BB Healthcare Trust

Monthly News
December 2019

As at 12/31/2019	Value	1 Month (December)	YTD	Since Launch (ITD)
Share	142.00	-1.2%	22.5%	51.9%
NAV	143.97	0.7%	25.6%	56.7%

Sources: Bloomberg & Bellevue Asset Management AG, 31.12.2019, NAV and share price returns are adjusted for dividends paid during the period (but not assuming reinvestment)

Note: 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.

Welcome to our December update. As memories of the festive frivolities fade and 2019 performance is set in stone, one's attention animistically turns to the coming year (and indeed the new decade). Polarised prognostications often abound at this time and rare is the broker who urges inactivity. Nonetheless, equanimity serves well and cooler heads should ultimately prevail. We therefore set aside the remaining mince pies and consider what 2020 might offer...

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 (UK).

2019 - A Vintage Year

In sterling terms, the MSCI World Index delivered a total return of 22.5%, well above the annualised average of 11.6% across the 10-year bull market that we have enjoyed since 2009 (and the 5.5% average of the past 20 years). It was not just a banner year for equities either: bonds, gold and oil also did well. It is unusual to see simultaneous material positive returns across multiple asset classes.

It is fair to say that very few of us would have predicted this in December 2018, when markets were roiled by multiple headwinds and volatility spiked. Cassandras are everywhere at the end of a bull market and some sort of market pullback was widely anticipated. The sharp 'V-shaped' recovery that followed in early 2019 was much less so, catching many off guard.

The grapes of wrath?

Aphorisms abound in outlook pieces and it would be easy to pour cold water on expectations for 2020 based merely on mean reversion. Additionally, there are any number of insidious factors the pessimist could cite: rising geo-political tensions in the Middle East, an election and impeachment process in the US and of course market-wide valuations are still high relative to history on certain metrics as trade issues continues to weigh on the wider growth outlook.

The positive market trend will end at some point; it always does. Nevertheless, we see many reasons to be positive on the healthcare sector in both the short and medium term. Before we explain why, and delve into the sub-sector outlook in a little more detail, we should first review the final month of 2019 and where that left us for the year overall.

Measured in sterling, the Trust's net asset value appreciated 0.67% over the month to 143.97p, slightly lagging the MSCI Healthcare Index, which rose 0.75%. Sterling appreciated significantly over the month (+2.6%) on the back of the UK election result and this was a material headwind. The sub-sector performances are summarised in Table 1 and the notable leaders and laggards are briefly detailed below:

- **Healthcare technology**: this sub-sector only contains two stocks with closely related dynamics. The diabetes dynamos Dexcom and Insulet gave up some of the strong gains they posted following impressive Q3 results.

- **Distributors**: hopes for rapid resolution of the opioid overhang receded, weighing on sentiment for wholesalers in the US.

- **Animal Health**: on the positive side, Elan and Zoetis continue to enjoy favoured status, being free from political overhangs.

- **Conglomerates**: within the group, both Bayer and J&J were duly rewarded following favourable outcomes with respect to potential legal risks that weighed heavily on sentiment during 2019.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Perf. (USD)	Perf. (GBP)
Biotech	9.0%	-0.6%	-3.0%
Conglomerate	11.1%	5.0%	2.6%
Dental	0.6%	1.3%	-0.8%
Diagnostics	2.0%	0.7%	-1.7%
Distributors	3.1%	-2.6%	-4.9%
Facilities	1.1%	4.3%	1.7%
Generics	0.4%	0.0%	-2.5%
Healthcare IT	1.0%	0.8%	-1.4%
Healthcare Tech.	0.6%	-5.2%	-7.6%
Managed Care	8.9%	4.6%	2.0%
Med-tech	15.6%	2.4%	0.1%
Animal Health / Othei	1.2%	9.3%	6.6%
Pharma	34.2%	4.8%	2.6%
Services	1.8%	4.6%	2.5%
Specialty Pharma	4.1%	2.2%	-0.3%
Tools	5.4%	4.5%	1.9%

Source: Bloomberg/MSCI and Bellevue Asset Management. Weightings as of 30-11-19. Performance to 31-12-19.

