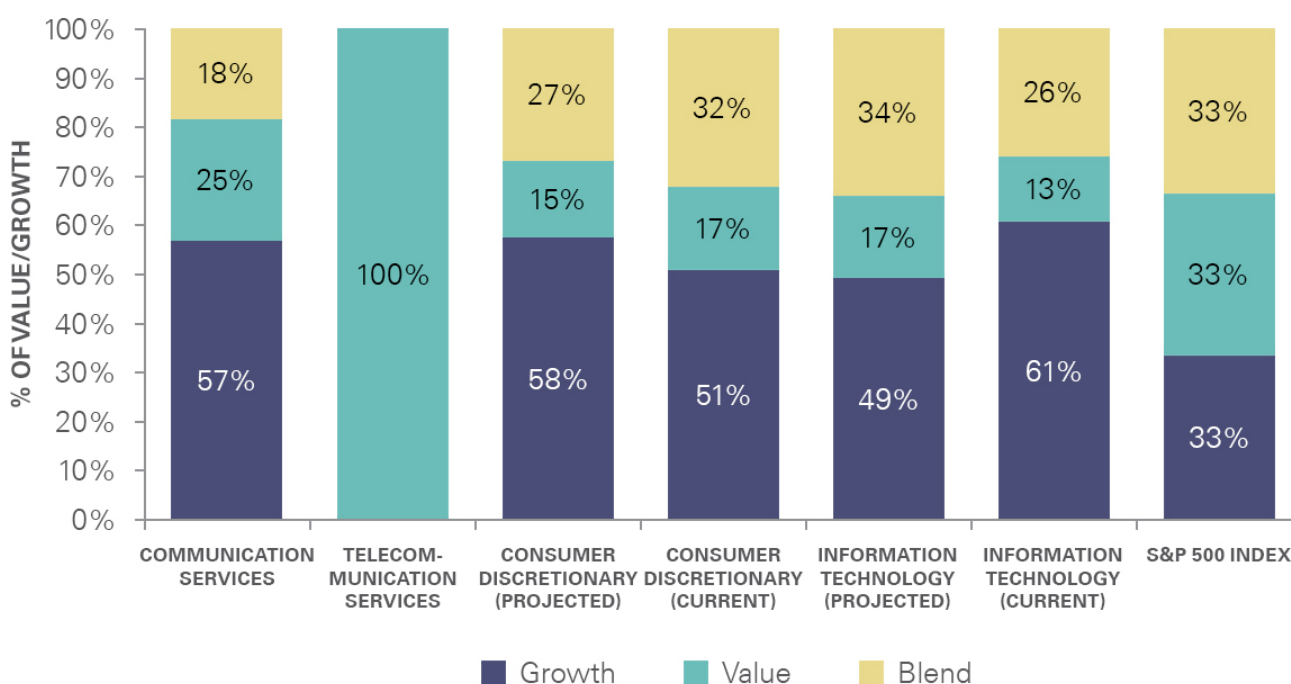
It is important to highlight here that there are far more and far bigger Tech sector ETFs than Telecom ETFs. Thus, we can expect strong selling activity of Alphabet, Comcast, Facebook and other shares of reclassified companies by heavyweight Technology funds in need of “offloading” to align themselves with the new sector classification. Such a selling surge could overshadow demand from a handful of smaller Telecom funds that will now need to buy the new Communication sector constituents.

“Mismatch” scenarios like this could result in some turbulence. Of course, such fluctuations will likely be balanced out and normalized over time. However, unless most ETFs go about the realignment process in a timely and orderly manner and avoid last-minute, panicked trades, we could see a period of price swings and increased pressure on the affected companies and sectors.

## What the changes practically mean for investors

One of the most significant implications of the upcoming GICS reclassification is that investors will likely need to re-evaluate their preferred sector-ETFs and make sure they will continue to reflect their needs and goals. Particular caution and attention to detail will be needed for those currently invested or planning to invest in Technology, Telecommunication or Consumer Discretionary ETFs. Come September, some investors might find that they no longer own what they did when they originally bought the ETF.

### GICS Sector Style Exposure



Source: State Street Global Advisors

Also, the radical changes in the basket of stocks that their ETF will be tracking could have a severe impact on the risk levels and income expectations from the fund.

What is also important to remember is that historical studies and track records of the three sectors affected by the reclassification will be rendered largely useless. Until enough time has gone by, providing accurate historical data for these sectors with their updated constituents, there will be no meaningful guidance for investors seeking to include past sector performance in their decision-making process.

Last, but definitely not least, considerable changes can be expected in the performance of the affected sectors. The breakup of the Information Technology sector might have been a rational and sensible idea. However, removing 3 out of 5 "FAANG" stocks, namely Facebook, Netflix and Google, could cause the sector to lose some steam after September.

On the other hand, the new Communications sector will likely be reinvigorated and should no longer be considered as a lackluster and uneventful corner of the market. After the changes come to pass, the new sector will combine the reliable dividends and "slow-but-sure" performance of the old Telecommunications constituents, albeit to a lesser extent, with some promising growth from the new high-powered additions.



