BB Healthcare Trust

Monthly News
January 2018

As at 01/31/2018	Value	1 Month (January)	YTD	Since Launch (ITD)
Share	117.00	-0.43%	-0.43%	18.79%
NAV	112.39	0.12%	0.12%	14.15%

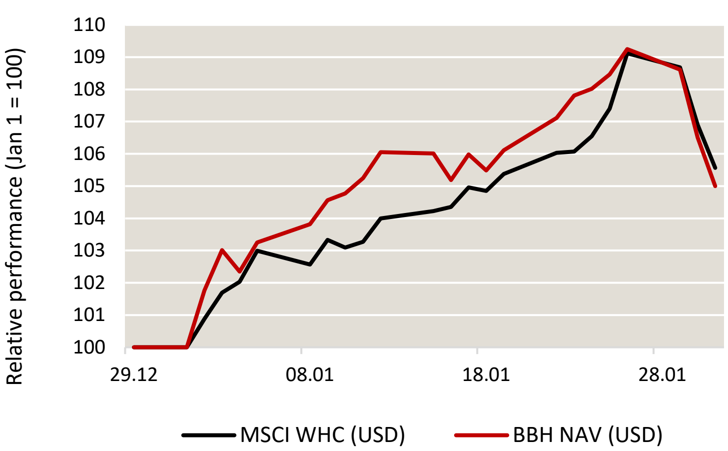
Welcome to our January update. Wow! What a rollercoaster month. January started strongly; all that festive Factor nonsense soon became long-forgotten fake news; growth was back in vogue and valuation anxiety was forgotten… until it wasn't. The month-end saw most of our gains wiped out and, unfortunately for those of us managing global money (and who long ago paid for their skiing holiday), the only thing that keeps going up is sterling.

Summary

BB Healthcare Trust is a high conviction, unconstrained, long-only vehicle invested in global healthcare equities with a max of 35 stocks. The target annual dividend is 3.5% of NAV and the fund offers an annual redemption option. BB Healthcare is managed by the healthcare investment trust team at Bellevue Asset Management, which also manages BB Biotech.

Whoa! Becomes woe, oh…

The Trust's ex-income net asset value (NAV) rose 0.12% to 112.39p. In sterling terms, the MSCI Healthcare benchmark rose 0.65%. The continued strengthening of sterling was a material headwind this month. In local currency terms, the benchmark rose 5.57%, making the FX impact 4.92% for the month. We estimate the drag from FX on our month-end NAV to have been 4.63%. Healthcare began the year as the best performing sector, but the strength did not last. The extent of the volatility this month is illustrated in Fig 1 below, where our performance versus the benchmark is illustrated in US dollars to exclude the effect of sterling appreciation (>95% of our portfolio is US-dollar denominated).



Source: Bloomberg/MSCI and Bellevue Asset Management.

Innumerable suggestions abound as to why Healthcare's year started so strongly; or indeed why it has faded away so quickly; although we admit to being as flummoxed as anyone else by the whole situation. It is not obviously driven by fundamental disappointments; if anything the FY17 results and FY18 outlook thus far have been to the upside.

I need a dollar…

A wisened former colleague of the Managers used to lament the market's seduction by non-GAAP performance measures, which he dismissed as "earnings before bad stuff". We too are generally unimpressed by such confections. However, one can see where the temptation to use adjusted measures comes from; our portfolio has a significant US dollar bias and is likely to remain so for some time. Undoubtedly, our investment performance would be more transparent if we reported our 'NAV in constant currency'.

It would be rather time consuming to accurately determine the cumulative impact of sterling's rise on the NAV performance since inception, but we can note that the benchmark index has seen a negative currency impact of 14.4% since our launch in December 2016. Given our higher-than-benchmark dollar exposure, it would be reasonable to assume that the impact on the portfolio would have been greater.

New Year, new narrative?

In the real world, though, sterling is our basis and we must keep our lassitudinous minds concentrated on the fundamentals, but that is far from easy: it would be an understatement to suggest these past two months have been surprising, and the battle against 'noise-flow' from the sell-side is unhelpful.

