Bellevue Healthcare Trust

MAY 2022

Factsheet

London Stock Exchange (LSE)

Marketing document

Investment focus

Bellevue Healthcare Trust intends to invest in a concentrated portfolio of listed or quoted equities in the global healthcare industry. The investable universe for the fund 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 is no restrictions on the constituents of the fund's portfolio by index benchmark, geography, market capitalisation or healthcare industry sub-sector. Bellevue Healthcare will not seek to replicate the benchmark index in constructing its portfolio. The Fund takes ESG factors into consideration while implementing the afore-mentioned investment objectives.

Fund facts

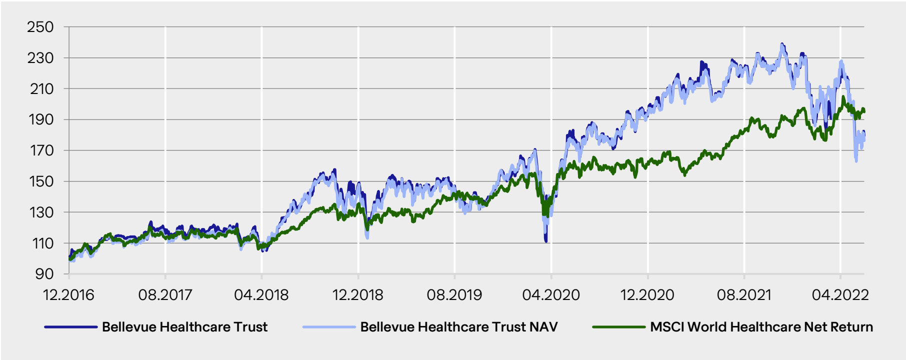
Share price	GBP 153.60
Net Asset Value (NAV)	GBP 150.41
Market Capitalisation	GBP 902.5 mn
Investment manager	Bellevue Asset Management (UK) Ltd.
Administrator	Sanne Funds Services (UK) Ltd.
Launch date	01.12.2016
Fiscal year end	Nov 30
Benchmark	MSCI World Healthcare Net Return
ISIN code	GB00BZCNLL95
Bloomberg	BBH LN Equity
Number of ordinary shares	586'057'380
Management fee	0.95%
Performance fee	none
Min. investment	n.a.
Legal entity	UK Investment Trust (plc)
EU SFDR 2019/2088	Article 8

Key figures

Beta	1.27
Correlation	0.77
Volatility	28.8%
Tracking Error	18.98
Active Share	95.32
Sharpe Ratio	0.5
Information Ratio	-0.11
Jensen's Alpha	-6.83

Source: Bellevue Asset Management, 31.05.2022;
Calculation over 3 years.

Indexed performance since launch



Cummulated & annualized performance

Cummulated

	1 M	1 Y	2 Y	3 Y	4 Y	5 Y	ITD
Share	-9.2%	-13.7%	2.1%	25.8%	43.3%	58.2%	79.6%
NAV	-8.6%	-14.8%	0.3%	25.3%	39.8%	60.1%	76.2%
BM	0.2%	17.0%	19.6%	51.1%	67.3%	72.5%	94.8%

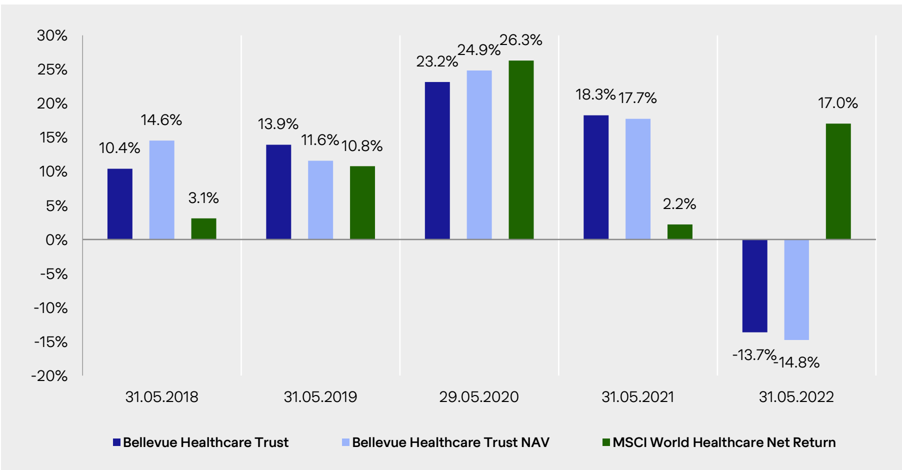
Annualized

	1 Y	3 Y	5 Y	10 Y	ITD
Share	-13.7%	7.9%	9.6%	n.a.	11.2%
NAV	-14.8%	7.8%	9.9%	n.a.	10.8%
BM	17.0%	14.7%	11.5%	n.a.	12.9%

Annual performance

	2017	2018	2019	2020	2021	YTD
Share	14.8%	4.9%	22.7%	29.1%	16.6%	-22.3%
NAV	12.7%	8.6%	25.9%	25.7%	15.2%	-22.0%
BM	9.4%	8.8%	18.4%	10.3%	20.8%	-0.7%