## “America First”: Trade war casualties and ripple effects

by Dirk Steinhoff

Back in December 2017, many investors rejoiced at the Trump administration's tax cuts and saw it as a step in the right direction. President Trump's positions and initial moves towards a simplified regulatory environment also raised hopes for better times ahead for business and for a brighter economic outlook.

However, the US President's "America First" approach soon manifested into firm threats and corresponding actions, giving rise to widespread fears of an all-out international trade war. President Trump's style of negotiation, mixing foreign policy aims, trade goals and fiery rhetoric, has confused many allies and trading partners. Throwing away the old rulebook on diplomatic and discreet communications, multilateral consensus, and compromise has provoked hostile reactions and sharp criticism, but it has also forcibly jump-started a number of important conversations about foreign relations and trade deals.

As it stands today, President Trump has got the US into trade fights with China, Canada and the EU (just to name the most important fronts) and even though the enforcement of the tariffs and sanctions has barely begun, concern is growing over the potential damage to the global economy. In this article, we'll take a closer look at the key events and decisions that led to the current impasse and we'll outline the most likely and significant implications for investors and for the global economy at large.

### Standoff with China

After a long period of sustained hostile rhetoric and Twitter-delivered threats and ultimatums, on July 6<sup>th</sup>, 2018, the US initiated what China called "the largest trade war in economic history". It imposed a 25% duty on \$34 billion of Chinese imports, with more tariffs to follow. Beijing immediately responded with its own tariffs, targeting soybeans, meat and vehicles, hitting industries with large concentrations of Trump voters.

In this battle, which has been long in the making, the U.S. would appear to have a key advantage. It could in theory impose tariffs on \$505 billion worth of Chinese goods, which is the total dollar value of imports. In fact, President Trump has threatened to do exactly that, should things escalate. For Beijing, on the other hand, there is no way to retaliate on this scale. In 2017, China only imported \$130 billion in US goods. Nevertheless, upon closer inspection, this advantage is much weaker than one might initially estimate. Although its capacity for tariff-based retaliation might be insufficient, China's Commerce Ministry has already warned of other "comprehensive measures" it could take. From currency devaluation and harassing American companies to selling US Treasuries and derailing diplomatic efforts with North Korea, China has a number of weapons at its disposal that can inflict severe and lasting damage to the U.S.

### Chip Wars

Another interesting aspect of the current trade tensions is the US history of targeting competitors in often indirect ways. In a pattern that long predates President Trump, one prominent example has been Switzerland through the "War on Tax Evasion" the US launched almost a decade ago. The international hunt for hidden tax dollars yielded impressively poor results, corresponding to a mere \$0.7-\$1.0 billion in additional tax revenue, as shown in a recent report by the National Bureau of Economic Research (NBER). To put this figure in context, in 2017, the total tax receipts of the US government stood at \$3.32 trillion, the country's national debt climbed \$21 trillion and the US household deficit alone was \$887 billion.

But the US did achieve something else which might have been the real motivation behind this entire exercise. Since 2010, the US has seen the largest absolute gain in new international assets under management. American banks welcomed an additional \$1.84 trillion, a 41% increase that placed the US in third place globally in terms of size in Deloitte's In-

ternational Wealth Management Centre Ranking for 2018. Of course, Switzerland continues to hold the leading position globally in terms of size, competitiveness and performance. However, the additional costs and efforts that the US “War on Tax Evasion” saddled the country with were not negligible.

US “elbowing” maneuvers in the global wealth management arena over the last decade present a striking parallel to what can be seen today in the technology sector. Especially in the context of the current US-China trade conflict, the chip industry in particular takes center stage. The US is at the helm of the semiconductor industry globally, with heavyweights such as Qualcomm, Nvidia and Intel, and dominance of this sector also comes with considerable political clout. China, on the other hand, burdened with a poor track record in producing high-end products domestically, has also made chip development a key priority in its “Made in China 2025” drive, which is aimed at reducing reliance on foreign technology imports. By far the world’s largest buyer of semiconductors and heavily dependent on US products, China’s target is for locally produced smartphone chips to cover at least 40% of domestic demand by 2025.