Firstly, the December sell-off seemed concentrated on highly rated 'structural growth' stories (such as Align, Intuitive and Illumina) and yet these have been strongest out of the gate in January (in part explaining our outperformance versus the benchmark in the first half of January). One could attribute this to mean reversion, but in fact these stocks briefly broke away from their longer-term upward trend. We took some profits at these levels and re-weighted the portfolio, which proved prudent in light of the subsequent sell-off. We feel that maintaining a robust selling discipline around valuation is an important aspect of risk management for the long-term.

The final version of the US tax reform bill came later in December than many had anticipated and threw up a few surprises in terms of who benefits most. The annual JP Morgan healthcare jamboree (second week of January) often provides a lot of colour on the outlook for the year and key catalysts. However, a number of companies did not feel ready to provide tax guidance so quickly after the new legislation was published. Following Abbvie's Q4 report and turbo-charged tax treat on January 26, the market seemed to fully price in tax-related upside for the rest of the group.

After the minor hiccup of a government shutdown that temporarily left the world's largest economy without a functioning administration (as they say, you can't make an omelette without breaking a few eggs), we have also seen a subsequent positive healthcare tailwind from the budget approval process. This temporarily suspended the medical device excise tax (a positive relief for Med Tech stocks, since this was previously expected to form part of the tax reform bill), delayed the Cadillac tax on high value 'premium' health plans and suspended the health insurer fee (HIF) again for 2019. These are short-term positives for managed care providers.

M&A has returned as a major theme; with several high profile deals during the month. For us, the surprises have been more around the prices paid (especially by Sanofi, which we would not own) and the performance of the acquirers. The reflexive "short the buyer" trade has not worked.

Moreover, some of the laggards of late 2017 (Gilead, Biogen, Abbvie) have been very strong performers year-to-date, in part due to capital deployment-related themes. To each their own. For us, present valuing the future success of acquirers from companies as yet unbought, in an industry with a high R&D attrition rate, at a time when M&A asset prices are at record levels seems a rather thin basis for an investment thesis, but one that has cost us dear in terms of relative performance.

Fig 2 illustrates every sub-sector in positive territory when measured in dollars.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Performance (GBP)	Performance (USD)
Biotech	11.1%	1.1%	6.1%
Conglomerate	13.2%	-2.6%	2.2%
Dental	0.5%	9.5%	14.9%
Diagnostics	1.8%	1.2%	6.1%
Distributors	1.9%	4.4%	9.5%
Facilities	1.1%	3.7%	8.7%
Generics	0.8%	-0.5%	4.3%
Healthcare IT	1.2%	1.7%	6.7%
Managed Care	9.2%	2.2%	7.2%
Med-Tech	12.8%	3.0%	8.0%
Other HC	0.7%	1.6%	6.5%
Pharma	35.9%	-1.3%	3.5%
Services	2.7%	1.3%	6.3%
Specialty Pharma	3.4%	1.7%	6.6%
Tools	3.8%	6.5%	11.7%

Source: Bloomberg/MSCI and Bellevue Asset Management. Performance is 30-11-17 to 31-01-18 and benchmark weightings are as of 30-11-17. BBH exposure as per 31-01-18

*Note: DexCom is no longer in the benchmark, effectively removing the Health Tech sub-sector

Developments within the Trust

We issued a further 1.2 million shares during the month via the block-listing facility. In terms of the portfolio, we have added two new positions – both are small-cap, late stage clinical development therapeutics companies. Thus, although our weighting toward bio-pharma has declined, the number of such companies in the portfolio remains the same as it was in November. As noted previously, we have re-balanced the portfolio, adding to some of our smaller holdings and trimming the larger exposures.

We rapidly deployed the cash buffer built up in December and have modestly increased our borrowings. The leverage ratio now stands at 5.1% of gross assets (versus 2.9% at the end of December and 3.4% at the end of November). Our watch-list of potential investments continues to increase, but we are sticking to our valuation parameters and are unwilling to chase things simply because the healthcare sector has been re-rated in the first few weeks of the year, for reasons now arguably all too apparent.