Despite ending the year on a slight discount to NAV (-1.4%, which has since corrected), BB Healthcare delivered a positive total return for the calendar year of 22.7%, versus 18.4% for the MSCI World Healthcare Index. Globally, healthcare lagged the wider market by ~4.4% in dollars. In the all-important US market though, the picture was starker: The healthcare sub-sector of the S&P500 Index under-performed its parent by 10.7% across the year and this is something worth considering as we move into 2020.

The Trend is your friend

Everyone loves a homily. Investing is not short on edifying clichés and sometimes it does behove one to consider these; the stockmarket is little more than the supposed wisdom of crowds. In this vein, it is a widely held view that one is well served being underweight healthcare in a US election year. However, as we detailed in last month's factsheet, our feeling is that much of the speculation as to what impact various political interventions could have on the sector have largely played out through 2019.

Put simply, 'Medicare for All' looks dead on arrival. If the outcome of the recent UK election has anything to teach the Democratic party, it is surely that metropolitan politicos banging on and on about stuff the wider electorate do not care about anything like as passionately does not help you win. This is patently the case for the Medicare for All pitch, which has polled poorly for years. Perhaps they should consider nationalising broadband instead?

The political situation in the US improved further in the closing weeks of the year, with permanent repeals of the Health Insurance Fee ("HIF") and Medical Device Tax, making medium-term profit forecasting a bit more certain. The thorny question of the legality of the mandate around Obamacare (which is being litigated in Texas) has been pushed back to the lower court, which likely means there will be no conclusion to this in 2020, removing yet another uncertainty for the year ahead.

As we go to press, the marquee JP Morgan Healthcare conference will be underway in San Francisco; a city that probably doesn't need another 8,000+ people trying to grab a table in a coffee shop for a quick chat. This first-world problem can be assiduously avoided by not attending, an approach paradoxically made easier by virtue of the event's importance – key presentations are webcast and commenting on management prognostications from the conference occupies most of the healthcare sell-side for much of mid-January. Thus, we will be watching it all from the comfort of Bellevue Towers.

What are we likely to hear, as regards the companies in our portfolio and on our watch list? In all probability, it will be benignly positive murmurings, rather than trenchant orations. This was largely the case in January 2019 (although Illumina caused a bit of a wobble in what ultimately proved to be a portentous rather than propitious presentation). Why shouldn't it be so? The dynamics of this industry evolve slowly and are demographically driven; pricing is quite stable outside of generic drugs and healthcare items are generally protected goods when it comes to trade tariffs. Reassuringly predictable is what this sector should be all about.

Healthcare may have its own dynamics, but it does not exist in splendid isolation from the rest of the market. The JP Morgan event is not the only source of commentary over the coming week; Apple fell 10% in early January 2019 on a cautious outlook, taking wider market sentiment down with it, albeit transiently and of course the situation in the Middle East is evolving in real-time. One can never account for the "unknown unknowns" but our key message is that we do not see any negative "known unknowns" at this point.

"I am not uncertain"

With the ever-applicable caveat that the whole point of having an opinion, incisive or otherwise, is so that one can change it as the facts evolve (and also because we are neither as gifted or as crooked as Dollar Bill), we summarise our thoughts on the outlook per sub-sector, as it pertains to our holdings:

- **Biotech:** having delivered stellar returns in 2017 and the first 9 months of 2018, the US Biotech sector latterly struggled to deliver comparable returns to the rest of healthcare and has underperformed over the period since the inception of BBH. As we have noted before, this feels rather against the run of success that the industry has demonstrated at a fundamental level; compelling innovations are far from scarce.

  Concerns over drug pricing legislation and action to ease biosimilar entry seems to have been the main fear factors (arguably median pricing per treatment is significantly higher in this group) and this had receded somewhat. More importantly, M&A has come back as a significant force and the pharma industry remains underweight new products to sustain growth. We expect a more positive outlook in 2020 than 2019, but we also thought that last year and it proved misplaced.

