CONFIDENTIAL
PREMIUM RECOMMENDATIONS

Selection
SPDR S&P PHARMACEUTICALS ETF (XPH)
Volume 5 | **Issue 2**

VALUE LINE SELECT®

ETFs

Value Line®

MONTHLY FUND SELECTION SERVICE

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STATE OF THE ECONOMY

The economic recovery was showing some nicks and dents as 2020 concluded. After a record comeback in the third quarter—in which strength in consumer spending and housing helped lift GDP by 33.4%—and a further, if muted, uptick early in the final period, the economy began to falter. Specifically, weekly jobless filings have pushed higher; sales of new and existing homes have slipped back; personal income has eased; and gains in durable goods orders have slowed. Perhaps most important, consumer spending, the main engine of the U.S. economy, has begun to slip. We expect the GDP reading for the last quarter of 2020 to show growth in the low single-digit percentage range.

The outlook may darken further in the coming weeks. Once again, it will be COVID-19 and the increasing economic toll it is taking on our nation via mounting layoffs, new lockdowns, and selective curfews that will pressure business in the coming months—or at least until vaccines have been given to most Americans. For now it is questionable whether there will be any measurable growth in the opening stanza.

Encouragingly, these early 2021 struggles should be short-lived, lasting perhaps through the spring. By then, most Americans likely will be vaccinated and the beginning of the end for this pandemic may be at hand. Growth should respond as the labor force ramps up, deferred demand starts to be satisfied, the Federal Reserve continues its easy monetary policies, and new fiscal stimulus measures likely will have been passed. Adding it up, growth may see a midyear spurt before settling onto a sustained long-term path forward.

It's this benign outlook, albeit taking effect after a wait, that explains Wall Street's continuing optimism. Investors typically look ahead by as many as six months. And with a solid second half of 2021 likely looming for the economy following a difficult opening number of months, stock market records may continue to fall. However, it also is true that P/E ratios appear elevated and there is little margin for error. So, disappointments could be dealt with harshly at times. Currently, though, the investment backdrop is still relatively positive.

Conclusion: We think a healthy weighting in equities is the preferred choice as we begin 2021.

Recommended ETF Selection

SPDR S&P PHARMACEUTICALS ETF (XPH)

TABLE 1: **SPDR S&P Pharmaceuticals ETF (XPH)**	
Inception Date:	6/16/2006
Primary Exchange:	NYSE ARCA Exchange
Issuer:	SSGA Funds Management
Index Provider:	S&P Global
Geography:	Global
Investment Philosophy:	Passively Managed
Underlying Index:	S&P Pharmaceuticals Select Industry Index
Index Composition:	Equal Weighted
Asset Class:	Equity
Capitalization:	Broad/Multi Cap
Style:	Blend
Sector:	Healthcare

In this installment of *Value Line Select: ETFs*, we revisit the healthcare industry with a fund that offers exposure to a segment of the economy that is integral to overcoming COVID-19, the SPDR S&P Pharmaceuticals ETF. This fund seeks to provide investment results that, before fees and expenses, correspond generally to the total return performance of the S&P Pharmaceuticals Select Industry Index. XPH is passively managed with a 0.35% expense ratio, and has performed quite well of late (up 20% over the past six months or roughly on par with the broader S&P 500 Index). While the obvious appeal of drug stocks at this juncture is linked to recent COVID-19 vaccine breakthroughs from Pfizer (joint venture with BioNTech) and Cambridge-based Moderna—as well as the ongoing race to develop treatments for the disease—we think Big Pharma has a lot more going for it that should entice investors. For starters, as a group, these stocks tend to trade at reasonable valuations and pay good, sustainable dividends. What's more, divided government in Washington looks quite possible, with President-elect Biden set to take office on January 20th and Democrats retaining control of the House of Representatives. Republicans currently have a slim majority in the Senate, though that could change on January 5th when two Senate runoff races are scheduled to take place in Georgia. This is worth mentioning because divided government all but eliminates the possibility of sweeping new healthcare legislation (i.e. drug pricing controls or the elimination of private health insurance) that threaten Big Pharma's cash cow. Lastly, and perhaps most important, with equity markets sitting at record highs and valuations nearing levels that some say resemble the height of the 2000 dot-com bubble, we think it would be prudent to add a defensive ETF to the portfolio to guard against a potential correction.