Jaws

The Cinema buffs amongst you could probably devote many hours to the question of who started the trend for 'franchise movies' with endlessly worsening sequels. We would nominate Jaws (1975). The Spielberg film is an undeniable classic, but is probably better for everyone if we skip over the next three. How does one market such interminable dross? With a catchy strapline of course: "just when you thought it was safe to go back into the water".

Being a healthcare investor can sometimes feel like trying to follow a plotless movie: you literally have no idea what is going on and you just have to sit back and watch the action unfold and that feels very much like the story of December and January. Healthcare can also feel as if one is navigating dangerous waters, although ours are not infested with Carcharodons; the menace seems more orange than white. Regardless, as long as the risk of an unprovoked attack remains ever present, the casual bather is going to swim elsewhere.

We thought that the first few months of 2018 would entice a few aquanauts back, the waters remaining calm until the mid-terms campaigning began in a few months' time. They say a week is a long time in politics and seemingly the respite is over. It was always likely that drug pricing noise will again come to the fore, since this messaging plays well with the electorate. That said, we admit to being slightly surprised that Trump himself fired the gun on drug pricing rhetoric in late January, as he appointed (former big pharma executive) Alex Azar to HHS and again pledged to bring prices "way down", repeating the message during the State of the Union (SOTU) address.

Interestingly, there was a comparably muted initial reaction to these comments: the US Pharma (DRG) Index actually closed up on that day, a stark contrast to the reaction to similar comments in January 2017, when the DRG declined almost 2%. One might have concluded investors now appreciate better the practical hurdles to Federal action on drug prices, but it was a merely a delayed reaction, with the fall coming after the SOTU speech. The outgoing CEO of Novartis also stated that he expected US drug prices to converge with those in Europe and this rhetoric is unlikely to help wider enthusiasm for Pharma in an election year.

The contagion spread beyond drug stocks as that other beast of the deep, Amazon, also reared its ugly head. Many imagine Amazon is like the Humboldt squid; swarming across the ocean consuming everything in its path. Sometimes, though, they end up eating one another. As we said many times last year, the potential risk to the drug supply chain from Amazon entering healthcare at scale appears limited and it certainly seemed like common sense was prevailing in late December/early January, prompting a recovery in the supply chain companies (wholesalers and PBMs), that is now reversing.

This time, it was Amazon's announcement of a collaboration with JP Morgan and Berkshire Hathaway to try and bring down insurance costs for their (c1.1m) employees. In predictable sell-side fashion, this morphed into a non-profit disruptor of the insurance market and calls to sell/short managed care. We are more sanguine. This feels like a smaller version of the Health Transformation Alliance, a 46 company initiative covering >6m lives… that buys its services from United Health. Most large employers in the US self-insure already, bulk buying simply enables more efficient risk pooling. This is, in essence, a non-event from market disruption perspective, but has been very painful in share price terms. We can only hope that, as was the case in H2 17, common sense prevails and the affected shares are duly re-rated.

No one said navigating any of this was easy, nor that the rewards of doing so would come quickly or predictably. We feel that we understand the landscape, though, and the path to the sunny uplands is winding but visible.

Paul Major, Daniel Koller and Brett Darke

B|B Healthcare Trust

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SUB SECTOR BREAKDOWN

Med-Tech	30.3%
Biotech	16.4%
Distributors	11.1%
Spec. Pharma	9.9%
Dental	7.9%
Pharma	7.8%
Health Tech	6.9%
Other HC	4.9%
Facilities	2.5%
Generics	2.3%