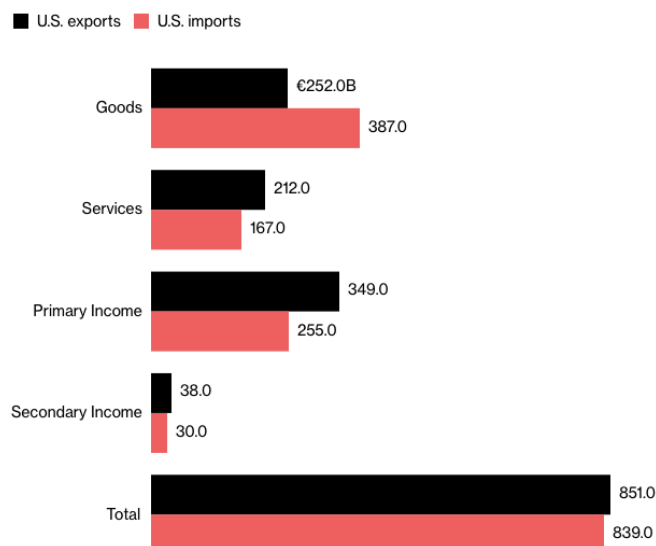
In this light, the US tariffs came as a compounding force to the pressure already exerted against Chinese companies earlier in the year. The ZTE case was of particular note: The US Department of Commerce banned component sales to the Chinese smartphone manufacturer, ZTE. Without access to Qualcomm’s processors, ZTE eventually had to stop production and almost went out of business. Such a rattling precedent, combined with the intensifying tariff pressures from the US, could cause President Trump’s strategy to backfire. Instead of the mounting pressure quashing China’s chip manufacturing plans, it can easily end up accelerating them instead. In fact, the Chinese government is reportedly already exploring ways to increase and speed up investment in the sector, in order to bring its 2025 plans forward and cut import dependence. In other words, the US, in its efforts to assert its dominance and achieve a short-term advantage, could actually trigger the emergence of a formidable opponent in the long run.

## Europe and NAFTA

Similar to his stance on China, President Trump has also described the trade relationship between the US and the EU as “unfair”. He has regularly pointed to a severe trade deficit, which he claims stands at \$151 billion. However, as head of the European Commission, Jean-Claude Juncker, told the European Parliament: “If you add up all of the trade in goods and services and the profits made by American companies, the benefit is on the other side of the Atlantic.” Indeed, as can be seen in the chart below, the US has a EUR12 billion (US\$14 billion) surplus with the EU when one looks beyond just goods. Services, primary income (which includes labor income of non-residents, earnings on foreign investments and assets), as well as secondary income encompassed by regular unrequited cross-border payments (such as foreign aid, or workers sending money home), tip the balance in favor of the US.

### Balance of Trade

The U.S. has a 12 billion-euro surplus with the EU when including more than just goods



Source: European Commission, Bloomberg

As for Canada and Mexico, Trump’s main complaint stems from the North American Free Trade Agreement (NAFTA), which he has repeatedly called a “disaster”. He has promised to renegotiate the terms of the agreement and tariffs are widely seen as leverage in order to achieve this.



In June, the US introduced tariffs against the EU, Canada and Mexico all at once, imposing duties of 25% on steel and 10% on aluminum. Less than a month later, the EU retaliated with a 25% duty on \$3.2 billion of US goods, while it also filed a complaint with the WTO. Subsequently, the US threatened to hit back with car tariffs of 20%, which would be severely damaging for the German auto industry. Canada was also quick to respond by imposing its own retaliatory tariffs on more than 100 US products, while Mexico has targeted \$3 billion worth of US products.

However, in a surprise turn of events, the potential for further US-EU hostilities came to an apparent halt, at least temporarily, after a meeting between President Trump and European Commission President Juncker on the 25<sup>th</sup> of July. Both parties agreed to hold off on further duties and to “work together toward zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods”. While the announcement was welcomed enthusiastically by both the political world and by the markets, it is still important to note that the above-mentioned recently introduced tariffs will remain in place while negotiations continue and that there was no schedule set to complete the talks.

## Impact on the US

Although the tariff hostilities have barely had time to go into full effect, the precarious state of the global trade environment is starting to shake business confidence. The latest ISM Manufacturing Purchasing Managers Index showed that while business in the sector so far remained strong, respondents “are overwhelmingly concerned” about how tariffs will impact their business. Harley-Davidson has already announced it would move some production out of the US to offset EU duties. Also, in a controversial move, the Trump administration announced that \$12 billion will be provided to support US farmers, who have already been feeling the impact of the Chinese counter-tariffs.

One explanation for the Trump administration’s decision to defy the party line and support the tariff-hit farmers with taxpayer money can be found

