

# Historical Healthcare Performance, Election Years and 2016 Top Picks

## A Look Back At Healthcare Performance In Election Years Yields Clear Trends

### Summary

Most investors would agree that elections matter to the performance of healthcare services stocks. Indeed, we see 2016 performance as closely tied to the outcome of the Presidential and Congressional elections. But what may be surprising is the result of our analysis of the S&P 500 vs. S&P 500 Healthcare indices in the last 12 elections. One clear trend: HC outperforms the S&P 500 (and by a lot) in pre- and post-election periods when there is a balance of power in DC. Our top picks in healthcare services are ACHC, MD and UNH.

### Key Points

- **Gridlock in Washington is good for healthcare stocks.** When there is joint control in Washington with one party controlling the Presidency and the other party controlling at least one chamber of Congress, the S&P 500 Healthcare outperformed the S&P 500 pre-election (+10% versus +2%) and post-election (+16% versus +12%) on average.
- **One party control in Washington equals under-performance for healthcare stocks.** When there is no joint control in Washington, the S&P 500 Healthcare underperformed the S&P 500 pre-election (-2% versus -0%) and post-election (+1% versus +11%) on average. Note that this performance is independent of which party controls Congress.
- **Looking at the data on a forward PE basis.** The trends remain the same but only more pre-announced with healthcare PEs multiples expanding at a greater pace post-election if there is a balance of power, and decelerating at a greater pace with no balance of power.
- **Based on our analysis, healthcare service stocks *should* outperform the market pre-election and post-election but...2016 might prove to be more volatile** for healthcare leading up to the election given Washington's increased focus on drug pricing, continued Republican talks of de-funding or repealing health reform, uncertainty regarding who will be the Republican nominee for President, rising interest rates and the recent use of Executive Order to bypass Congress to enact legislation.
- **MSUSA Healthcare Services Top Picks.** ACHC (Ann Hynes), MD (Ann Hynes) and UNH (Sheryl Skolnick).

Company	Symbol	Price (1/04)	Rating		
			Prior	Curr	PT
Acadia Healthcare Company, Inc.	ACHC	\$64.23	-	Buy	\$92.00
MEDNAX, Inc.	MD	\$71.05	-	Buy	\$88.00
UnitedHealth Group Incorporated	UNH	\$116.46	-	Buy	\$131.00

Source: Bloomberg and Mizuho Securities USA

**Ann Hynes**

+1 617 235 1741

ann.hynes@us.mizuho-sc.com

**Sheryl R. Skolnick, Ph.D.**

+1 212 205 7853

Sheryl.Skolnick@us.mizuho-sc.com

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## Historical Healthcare Performance, Election Years and 2016 Top Picks

We think the performance of healthcare services stocks in 2016 will be closely tied to the outcome of the 2016 Presidential and Congressional elections given the increased scrutiny in Washington on drug pricing and continued Republican talks of defunding or repealing health reform. As a result, we analyzed the performance of the S&P 500 versus various S&P 500 healthcare indices in the last 12 elections (including midterm elections) since the 1992 Presidential election and look at the upcoming 2016 Congressional elections. The following are key highlights from the analysis:

- **Gridlock in Washington is good for healthcare stocks.** When there is joint control in Washington with one party controlling the Presidency and the other party controlling at least one chamber of Congress, the S&P 500 Healthcare outperformed the S&P 500 pre-election (+10% versus +2%) and post-election (+16% versus +12%) on average.
- **One party control in Washington equals underperformance for healthcare stocks.** When there is no joint control in Washington with one party controlling the Executive and Legislative branches the S&P 500 Healthcare underperformed the S&P 500 pre-election (-2% versus -0%) and post-election (+1% versus +11%) on average. Note that this performance is independent of which party controls Congress: whether control is in the hands of either the Democrats or Republicans, the health care index underperformed the S&P 500.
- **Based on our analysis, healthcare service stocks *should* outperform the market pre-election and post-election, but...**2016 might prove to be more volatile for healthcare leading up to the election given Washington's increased focus on drug pricing, continued Republican talks of defunding or repealing health reform, uncertainty regarding who will be the Republican nominee for President, rising interest rates and the recent use of executive order to bypass Congress to enact legislation.

Given the likely volatility and uncertainty in healthcare leading up to the 2016 elections, Ann Hynes's top picks in her healthcare services coverage universe are **ACHC and MD**. Both companies boasts a solid industry backdrop that supports double-digit organic growth and consolidation opportunities, have no exposure to changes in drug pricing, negligible impact from the introduction of health reform and little risk to Medicare payments in the near-to-immediate term. Our top pick in Sheryl Skolnick's healthcare services coverage is **UNH**: the company's 4Q15 bombshell de-risked 2016 with respect to exchanges and other losses and positioned UNH to resume double-digit growth in 2016 and beyond from better than expected Medicare Advantage enrollment and likely continued outperformance by Optum across all three of its segments.

