

Federal Health Reform and Stock Market Returns of Health Insurers

By John R. Graham

Perhaps the most dispiriting occurrence during the debate over health reform in 2009 and 2010 was the eagerness with which many business interests in the health sector embraced the federal government takeover of Americans' access to health care. This was very different than what happened in the 1993 debate over "Hillarycare," when a plurality of business interests collaborated to defeat President Clinton's proposal.

In 2009 and 2010, virtually every interest group rushed to get a seat at the table. Why? With the benefit of hindsight, the Patient Protection and Affordable Care Act (PPACA) signed in March 2010 was what soccer players call an "own goal," a mistaken shot into one's own net, which benefits the opposing team.

At this point, it hardly bears repeating that pretty much every poll since the law passed shows that a majority of Americans want PPACA repealed.¹ It remains under pressure from a number of lawsuits asserting that it violates the U.S. Constitution.² Republicans in Congress continue uniformly to oppose the law. The U.S. House of Representatives passed a bill to repeal it last January, and every credible Republican presidential candidate loudly proclaims that he looks forward to signing the repeal legislation, if elected.

If, as in 1993, the health sector's business interests – broadly defined as anyone who earns revenue from health care – had raised their hands against PPACA, the bill would not have passed. In 2009, however, it was not so clear that PPACA would become its own poison pill. As the old saying goes: "If you don't have a seat at the table, they'll serve you for dinner."

And having a seat at the table certainly mitigated some of the worst aspects of the law. For example, advocates of a single-payer

Key Points:

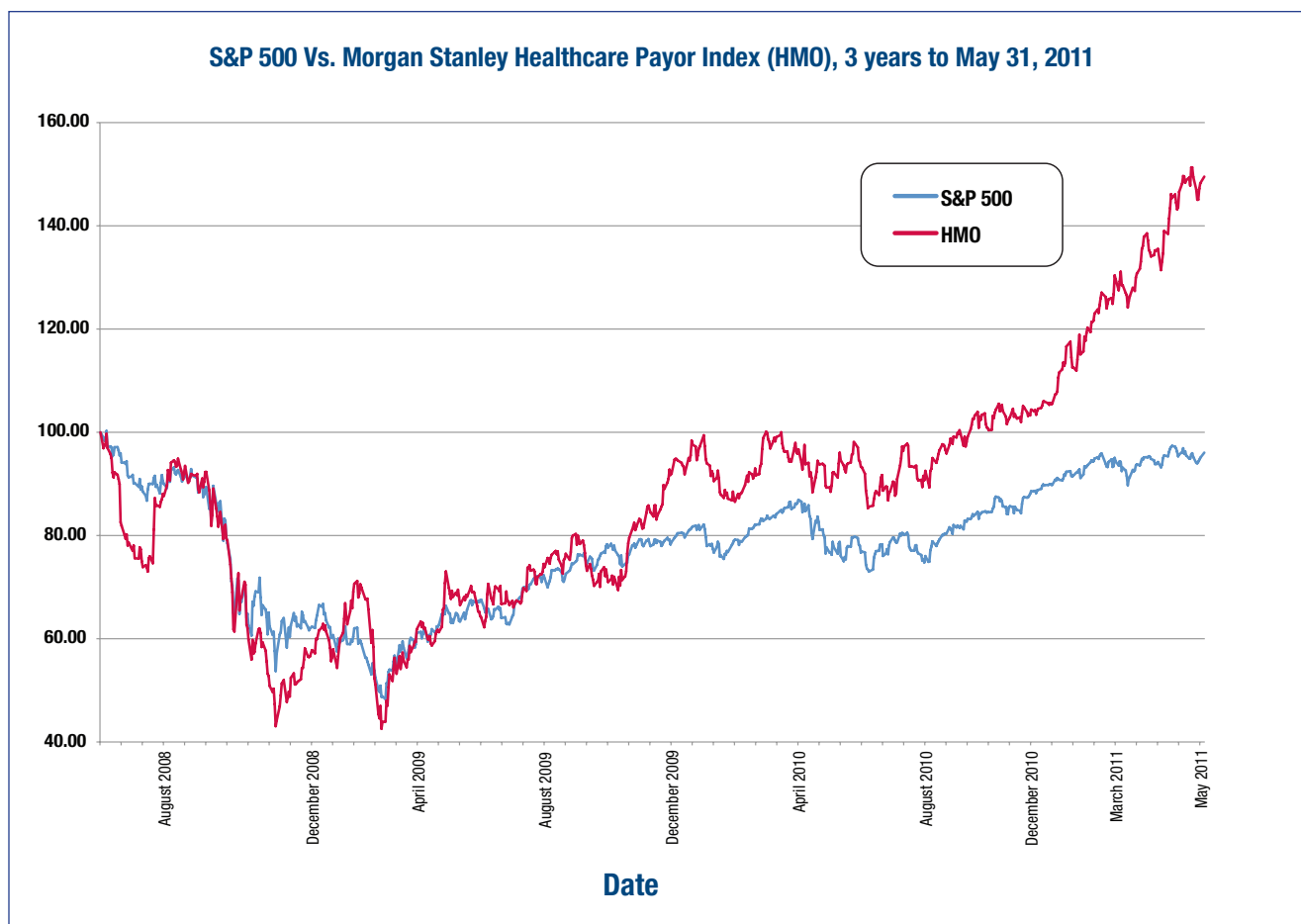
- The Patient Protection and Affordable Care Act (PPACA) would not have passed without the support of business interests in the health sector.
- Stock prices of for-profit health plans have significantly outperformed the broader stock market since President Obama's election in 2008, but also since the Republican "wave" of 2010.
- This indicates that investors believe that PPACA is favorable to health plans, and believe that it will harden into a bipartisan reality.
- Proponents of the repeal of PPACA must be hyper-vigilant to ensure that politicians who promise to repeal the federal take-over stick to their commitment.