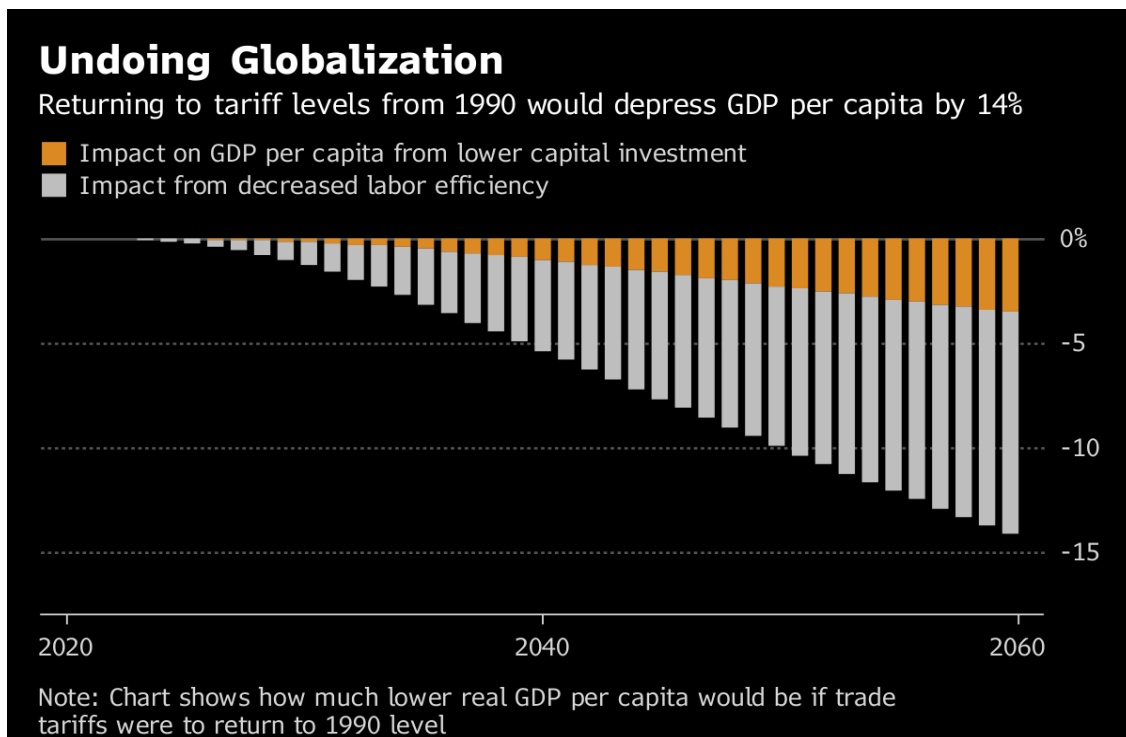
in the fast-approaching midterm elections in November. Trump’s “America first” trade policies have been seen as a “play to his base”, but their adverse effects are also increasingly being used against him by the Democrats in their battle to take the Senate. If the Republicans are victorious in the midterms, the Trump administration could interpret it as an encouragement to double down on the current trade policy direction. However, even if the Democrats manage to gain ground, Trump could accelerate his plans, for fear of only having 2 years left to bring them to fruition.

Looking beyond the short-term effects, the impact of further escalation in trade tensions would clearly have a wide reach, but their impact would also place the US under considerable pressure. Trump’s position might be that “trade wars are good and easy to win”, yet most economists agree that they are invariably bad and very easy to lose. Mark Carney, the governor of the Bank of England, recently warned that “a larger increase in tariffs of 10 percentage points between the US and all of its trading partners could take 2.5% off US output and 1% off global output through trade channels alone.”

## Global implications

Overall, increased trade barriers would have an obvious and clearly foreseeable negative impact on the prospects of global economic growth. Should the trade liberalization trend of the last decades be reversed, a recent study by the OECD paints a sinister picture of the future, as in the following chart. Also, at the end of the day, the consumer will arguably be the biggest loser of a trade war, as heavier tariff burdens on manufacturers and retailers could drive up prices for consumer goods.

Early evidence of this can be plainly seen in the recent surge in steel and aluminum prices. The 25% US tariffs on steel imports, combined with spiking demand, caused the benchmark US prices for the metal to climb more than 40%. Many affected companies, such as General Motors, already lowered their profit forecasts, highlighting the gravity of the knock-on effects of the trade tensions.



Source: OECD, Bloomberg

The isolationist direction of the US has the potential of shaking and reshaping the balance of global trade relations with huge economic, as well as political, impact. President Trump's stance against China might be justifiable, as the country has a long track record of not "playing by the rules". It is known to flout WTO guidelines, to often violate IP rights and it is still impossible for western companies to freely enter the Chinese domestic market without facing a series of hurdles or even targeted harassment in some cases. At the same time, it is much easier for Chinese companies to produce and sell their products in the US. In this light, the push for free trade, on equal terms, is far from unreasonable.

However, launching an all-out trade war to achieve this might prove to be a move that will end up hurting the US as much, if not more, than China, especially in the long run. In this vein, China can already be seen using the current tensions to its advantage, positioning itself closer to the EU. The recent Joint Statement presented after the 20th EU-China Summit made multiple references to the "global dimension" of this partnership and made clear both parties' opposition to the current US stance on trade. The positions and commitments outlined in the statement, going beyond cooperation on trade issues, also encom-

passed the areas of defense and security, underlining the geopolitical implications of a strengthened EU-China partnership.

Overall, our long-term view is that global and regional trade will continue to grow, as will globalization in general. We see the current situation as temporary and mainly as a matter of renegotiating certain trade treaties or replacing them with new deals. Doing so can provide a unique opportunity to make improvements in global trade and this current "interlude" will most likely trigger a movement towards more free trade in the future. Current discussions between the EU and the US are an excellent example. What looked like the outbreak of a major trade war just weeks ago, is now turning into a discussion about eliminating all existing tariffs and trade barriers. Ultimately, without governments dictating with whom corporations can trade and under what conditions, everyone stands to benefit. It is therefore important for investors to understand the current tensions as part of an overall process that might eventually lead to a situation that will yield a lot of attractive investment opportunities internationally.