Recent Developments

Despite its widely accepted classification of being a defensive sector, pharmaceutical stocks have enjoyed unusually strong growth in recent years. Even in 2020, when the coronavirus all but crippled vast segments of the economy, drug companies held up relatively well. What's more, with the onset of COVID-19, the industry's profits will likely expand at an increasing rate in the years to come. Most notably, the rapid pace at which these companies created, tested, manufactured, and received regulatory approval for their vaccines has changed the nature of medical science. Prior to this, the fastest vaccine development was for mumps in the 1960s, taking four years. The efficacy research required for vaccines can sometimes take a decade. However, the current situation has changed that narrative, demonstrating the incredible feats that can be accomplished with adequate resources and government support.

A Favorable Environment

The United States is a critical market for healthcare companies due to its size, economic strength, and reputation for prodigious spending. Moreover, the bureaucratic red tape surrounding government programs and employer-sponsored coverage offers little in the way of negotiating leverage to control prices. As a result, therapeutics and surgical procedures often cost far more here than in other developed nations; the U.S., on average, spends about 18% of its GDP on healthcare, whereas the median spend for economically similar countries is closer to 12%. This is likely to remain the case for the foreseeable future. Though President-elect Biden has made proposals that would seek to limit drug price increases, those plans would probably face stiff resistance in a Republican-led Senate. Even though both parties have talked about reining in drug costs, any compromise on legislation that emerges would probably be modest and business-friendly, especially in light of the current crisis. To wit, Big Pharma's profitability prospects are quite healthy going forward, in our view.

The Broader View

Current macroeconomic factors aside, pharmaceuticals are compelling for a number of reasons. The main appeal of XPH lies with its emphasis on firms that have FDA-approved treatments as well as promising drugs in the clinical trial stage. Clinical trials are costly, and often can make-or-break smaller pharma companies. Larger companies with significant resources are better able to navigate this process. Successful results typically equate to major market gains, while failure to advance beyond this stage can deal a crushing blow. In terms of new drug approvals, the rare disease, oncology, and autoimmune categories are perhaps the most attractive in terms of potential impact on pharmaceutical stock prices. Drugs for these ailments already generate well over $100 billion in annual global sales, and recent pipeline advancements by major companies including Eli Lilly, Bristol-Myers Squibb, and Johnson & Johnson (all top-10 XPH holdings) suggest there is plenty of runway left here.

Conclusion

Pharmaceutical stocks offer investors the opportunity to capitalize on product innovation, ground-breaking treatment advances, and strong profit potential over the long term. Reasonable valuations—XPH's forward price-to-earnings ratio is 12, compared to 20 for the S&P 500 Index—and a reputation for consistent, generous dividend payments only add to the appeal. On point, we believe this ETF is a solid choice for any well-balanced portfolio.

TABLE 2: XPH Key Facts

as of 12/22/2020	
Expense Ratio:	0.35%
12-month ETF return	5.10%
Shares Outstanding	5,300,000
Assets in top 10	44.30%
Forward Price/Earnings Ratio	11.55
Price/Book Ratio	3.1
30-Day Avg. Trading Volume	6.5%
30-Day SEC Yield	0.45%
Number Of Holdings	42
Legal Structure	Open-End Investment Company
Last Dividend Paid: 9/23/2020	$0.05
Net Asset Value	$270,540,000

TABLE 3: XPH Performance Breakdown

as of 12/22/2020	Fund NAV Return
Year to date	5.1%
1 Year	17.7%
3 Year	4.3%
5 Year	-0.5%
10 Year	10.3%
Since Inception	10.0%

INDUSTRY FOCUS: DRUG

As a group, stocks in the Drug Industry continued to trend upward during the fourth quarter of 2020. We saw nice acceleration after a somewhat stagnant September period, but gains didn't quite match those that were witnessed in March and April, when markets were surging off their pandemic-fueled lows. Key catalysts over these past few months included a generally solid third-quarter earnings season, in which many of the top players in the space either matched or exceeded consensus earnings and sales expectations. We also saw multiple guidance hikes across the board, as COVID-related challenges seem to be easing a bit. Talks of further government stimulus and recent commentary from the Federal Reserve suggesting that interest rates will remain low in the coming years also can't be discounted, as they appear to have created major tailwinds for the broader equity arena. Lastly, positive news on the COVID-19 vaccine front has boosted optimism that drugmakers could see a return to more normalized operating conditions in 2021.

COVID-19 Programs

After months of development news and speculation, we now have two COVID-19 vaccines authorized for use in the United States. New York drug giant Pfizer, in collaboration with Germany-based BioNTech, was first to get their candidate approved by the FDA on December 11th. While there were initially some concerns tied to efficacy and distribution capabilities, these appear to have abated somewhat and shipments of the Pfizer/BioNTech vaccine are already well underway. Management previously indicated that it had the potential to supply globally up to 50 million doses in 2020 and up to 1.3 billion by the end of 2021.