Rolling 12-month-performance



Source: Bellevue Asset Management, 31.05.2022; all figures in GBP %, total return / BVI-methodology
Past performance is not a reliable indicator of future results and can be misleading. Changes in the rate of exchange may have an adverse effect on prices and incomes. All performance figures reflect the reinvestment of dividends and do not take into account the commissions and costs incurred on the issue and redemption of shares, if any. The reference benchmark is used for performance comparison purposes only (dividend reinvested). No benchmark is directly identical to the fund, thus the performance of a benchmark is not a reliable indicator of future performance of the Bellevue Healthcare Trust to which it is compared. There can be no assurance that a return will be achieved or that a substantial loss of capital will not be incurred.

Top 10 positions

Jazz Pharmaceuticals	8.0%
Option Care Health	6.9%
Sarepta Therapeutics	6.6%
Insmed Incorporated	5.3%
United Health Group	5.3%
Caredx	5.0%
Amedisys	4.7%
Axonics Modulation	4.6%
Anthem	4.5%
Charles River	4.1%
Total top 10 positions	55.2%

Sector breakdown

Focused Therapeutics	24.3%
Services	15.7%
Med-Tech	15.4%
Diagnostics	11.9%
Managed Care	9.8%
Diversified Therapeutics	8.0%
Tools	5.6%
Healthcare IT	4.9%
Health Tech	3.6%
Dental	0.7%

Geographic breakdown

United States	94.4%
China	2.4%
Canada	2.4%
Switzerland	0.7%

Market cap breakdown

Mega-Cap	15.1%
Large-Cap	8.5%
Mid-Cap	50.1%
Small-Cap	26.4%

Source: Bellevue Asset Management, 31.05.2022;
For illustrative purposes only. Holdings and allocations are subject to change. Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. Where the subfund is denominated in a currency other than an investor's base currency, changes in the rate of exchange may have an adverse effect on price and income.

Welcome to our May missive. It has been another challenging month for investors, driven once again by a series of macro events that seem increasingly difficult to legislate for. Why is anyone surprised at this point by persistent inflation or falling consumer confidence? When so much already seems to be priced in, why does the market act as if it is not priced in?

Whilst all this noise takes up most of the attention, one can step back and look at the broader healthcare market in Q1 with some satisfaction. Lots of positive clinical progress, record levels of backlogs for early stage drug development services and patients returning to their doctors and surgeons for routine and elective procedures. Normality is returning.

It is easy to be swept up in a wave of despondency whilst politicians vacillate and posture as a pointless war rages on our doorstep, our public services crumble around us and children go hungry in the planet's fifth richest economy. It is much harder to look past it all and see that the future offers some exciting opportunities for us all. But it does: if you look, they are there.

Monthly review

The wider market
Having touched new lows for the year mid-way through the month, the MSCI World Index staged a rally in the closing days of May to end only modestly down for the month (-0.5% in sterling, -0.2% in dollars), albeit still down 8.4% from its all-time high in December 2021.

It was again a very top-down/macro-driven market dynamic, with the Russia/Ukraine calamity continuing to hold sway as the predominant driver of everything, followed by China's self-harming zero-COVID nonsense. Whilst there has been tragically little progress on resolving the former issue, China did announce some relaxations of restriction to help the economy. Omicron will not be so easy to contain though; this feels like an endless game of 'whack-a-mole' where the odds are stacked against the Chinese Communist Party.

Looking at the S&P500, Q2 has seen net negative revisions to earnings expectations, presumably as analysts fret that deteriorating consumer sentiment and rising inflation will crimp future profits. That having been said, the magnitude of the revisions has been modest and is actually in line with multi-year historical trends: everyone is irrationally exuberant at the beginning of the year and then realisation creeps in slowly and numbers are adjusted accordingly, hence the axiom – "sell in May and go away".

When one looks at the wider pattern of revisions for the S&P500 across the year, it has been positive overall. This does not mean that the recession fears are misplaced; the huge increases in earnings expectations for extractives and energy companies are offsetting the decreases in consumer discretionary and staples. In short then, very little has changed at the macro level. Putin is still insane, inflation is still rising and energy costs do not bode well for a retrenchment in broad inflation in the near-term. The impotence (inappropriateness?) of interest rate rises as a mechanism to mollify such imported cost increases appears glaringly obvious to all bar occidental central bankers...