## Investing in Healthcare

by Sune Hojgaard Sorensen

*Mr. Sorensen is the founder of Librarium Associates, an independent research company focusing on global macro and geopolitical monitoring and analysis.*



Sune H. Sorensen  
Librarium Associates

It has been well said that the key to success is to invest ahead of the path of progress. In order to do this, one must devise an investment strategy that focuses on monitoring broad trends and implement active investment strategies that capture such broad

changes. As an investor and a student of economic history, it is clear to see that innovation - applied in core economic sectors supported by favorable long-term trends, such as demographics - has represented a consistent and powerful returns generator.

### Healthcare sector dynamics & potential

*Global healthcare spending is expected to reach \$8.7 trillion by 2020. - PwC*

The healthcare sector fits this profile perfectly and as we will show in this overview, it's poised to benefit from major demographic and socio-economic catalysts. Additionally, innovative seeds were planted over the last couple of decades, that is now providing the framework to support a range of interlocking and reinforcing breakthroughs that will significantly alter the way healthcare is done across most segments. Technology begets technology and the compounded effects of this innovation represent a great opportunity today.

This level of innovation provides a traditionally 'defensive' investment sector with the kind of catalysts for growth that will power its potential in the coming years beyond the merely defensive. The opportuni-

ty is global in nature, as our demographic and socio-economic overview will clearly show, providing investors with an attractive, broad and deep global investment universe.

We see plenty of diverse investment opportunities from the more mundane and stable options, such as healthcare real estate investment trusts (REITs), and areas such as the eyewear and hearing aid sectors, to these 4 key sub-sectors that we see as poised for major developments powered by innovation:

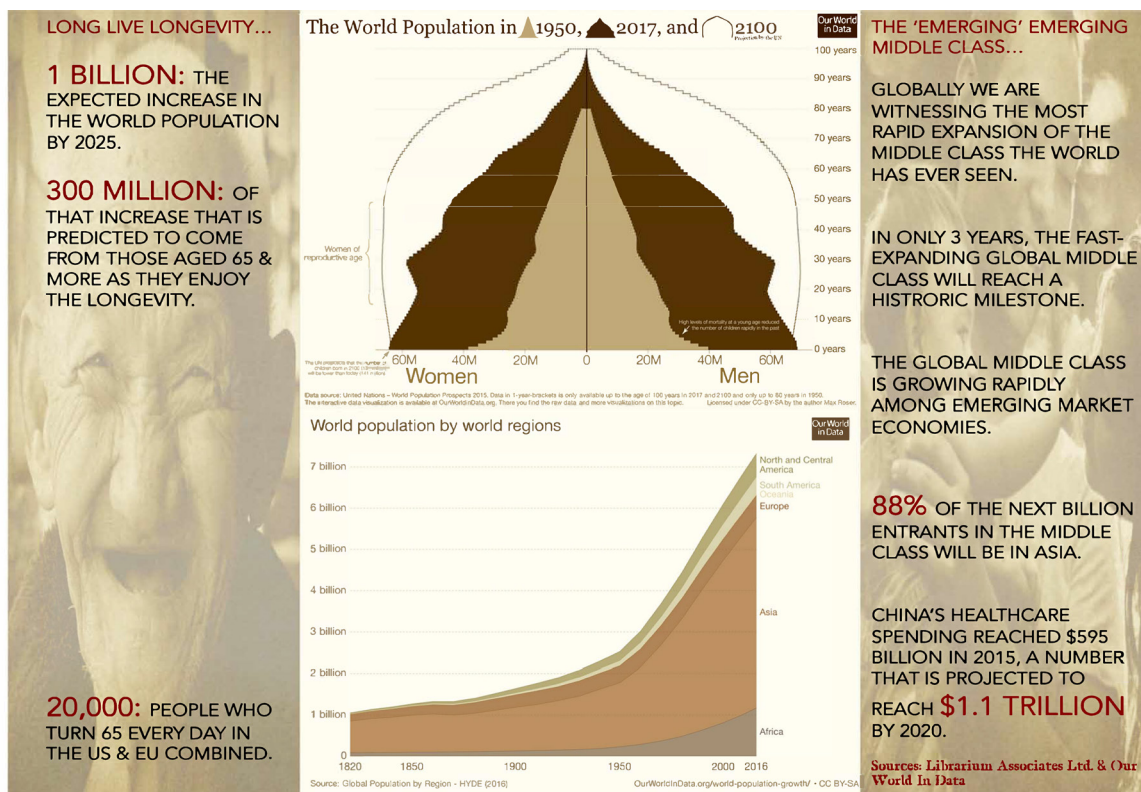
- Digital Health Technologies
- Med-Tech & Medical Devices
- Drug Discovery & Development
- Care Delivery & Innovative Business Models

### A tale of global demographics: An expanding and graying world

Healthcare is about people in the truest sense. It's about our lifespan and our quality of life, and as such, it is best observed through the lens of demographics.