Massachusetts-based biotech Moderna was the second to receive FDA approval for its vaccine on December 18th. At the time of this writing, nearly six million doses had been earmarked for distribution and were expected to be shipped to roughly 3,300 locations across the country. Moderna estimated that it had the capabilities to deliver 20 million doses to the U.S. government by the end of 2020. British drugmaker AstraZeneca also has a development program in the works, though efficacy results in late-stage studies have not quite matched the Pfizer and Moderna shots; British authorities recently approved its use. Management recently noted that it would likely need another trial before being considered for U.S. approval. Healthcare behemoth Johnson & Johnson and Maryland-based biotech Novavax are also in Phase 3 testing and plan to release their initial efficacy results soon.

Current projections suggest that the COVID-19 vaccine market could be worth as much as $40 billion in sales in 2021. The aforementioned companies will likely all be jockeying for position, but we anticipate Pfizer and Moderna to command the largest pieces of the pie given their status as first and second to market. Aside from vaccines, several other drugmakers herein have COVID-19 therapeutics that are expected to contribute significantly to top lines in 2021. Indianapolis-based Eli Lilly was granted emergency use authorization for its arthritis drug Baricitinib in November to treat hospitalized patients with the virus. It anticipates COVID-19 therapies to contribute $1 billion-$2 billion in sales this year.

2021 Outlook

The COVID-19 outbreak clearly had a significant impact on Drug Industry performance in 2020. On recent conference calls, some of the top players in the space estimated that the pandemic cost them billions of dollars in revenue due to a combination of social distancing measures, reduced access to healthcare providers, and widespread weakness in vaccine demand. In fact, New Jersey-based Merck & Co. forecasted a roughly $2.4 billion negative impact to its top line in 2020. On a positive note, the recovery did appear to gain traction over the back half of that year, and while a recent spike in cases has again raised concern of a potential slowdown, it seems unlikely that we will see the same level of disruption going forward. The prospect of a widely available COVID-19 vaccine has many hopeful that operating conditions will continue to normalize in 2021. We believe this should help to drive meaningful improvement in Drug Industry performance over the next several quarters.

Conclusion

The outlook for Big Pharma has brightened considerably in recent weeks. In addition to the revenue tailwind from COVID-19 vaccines, 2021 looks set to be a big year for new drug approvals. And with divided government likely in Washington, the chances of sweeping new healthcare legislation being implemented appear pretty slim, in our view. For investors interested in drug stocks, we suggest considering broad-based exposure through the SPDR S&P Pharmaceuticals ETF (XPH).

TOP 10 HOLDINGS

TABLE 4: XPH HOLDINGS: 42 COMPONENTS (ONLY TOP 10 SHOWN)								
Company Name	**Symbol**	**Stock Price**	**P/E Ratio**	**Weight**	**Currency**	**Region/ Country**	**Sector**	**Industry**
Royalty Pharma	RPRX	$48.75	NMF	4.86%	USD	North America / United States	Healthcare	Pharmaceuticals
Catalent	CTLT	$104.88	44.6	4.70%	USD	North America / United States	Healthcare	Pharmaceuticals
Elanco Animal Health	ELAN	$30.43	34.9	4.50%	USD	North America / United States	Healthcare	Pharmaceuticals
Eli Lilly and Co.	LLY	$166.36	21.3	4.45%	USD	North America / United States	Healthcare	Pharmaceuticals
Jazz Pharmaceuticals	JAZZ	$155.21	12.8	4.44%	USD	North America / United States	Healthcare	Pharmaceuticals
Viatris	VTRS	$18.01	4.4	4.37%	USD	North America / United States	Healthcare	Pharmaceuticals
Zoetis	ZTS	$160.55	40.1	4.33%	USD	North America / United States	Healthcare	Pharmaceuticals
Bristol-Meyers Squibb	BMY	$61.10	9.6	4.32%	USD	North America / United States	Healthcare	Pharmaceuticals
Johnson & Johnson	JNJ	$152.51	17.2	4.26%	USD	North America / United States	Healthcare	Pharmaceuticals
Merck	MRK	$80.18	13.4	4.09%	USD	North America / United States	Healthcare	Pharmaceuticals

KEY HOLDING: PFIZER (PFE)

Pfizer's COVID-19 vaccine was granted FDA approval. The vaccine, which Pfizer has developed in collaboration with Germany-based BioNTech, proved to be more than 90% effective in preventing the virus during clinical trials. Management promptly applied for emergency use authorization and it was given the nod from the FDA on December 11th. While there seemed to be some concerns tied to efficacy and distribution (cold temperatures must be maintained from factory to point of use), shipments of the vaccine are already well underway. Management indicated that it had the potential to supply up to 50 million doses globally in 2020 and up to 1.3 billion by the end of 2021. It is worth noting that Moderna's COVID-19 vaccine was approved on December 18th.