(government-monopoly) health system desperately wanted a so-called “public option” which would gradually crowd private plans out of the Health Benefits Exchanges through which millions of Americans will receive federally dictated policies in the years to come.³

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Advocates of individual choice in health care (like me) generally continue to insist that PPACA moves the U.S. towards government monopolizing our access to medical services. Advocates of a government-monopoly system generally bemoan the loss of the “public option” and certain other items on their wish list, such as government-dictated prices for prescription drugs. These advocates assert that PPACA degenerated into a grab bag of goodies for various lobbyists. It’s not easy to figure out the truth.

One method is to compare the stock-market returns of for-profit health plans with a broad benchmark, and see how those returns reacted to political developments over the past few years. Of course, stock-market returns – even of health plans – respond to many events other than political developments. Nevertheless, they are “unspinnable” by advocates of one side or another. Figure 1 graphs the level of Standard and Poor’s index of 500 stocks representative of the broad market (“S&P 500”) and the Morgan Stanley Healthcare Payers Index (“HMO”), an index of the 10 largest listed health plans, excluding dividends.⁴ Figure 1 covers the three years from the beginning of June 2008, to the end of May 2011, and includes two important dates: November 4, 2008 and November 2, 2010, the dates of the two most recent national elections.



For opponents of PPACA, Figure 1 presents a chilling picture: Health insurers appear to have *benefitted* from PPACA. The total return of the S&P 500 over the three-year period was *minus* 4 percent versus *plus* 40 percent for HMO.

Table 1 shows measurements of performance for the entire period, as well as the three sub-periods defined by the two elections. Because the three sub-periods cover different lengths of time, Table 1 reports annual results, in order to compare apples to apples. The annualized return of the S&P over the entire period was minus 1.34 percent versus plus 13.41 percent for HMO (Panel A). When we look at the sub-periods, the tale is even more discomfoting. For the 110 trading days leading up to the 2008 election, HMO significantly underperformed the S&P 500: minus 110 percent versus only minus 76 percent, annualized (Panel B). The HMO index's outperformance occurred *subsequent* to President Obama's election.