Healthcare as an investment has the backing of several powerful demographic trends. People are living longer and the global population is growing. The particularly strong population growth in the emerging countries is also accompanied by dynamic economies that are in turn propelling an increasingly large part of their populations towards a 'middle class' level of living standards. These broad global demographic trends present an investment opportunity.

## A demographic snapshot



## Innovation to the rescue

*"Science isn't often discovery out of nowhere. It comes out of fortuitous collisions, in which different fields that don't typically communicate come together."* – Dr. Gambhir, Professor for Clinical investigation in Cancer Research.

As part of our wider investing in innovation thesis in core economic sectors, we pinpointed the healthcare industry as one that was ideal for such consideration. It's a crucial component of human life and it's faced with serious challenges that only innovation can provide the solutions for.

As investors, these are the kind of dynamics that we seek and appreciate. The global demographic trends dictate that the need for healthcare is rising, while governments are facing serious budget restraints and a shortage of doctors and other professionals remains. The answers that technology and other medical advances can provide will be crucial to enable the healthcare industry to reach more people with less resources, while remaining profitable.

In the face of these powerful dynamics - rising population numbers, increasing percentages of older citizens living longer and the rising income levels across emerging markets - healthcare is currently transforming, with new developments challenging existing structures. Cost restraints and multiple bottlenecks demand and ultimately give rise to innovation.

## A closer look at the 4 key sub-sectors

## Digital Health Technologies

*"Digital health technologies are those that apply information and communications technologies to improve care outcomes, reduce per capita costs and improve the patient and doctor experience, continue to hit the market with breakneck speed. Major categories include wearables and biosensing, analytics and big data, patient engagement, telemedicine, employee wellness, EHR and workflow."* – Dr. Arlen Meyers, President & CEO at the Society of Physician Entrepreneurs.



While working on the report that forms the basis for this overview, I had the great benefit of the counsel of a renowned thinker, educator, entrepreneur and activist, Dr. Arlen Meyers, on the challenges of the global healthcare sector, or as he calls it “the sick care” sector. What became clear to me was the fact that in most nations, a grand edifice has been constructed that is more focused on providing ‘life jackets’ rather than being a ‘lighthouse’, with the prevailing system riddled with skewed incentives towards the wrong kind of choices and solutions.

As Dr. Meyers highlights in his excellent article, “How to create the Big Fix”: “Fixing the US healthcare system is ongoing and will require balancing quality, costs and access and optimizing resources. Ultimately the solution, however, will require reducing the supply and demand for sick care by eliminating worthless, unnecessary and inappropriate interventions and transforming sick care to health care. Accomplishing that will mean making substantive changes in payer, patient and practitioner behavior.”

Much of this new model will have to come from technological innovation and this is both a major opportunity and a crucial challenge that we must overcome. Digital technology is one of the cornerstones of this new foundation.

Technology enabled care (TEC) is capable of providing cost-effective solutions at a time when the demands on health and social care services continue to increase due to the world’s growing and ageing population, the rising costs of advanced medical treatments, and the constrained health and social care budgets. Indeed, wide scale adoption of TEC will be essential for sustaining the future health and social care system.

A popular refrain from the 1980’s by Dr. Robert Butler was: “If exercise could be packed into a pill, it would be the single most widely prescribed and beneficial medicine in the nation.” Decades of research show that regular exercise is one of the most important factors in warding off cardiovascular disease, many types of cancer, diabetes and obesity. TEC will play an increasingly important role in turning our sick care system into a healthcare system.

As investors, we want to be a part of this wave that aims to realize Dr. Myers’ prescription to transform “a fee for service-, specialty-driven, facility-centered, structure- and process-orientated, inequitable sick care system, into a value-oriented, generalist-driven, patient-centered, outcome-oriented and more equitable system.”

**TEC-TOC: What’s the state of play in TEC today?**

Current notable developments are the availability of healthcare ‘bio-sensing’ wearables, such as digital blood pressure monitors and glucose sensors and patient and provider access to real-time healthcare data and information.

Other aspects of the growing applications of TEC are remote monitoring of changes in the health status of patients and the use of digital messages to remind or alert patients to adhere to their long-term course of treatment.

Innovations in science and technology today will transform healthcare tomorrow. At the moment, the pace of change in technology is increasing at an exponential rate. On the basis of estimates by BCC Research, covering connected medical devices, healthcare applications and related mobile technology, the value of the market in 2013 was \$2.4 billion and is forecast to reach \$21.5 billion by the end of 2018, a compound annual growth rate of 54.9%.

The diagnosis is clear: Eat healthy and get lots of exercise and put some TEC in your portfolio – health and wealth can go hand in hand.

**Med-Tech and Medical Devices:**

**Amplifying natural abilities**

The key objectives for innovators in the medical device industry is to decrease surgery complications, hospital waiting times and the overall cost of healthcare. The pressure to develop a better healthcare system and reduce the cost, while dealing effectively with an increased workload driven by the demographic factors outlined earlier, has brought the adoption of ‘smart automation’ to the forefront.

