Fixed Income Market Comments

Ascent Investment Partners

February 27, 2017

What Trump Means for Bonds – Health Care

This report is one in a series examining the potential implications of the Trump administration on bond markets. Through the presidential campaign and since the election, President Trump has highlighted policy areas on which his administration will focus. In this series, Ascent will address some of the proposed or discussed policies and examine their potential impacts on taxable and tax-exempt bond markets.

Policy:

One of the cornerstones of the Trump campaign was his pledge to "repeal and replace" the Affordable Care Act (aka, the ACA or "Obamacare"). It appears that President Trump and the Republican Congress will move soon to make sweeping changes to health care laws, though it remains unclear what will be put in place.

Implications:

Until there is a "Trump Plan," or a plan forwarded by Congress, it is impossible to determine what the concrete impacts will be on health sector-related credits. What we can say is that there will be a tremendous amount of uncertainty in the health care sector until there is a plan in place. As we saw with the passage and implementation of the ACA, uncertainty creates negative pressure on health care credit quality.

The ACA dramatically expanded the insured population in the country, much of that accomplished through the expansion of Medicaid eligibility at the state level. Most of the analysis of health care changes under Trump has focused on the likelihood that the number of insured Americans would decline toward pre-ACA levels. There are also questions of whether expanded Medicaid payments from the federal government to states would be reduced or curtailed. Any combination of policies that moves the system back toward the "pre-ACA" model could have significant negative impacts for companies in health-related sectors and for state and local governments.

To put magnitude of the changes in perspective, spending on health care in the U.S. over the past four years rose at an annual average rate of 4.5%* (an average of more than $125 billion per year). One of the largest drivers of that increase was Medicaid spending, which rose an average of 8.6% per year over that period. Although Medicaid programs are administered at the state level, and states budget significant state resources to their programs, since the passage of the ACA, the federal government is by far the largest contributor to funding health care for the poor.

Impacts on Bonds:

Until the path becomes clearer, we expect investors to view health care-related issuers as having a relatively higher level of credit risk than they did under President Obama, or would have had under a Clinton Administration. All else equal, we would expect health care related prices to fall relative to the general market and yield spreads to widen. Corporate bonds in health care related sectors will also be very sensitive to specific policy proposals.

We do not expect the pace of health care sector M&A activity to slow considerably. The Trump Administration is generally viewed as being supportive of business. The general level of interest rates and continued access to inexpensive debt are likely to be more significant drivers of corporate actions.

State budgets could come under significant pressure to the extent that the federal government reduces Medicaid funding. The 32 states that expanded Medicaid under the ACA would appear to be most at risk.

Ascent's Approach:

Ascent believes that the uncertain course of national health care policy should not change investors' approach to their fixed income portfolios. Issuers that were strongly positioned under the ACA will likely remain so under any new plan. Rather than reacting to policy changes on the fly, investors are better served sticking to their long-term strategy or asset allocation. A rising interest rate environment would generally be a positive development for income-oriented investors, who have been yield starved for many years. If health care policy reform drives yields higher, long-term buy-and-hold investors will benefit from rolling interest payments and maturing bond proceeds into new positions at higher yields. Declining bond prices are only a problem for traders; buy-and-hold investors who exercise careful credit selection can feel confident that their bonds will mature at par as scheduled.

*Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group.

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