Table 1: Performance of Morgan Stanley Healthcare Payors Index (HMO) Vs. S&P 500, June 2008 through May 2011

Panel A: June 1, 2008-May 31, 2011

	Return	Volatility	Sharpe ratio	Modigliani & Modigliani's Risk-Adjusted Performance	Beta
HMO	13.41%	39.35%	0.27	13.41%	0.96
S&P 500	-1.34%	29.60%	-0.14		

Panel B: June 1, 2008-November 4, 2008

	Return	Volatility	Sharpe ratio	Modigliani & Modigliani's Risk-Adjusted Performance	Beta
HMO	-109.69%	55.80%	-2.0	-109.69%	0.94
S&P 500	-75.83%	46.37%	-1.68		

Panel C: November 5, 2008-November 2, 2010

	Return	Volatility	Sharpe ratio	Modigliani & Modigliani's Risk-Adjusted Performance	Beta
HMO	25.60%	39.17%	0.62	25.60%	0.96
S&P 500	8.59%	28.31%	0.26		

Panel D: November 3, 2010-May 31, 2011

	Return	Volatility	Sharpe ratio	Modigliani & Modigliani's Risk-Adjusted Performance	Beta
HMO	64.94%	18.56%	3.49	64.94%	1.02
S&P 500	20.93%	12.02%	1.73		

During the two years between the two elections, the HMO index significantly outperformed the broader index: Plus 26 percent versus plus 9 percent, for an annualized outperformance of 17 percent (Panel C). This was the period when President Obama's faction was at the height of its power, driving the hyper-partisan PPACA through a Congress with very weak opposition. For the period since the 2010 election, we see that HMO has continued to outperform at an even faster rate: 65 percent versus 21 percent, for an annualized outperformance of 44 percent (Panel D).

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For those interested in more technically advanced financial analysis, Table 1 also reports four standard measurements of portfolio risk and return: Annualized volatility and the Sharpe ratio of both indexes; and

Modigliani & Modigliani's Risk-Adjusted Performance measure (M^2) and beta of the HMO index versus the S&P 500 benchmark. Beta measures the degree to which returns to a security or portfolio (in this case, HMO) are explained by moves in the broader benchmark (in this case, the S&P 500). Betas close to one indicate that returns to the benchmark explain most of the portfolio's return, that is, the portfolio is diversified. The part of the portfolio's return that is not explained by returns to the benchmark is called alpha. The Sharpe ratio and M^2 measure whether the increased alpha was gained with an appropriate increase in risk. Although HMO is slightly more volatile than the S&P 500, both the Sharpe ratio and the M^2 , which measure performance relative to volatility, demonstrate that HMO outperformed the S&P 500 for the entire period and the two latter periods on a risk-adjusted basis.⁵

With respect to the post-2010 election period, it is hardly likely that the stock market is discounting the repeal of PPACA into stock prices. If that were the case, outperformance over the last six months would have been preceded by significant *underperformance* in the previous two years. Furthermore, none of these health plans is openly agitating for repeal of PPACA.

The most likely explanation for health plans' stock performance is that investors saw PPACA itself as a boon for health plans. Also, investors likely do not believe that Republicans will eventually repeal it, but instead exercise even less oversight and give health plans more favors than a single-party Democratic federal government would. In other words, investors likely expect that PPACA will evolve into a bipartisan reality that will favor health plans, despite current political rhetoric.

The stock market does not lie, but politicians sometimes do not tell the truth. Proponents of the repeal of PPACA must be hyper-vigilant to ensure that politicians who promise to repeal the federal takeover stick to their commitment.

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Endnotes

- 1 Jeffrey H. Anderson of the *Weekly Standard* consistently tracks these polls. See Jeffrey H. Anderson, “A Triple Crown of Failed Health Care Reform,” *Weekly Standard*, June 6, 2011, available at <http://tinyurl.com/68855eg>.
- 2 A running tally of the lawsuits is available at <http://www.healthcarelawsuits.org/>.
- 3 Even without a public option, Health Benefits Exchanges are one of the worst elements of PPACA. See John R. Graham, “Will There Be Health Benefits Exchanges by 2014?” John Goodman Health Policy Blog (June 2, 2011), available at <http://tinyurl.com/3gs4wjo>; and John R. Graham, “Should Your State Establish an Obamacare Health Insurance Exchange?,” *Health Policy Prescription*, vol. 8, no. 10 (October 2010).
- 4 The components of HMO are listed at <http://tinyurl.com/3cr4yb4>. Note: HMO is an *equal-dollar* weighted index which is rebalanced once a year, whereas the S&P 500 is a *market-capitalization* weighted index. Furthermore, there is no publicly available data series of HMO which includes reinvested dividends. Nevertheless, the point of this article is not portfolio optimization, but to understand the impact of public policy.
- 5 The Sharpe ratio is calculated using the appropriate Treasury bill or note rate as the risk-free rate. For example, the return on the two-year T-note is used for the two-year sub-period.