The sector performance is summarised in Figure 1 below. When one studies the returns dispersal, the laggards seem uncontroversial: technology stocks have been out of favour for a while now. Household and personal care companies are at the mercy of consumers trading down as they feel the pinch. The same is true for broad retail - people are spending less as discretionary income falls. Recent results from Walmart (hypermarket, about 90% non-food) and Target (a 'big box' retailer) attest to this; a fusillade of frugality has left their warehouses full of unwanted seasonal inventory. Owning retail, leisure or commercial property can be challenging if we go into a recession and tenants go bankrupt.

That said, Food retailers might have seemed an obvious safe haven (we all need to eat, after all) but they too are suffering on two fronts; firstly, consumers are spending less and focusing on cheaper (often lower margin) items in the basket. Secondly, there is a long-standing trend of moving into non-food. Like Walmart, your local Sainsbury's or Tesco store will also be full of hard goods that you probably can do without and, lest one forget, the exalted 'middle aisle' Twilight Zone at Lidl, comprised of things most people never even knew they desired.

The relative winners mostly seem obvious in hindsight too; ongoing geo-political tensions have ensured that oil and gas prices remain strong, benefitting the extractive sector. The re-opening of China (however long that lasts) will likely exacerbate this trend. Rising rates, however inappropriate, will benefit banks. Finally, cars remain expensive and difficult to obtain as the microchip miasma continued, although there are signs this particular industry's chip shortage may now be easing.

The utilities sector may seem less obvious; energy input costs are rising and not every provider can pass these fully to the consumer (UK and France price caps for example), crimping margins. Bad debts may also rise if recession bites. Whilst we may grumble about the cost, those that can pay will continue to do so and demand will continue to rise as we electrify transport. The same applies to Telecoms: is modern life in western countries even possible without a smartphone these days? You may elect to cut back on subscription apps like Netflix and Spotify, but the phone itself will stay.

With so many headlines about technology being out of favour, the semiconductor segment's presence as the second-best performer might surprise a little, but these are now ubiquitous and essential products within almost everything we purchase. Rising demand (volume output rose 26% in 2021 and is forecast to be ~8-10% higher in 2022 than 2021) has led to a situation where volumes and prices are rising together, versus the usual 'semis-cycle' situation of production volume increases exceeding demand and thus driving down prices.

With the chip shortage set to persist well into 2023 and very high barriers to entry, this makes for a compelling market dynamic: industry revenues grew 23% in Q1 2022 and this year could see another double-digit rise in overall revenues, taking them above $600bn for the first time.

Sector	**Monthly perf (USD)**
Energy	12.8%
Semiconductors & Semiconductor Equipment	5.1%
Telecommunication Services	5.0%
Banks	4.4%
Utilities	2.8%
Pharmaceuticals, Biotechnology	0.9%
Diversified Financials	0.8%
Materials	0.6%
Capital Goods	0.5%
Insurance	0.5%
Media & Entertainment	-0.1%
Healthcare Equipment & Services	-0.8%
Consumer Duables & Apparel	-1.3%
Food, Beverage & Tobacco	-2.0%
Software & Services	-2.7%
Commercial & Professional Services	-2.8%
Transportation	-2.8%
Consumer Services	-2.9%
Retailing	-3.5%
Household & Personal Products	-3.8%
Real Estate	-4.0%
Technology Hardware & Equipment	-4.2%
Automobiles & Components	-5.9%
Food & Staples Retailing	-8.4%

Source: Bellevue Asset Management, 31.05.2022

Healthcare

Amidst the wider market's ponderous peregrinations, healthcare's defensive qualities (manifested in a lack of negative cyclical revisions to longer-term earnings expectations) led healthcare to modestly outperform the wider marketplace over the month. The MSCI World Healthcare Index was essentially flat in sterling terms (+0.3% in dollars). In sterling terms, this leaves the Healthcare Index with a year-to-date total return of -0.4%, as compared to -6.4% for the parent MSCI World Index.

Superficially then, and paraphrasing Ronseal adds from the mid-90s (we are getting old!), the sector 'is doing exactly what it says on the tin'. As ever though, the water becomes murkier below the surface. The performance dispersion by sub-sector is illustrated in Figure 2:

	Weighting	**Perf (USD)**	**Perf (GBP)**
Generics	0.4%	9.1%	8.7%
Distributors	1.4%	3.1%	2.8%
Tools	8.0%	2.9%	2.5%
Focused Therapeutics	7.1%	1.7%	1.2%
Conglomerate	12.6%	1.1%	0.8%
Diversified Therapeutics	37.0%	0.8%	0.4%
Services	2.5%	0.2%	-0.1%
Managed Care	11.2%	-0.2%	-0.5%
Med-Tech	13.2%	-0.3%	-0.8%
Dental	0.5%	-0.5%	-0.8%
Facilities	1.1%	-1.7%	-2.0%
Other HC	1.5%	-3.8%	-3.8%
Healthcare IT	1.0%	-3.6%	-4.0%
Diagnostics	1.7%	-5.9%	-6.5%
Healthcare Technology	0.8%	-22.3%	-22.5%
Index perf		**0.3%**	**0.0%**

Source: Bloomberg/MSCI and Bellevue Asset Management (UK) Ltd. Weightings as of 30.04.2022. Performance to 31.05.2022.

