BB Healthcare Trust

Monthly News
July 2018

As at 07/31/2018	Value	1 Month (July)	YTD	Since Launch (ITD)
Share	135.50	6.62%	18.95%	41.87%
NAV	132.09	6.90%	21.37%	38.40%

Welcome to our July update. Summer is officially upon us, and those old enough to remember 1976 can bore their children with happy memories of those tranquil days before air conditioning, sunscreen ("pass the factor 3") and the realisation that vinyl is an appalling upholstery choice for a car. As parents everywhere begin the annual battle over screens vs. real-world fun, we muse on the outlook for the Pharma sector, whose CEOs probably also look back wistfully at years gone by...

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.

Momentum or materiality?

Over the month, the Trust's dividend-adjusted ex-income net asset value (NAV) rose 6.9% to 132.09p, modestly outperforming our benchmark. The Trust's shares began trading ex-dividend with respect to the first interim dividend of 2.0p on 26 July.

After a volatile June that saw all of the early gains erased, markets resumed their upward march through July. The MSCI World Index rose 9.3% in dollar terms. In contrast, the benchmark MSCI Healthcare Index 'only' rose 6.1% in dollars, but remains ahead of the wider market YTD.

Sterling weakened further as the multitudinous pitfalls of delivering Brexit become ever more apparent. Consequently, the benchmark rose 6.6% in sterling terms. We estimate that currency movements added ~0.6% to the NAV evolution over the period.

July is typically an eventful time with Q2 reporting, and many stock-specific and macro factors often converge to create a more volatile trading period. We have seen a repeat of the "trade the fade" phenomenon, where growth companies that do not "beat and raise" are punished with a sell-off for in line numbers. One might reasonably argue such a dynamic befits a late-cycle market trading close to all-time highs.

However, not all is, necessarily, as it seems, especially in a sector where the pervasive dynamics are not governed by typical economic considerations of supply, demand and price. Political machinations around cost aside, the overwhelming outlook for healthcare remains one of demographic and technology/innovation led growth offering ever more products to meet insatiable demand from an ageing and growing population.

What's in a number?

Broadly speaking, it was a positive reporting season for the sector overall, with a higher than market average proportion of stocks beating consensus expectations and raising guidance. Does this reflect the reality of the previous paragraph, namely that growth is slowing elsewhere, but healthcare continues to march to its own special tune or, is it a more simplistic failure to forecast the financial outlook accurately? Our own surprise index for earnings versus our internal forecasts was much lower; so we think the answer lies somewhere in the middle...

With respect to the US market in particular (more than two thirds of the Healthcare benchmark by value); one needs to be punctilious when thinking about consensus numbers going into a reporting cycle. There seems to be a reluctance for analysts to go 'out on a limb' and deviate meaningfully from company guidance for a year or even a quarter, even when various data points support a different conclusion.

Sometimes we even see a situation where there is a so-called "whisper number", where almost everyone is expecting a company to report above its guidance, even though their official forecasts mirror conservative company guidance. In such cases, this can explain why an apparent beat might not be enough to see a share move higher, since the market was already there and, in effect, the results are in line with already raised expectations. Quite whom such a situation is supposed to help is beyond us, but it is what it is.

The breadth of strength over the previous month is clear from the sub-sector performances illustrated in the table below. Hospital operators have been the standout sub-sector as better-than-expected operating performance collides with high leverage to drive material equity gains. Generics were the laggard; pricing continues to erode and fundamentals remain challenging. Healthcare IT was caught in the backwash of the broader technology sell-off; quite what Facebook's issues with data privacy and content management have to do with future healthcare utilisation trends, but then if markets were constantly rational, we would all be redundant.

As noted last month, we had increased our cash on hand going into reporting season to take advantage of any share price movements that we deem egregious to increase some positions and we have been adding selectively in Med-Tech and Biotech.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Performance (USD)	Performance (GBP)
Biotech	10.1%	8.5%	9.1%
Conglomerate	11.9%	6.7%	7.2%
Dental	0.7%	3.8%	4.3%
Diagnostics	2.1%	5.7%	6.2%
Distributors	3.0%	0.0%	0.5%
Facilities	1.2%	13.0%	13.6%
Generics	0.9%	6.0%	1.1%
Healthcare IT	1.1%	2.7%	3.2%
Managed Care	9.6%	4.1%	4.6%
Med-Tech	14.1%	3.4%	3.9%
Other HC	0.9%	1.5%	2.0%
Pharma	33.8%	7.5%	8.1%
Services	2.6%	6.3%	6.9%
Specialty Pharma	3.8%	5.8%	6.3%
Tools	4.1%	4.6%	5.2%

Source: Bloomberg/MSCI and Bellevue Asset Management. Weightings as of 30-06-18. Performance to 31-07-18.