### Exhibit 1: Election Summary

President		House Before Election			Control of House			Senate Before Election		Senate Seats Up For Election		Senate Results		Control of Senate		President
Year	During Election	D*	R*	Vacant	D*	R*	Post Election	D*	R*	D*	R*	D*	R*	Post Election <sup>#</sup>		
1992	Bush	267	167	1	-9	9	Remains Democrat	57	43	21	15	0	0	Remains Democrat	Clinton	
1994	Clinton	254	175	6	-54	54	Shift To Republican	56	44	22	13	-8	8	Shift To Republican	Clinton	
1996	Clinton	205	230	0	9	-9	Remains Republican	47	53	15	19	-2	2	Remains Republican	Clinton	
1998	Clinton	207	228	0	5	-5	Remains Republican	45	55	18	15	0	0	Remains Republican	Clinton	
2000	Clinton	212	223	0	1	-2	Remains Republican	46	54	15	19	4	-4	Shift To Democrats	Bush	
2002	Bush	214	221	0	-7	8	Remains Republican	51	49	14	20	-2	2	Shift To Republican	Bush	
2004	Bush	202	232	1	-2	3	Remains Republican	49	51	19	15	-4	4	Remains Republican	Bush	
2006	Bush	202	229	4	31	-30	Shift To Democrat	45	55	18	15	6	-6	Shift To Democrats	Bush	
2008	Bush	235	199	1	21	-21	Remains Democrat	51	49	12	23	8	-6	Remains Democrat	Obama	
2010	Obama	255	177	3	-63	63	Shift To Republican	59	41	19	18	-6	6	Remains Democrat	Obama	
2012	Obama	192	242	1	-8	8	Remains Republican	53	47	23	10	2	-2	Remains Democrat	Obama	
2014	Obama	199	233	3	13	-13	Remains Republican	55	45	21	15	-9	9	Shift To Republican	Obama	
2016	Obama	188	246	1	NA	NA	NA	46	54	10	24	NA	NA	NA	NA	

Source: Office of the Clerk of U.S. House of Representatives, US Election Atlas Org. and MSUSA USA. \* Totals may include independents that caucus with either party. \*D = Democrat and R = Republican. In the 2000 elections, the Senate initially remained Republican but shifted to Democrat in 2001 due to Senator Jeffords (VT) leaving the Republican Party and caucusing with Democrats.

## The Historical Performance Analysis

We analyzed the performance of the S&P 500 versus various S&P 500 healthcare indices in the last 12 elections (including midterm elections) since the 1992 Presidential election. One thing is clear from the data—although the healthcare issues may change and the party controlling Congress may change—healthcare stocks historically outperform the S&P 500 and trade at a higher forward one-year PE than the market when there is joint control of Washington pre-election (similar to the current environment) and post-election. When averaging all 12 elections together, the S&P 500 Healthcare outperformed the S&P 500 pre-election (+10% versus +2%) and post-election (+16% versus +12%) on average when there is joint control in Washington. When one party controls both the Executive and Legislative branches the S&P 500 Healthcare underperformed the S&P 500 pre-election (-2% versus -0%) and post-election (+1% versus +11%) on average.

### Exhibit 2: Election Performance Summary Pre-Election and Post-Election

Election Year	Pre-Election			Post-Election		
	Balance of Power	S&P 500 HC	S&P 500	Balance of Power	S&P 500 HC	S&P 500
1992	Yes	(18%)	+1%	No	(12%)	+10%
1994	No	+8%	+0%	Yes	+42%	+27%
1996	Yes	+18%	+15%	Yes	+31%	+29%
1998	Yes	+30%	+14%	Yes	+9%	+22%
2000	Yes	+28%	(3%)	Yes	(8%)	(22%)
2002	No	(17%)	(20%)	No	(1%)	+15%
2004	No	(8%)	+2%	No	+9%	+7%
2006	No	+5%	+9%	Yes	+5%	+6%
2008	Yes	(22%)	(32%)	No	+9%	+12%
2010	No	+1%	+7%	Yes	+6%	+5%
2012	Yes	+14%	+12%	Yes	+33%	+25%
2014	Yes	+21%	+9%	Yes	+7%	+7%
Pre-Election			Post-Election			
Balance Of Power:			+10%			+12%
No Balance of Power:			(2%)			(0%)
			+16%			+11%
			+1%			

Source: Mizuho Securities USA estimates and Bloomberg. \*Pre-election is performance January 1<sup>st</sup> to election date. Post-election is performance 12 months post-election date.

Below we analyze the election data in Presidential election years and mid-term election years based on price performance of the S&P 500 Healthcare Index, S&P 500 Healthcare Equipment & Services Index, the S&P 500 Pharmaceutical, Biotech and Life Sciences Index versus the S&P 500 both on an absolute price performance basis and on a forward PE basis. Breaking down the data by Presidential election years and mid-term elections years the trend remains the same with healthcare outperforming the S&P 500 when there is a balance of power.

**Presidential Election Years Breakdown.** According to our data, the S&P 500 Healthcare Index outperformed the S&P 500 pre-presidential elections when there was a balance of power, gaining +4% versus a decline of -1%, respectively. Further, the S&P 500 Healthcare Index outperformed the S&P 500 post-presidential elections when there was a balance of power, gaining +19% versus +11%, respectively. Some years, the outperformance was greater depending on the healthcare issues at the time. For example, 2012 was an important year for healthcare legislation, with the Republicans campaigning to repeal Obamacare. Post the 2012 elections, a balance of power remained in Washington.