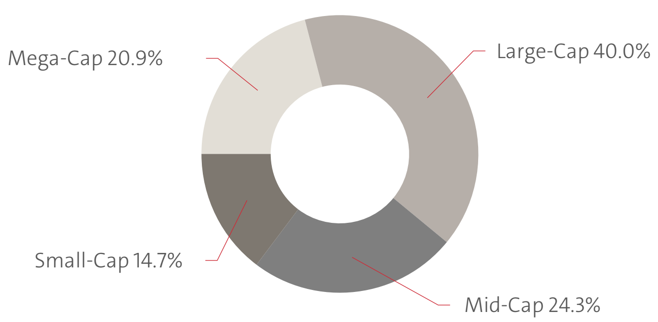
Source: Bellevue Asset Management, 31.01.2018

TOP 10 HOLIDINGS

Align Technology	7.9%
Anthem	7.3%
Celgene	5.7%
Illumina	5.2%
Intuitive Surgical	5.0%
Walgreens Boots	4.9%
Shire	4.7%
AmerisourceBergen	4.7%
Dexcom	4.2%
Hologic	3.8%

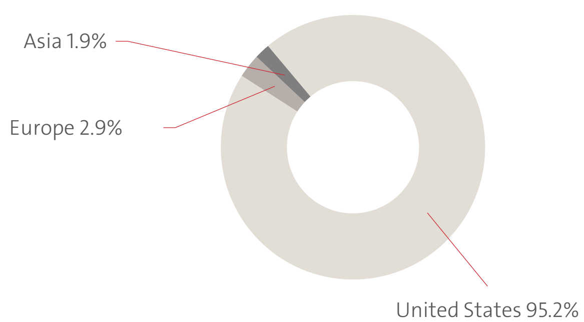
Source: Bellevue Asset Management, 31.01.2018

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.01.2018

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.01.2018

"five companies representing ~14% of the portfolio have a non-US legal domicile (primarily for tax reasons) but operate out of the United States and their primary stock market listing (in terms of volume traded) is in the United States".

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INVESTMENT FOCUS

- The BB Healthcare Trust invests in a concentrated portfolio of listed equities in the global healthcare industry (maximum of 35 holdings)
- Managed by Bellevue Asset Management AG ("Bellevue"), who manage BB Biotech AG (ticker: BION SW), Europe's leading biotech investment trust
- The overall objective for the BB Healthcare Trust is to provide shareholders with capital growth and income over the long term
- The investable universe for BB Healthcare is the global healthcare industry including companies within industries such as pharmaceuticals, biotechnology, medical devices and equipment, healthcare insurers and facility operators, information technology (where the product or service supports, supplies or services the delivery of healthcare), drug retail, consumer healthcare and distribution
- There will be no restrictions on the constituents of BB Healthcare's portfolio by index benchmark, geography, market capitalisation or healthcare industry sub-sector. BB Healthcare will not seek to replicate the benchmark index in constructing its portfolio

DISCLAIMER

FIVE GOOD REASONS

- Healthcare has a strong, fundamental demographic-driven growth outlook
- The Fund has a global and unconstrained investment remit
- It is a concentrated high conviction portfolio
- The Trust offers a combination of high quality healthcare exposure and a 3.5% dividend yield
- BB Healthcare has an experienced management team and strong board of directors

MANAGEMENT TEAM

Paul Major

Daniel Koller

Brett Darke

GENERAL INFORMATION

Issuer	BB Healthcare Trust (LSE main Market (Premium Segment, Offical List) UK Incorporated Investement Trust
Launch	December 2, 2016
Market capitalization	GBP 307.6 million
ISIN	GB00BZCNLL95
Investment Manager	Bellevue Asset Management AG; external AIFM
Investment objective	Generate both capital growth and income by investing in a portfolio of global healthcare stocks
Benchmark	MSCI World Healthcare Index (in GBP) - BB Healthcare Trust will not follow any benchmark
Investment policy	Bottom up, multi-cap, best ideas approach (unconstrained w.r.t benchmark)
Number of ordinary shares	262 869 268
Number of holdings	Max. 35 ideas
Gearing policy	Max. 20% of NAV
Dividend policy	Target annual dividend set at 3.5% of preceding year end NAV, to be paid in two equal instalments
Fee structure	0.95% flat fee on market cap (no performance fee)
Discount management	Annual redemption option at/close to NAV

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