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

Whither pharma?

The ostensible recent return of broader investor interest in large-cap pharma has been the subject of much commentary. During July, the Pharma sub-index of the benchmark returned 3.6% more than the non-pharma stocks (8.4% vs 4.7%); the first time this has been true since BB Healthcare was incepted. What, if anything underlies this apparent newfound enthusiasm for these historical sector bellwethers? Is this the canary in the coalmine, or simply a logical response to the previously boundless enthusiasm for FAANG abating?

Sadly, Pharma has not been the place to be invested for pretty much the entire working lives of the investment team at BB Healthcare. Figure 2 below illustrates the performance of pharma versus non-pharma within the MSCI World Healthcare Index since the fund's inception; the aggregate underperformance of the drug companies is stark. Issues of scale, already high profitability and low R&D productivity have weighed on the ability to generate visible growth and thus sustain a premium rating relative to the wider equity marketplace.

Source: Bloomberg, Bellevue Asset Management, 31.07.2018

More recently, the sector has struggled with the added worry of pressure from potential political action in the US to address the above-inflation rises in drug prices in the US. Despite these worries, the Pharma Index has seen a gradual positive re-rating; the forward P/E stood at 14.7x back in December 2016 versus 15.8x today (with a high of 16.8x in October 2017). The wider market forward P/E stands at 14.9x.

Substance versus semantics

As Facebook's vicissitudes illustrate all too well; size is the enemy of growth and it is very easy to grow rapidly in new markets where demand is high and competition limited. In contrast, the drug industry has long existed, so growth will inevitably be harder. There is a semantic point here as well - which is that the growth of the Drug market has not accrued solely to pharma owing to the classification of Biotechnology as a separate sub-sector. If biotech were not considered to be a separate entity, would the return profile for "therapeutics" overall look different? Not really - the combined "Pharma/Bio" would have underperformed the rest of the MSCI World Healthcare Index by even more over the life of the Trust (41% versus the 21% illustrated in Figure 2), because Biotech has been outperformed by Med-Tech and Tools over this period.

Recent positive commentary from Drug Company CEOs about the reality of the Trump blueprint to lower drug prices have likely helped sentiment by reducing fear of a worst-case outcome that the industry cannot easily adjust to. Probably equally important though, is the reality that large-cap pharma is a highly liquid sector with defensive characteristics that offers a viable home for a large swathe of cash as institutional investors reduce Tech holdings; the money has to go somewhere after all.

Our own take on the outlook for drug pricing and pharma more widely is broadly unchanged. We think a post-rebate world will change little for the industry, save for offering more potential for price negotiation with those who offer broad portfolios or who can demonstrate value through robust clinical outcomes data. This could drive further industry consolidation as bundled pricing strategies might be an advantage.

If I could own one thing...

In the end, we are agnostic to where we should be invested; seeking only visible growth opportunities within the healthcare firmament. That growth needs to be risk-adjusted and this is an aspect where, in the end, we rarely find Pharma to be compelling. Companies like Align, Illumina, Dexcom, Intuitive Surgical and Teladoc are carving out leading roles in new markets that are transformational to the productivity and economics of healthcare practice. Pharma companies, in contrast, turn out mostly incremental innovations whose most valuable facet is a patent, the cost/benefit over existing treatments to the medical system is often less obvious.

Conceptualising value for 'theoretical addressable market' stories can be challenging short-term, but one can re-frame this debate into an analysis of implied future growth. Put simply, how fast does a company need to grow for value to normalise in a reasonable timeframe? If the implied growth rate looks more than achievable, then the stock is not expensive versus its peers.

We see many more opportunities for transformative innovation across the healthcare landscape that meet such criteria and so traditional Pharma is probably going to continue to be a de-minimis investment for the Trust outside of selective special situations, even if it may see some re-rating over the coming weeks; our focus is resolutely on the 3-5 year outlook.

Developments within the Trust

The Trust's premium to Net Asset Value (which averaged 1.9% from inception to the end of June 2018) averaged 0.2% over the month, but again increased toward the period end, enabling us to re-commence our tap programme, issuing a further 2.6m shares. The leverage ratio has risen from 3.2% at the end of June to 4.7% by end July. This is due mainly to the treatment of the forthcoming interim dividend as a liability. We continue to have some cash on hand to take advantage of potential mis-pricing events through the tail end of the reporting season.