Firstly, a positive note: whilst the leaders were the jejune Generic and Distributor segments, the sub-sector performance dispersal was somewhat less skewed to a 'risk-off' mindset when compared to April, with Focused Therapeutics outperforming Conglomerates and Diversified Therapeutics. A recovery in sentiment toward Tools was suggestive that the unconvincing narrative around a research slowdown at cash-strapped biotech companies was finally being laid to rest.

However, the overall performance and fund flow data is yet to indicate a broader desire for mutual fund (i.e. generalist) investors to get stuck into the beaten up sub-sectors such as Biotechnology (Focused Therapeutics) and Diagnostics. Healthcare IT again struggled amidst the broader 'sell technology' narrative, even as the reporting season affirmed there are no signals of an unfolding slowdown (Teladoc aside).

The Healthcare Technology sub-sector has Dexcom as a 70% weighting. The rumoured (and largely nonsensical) acquisition of Insulet was understandably poorly received. You cannot surprise people with odd strategic moves when you are trading on 12x forward revenues; there is precious little oxygen at that altitude.

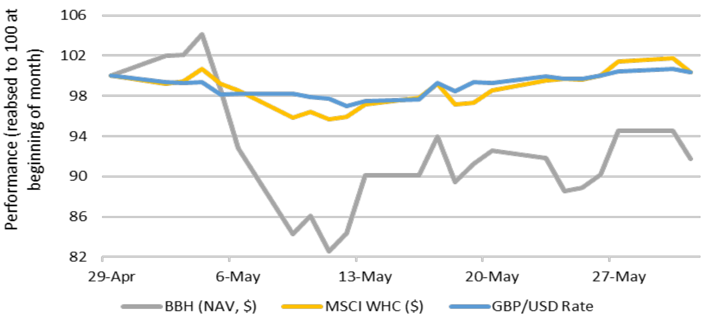
To our minds, the whole thing has a whiff of Teladoc/Livongo or Illumina/GRAIL about it. We don't own Dexcom anymore, but would have considered stepping back into the standalone entity at the right price. However, the rather weak-sounding press release stating that Dexcom is not currently planning a major acquisition has failed to assuage a swathe of investor concerns (including our own) as to why this transaction might have been contemplated in the first place; strong companies rarely pivot. We would have zero interest in the combined company and much prefer Tandem Diabetes Care over Insulet as a stand-alone investment proposition.

On a more negative tack for our own strategy, the size factor performance dispersion was again evident, with Mega-Cap healthcare providing the vast majority of the overall positive performance during the month and mid-caps were a net negative contributor to the index evolution during May.

The Trust

The Trust endured another miserable month on the relative performance side. The Trust's net asset value declined 8.6% to 150.41p, underperforming the MSCI World Healthcare Index by 8.6%. FX was a modest headwind during the month, impacting the NAV evolution by around 0.4%.

The leading detractors were Medical Technology, Focused Therapeutics and Diagnostics. Healthcare IT and Dental were the only positive contributors during the period in review. The evolution of the NAV during the period is illustrated in Figure 3 overleaf:



Source: Bellevue Asset Management, 31.05.2022

The portfolio remains at 29 stocks, although we have exited two positions (one from Focused Therapeutics and one from Diversified Therapeutics) and added two new positions (one in Dental and one in Medical Technology, the latter being a repurchase of a previous holding that we exited in 2020). We were pleased to see the Trust's share price close the discount to NAV during May, allowing us to issue 6.0m new shares during the month. The leverage ratio increased from 10.2% at the end of April to 11.5% at the end of May. This was primarily due to the decline in the value of the investment portfolio rather than a meaningful rise in the level of net debt.

The evolution of the portfolio is summarised in Figure 4 below. Aside from the entries and exits, we added to 21 positions in the portfolio, reduced five and left one unchanged. The decrease in Diversified Therapeutics was driven by re-positioning following strong relative performance compared to the rest of the portfolio. Managed Care rose mainly due to better relative performance and Healthcare IT also outperformed; we actually reduced our overall exposure materially over the course of the month even if it is not apparent from the unchanged weighting.

	Subsectors end Apr 22	Subsectors end May 22	Change
Dental	0.0%	0.7%	Increased
Diagnostics	11.7%	11.9%	Increased
Diversified Therapeutics	10.9%	8.1%	Decreased
Focused Therapeutics	25.3%	24.5%	Decreased
Healthcare IT	4.9%	4.9%	Unchanged
Healthcare Technology	4.0%	3.5%	Decreased
Managed Care	9.6%	9.8%	Increased
Med-Tech	13.5%	15.2%	Increased
Services	15.1%	15.8%	Increased
Tools	4.9%	5.6%	Increased
	100.0%	**100.0%**	

Manager's Musings

Pruritus Ani

Back in the Halcyon days of January (what we would give to be whinging today about a NAV that had declined as far as 174p), we made reference to the childish market aphorism about monkeys and picking bottoms, noting that "engaging in such an activity in public is unseemly and likely to cause embarrassment", but also that "embarrassment can often be quelled with sufficient pecuniary reward".