## Exhibit 3: Stock Market Performance in Presidential Election Years

	1992 Pre Election	1992 Post Election	1996 Pre Election	1996 Post Election	2000 Pre Election	2000 Post Election	2004 Pre Election	2004 Post Election	2008 Pre Election	2008 Post Election	2012 Pre Election	2012 Post Election
S&P 500 Healthcare Index	(18%)	(12%)	+18%	+31%	+28%	(8%)	(8%)	+9%	(22%)	+9%	+14%	+33%
S&P 500 Healthcare Equipment & Services	(17%)	(11%)	+6%	+12%	+48%	(8%)	+3%	+24%	(33%)	+14%	+13%	+29%
S&P 500 Pharma, Biotech & Life Sciences	(18%)	(12%)	+22%	+37%	+23%	(7%)	(13%)	(2%)	(16%)	+7%	+15%	+35%
S&P 500 Index	+1%	+10%	+15%	+29%	(3%)	(22%)	+2%	+7%	(32%)	+12%	+12%	+25%
<div> <div>Average All Elections</div> <div>Balance Of Power</div> <div>No Balance Of Power</div> </div>												
	Pre	Post	Pre	Post	Pre	Post	Pre	Post	Pre	Post	Pre	Post
S&P 500 Healthcare Index	+2%	+10%	+4%	+19%	(8%)	+2%	(8%)	+2%	(8%)	+2%	(8%)	+2%
S&P 500 Healthcare Equipment & Services	+3%	+10%	+3%	+11%	+3%	+9%	+3%	+9%	+3%	+9%	+3%	+9%
S&P 500 Pharma, Biotech & Life Sciences	+2%	+10%	+5%	+22%	(13%)	(2%)	(13%)	(2%)	(13%)	(2%)	(13%)	(2%)
S&P 500 Index	(1%)	+10%	(1%)	+11%	+2%	+10%	+2%	+10%	+2%	+10%	+2%	+10%

-Pre the 1992, 1996, 2000, 2008 and 2012 elections there was a balance of power in Washington  
-Post the 1996, 2000, and 2012 elections there was a balance of power in Washington  
-Pre the 2004 election no balance of power  
-Post the 1992, 2004 and 2008 elections there was no balance of power in Washington

Source: Mizuho Securities USA estimates and Bloomberg. \*Pre-election is performance January 1 to election date. Post-election is performance 12 months post-election date.

On a forward PE basis, the same trend is evident that a balance of power is good for healthcare stocks with post elections the PE for healthcare is 19.9x versus 13.4x if there is a no balance of power environment.

## Exhibit 4: Election Year Stock Market Price to Earnings Valuation

	1992 Pre Election	1992 Post Election	1996 Pre Election	1996 Post Election	2000 Pre Election	2000 Post Election	2004 Pre Election	2004 Post Election	2008 Pre Election	2008 Post Election	2012 Pre Election	2012 Post Election
S&P 500 Healthcare Index	16.0x	13.1x	17.8x	21.1x	25.2x	24.8x	16.6x	16.8x	12.4x	10.3x	11.7x	13.8x
S&P 500 Healthcare Equipment & Services	17.0x	14.0x	16.8x	18.3x	21.7x	23.2x	16.6x	18.3x	13.2x	10.4x	11.4x	12.8x
S&P 500 Pharma, Biotech & Life Sciences	15.9x	13.0x	18.1x	21.8x	26.1x	25.2x	16.5x	15.7x	12.1x	10.2x	11.9x	14.4x
S&P 500 Index	13.4x	13.8x	13.7x	16.0x	20.9x	17.4x	14.7x	14.8x	12.0x	11.8x	11.8x	13.0x
<div> <div>Average All Elections</div> <div>Balance Of Power</div> <div>No Balance Of Power</div> </div>												
	Pre	Post	Pre	Post	Pre	Post	Pre	Post	Pre	Post	Pre	Post
S&P 500 Healthcare Index	16.6x	16.7x	16.6x	19.9x	16.6x	13.4x	16.6x	13.4x	16.6x	13.4x	16.6x	13.4x
S&P 500 Healthcare Equipment & Services	16.1x	16.2x	16.0x	18.1x	16.6x	14.2x	16.6x	14.2x	16.6x	14.2x	16.6x	14.2x
S&P 500 Pharma, Biotech & Life Sciences	16.8x	16.7x	16.8x	20.5x	16.5x	13.0x	16.5x	13.0x	16.5x	13.0x	16.5x	13.0x
S&P 500 Index	14.4x	14.5x	14.4x	15.5x	14.7x	13.5x	14.7x	13.5x	14.7x	13.5x	14.7x	13.5x

-Pre the 1992, 1996, 2000, 2008 and 2012 elections there was a balance of power in Washington  
-Post the 1996, 2000, and 2012 elections there was a balance of power in Washington  
-Pre the 2004 election no balance of power  
-Post the 1992, 2004 and 2008 elections there was no balance of power in Washington

Source: Mizuho Securities USA estimates Bloomberg. \* Pre-election is average PE January 1<sup>st</sup> to election date. Post-election is average PE 12 months post-election date.