Other countries appear likely to follow suit. The U.K. also gave the nod last month and European Union regulators just recently recommended authorization for use, paving the way for the 27-bloc nation to ramp up its rollout program in the coming weeks. While projections have varied, some suggest the COVID-19 vaccine market could be worth as much as $40 billion in sales in the year ahead. Given its status as first to market, we believe Pfizer is in good position to command the largest piece of this pie.

Value Line Ranks and Projections	
Recent Price:	$37.37
Safety Rank:	1
Financial Strength:	A++
2023–'25 Target Price Forecast	$45-$55

Company Data	
Industry:	Pharmaceuticals
Ticker Symbol:	PFE
Options:	Yes
Exchange:	NYSE
Actual EPS for Fiscal Year 2018:	$2.87
Estimated EPS for Fiscal Year 2019:	$1.90
Estimated EPS for Fiscal Year 2020:	$2.80
Current P/E Ratio:	17.6
***Relative P/E Ratio:**	0.90
Dividend Yield:	4.20%
Shares Outstanding:	5,558,396,599
Market Capitalization:	$208 billion
Incorporated:	Delaware
Address:	235 East 42nd Street, New York, NY 10017
Telephone:	212-733-2323
Internet:	www.pfizer.com

Meanwhile, the company has completed the spinoff of its Upjohn business. Pfizer also shed its generics unit and merged it with Mylan to form Viatris (Ticker: VTRS). Under the terms of the deal, which was structured as an all-stock Reverse Morris Trust, PFE shareholders received 0.124079 shares of VTRS common stock for each unit held. Upjohn had accounted for roughly 17% of Pfizer's total sales through the first nine months of 2020, but is now excluded from our forward-looking estimates. The impact on 2021 sales should be largely mitigated by higher projected vaccine sales.

The stock's Timeliness rank remains suspended due to the restructuring. With consumer health and generics off the table, Pfizer's business is now primarily geared toward the more lucrative and higher-margined Biopharma sector. All in all, we view the transformation favorably and believe it better positions the company for sustainable long-term growth. On a risk-adjusted basis, the stock offers solid total-return potential out to 2023-2025.

PFIZER

Annual Rates of Change Per Share			
	Past 10 Years	Past 5 Years	Projected Growth Rates from 2017 - 2019 through 2023 - 2025
Revenues:	3.0%	2.5%	2.0%
Cash Flow:	4.0%	6.0%	5.5%
Earnings:	3.5%	8.5%	8.5%
Dividends:	2.5%	7.0%	5.0%
Book Value:	1.5%	NMF	4.0%

PFIZER

Revenues (In millions)					
	Mar. 31	**Jun. 30**	**Sep. 30**	**Dec. 31**	**Full Yr.**
2017	12779.00	12896.00	13168.00	13703.00	52546.00
2018	12906.00	13466.00	13298.00	13976.00	53646.00
2019	13118.00	13264.00	12680.00	12688.00	51750.00
2020	12028.00	11801.00	12131.00	**12140.00**	**48100.00**
2021	**13100.00**	**13600.00**	**14200.00**	**14800.00**	**55700.00**

Quarterly Revenue Growth (Year-to-Year)					
	Mar. 31	**Jun. 30**	**Sep. 30**	**Dec. 31**	**Full Yr.**
2018	0.99%	4.42%	0.99%	1.99%	2.09%
2019	1.64%	-1.50%	-4.65%	-9.22%	-3.53%
2020	-8.31%	-11.03%	-4.33%	**-4.32%**	**-7.05%**
2021	**8.91%**	**15.24%**	**17.06%**	**21.91%**	**15.80%**

Quarterly Earnings Per Share					
	Mar. 31	**Jun. 30**	**Sep. 30**	**Dec. 31**	**Full Yr.**
2017	0.51	0.51	0.47	0.23	1.73
2018	0.59	0.65	0.69	-0.07	1.87
2019	0.68	0.89	1.36	-0.06	2.87
2020	0.61	0.61	0.39	**0.29**	**1.90**
2021	**0.69**	**0.75**	**0.79**	**0.57**	**2.80**