We did not foresee the longstanding, even by that point, relative underperformance of SMID healthcare continuing in such a negative manner, but were of course cognisant of the unfolding Russia/Ukraine situation and the broader view that a 'risk-off' mindset would be favourable to the relative performance of healthcare.

Quite how the macro scenario has become so conflated with size factor remains something of a mystery to us, but the market can be very short-term in the midst of an existential crisis and this inevitably creates opportunity. One can ignore an itch for so long, but eventually the compulsion to scratch becomes overwhelming.

The ongoing situation with Russia and continued risk of escalation/contagion cannot be overlooked and this is reflected in our decision not to 'max out' the gearing currently deployed. However, we thought it worth offering some soothing balm to those who might, like us, feel the broader valuation decoupling has got to the point of being irresistible.

Anusol

The application of symptomatic relief medication without a diagnosis of the underlying pathology is not recommended, so before we consider why now increasingly feels like bottom picking time, we should reflect upon how we got to be in this uncomfortable situation in the first place.

Let us first offer a qualitative explanation: the market sell-off is a culmination of multiple factors: economic and geo-political uncertainty makes future demand harder to predict. Furthermore, rapidly rising inflation also weighs on demand and potentially erodes corporate profit margins as companies need to spend more money to make goods or deliver services. They may not be able to pass all of these higher costs on to consumers in the form of higher prices for those products or services. This is a particular risk when input costs rise very quickly, as they have done in recent months.

Simply put, the combination of these various factors creates a meaningful risk that overall corporate profits will be lower. If this is your expectation, then of course it is understandable and rational that you would want to pay a lower price for a share of those profits than you were previously and so the stock market is falling. It will continue to do so until investors reach a point where they feel confident that share prices imply a level of future profits that is, at a minimum, realistic and probably overly cautious. In that scenario, shares prices could start to rise again as investors put more capital into the market in the expectation of future returns.

Now let us quantify this scenario in mathematical terms. The equity risk premium (ERP) is the incremental investment return an investor should expect over and above so called risk-free assets such as sovereign bonds. The ERP has risen to reflect the uncertainty: if you are taking a bigger risk then you rationally expect a bigger payoff. How much it should rise is the existential question of course, but we can back-solve what is implied by current market valuation and then look at this versus historical precedent to gain some idea of what the 'bottom' might look like. The science of picking, if you will.

The ERP is not the only consideration though. As a consequence of the inflationary outlook, central banks are increasing interest rates. The theory is simple enough: if borrowing is more costly, people (and companies) can do less of it and so overall spending power (i.e. demand) in the economy goes down and this reduces inflationary pressure. This is a blunt tool, but the only one governments really have available to try to tame inflation. Its utility is especially limited if the inflation is imported from globally traded goods becoming more expensive due to a war and supply chain interruptions linked to COVID policies in far-away shores versus an excess of consumer demand.

In mathematical terms, rising risk-free rates argue for a further change to the discount rate that one should be applying to future equity earnings. The combination of these two elements (i.e. higher risk-free rates and a higher equity risk premium) explain why it is warranted for earnings multiples to be compressed during an inflationary period that is concurrently marked by significant economic uncertainty. This is the maths of a bear market.

Those stocks that previously attracted a premium valuation for high expected growth are likely to suffer more in this scenario than a lower-rated lower growth stock for two reasons:

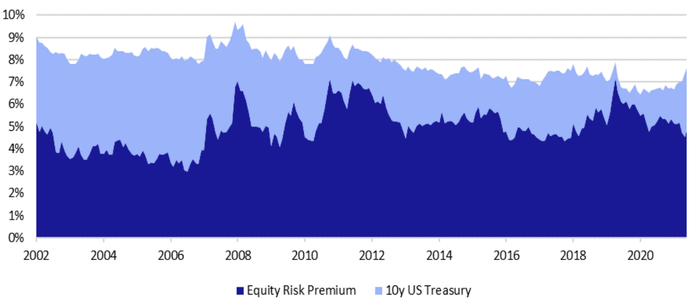
- Firstly, the mathematical expression of their higher price-to-earnings (P/E) rating is a lower implied discount rate. In this scenario, a 100bp (i.e. 1%) increase in the risk free rate is a much greater proportional increase in the implied discount rate.

- Secondly, if their growth were consumer oriented and thus in the discretionary bucket there is significant risk that it will be lower in future (cf. Netflix). Thus, investors are now applying a higher discount rate to a lower future cashflow stream and so the share price needs to fall much further to appear attractive once again from a risk-reward perspective.