**Mid-Term Election Years Breakdown.** It's the same trend only more pronounced pre-election when looking at the data from a forward PE basis. Note again that gridlock is good for health care – there's a nearly 50% premium multiple in the post-election 12 months when there is gridlock versus when there isn't. (20.9x versus 14.6x). But what is different is that there is a surge in the index pre-mid-term election that is more than DOUBLE the average appreciation for the broader S&P 500 when gridlock prevails before and after the election.

### Exhibit 5: Stock Market Performance in Mid-Term Election Years

	1994 Pre Election	1994 Post Election	1998 Pre Election	1998 Post Election	2002 Pre Election	2002 Post Election	2006 Pre Election	2006 Post Election	2010 Pre Election	2010 Post Election	2014 Pre Election	2014 Post Election
S&P 500 Healthcare Index	+8%	+42%	+30%	+9%	(17%)	(1%)	+5%	+5%	+1%	+6%	+21%	+7%
S&P 500 Healthcare Equipment & Services	+8%	+32%	+5%	(13%)	(9%)	+9%	(5%)	+13%	(1%)	+10%	+19%	+12%
S&P 500 Pharma, Biotech & Life Sciences	+10%	+45%	+36%	+15%	(19%)	(5%)	+11%	+2%	+1%	+5%	+22%	+4%
S&P 500 Index	+0%	+27%	+14%	+22%	(20%)	+15%	+9%	+6%	+7%	+5%	+9%	+4%
	Average All Elections		Balance Of Power		No Balance Of Power		-Pre the 1998 and 2014 elections there was a balance of power in Washington there was a					
	Pre	Post	Pre	Post	Pre	Post	-Post the 1994, 1998, 2006, 2010 and 2014 elections there was a balance of power in Washington					
S&P 500 Healthcare Index	+8%	+11%	+26%	+14%	(1%)	(1%)	- Pre the 1994, 2002, 2006 and 2010 elections no balance of power in Washington					
S&P 500 Healthcare Equipment & Services	+3%	+11%	+12%	+11%	(2%)	+9%	- Post the 2002 elections there was no balance					
S&P 500 Pharma, Biotech & Life Sciences	+10%	+11%	+29%	+14%	+1%	(5%)						
S&P 500 Index	+3% +13%		+12% +13%		(1%) +15%							

Source: Mizuho Securities USA estimates and Bloomberg. \*Pre-election is performance January 1<sup>st</sup> to election date. Post-election is performance 12 months post-election date.

### Exhibit 6: Election Stock Market Price to Earnings Valuation

	1994 Pre Election	1994 Post Election	1998 Pre Election	1998 Post Election	2002 Pre Election	2002 Post Election	2006 Pre Election	2006 Post Election	2010 Pre Election	2010 Post Election	2014 Pre Election	2014 Post Election
S&P 500 Healthcare Index	12.7x	15.0x	26.6x	28.1x	19.3x	17.1x	15.8x	15.4x	10.6x	10.9x	15.1x	16.1x
S&P 500 Healthcare Equipment & Services	14.0x	14.9x	21.4x	21.7x	18.9x	16.2x	16.4x	16.1x	11.8x	11.9x	14.6x	16.4x
S&P 500 Pharma, Biotech & Life Sciences	12.5x	15.0x	27.8x	29.7x	19.4x	17.4x	15.5x	15.1x	10.0x	10.5x	16.0x	16.0x
S&P 500 Index	12.7x	12.2x	18.3x	21.4x	14.5x	14.0x	13.8x	14.3x	11.8x	11.7x	14.5x	15.6x
-Pre the 1998 and 2014 elections there was a balance of power in Washington there was a												
Average All Elections				Balance Of Power				No Balance Of Power		of power in Washington there was a		
	Pre	Post			Pre	Post			Pre	Post	-Post the 1994, 1998, 2006, 2010 and 2014 elections there was a balance of power in Washington	
S&P 500 Healthcare Index	16.7x	17.1x			20.9x	17.1x			14.6x	17.1x	- Pre the 1994, 2002, 2006 and 2010 elections no balance of power in Washington	
S&P 500 Healthcare Equipment & Services	16.2x	16.2x			18.0x	16.2x			15.3x	16.2x	- Post the 2002 elections there was no balance	
S&P 500 Pharma, Biotech & Life Sciences	16.9x	17.3x			21.9x	17.3x			14.4x	17.4x		
S&P 500 Index	14.3x	14.9x			16.4x	15.0x			13.2x	14.0x		

Source: Mizuho Securities USA estimates and Bloomberg. \* Pre-election is average PE January 1<sup>st</sup> to election date. Post-election is average PE 12 months post-election date.

It should be noted 1994 was a particularly important year for healthcare legislation. A taskforce (also known as a cast of thousands) established immediately after the inauguration in January of 1993 chaired by First Lady Hillary Rodham Clinton worked to create a health reform plan dubbed "HillaryCare." In September 1993, President Clinton gave a major speech to Congress outlying his healthcare plan. The Democrats, who controlled both chambers of Congress, could not unite under President Clinton's proposal and offered several different competing proposals. "HillaryCare" was stalled in Congress and no legislation passed. Post the 1994 elections, the balance of power shifted with the Republicans taking control of both chambers of Congress and healthcare subsequently outperformed on a price performance basis and PE multiple expansion basis.