A recent study by Accenture Research anticipates significant growth in the industry, both in terms of

jobs and revenues, as AI moves beyond rudimentary automation and enables greater collaboration between humans and machines. The data predicts that from 2018 to 2022 employment in healthcare will increase by 15%, while revenues will surge by 49%. Much of that growth will come from the new ways in which smart machines will enable humans to improve performance.

This can be achieved by amplifying people's natural abilities, enhancing their insight and intuition through the use of powerful analytics and copious historical data. A Harvard-based team of pathologists for example, recently developed an AI-based technique to identify breast cancer cells with greater precision.

Another way that smart machines are helping humans is by embodying physical attributes that work to extend people's capabilities beyond their natural limits. A good example of this in the health care field is robot-assisted surgery: Instead of using a scalpel, the surgeon sits at a console and nudges a joystick that controls robotic arms. This AI-assisted technology has been a huge asset for certain types of surgeries that require incredible precision — for instance, when a doctor has to remove an overgrown retina membrane that's only a hundredth of a millimeter thick.

The above examples are just a few of the many that illustrate the power of human-machine collaborations in which each party does what it does best: human intuition, creativity, teamwork and social skills, combined with the machine's precision, speed, scalability, and quantitative capabilities.

#### Drug Discovery & Developments: a sector with innovation in the genes

Continuous innovation is one of the pharma industry's most defining characteristics. Because of its rich potential and high significance, research in drug innovation seems poised to gain increasing momentum in the years to come. 2017 was another year with more launches of specialty pharmaceuticals than conventional mass-market ones, continuing the shift into specialty pharma. New and more nimble players are entering the arena with new

perspectives and ideas for how to approach R&D, drawing on lessons from the technology sector.

Such efforts, combined with increased capital flows, mean that we could be finding ourselves at the beginning of an extensive pipeline of new discoveries and subsequent treatments. Many of these could be driven by progress in human genome research, which is becoming increasingly more affordable and holds great promise.

#### Turning the tables on cancer

A promising example of this innovation drive is immunotherapy. Immunotherapy is a treatment that uses certain parts of a person's immune system to fight disease. In the last few decades, immunotherapy has become an important part of treating some types of cancer.

Newer types of immunological treatments are now being studied, and they'll impact how we treat cancer in the future. Conceptually, immunotherapy presents an attractive route in cancer treatment for a plethora of reasons. Using the human body's innate resources towards the evolution of a defense mechanism against malignant tissue that would be exclusively treated, had thus far been an elusive goal in conventional cancer therapies.

Citigroup analysts predict that immuno-oncology drugs could be generating \$35 billion in annual sales over the medium term, and will constitute 60% of cancer treatments by 2023 (from 3% today). This would make immunotherapy the biggest market in medicine and transform cancer treatment as we know it.

#### Care Delivery & Innovative Business Models: The Quest

Since the mid-90's, people have sought to harness the power of information technology to create the optimal digital health system and uproot the status quo with a whole new paradigm and business model for healthcare. While the large-scale, broad achievements have been mixed so far, there are rays of light at the micro level and in the private sector. The common denominator has been a rigorous focus on the specific needs of the end user, be it the patient or the clinician.



Giant tech companies such as Alphabet, IBM, Amazon and Apple have joined the quest and the rapid innovation in AI, Big Data, automation, robotics, decentralized ledger technology and communication technologies can be a catalyst for real change and improvements across the whole healthcare system, rationalizing the 'back office' aspects, empowering the healthcare practitioners and enabling them to focus on client care, while creating a framework for identifying & sharing best practices.

## From the mundane to the spectacular: A summary of our investment case

One of our core investment tenets is that the best opportunities are often around the edges of things, in the more mundane and less obvious secondary effects of major trends. Away from the headlines, where you have to dig a little deeper and work a little harder, really attractive risk/reward scenarios can be found. The 'Investors Note' below highlights a few of the opportunities we see in the global healthcare sector.

We suggest that you make healthcare one of the core building blocks of your investment portfolio, so that you too can benefit from these enduring trends, enabling you to mature with peace of mind along with your investments.

*This overview was inspired by a report in our Librarium Focus Series done in collaboration with the renowned healthcare scholar & entrepreneur Dr. Arlen Meyers, MD, MBA, President & CEO at the Society of Physician Entrepreneurs, [www.sopenet.org](http://www.sopenet.org).*

### INVESTORS NOTE:

#### HEALTHCARE = A WORLD OF OPPORTUNITIES.

THE MUNDANE = ATTRACTIVE & WELL BALANCED RISK/RETURN PROFILES WITH A DEEP AND BROAD GLOBAL OPPORTUNITY SET.

##### A FEW EXAMPLES:

EYEWEAR – THE OPPORTUNITY RIGHT UNDER YOUR NOSE, OR TO BE SPECIFIC ON YOUR NOSE. A \$100 BILLION INDUSTRY WITH A APPROX. 2.5 BILLION PEOPLE IN NEED OF ITS SERVICES IN 2018 & SUPPORTED BY THE AGING DEMOGRAPHIC TREND GLOBALLY.