We have no problem with any of this, so far as it goes. The important question of course is how to know when it has gone too far, because we know the market has a tendency to overreact on any directional change and also tend to apply 'group think' that over simplifies the business dynamics of individual companies.

Continuing with Netflix as an example, its recent disappointing results sent the share price down 40% in the immediate aftermath but also pushed the whole US technology complex lower. The latter outcome is not necessarily rational, it is emotional and reactionary. However, it is these sorts of moves that create opportunities for investors to buy into stocks at attractive prices, when the downward move has been overdone and the risk-reward seems attractive once more. In broad terms then, how can we identify the point at which things have objectively gone too far?

Hemosan
Figure 5 below is a data series showing the US 10-year Treasury Bill yield as a risk-free rate proxy and also the equity risk premium implied by the valuation of the S&P500 Index over the past 20 years. We could go back much further, but the nature of the market and the economy becomes so different that historical data becomes almost irrelevant.



Source: Bellevue Asset Management, 31.05.2022

The data suggests a couple of things to us. Firstly, the market seldom trades with an implied discount rate above 9% and, absent a known risk factor that suggests future profit forecasts are wrong, a profitable company trading at an implied discount above 10% is viewed by us as a clear buy signal. Secondly, the ERP seldom rises above 7% (the last time being March 2020 and prior to that, 2012).

Over the past 20 years, the average ERP has been 494bp and the average yield on the 10-year has been 292bp. If we take the time series back so it is closer to 40 years, then the average for the ERP is ~430bp and the 10-year yield ~490bp. When we think about the broad market there is scant evidence for the application of a discount rate >10% when considering the fair value for the long-term earnings of an equity security in the United States.

The pessimist might well counter with the observations that, whilst such academical affirmations are well and good, the ERP is not currently at 7%, the implied discount rate is still well below 10% and US rates are set to rise further in the coming months. This is true; the overall market could fall further. However, we are not in the business of buying market futures or ETFs, we are in the business of buying individual companies on a multi-year investment horizon. Let us consider these two points (implied discount rates and interest rates) in more specific detail.

E45
The mechanics of the US interest rate system is that the bank targets a range for the Federal Funds Rate (the amount the central bank pays in interest for the regulatory capital that banks must keep on deposit with the Federal Reserve) and the yield on the 10-year bond, which any investor can buy, reflects the market's current expectation of how that central rate will evolve over the coming years.

The best way to track this via the spread between the two rates (Fed Funds and rolling 10-year yields; this is known as the constant maturity index). Over a 5-year period, the spread has averaged ~100bp. Intuitively, when the spread rises above the average, it is a signal that rates are expected to continue to increase and when it falls back toward it, that the interest rate outlook is stable. If it goes well below, that indicates an expectation the Federal Fund rate is set to decline. We illustrate the spread over the last five years in Figure 6 below.

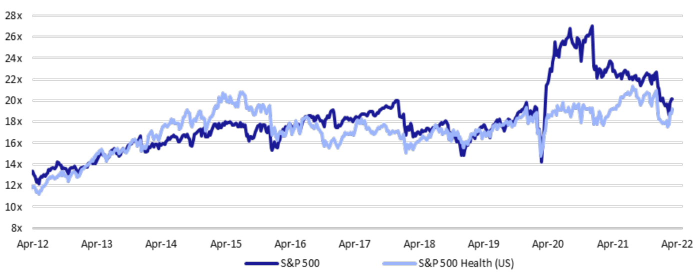
Source: Bellevue Asset Management, 31.05.2022

Having explained the data previously, it is worth highlighting what happened in March 2020. The market expected rates to be cut as the pandemic began to unfold and indeed this was the case; two cuts totalling 150bp in March 2020 took the Fed rate to zero and engaged in an unprecedented bout of quantitative easing, which distorted the picture, so it is probably best to ignore that short period.

Interesting as that may be, the more important point is surely what the most recent movement in the spread is telling you as a forward indicator of peak interest rates: it's not rising anymore. This does not mean that there will not be further interest rate rises, but it does suggest that the market is less fearful that rates will need to rise further than current expectations, which are for the rate to peak in 2023 somewhere around 3.5%.

Preparation H
When considering the ERP and the relation to the risk free rate, we have made reference to data for the S&P500. Of course it would be better to have a comparable dataset for a healthcare index, but this is not as straightforward as we would like it to be and we cannot provide one, so a broad market index will have to do. Since our investment portfolio has consistently been >90% US equities, this index feels the most appropriate market proxy for our particular strategy.

In support of its relevance, we would note that the valuation correlation of the S&P500 to the S&P500 Healthcare sub-index is very good, as illustrated in Figure 7 below, save for that weird period in the early phase of COVID where valuations for technology stocks went stratospheric and distorted the S&P500 for a year or more. If the forward P/E's are similar and correlated then it is reasonable to conclude that their ERPs and their evolution are likewise similar and correlated.