## Could the 2016 Election Mirror Past Elections?

2016 might prove to be more volatile for healthcare leading up to the election given Washington's increased focus on drug pricing, continued Republican talks of defunding or repealing health reform, uncertainty regarding the Republican nominee for President, rising interest rates, and the recent use of executive order to bypass Congress to enact legislation.

**Executive Order.** We believe one factor that is not included in our analysis is the impact of a President Obama (or a future President Hillary Clinton) using an executive order to impose Medicare prescription drug pricing changes. Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, the federal government is prohibited from negotiating directly with pharmaceutical companies on drug pricing. The president's power to issue executive orders comes from article II of the U.S. Constitution and does not require Congressional approval. An executive order can be used for any matter involving domestic affairs, as long as the order does not encroach on a matter reserved for Congress. Congress can overturn an executive order by a two-thirds vote. In the past, Presidents have used executive orders for a wide range of issues from sending troops abroad to passing environmental protection. Historically, executive orders relate to routine administrative affairs and the internal operations of federal agencies. However, President Obama has used executive orders for several major issues ranging from immigration to delaying the implementation of certain aspects of health reform and to a pending order on gun control. In our view, we think the likelihood that President Obama will use executive order to impose changes to Medicare drug pricing is low. Although allowing Medicare to negotiate drug prices has been included in past budgets, President Obama's budgets historically have not been enacted into law. Importantly, the pharmaceutical industry was instrumental in working with the Obama administration to help fund the Affordable Care Act, so we believe there is some political goodwill between the industry and the administration.

## 2016 Election Preview

We believe the 2016 Presidential elections will be an important area to watch over the coming months, especially given the uncertainty regarding who will be the Republican nominee for President. We think it is too early to predict the outcome of the elections. This section of the note serves to provide a summary of key toss up re-election races for the House and Senate and highlight potential swing states in the Presidential election. In addition to the Presidential election, one-third of the Senate and the entire House are up for re-election. Currently in the House, Republicans have 246 seats and Democrats have 188. In the Senate, Republicans have 54 seats and Democrats (including two independents that caucus with the Democrats) hold 46 seats. A total of six senators (three Democrats and three Republicans are retiring). According to our analysis, there are two close Senate Democrat races and seven Republican. We believe the seven close Republican races are in Florida, Illinois, New Hampshire, North Carolina, Ohio, Pennsylvania and Wisconsin, which could all be swing states in the upcoming elections. All of these states voted Democrat in the



2008 and 2012 presidential elections with the exception of South Carolina voting Republican in 2012.

## Exhibit 7: Projected Close Races in 2016 Elections

Senate		House	
Democrat	Republican	Democrat	Republican
2	7	6	28

Source: Cook Political Report and Mizuho Securities USA estimates

In the House, the Republicans demonstrated a strong showing in 2014 gaining +13 seats in the House. Despite the partisan legislative environment and low approval ratings in Congress we do not believe a change in the House is achievable in 2016. The Democrats need to gain +30 seats in the House to regain control. Currently we are projecting six close Democrat races and 28 close Republican races.

## Exhibit 8: Senate Seats Up For Election In 2016

Senator	State	Party	In Office Since	Potential Opponent/Leading In Polls	Advantage	Comment
Lisa Murkowski	AK	Republican	2002	TBA Democrat	Likely Republican	
Richard Shelby	AL	Republican	1987	TBA Democrat	Solid Republican	
John Boozman	AR	Republican	2011	Conner Eldridge (D)	Solid Republican	
John McCain	AZ	Republican	1986	Ann Kirkpatrick (D)	Likely Republican	
Open Seat	CA	Democrat	NA	TBA Democrat and Republican	Likely Democrat	Open Seat Senator Barbara Boxer is not seeking re-election
Richard Blumenthal	CT	Democrat	2011	August Wolf (R)	Solid Democrat	
Open Seat	FL	Republican	NA	TBA Democrat and Republican	Toss Up	Open Seat Senator Marco Rubio is not seeking re-election
Johnny Isakson	GA	Republican	2005	TBA Democrat	Likely Republican	
Brian Schatz	HI	Democrat	2012	Charles Collins (R)	Solid Democrat	
Chuck Grassley	IA	Republican	1981	TBA Democrat	Solid Republican	
Mike Crapo	ID	Republican	1999	TBA Democrat	Solid Republican	
Mark Kirk	IL	Republican	2011	TBA Democrat	Toss Up	
Open Seat	IN	Republican	NA	TBA Democrat and Republican	Likely Republican	Open Seat Senator Dan Coats is not seeking re-election
Jerry Moran	KS	Republican	2011	TBA Democrat	Solid Republican	
Rand Paul	KY	Republican	2011	TBA Democrat	Solid Republican	
Open Seat	LA	Republican	NA	TBA Democrat and Republican	Solid Republican	Open Seat Senator David Vitter is not seeking re-election
Open Seat	MD	Democrat	NA	Chris Van Hollen (D) and TBA Republican	Solid Democrat	Open Seat Senator Barbara Mikulski is not seeking re-election
Roy Blunt	MO	Republican	2011	Jason Kander (D)	Likely Republican	
Richard Burr	NC	Republican	2005	TBA Democrat	Lean Republican	
John Hoeven	ND	Republican	2011	TBA Democrat	Solid Republican	
Kelly Ayotte	NH	Republican	2011	Maggie Hassan (D)	Toss Up	Maggie Hassan is the current governor of New Hampshire
Open Seat	NV	Democrat	NA	Catherine Cortez Mastro (D) and Joe Heck (R)	Toss Up	Open Seat Senator Harry Reid is not seeking re-election
Chuck Schumer	NY	Democrat	1999	TBA Republican	Solid Democrat	
Rob Portman	OH	Republican	2011	Ted Strickland (D)	Lean Republican	
James Lankford	OK	Republican	2015	TBA Democrat	Solid Republican	
Ron Wyden	OR	Democrat	1996	TBA Republican	Solid Democrat	
Pat Toomey	PA	Republican	2011	Katie McGinty (D)	Lean Republican	
Tim Scott	SC	Republican	2013	TBA Democrat	Solid Republican	
John Thune	SD	Republican	2005	TBA Democrat	Solid Republican	
Mike Lee	UT	Republican	2011	TBA Democrat	Solid Republican	
Patrick Leahy	VT	Democrat	1975	TBA Republican	Solid Democrat	
Patty Murray	WA	Democrat	1993	Chris Vance (R)	Solid Democrat	
Ron Johnson	WI	Republican	2010	Russ Feingold (D)	Toss Up	