HEARING AIDS – WITH AGEING DEMOGRAPHICS COMES AN INCREASED AMOUNT OF PEOPLE IN NEED OF ITS INCREASINGLY INNOVATIVE PRODUCTS. BY AGE 80 ALMOST 80% OF PEOPLE HAVE DIFFICULTIES HEARING.

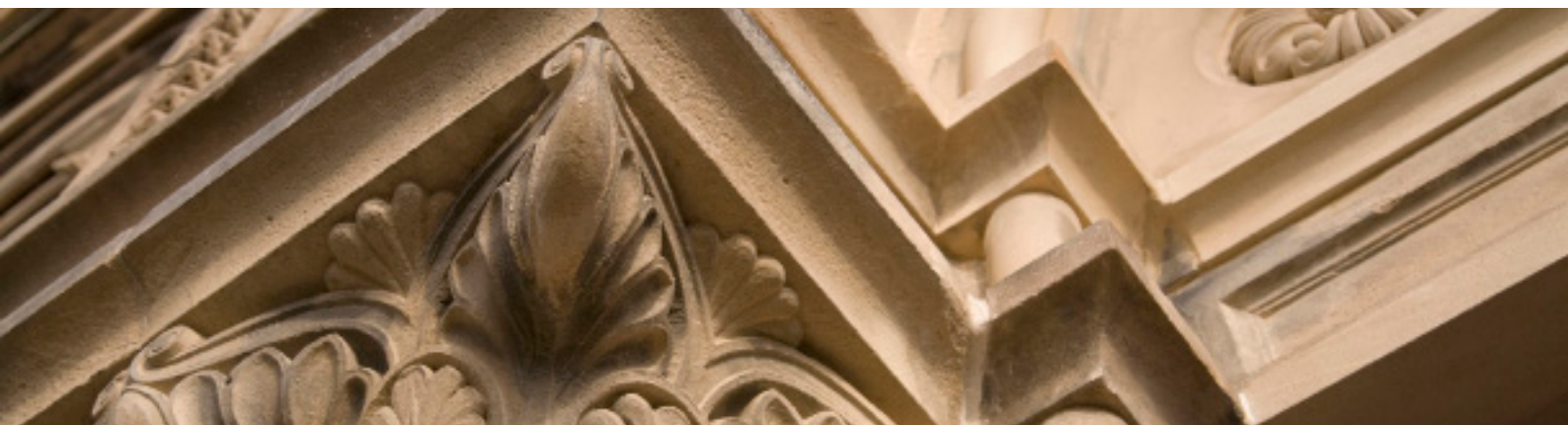
SLEEP APNEA – A FAST GROWING SEGMENT MOSTLY OVERLOOKED WITH JUST A FEW COMPANIES PROVIDING SOLUTIONS. 22 MILLION AMERICANS ARE AFFECTED, WHILE MANY GO UNDIAGNOSED, ACCORDING TO THE MAYO CLINIC.

REAL ESTATE – WITH GROWING NUMBERS OF PATIENTS & PEOPLE IN NEED OF CARE AND CARE FACILITIES AROUND THE WORLD INVESTMENTS SUCH AS HEALTHCARE FOCUSED REITS AND LISTED FACILITY OPERATORS CAN BE GREAT LONG TERM INVESTMENTS THAT OFTEN INCLUDE GOOD DIVIDEND PAYMENTS.

THE SPECTACULAR = HARNESSING THE POTENTIAL OF INNOVATION ACROSS THE INDUSTRY AND ESPECIALLY IN THE 4 SUB-SECTORS IDENTIFIED IN THIS OVERVIEW.

CAPTURE THE RISING TIDE WITH SECTOR & SUB-SECTOR INDEX FUNDS - WHILE PINPOINTING INDIVIDUAL START-UPS CAN BE VERY LUCRATIVE, IT IS ALSO A VERY UNRELIABLE AND TIMECONSUMING APPROACH. MID-SIZED AND SPECIALTY COMPANIES CAN BE A GREAT WAY TO RIDE A POTENTIAL M&A WAVE THAT IS CURRENTLY GETTING UNDERWAY, AS 'BIG PHARMA' MUST ADAPT TO NEW REALITIES & REPLENISH THEIR PRODUCT LINES. US COMPANIES COME ARMED WITH THEIR LARGE OVERSEAS HOLDINGS, WHICH CAN NOW BE REPATRIATED UNDER THE RECENT TAX LEGISLATION – ACCORDING TO A UBS REPORT, S&P500 US HEALTHCARE COMPANIES OVERALL HAD \$541 BILLION IN PROFITS HELD OVERSEAS IN 2016. WHEN YOU HAVE A SECTOR BEING DISRUPTED TO THIS DEGREE IT IS OFTEN THE OPTIMAL COURSE OF ACTION TO POSITION YOURSELF TO CAPTURE THE RISING TIDE VIA SECTOR AND SUB-SECTOR INDEX FUNDS.

Source: Librarium Associates



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