

Our Case for Health Care

Several state court challenges that questioned both the core and the constitutionality of President Obama's Affordable Care Act led to a seminal hearing before the highest court in the land. On June 28th, the Supreme Court upheld the law by a 5-4 vote.

While we can't predict how the Court's ruling will shape the investment markets or the health-care industry as a whole—nor do we believe anyone else can either—we are certain that demand for health-care products and services, both domestically and globally, will continue to grow over the coming years and decades.

Investing in health care, and often overweighting the sector through a focus on managers whose sole universe is the health-care field, has been a signature component of Adviser Investments' portfolio strategy for many years. While we know that uncertainties surrounding the sector haven't been alleviated by the Court's decision, we still believe that the health-care sector continues to offer opportunities for both long-term growth and reasonable portfolio defense during periods of market turmoil.

Health care encompasses many diverse sub-sectors including biotechnology, pharmaceuticals, managed care, medical services, medical equipment and devices and more. Skilled managers like Ed Owens and Jean Hynes of Wellington Management, who are responsible for two funds we've invested in, Vanguard Health Care and Hartford Healthcare, are well-versed in the ins and outs of the Supreme Court case and more focused on opportunities following the court's decision.

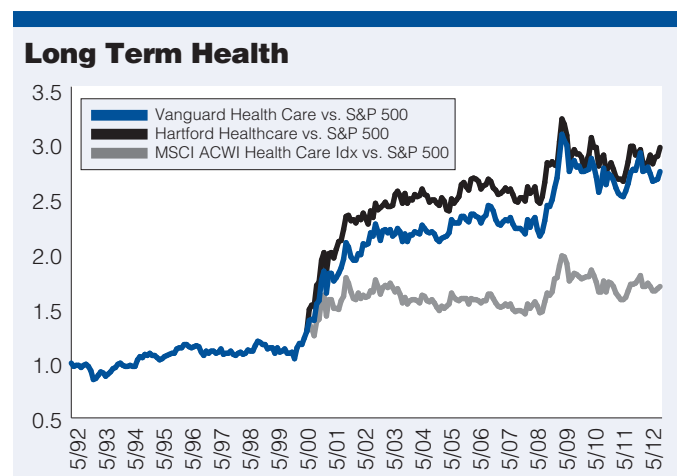
Demographics

Our aging population's story is an old one, but nevertheless meaningful from an investment perspective. In the U.S. alone there are more than 77 million baby boomers—nearly 11,000 of them are turning 65 every day. With the average lifespan in the U.S. (and around the world) continuing to

rise, we are all living longer thanks to improved drugs and medical treatments. As demand continues to increase, supply will have to keep up, which is good for business. The health-care industry will have an ever-growing impetus to provide innovative and less-invasive procedures and medicines to meet the needs of an aging population here and elsewhere in the developed world, but also those of the massive and growing populations in China and India as well as smaller but even faster-growing emerging markets nations. We believe this will be the foundation of stable and growing investment returns in the sector for decades to come.

Proven Outperformance

Of course, beyond broad themes like demographics and emerging market demands for health care, all we have to



Note: Chart shows relative performance—when line is rising, the fund/index is outperforming the S&P 500 Index. Source: Morningstar

do is look at the performance of this sector to see how investors in the Vanguard and Hartford funds have been rewarded over the years.

In the chart on the previous page, we've compared the performance of Vanguard Health Care, Hartford Healthcare and the MSCI ACWI Health Care Index (a proxy for the entire global health-care sector) against the S&P 500 Index over the last 20 years. In each case, a rising line indicates outperformance over the S&P 500 (and a falling line means relative underperformance). As you can see, the managed funds' long-term returns have trounced the returns of the broad U.S. stock market in spite of expected periods of underperformance. The MSCI index has also outperformed, but not by nearly the margin of the Wellington-run funds.

This strong outperformance has also come with considerably less downside risk than the market overall. Consider the defensive characteristics health care showed as the markets were rocked by the financial crisis in 2008 and 2009. While the S&P 500 suffered a loss (after factoring in

dividends) of 50.9%, Vanguard Health Care and Hartford Healthcare lost 33.2% and 37.7%, respectively, and recovered those losses over a period of 22 to 25 months. It took the S&P 500 37 months to finally recover from its 50.9% decline.

Our Diagnosis

We spoke to Owens and Hynes last June, while the questions about health-care reform were still shaping markets, and met with their colleague Ann Gallo in December. Both times, the managers saw the volatility created by uncertainty surrounding the health-care bill creating significant opportunity for finding value in the markets. But they also remained focused on the longer-term potential of new products and therapies being developed by the companies they follow.

Our takeaway is that Owens, Hynes and their team are confident in their investment process and are completely prepared to deal with whatever fallout stems from the Supreme Court ruling. We remain bullish on the sector.

Clinton Health Care Reform

Uncertainty surrounding the health-care sector has been a factor in the markets before. We thought it would be instructive to take a look at how stocks fared in the wake of the last major health-care debate when President Bill Clinton and then-First Lady Hillary Clinton had their go at reform. Health care dominated the national spotlight in September 1993 when both Clintons appeared before Congress ahead of their bill's November presentation to the House of Representatives, and continued to be a hot topic through the mid-term 1994 congressional campaign season. Efforts at reform ultimately failed, and the final compromise health-care bill was declared dead in September 1994, shortly followed by Republicans winning a majority in the House of Representatives that November.

As you can see in the accompanying table, despite fears of an overly complex, costly universal health-care system and through all of the partisan bickering, the health-care sector (as represented by the Vanguard Health Care fund) generated strong returns relative to the market during the debate. In the years following the failed attempt at reform, the fund continued to outperform, albeit by a lesser margin.

A Healthy Debate

| | Vanguard Health Care | S&P 500 |
|---|----------------------|---------|
| The Debate: Health Care Bill goes to Congress (9/93–9/94) | 20.1% | 3.7% |
| One Year Later (9/94–9/95) | 31.6% | 29.7% |
| Three Years Later (9/94–9/97) | 31.1% | 29.9% |
| Five Years Later (9/94–9/99) | 25.7% | 25.0% |
| 10 Years Later (9/94–9/04) | 19.3% | 11.1% |

Note: Multi-year period returns are annualized. Source: Morningstar

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