Quarterly Earnings Growth (Year-to-Year)					
	Mar. 31	**Jun. 30**	**Sep. 30**	**Dec. 31**	**Full Yr.**
2018	15.69%	27.45%	46.81%	-130.43%	8.09%
2019	15.25%	36.92%	97.10%	-14.29%	53.48%
2020	-10.29%	-31.46%	-71.32%	**NMF**	**-33.80%**
2021	**13.11%**	**22.95%**	**102.56%**	**96.55%**	**47.37%**

Quarterly Dividends Paid (per share)					
	Mar. 31	**Jun. 30**	**Sep. 30**	**Dec. 31**	**Full Yr.**
2017	0.320	0.320	0.320	0.320	1.280
2018	0.340	0.340	0.340	0.340	1.360
2019	0.360	0.360	0.360	0.360	1.440
2020	0.380	0.380	0.380	0.380	1.520
2021	0.390				

UPDATES ON OUR PREVIOUS SELECTIONS

iShares Transportation Average ETF (IYT)

Much like the broader market averages, the iShares Transportation Average ETF hasn't seen a lot of price movement in either direction since our November recommendation. The ETF's top holding, FedEx, reported strong fiscal second-quarter results in mid-December, led by robust e-commerce orders, but management's decision to refrain from issuing guidance sent the shares modestly lower. Our premise that IYT will continue to benefit from an improved freight environment, pent-up demand, renewed fiscal stimulus, and the shift toward online shopping still stands. **Buy.**

Vanguard Financials ETF (VFH)

The Vanguard Financials ETF has surged higher over the past month, buoyed by the deployment of COVID-19 vaccines, the prospect of divided government in Washington (this reduces the chances of significant tax/regulatory changes), and the fiscal stimulus bill that was passed last month. Attractive valuations and a heavy concentration in cyclical industries (financial firms tend to be sensitive to the business cycle) should allow VFH to further benefit from what we anticipate will be a continued pickup in economic activity. **Buy.**

SELL RECOMMENDATIONS

Invesco Dynamic Leisure and Entertainment ETF (PEJ)

For the second time in a row, we are advising investors to sell a fund that we recommended just two short months ago. The Invesco Dynamic Leisure and Entertainment ETF has had an incredible run since our October proposal. It is now up about 25%, buoyed by the deployment of COVID-19 vaccines and a general rebound in stocks that have been disproportionately hurt by the pandemic. Although we still expect PEJ to perform reasonably well in the coming months, the ETF is now trading near pre-pandemic levels, and valuations are no longer attractive. Subscribers who followed our recommendation earned an annualized return of 150%. **Sell.**

Global X Social Media ETF (SOCL)

The Global X Social Media ETF has risen more than 25% in price since our August recommendation. Although we still like the fund's long-term prospects, and may even revisit it at some point, we believe now is a good time to take profits, especially with antitrust scrutiny among some of SOCL's larger holdings (Facebook, Google, and Tencent, just to name a few) starting to ramp up. Subscribers who followed our initial recommendation earned an annualized return of approximately 75%. **Sell.**

iShares U.S. Broker-Dealers & Securities Exchanges ETF (IAI)

The iShares U.S. Broker-Dealers & Securities Exchanges ETF has had a strong run over the past few months, buoyed by encouraging news on the vaccine front, the recent fiscal stimulus bill, and a pickup in M&A activity across the industry. The fund is up 27% since our July recommendation, and we believe now is a good time to take profits and deploy capital into one of this Service's "buy" recommendations. **Sell.**

FOOTNOTES

Tracking Error: Refers to the annualized standard deviation of daily return differences between the total return performance of the ETF and the total return performance of its underlying index. This figure increases based on the variability between the annualized performance of the ETF and its target index. A lower number means the ETF accurately reflects its industry.

Concentration Risk: Refers to the total asset weighting of the top 5 holdings in the ETF portfolio versus the remaining equities in the portfolio. These more heavily weighted holdings have a more material impact on the portfolio's performance than the lower-weighted equities.

Market Impact: Refers to the liquidity of the ETF based on trading volume and the effect of large trades on the ETF's price.

Efficiency: Refers to the measure of how well the ETF achieves best results with minimum costs by accounting for its expense ratio, as well as its tracking error and its tax efficiency.

Relative P/E: Compares the current absolute P/E to the comparable stock market index.

Earnings Yield: The cumulative earnings for the 12-month period divided by the total market capitalization.

NOTES

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