Source: Bellevue Asset Management, 31.05.2022

It is fair to point out that some healthcare companies, especially those in the drug development arena carry a level of risk regarding future cashflows that is different to the wider market. There are not many industries where you can sink billions into a single product development project over the best part of a decade to then have a regulator say “no”. Perhaps the aerospace sector is similar (think of Boeing’s travails with the 737-Max or Airbus’ A380 jalopy).

How does one account for this structurally higher level of systematic risk for these companies versus other industries? In reality, the answer for the generalist investor is that they do not have to; it has already been taken care of. The underlying analyst projections that make up the consensus forward revenue and earnings picture are normally probability adjusted.

Simply put, if the analyst believes that a product would ultimately go on to reach sales of $500m in five years’ time, but there is only a 60% chance of it being approved based on currently available clinical data or potential competitive obsolescence, the FY5 forecast will be $500*60% = $300m. This is why you often see the valuations of Biotechnology companies jump up when they report incremental clinical data or progress; the market is reducing the magnitude of the probability adjustment, which argues for a higher net present value for the shares.

Germaloid

The previous sections were intended to lay out our thinking as to why one can objectively consider equities discounting future earnings at a rate above 10% as being very cheap in any reasonable historical context and, if one is applying this to the healthcare sector, those future earnings projections should include appropriate probability adjustments for products that have yet to achieve regulatory approval in key markets. Let us now consider the current BBH portfolio in these terms.

When we are looking at potential investments, we utilise a number of different metrics but in particular we use discounted cashflow analyses, reverse DCF (i.e. what does the current share price imply) and FY5 normalised earnings. We would also look at these parameters across a number of different scenarios and levels of probability adjustment.

We are currently using a range of discount rates from 7.0-9.0%, with a weighted average of 8.0%. Our terminal growth rates (usually covering the period >2035) range from -5.0% to 3.5%, with a weighted average of 1.6%, which is well below the historical level of inflation and thus very cautious. We look for a teens or better IRR from these investments over the holding period (which is assumed to be at least 3 years, usually 5+).

For the curious, the -5.0% is applied to a Focused Therapeutics company where our model includes all of their existing drugs out to patent expiration and, since they do reformulation rather than research, we assume no additional products come into their portfolio in our base case model, hence the cashflows decline post patent expirations.

Now for the reverse DCF analysis. If we keep the scenarios the same and the discount rates the same, what terminal growth rate do we need to apply to each stock for the models to return the current share price as the ‘right’ answer. The range goes from -110% (!) to +2.5%, with a weighted average of -8.8%. Nothing has happened in the last nine months that should prompt anyone to take a different view on the structural growth opportunity of the healthcare market, especially not one where the implication is that less money is spent in the future!

The more relatable analysis is to keep our terminal growth rate assumptions the same as our base case and look at the implied discount rate needed to yield the current share price. Here we would need to apply a range of rates from 7.0% to 20.6%, with a weighted average of 11.5% – well above the 10% highlighted previously (with interest rates where they are currently, a 10% discount rate implies an ERP >7%). Indeed, six of the 29 stocks in the portfolio require a discount rate >14% to generate the current share price, 14 require a rate >10.0% and 22 require a rate >9.0%.

As we noted previously, it is rare that the wider market discounted such a scenario and never for a protracted period of time.

Finally, it bears repeating that we see no macro-economic or regulatory reason to have a less positive view on the dynamics of the global healthcare market today than we had six or twelve months ago. Our companies operate in an environment where demand is largely inelastic and is set to continue to rise due to the twin demographic drivers of a rising and concurrently ageing global population, allied to the expansion of the available treatment options through continued progress in biomedical research and product development.

Because demand is inelastic, they have considerable pricing power to pass on rising costs and generally already have high gross margins so non-labour input costs are only a small driver of the resultant operating margin. Again, we see no reason why these longstanding ‘defensive’ attributes of healthcare have changed in the recent past or why they are likely to change in the future. If you are worried about consumption patterns and inflation or stagflation then we believe that you cannot do much better than to own healthcare assets.

Finally, there is no reason why one should think these attributes are stronger for large companies than small ones. The only difference is that a broader product portfolio gives you lower systematic product-specific volatility in sales and earnings. Healthcare is healthcare at the end of the day.

Forget the creams and pick away!

Hindsight is the worst form of wisdom, since we cannot do very much about the past. As a consequence, we must accept that we are where we are in terms of our relative and absolute performance since H2 2021. We noted last month how we regularly review the portfolio from the perspective of a clean sheet of paper. We reiterate again that, looking forward on any objective measure, this is a collection of very cheap, high quality growth assets and hope that the previous analyses offer some additional colour as to why we are so convinced this is the case.