Source: Cook Political Report and Mizuho Securities USA estimates. \* Note it is still early in the primary process and not all candidates may declare intent to run.

### Exhibit 9: Notable House Races In 2016

Lean Democrat	Party	State	Toss Up	Party	State	Lean Republican	Party	State
Ami Bera	Democrat	CA	Open AZ-01	Democrat	AZ	Martha McSally	Republican	AZ
Open FL-13	Republican	FL	Open FL-18	Democrat	FL	Jeff Denham	Republican	CA
Rick Nolan	Democrat	MN	Brad Ashford	Democrat	NE	David Valadao	Republican	CA
Crescent Hardy	Republican	NV	Mike Coffman	Republican	CO	Steve Knight	Republican	CA
			Carlos Curbelo	Republican	FL	John Mica	Republican	FL
			Bob Dold	Republican	IL	David Young	Republican	IA
			Rod Blum	Republican	IA	Open MI-01	Republican	MI
			Bruce Poliquin	Republican	ME	Tim Walberg	Republican	MI
			Open MN-02	Republican	MN	Scott Garrett	Republican	NJ
			Open NV-03	Republican	NV	Lee Zeldin	Republican	NY
			Frank Guinta	Republican	NH	John Katko	Republican	NY
			Open NY-19	Republican	NY	Mia Love	Republican	UT
			Richard Hanna	Republican	NY	Randy Forbes	Republican	VA
			Open PA-08	Republican	PA			
			Will Hurd	Republican	TX			
<b>Total</b>		<b>4</b>	<b>Total</b>		<b>15</b>	<b>Total</b>		<b>13</b>

Source: Cook Political Report and Mizuho Securities USA estimates.

### 2016 Presidential Election

Though it is still early in the election and primary process, the result of the Presidential election could shape the legislative environment and thus ultimately drive the healthcare sectors performance. It appears that Hillary Clinton (D-NY) will be the likely Democrat candidate with Bernie Sanders (I-VT) trailing in second place. Though the Republican convention in July 2016 is several months away, Donald Trump (R-NY) is the current front runner in the Republican field, with Ted Cruz (R-TX), Marco Rubio (R-FL), and Dr. Ben Carson (R-MD) also drawing strong support. We think the uncertainty surrounding who will be the Republican candidate will add to the volatility in healthcare stocks early in 2016.

Though it still early to determine a front runner in the race or if a specific state will vote blue or red, we believe key states to focus on in the presidential race are: Colorado, Florida, Iowa, Nevada, New Hampshire, Ohio, Pennsylvania, Virginia, and Wisconsin. To win the Presidential election 270 electoral votes are needed. According to the Cook Political report, the Democrats are likely to obtain 186 electoral votes in the general election to and the Republican 164. It appears there are still 115 electoral votes are that are currently toss ups.



**Exhibit 10: 2016 Presidential Election Summary**

Solid Democrat	Electoral Vote	Likely/Lean Democrat	Electoral Vote	Toss Up	Electoral Vote	Likely/Lean Republican	Electoral Vote	Solid Republican	Electoral Vote
CA	55	MI	16	CO	9	NC	15	AL	9
CT	7	MN	10	FL	29	AZ	11	AK	3
DE	3	NM	5	IA	6	GA	16	AR	6
DC	3			NV	6			ID	4
HI	4			NH	4			IN	11
IL	20			OH	18			KA	6
ME	4			PA	20			KY	8
MD	10			VA	13			LA	8
MA	11			WI	10			MS	6
NJ	14							MO	10
NY	29							MT	3
OR	7							NE	5
RI	4							ND	3
VT	3							OK	7
WA	12							SC	9
								SD	3
								TN	11
								TX	38
								UT	6
								WV	5
								WY	3
<b>Total</b>	<b>186</b>	<b>Total</b>	<b>31</b>	<b>Total</b>	<b>115</b>	<b>Total</b>	<b>42</b>	<b>Total</b>	<b>164</b>

Source: Cook Political Report and Mizuho Securities USA estimates. \* Note 270 electoral votes needed to the win the presidential election.