Please do feel free to submit any questions raised by the discussion in the factsheet to: shareholder_questions@bbhealthcaretrust.co.uk and we will endeavour to respond in a timely fashion.

Paul Major, Daniel Koller and Brett Darke

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SUB SECTOR BREAKDOWN

Med-Tech	17.5%
Biotech	16.7%
Managed Care	11.0%
Specialty Pharma	8.9%
Diagnostics	8.4%
Pharma	7.7%
Dental	6.9%
Health Tech	6.1%
Healthcare IT	5.5%
Services	4.5%
Distributors	3.8%
Other HC	2.9%

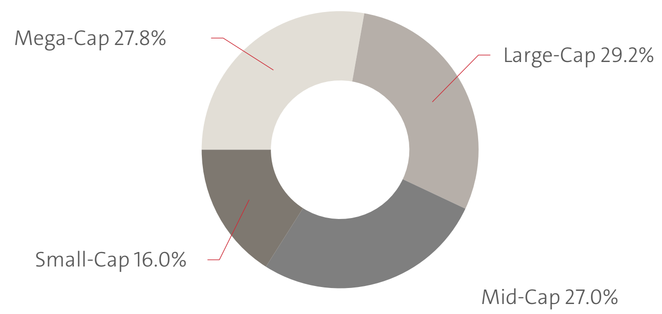
Source: Bellevue Asset Management, 31.07.2018

TOP 10 HOLIDINGS

Anthem	7.8%
Align Technology	6.9%
Illumina	6.8%
Teladoc	5.5%
Celgene	4.9%
Shire	4.8%
Intuitive Surgical	4.5%
Lonza	4.5%
Amerisourcebergen	3.8%
Dexcom	3.7%

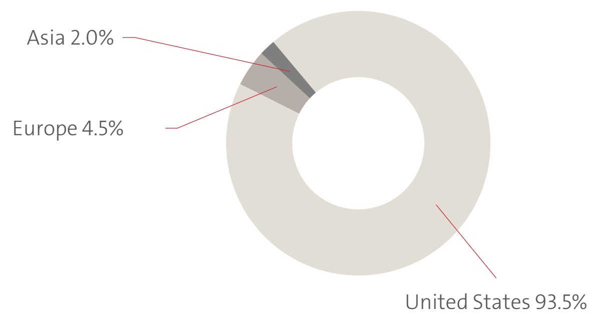
Source: Bellevue Asset Management, 31.07.2018

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.07.2018

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.07.2018

"four companies representing ~12% 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

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 369.4 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	276 723 313
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

DISCLAIMER

BB Healthcare Trust PLC (the "Company") is a UK investment trust premium listed on the London Stock Exchange and is a member of the Association of Investment Companies. As this Company may implement a gearing policy investors should be aware that the share price movement may be more volatile than movements in the price of the underlying investments. **Past performance is not a guide to future performance. The value of an investment and the income from it may fall as well as rise and is not guaranteed. An investor may not get back the original amount invested.** Changes in the rates of exchange between currencies may cause the value of investment to fluctuate. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially over time.. This document is for information purposes only and does not constitute an offer or invitation to purchase shares in the Company and has not been prepared in connection with any such offer or invitation. Investment trust share prices may not fully reflect underlying net asset values. There may be a difference between the prices at which you may purchase (“the offer price”) or sell (“the bid price”) a share on the stock market which is known as the “bid-offer” or “dealing” spread. This is set by the market markers and varies from share to share. This net asset value per share is calculated in accordance with the guidelines of the Association of Investment Companies. The net asset value is stated inclusive of income received. Any opinions on individual stocks are those of the Company’s Portfolio Manager and no reliance should be given on such views. Any research in this document has been procured and may not have been acted upon by Bellevue Asset Management AG for its own purposes. The results are being made available to you only incidentally. The views expressed herein do not constitute investment or any other advice and are subject to change. They do not necessarily reflect the view of Bellevue Asset Management AG and no assurances are made as to their accuracy. Bellevue Advisors Limited is an Appointed Representative of Mirabella Advisers LLP, which is authorised and regulated by the FCA (RFN: 606792).

CONTACT

Bellevue Advisors Limited
Claude Mikkelsen, Director of Investor Relations
Phone: +44 (0) 203 326 29 83
Moblie Phone: +44 (0) 755 704 85 77
E-Mail: cmi@bellevue.ch
32 London Bridge Street
24th Floor
London, SE1 9SG, UK
www.bbhealthcaretrust.com