Russia’s war against Ukraine and the lack of any obvious strategic objective that could enable an early resolution of it clearly complicates any long-term analysis of the broader economic and geo-political outlook. China’s zero-COVID nonsense is a further cloud on the economic outlook and again is one where an early resolution (i.e. capitulation) seems fanciful.

We are not so blinkered as to not recognise the risk that markets could yet fall further and that not everyone has the appetite to take on more short-term risk because the longer-term opportunity seems so incredibly compelling. We do though, and your managers have again added to their overall personal holdings in the Trust during May.

We always appreciate the opportunity to interact with our investors directly and you can submit questions regarding the Trust at any time via:

shareholder_questions@bellevuehealthcaretrust.com

As ever, we will endeavour to respond in a timely fashion and we thank you for your continued support during these volatile months.

Paul Major and Brett Darke

Objective

The fund's investment objective is to achieve capital growth of at least 10% p.a., net of fees, over a rolling three-year period. Capital is at risk and there is no guarantee that the positive return will be achieved over that specific, or any, time period.

Risk Return Profile

This product should form part of an investor's overall portfolio. It will be managed with a view to the holding period being not less than three years given the volatility and investment returns that are not correlated to the wider healthcare sector and so may not be suitable for investors unwilling to tolerate higher levels of volatility or uncorrelated returns.

low risk high risk

1	2	3	4	5	6	7

The risk indicator assumes you keep the product for 5 years. The actual risk can vary significantly if you cash in at an early stage and you may get back less.

The summary risk indicator is a guide to the level of risk of this product compared to other products. It shows how likely it is that the product will lose money because of movements in the markets or because the fund is not able to pay you.

This fund is classified as 6 out of 7, which is a medium-high risk class. This rates the potential losses from future performance at a medium-high level, and poor market conditions will likely impact the capacity to pay you.

The portfolio is likely to have exposure to stocks with their primary listing in the US, with significant exposure to the US dollar. The value of such assets may be affected favourably or unfavourably by fluctuations in currency rates.

This fund does not include any protection from future market performance so you could lose some or all of your investment.

If the fund is not able to pay you what is owed, you could lose your entire investment.

Target market

The fund is available for retail and professional investors in the UK who understand and accept its Risk Return Profile.

Chances

- 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 fund offers a combination of high quality healthcare exposure and a 3.5% dividend yield.
- Bellevue Healthcare Trust has an experienced management team and strong board of directors.

Inherent risks

- The fund invests in equities. Equities are subject to strong price fluctuations and so are also exposed to the risk of price losses.
- Healthcare equities can be subject to sudden substantial price movements owning to market, sector or company factors.
- The fund invests in foreign currencies, which means a corresponding degree of currency risk against the reference currency.
- The price investors pay or receive, like other listed shares, is determined by supply and demand and may be at a discount or premium to the underlying net asset value of the Company.
- The fund may take a leverage, which may lead to even higher price movements compared to the underlying market.

Management Team

Paul Major
Portfolio Manager
since inception of the fund

Brett Darke
Portfolio Manager
since inception of the fund

Awards

FE fundinfo Crown Fund Rating

Sustainability Profile – ESG

Exclusions:	X Compliance UNGC, HR, ILO	X Controversial weapons
	X Norms-based exclusions	
ESG Risk Analysis:	X ESG Integration	
Stewardship:	X Engagement	X Proxy Voting

CO2 intensity (t CO2/mn USD sales):	26.5 t (low)	MSCI ESG coverage: 100%
MSCI ESG Rating (AAA - CCC):	A	MSCI ESG coverage: 100%

Based on portfolio data as per 31.03.2022 (quarterly updates) – ESG data base on MSCI ESG Research and are for information purposes only; compliance with global norms according to the principles of UN Global Compact (UNGC), UN Guiding Principles for Business and Human Rights (HR) and standards of International Labor Organisation (ILO); no involvement in controversial weapons; norms-based exclusions based on annual revenue thresholds; ESG Integration: Sustainability risks are considered while performing stock research and portfolio construction; Best-in-class: systematic exclusion of "ESG laggards"; MSCI ESG Rating ranges from "leaders" (AAA-AA), "average" (A, BBB, BB) to "laggards" (B, CCC). Note: in certain cases the ESG rating methodology may lead to a systematic discrimination of companies or industries, the manager may have good reasons to invest in supposed "laggards". The CO2 intensity expresses MSCI ESG Research's estimate of GHG emissions measured in tons of CO2 per USD 1 million sales; for further information c.f. www.bellevue.ch/sustainability-at-portfolio-level

Important information

This document is only made available to professional clients and eligible counterparties as defined by the Financial Conduct Authority. The rules made under the Financial Services and Markets Act 2000 for the protection of retail clients may not apply and they are advised to speak with their independent financial advisers. The Financial Services Compensation Scheme is unlikely to be available.

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