Given the likely volatility and uncertainty in healthcare leading up to the 2016 elections, Ann Hynes's top picks in her healthcare services coverage universe are **ACHC and MD**. Both companies boasts a solid industry backdrop that supports double-digit organic growth and consolidation opportunities, have no exposure to changes in drug pricing, negligible impact from the introduction of health reform and little risk to Medicare payments in the near-to-immediate term. Our top pick in Sheryl Skolnick's healthcare services coverage is **UNH**: the company's 4Q15 bombshell de-risked 2016 with respect to exchanges and other losses and positioned UNH to resume double digit growth in 2016 and beyond from better than expected Medicare Advantage enrollment and likely continued outperformance by Optum across all three of its segments.

## 2016 Top Picks – Ann Hynes

### *Acadia Healthcare*

We rate Acadia Healthcare (ACHC, PT \$92) a Buy. We think earnings visibility is high given the favorable industry backdrop (both in the U.S. and U.K. markets), solid organic operating trends and potential for M&A.

**Favorable market backdrop.** The mental health market backdrop in the U.S. remains favorable due to increased demand, favorable supply/demand characteristics and legislative tailwinds that will likely provide steady underlying admissions growth for the foreseeable future. ACHC appears well positioned to capitalize on this supply/demand imbalance in our view. The U.K. market is a single-payer system with the National Health Service (NHS) managing 70% of mental health beds. The NHS has been rationalizing beds and outsourcing services to independent providers. Going forward, we expect the move towards care coordination and outcomes based care, as well as the capacity issues at NHS, to provide organic growth opportunities for independent providers. The market is highly fragmented (58% of market share controlled by the four largest providers) and offers continued runway for additional consolidation opportunities as evidenced by yesterday's announcement that ACHC is acquiring The Priory Group, the U.K. largest provider of behavioral services. For my thoughts on the announcement, please refer to our note published yesterday "*Initial Thoughts On The Priory Group Acquisition*".

**Potential modification of IMD Exclusion could provide meaningful upside.** The Centers for Medicare and Medicaid Services (CMS) proposed a modification to the IMD Exclusion that would expand federal funding to the Medicaid managed care population for short-stays at stand-alone IMD facilities. We estimate this would add \$21mm-\$26mm of adjusted EBITDA or \$0.20-\$0.25 our annual adjusted EPS estimates. This is now a likely 2017 event given the delay of the final managed Medicaid rule. We expect the final rule in the coming months.

**Solid organic trends expected to continue.** ACHC boasts double digit organic revenue and EBITDA growth over the last several years. We believe high-single digit organic revenue growth and double digit earnings growth is achievable based on the favorable market backdrop, ACHC's ability to take market share, and bed expansion plans. Our estimates assume same-store revenue and EBITDA growth of +8%-9% and +10.0%-10.5%, respectively. ACHC is adding 500 beds to existing hospitals. This activity is a very profitable, low cost investment.

**Unannounced M&A a likely source of upside to our estimates.** The mental health and substance abuse markets in the U.S. and U.K. remain highly fragmented and appear ripe for consolidation, in our view. We expect ACHC to remain an active acquirer due to its access to capital and management's successful track record of acquiring underutilized/underperforming assets and improving operating performance at these facilities.

### *MedNax*

We rate MedNax (MD, PT \$88) Buy. We view double-digit earnings growth across 2015E-2017E as achievable given the company's competitive positioning, favorable market backdrop and M&A runway. Cash generation is an investment highlight and, together with a clean balance sheet provides flexibility for acceleration in capital deployment.

**Fast growing market that is highly fragmented.** We believe the trend for hospitals to outsource should accelerate, especially where physicians want to be employed, including ER, anesthesiology, hospitalist and pediatric. Hospitals benefit from outsourcing physicians because it allows them to focus on facility management and more profitable suites (e.g. cardiology, orthopedics) while also receiving a higher level of specialized care from the outsourcing vendor. The outsourcing vendor guarantees and manages physician coverage, employees and recruits the doctor, and oversees regulatory and compliance requirements. We think MD has a favorable competitive positioning versus its peer group. MD is the market leader in the outsourced NICU/pediatric services segment. We view this as an attractive market niche characterized by steady demand and high margins relative to other outsourced services segments. We believe MD's extensive experience (spanning 35+ years) and scale are competitive advantages over competitors in the space that should allow it to gain a disproportionate share of new business opportunities going forward.

**Earnings visibility looks solid.** MD boasts double digit revenue, EBITDA and adjusted EPS growth. We view double-digit earnings growth across 2015E-2017E as achievable given the company's competitive positioning, favorable market backdrop and M&A runway. We think underlying demand remains strong in all three business segments. We think upside comes from accretive M&A and capital deployment. Further, MD boasts an attractive EBITDA margin (~22%E versus the publicly-traded peer group of 10-11%) and cash flow profile given its business mix and lack of emergency room (ED) exposure.

**Disciplined acquirer with flexibility to accelerate M&A.** MD has completed more than 130 acquisitions over the last ten years. Cash generation is an investment highlight and together with a clean balance sheet provides flexibility for acceleration in capital deployment. An under-levered balance sheet leaves room for M&A; debt-to-TTM EBITDA is at 2.2x versus for-profit peers of 4-5x.

## 2016 Top Picks – Sheryl R. Skolnick, Ph.D.

### *UnitedHealth Group*

We rate UnitedHealth Group (UNH, PT \$131) a Buy. We think UNH is uniquely positioned to transform health care via Optum and United Healthcare as UNH is driving down the cost of care directly (e.g., through UHC's patient-centered approach & Optum's care delivery business) and indirectly (Optum's services provided to more than 300 health plans, thousands of providers and state & Federal government). In our view, UNH is the only MCO positioned to address a more than \$1 trillion market opportunity.

**De-risked 2016 earnings now comparable to peers:** UNH's recent announcement of exchange losses, advance recognition and specific loss guidance for 2016, along with a shift to cash EPS that added \$0.50 of EPS to GAAP guidance, makes it the only company in the sector to have de-risked 2016 earnings. We expect investor sentiment will therefore continue to shift toward UNH and away from the other health plans, especially as UNH's handling of the situation has dramatically increased investors' confidence in management.

**Peers' M&A distraction creates market share opportunity for UHC** in commercial, which could augment likely robust growth in Medicare Advantage and Managed Medicaid. However, UNH's guidance on this point seems muted, making this a potential source of earnings upside in our view.

**Optum's growth is under-appreciated and when its CFFO becomes dominant, what will happen?** Already at 45% of Operating Income for 2016E, this unregulated subsidiary could contribute 40%+ of CFFO next year and could begin to dominate CFFO in three years. What will the market do when little Optum becomes the dominant business at UNH? We expect significant long-term multiple appreciation from this shift. Clinical, agbio, and new products should perform better than expected, accelerating top line growth.

**Estimates.** We are at the low-end of guidance of \$7.10 to \$7.30 GAAP/\$7.60 to \$7.80 Cash EPS, just to be conservative. But, based on the discussion in the recent investor day around near-term execution, we see significant upside potential.

## Price Target Calculation and Key Risks

### *Acadia Healthcare Company, Inc.*

Our \$92 price target is based on 18.5x our CY16E EV/EBITDA, in-line with the high trading average over the past several years. We are using the high multiple given the solid earnings visibility and potential for EPS upside through unannounced M&A and legislative tailwinds. Risks to valuation include private and government payer reimbursement pressures, the intense regulatory landscape, multiple contraction, and competition from acquisitions and integration risks.

### *MEDNAX, Inc.*

Our \$88 price target is based on a 13.5x multiple applied to our 2016E adjusted EBITDA. Our valuation multiple is in-line with the current forward-year multiple and near the high-end of the industry average range of 11x-14x over the last two to five years. We view a premium valuation multiple as warranted given the company's earnings visibility and consolidation opportunity. Risks to our thesis include increased competition in the sector, government reimbursement pressures, client and affiliated physician retention rates, and M&A integration risks.

### *UnitedHealth Group Incorporated*

**Price Target Methodology:** Our \$131 one-year PT is based on our DCF model using a 2.5% long-term growth rate, which could prove conservative. This equates to 18.4x our likely too conservative 2016 \$7.10 EPS estimate.

**Key Risks:** Among the key risks to our rating and price target are execution risk; reimbursement and regulatory risks; competitive risks and market risk. Further, UNH is modestly exposed to exchange rate risk, with less than 5% of its revenue derived from its global businesses, principally in Brazil. Execution risk includes risks in both the benefits and services businesses. In the benefits business, estimation of cost trends and other actuarial calculations are critical activities as they influence pricing and reserves for the Company's insurance products. Any misstep there could result in a material and negative effect on the stock price. In addition, the Optum services business is highly innovative and technology driven. Missteps there could lead to the potential for material disappointments in results and multiple compression. Reimbursement and regulatory risk could not only affect pricing, but also members served. The timing and extent of such changes are usually out of the Company's control and therefore could represent exogenous events with negative earnings and stock price implications. Should tax subsidies for Federal Exchange premiums be overturned by the Supreme Court, there could be meaningful downside to multiples, earnings and the stock price.

## Companies Mentioned (prices as of 1/04 )

Acadia Healthcare Company, Inc. (ACHC- Buy \$64.23)  
UnitedHealth Group Incorporated (UNH- Buy \$116.46)

MEDNAX, Inc. (MD- Buy \$71.05)

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Sell (Underperform)	0.57%	0.00%

For disclosure purposes only (NYSE and FINRA ratings distribution requirements), our Buy, Neutral and Underperform ratings are displayed as Buy, Hold and Sell, respectively.

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