- **Conglomerates:** generally speaking, investing in these sorts of companies is antithetical to our strategy. Nonetheless, with a c10% index weighting, this ragtag group of companies is important for sentiment to wider healthcare. Fresenius, Bayer and J&J had a torrid 2018, lagging wider healthcare, and did not catch up in 2019. For the latter two, resolution of legal overhangs is probably the critical issue.

- **Dental:** everyone has teeth and they are invariably wonky. As such, orthodontics has very compelling long-term supply and demand characteristics. Within this, we continue to expect clear aligners to take market share from traditional wires and brackets and for Align Technology to remain at the forefront of this market evolution.

  Align experienced significant falls in Q4 2018 and Q3 2019. In both cases, the stock largely recovered within a few months. We saw both situations as more of a misunderstanding of the business than reflective of real issues (as the recovery attests) but we are chastened by the experience and more mindful of covering off event risk into reporting periods. That said, we see this investment as a core long-term opportunity.

- **Diagnostics:** this is one of our largest sub-sector exposures heading into 2020 and with good reason. The patient journey through the healthcare system begins with diagnosis and preventative health programs are predicated on screening. Better understanding of a problem is the first step to a solution and the tremendous improvements in diagnostic power (driven as much by computational factors as better chemistry and genetic knowledge) offer huge opportunities.

  Our exposures cover a wide gamut from near patient testing to long-term monitoring and human genetics programmes. Despite the obvious growth potential, we also see significant value opportunities with some of our holdings, which are trading significantly below peer group averages. Our high weighting reflects our conviction and enthusiasm for this sector.

- **Distributors:** investment returns from this sub-sector probably depend more on the resolution of litigation and legislative overhangs around drug pricing and the US opioid crisis than it does on actual fundamental business performance. On the latter, the situation is probably looking better as generic drug pricing has stabilised versus recent years.

  Hopefully the market is now over its Amazon/Pill-pack paranoia, allowing investors to ascribe a higher fundamental P/E; this low-margin, infrastructure-heavy industry will not be an easy marketplace to disrupt. However, since we cannot have any edge on the former points, we will continue to eschew this sub-sector.

- **Facilities:** we think hospital operators in developed markets are likely to continue to struggle at an operational level. The simple reality is that medical treatment is changing profoundly, and the infrastructure needed to deliver this care will change with it. As such, a typical operator is long debt and out-of-date infrastructure (think of a telephone exchange in late 1990s – for those under 40, Wikipedia can explain to you what a telephone exchange was). We have made an active decision to own the agents of change rather than the customers of that change.

  The notable exception is in developing countries rolling out national healthcare schemes (e.g. Asia and the MENA region). Here, the infrastructure is de-novo and the rising utilisation trend a clear positive. We are happy to own operators focused on these high growth markets.

- **Generics:** this has been a tricky sub-sector to navigate for a number of years and we do not see that changing in 2020. A confluence of factors (negative pricing, litigation, over-capacity, pro-domestic policy in China) weigh on the growth outlook. In the midst of all this, determining the right valuation becomes challenging and thus we are happy to remain on the side lines.

- **Healthcare IT:** this is a sub-sector where we think the interesting stuff is outside of the benchmark, which is dominated by Cerner and Veeva (which we do not find that interesting from a price/growth perspective). Beyond these, we continue to see myriad opportunities in this area: healthcare is a veritable data treasure trove and, as much as we all like to think that we are special and unique, an actuarial analysis of your medical history and lifestyle can be highly predictive of potential future medical issues.

  These datasets will only become more powerful as the amount of familial genetic data available online increases. Preventative "population health" initiatives can be driven by these datasets, prompting early interventions in the highest risk member of society, thus lowering acute medical costs over the longer-term. Big Brother is watching, and he might just save your life...

- **Healthcare Technology:** if there is one segment of the market where we would like to have more exposure than we do, it is healthcare technology, which we describe as the application of continuous monitoring and algorithms to deliver improved care outcomes. Most of the opportunities are currently in the cardio-metabolic area.

  Sadly, the combination of limited listed options, tremendous potential and rapid visible growth has led to crowded longs and stretched valuations. It is hard to justify anything trading on double-digit revenue multiples. We will look to be more constructive in the event of a pull-back, but the momentum is definitely with this sector for those happy to ignore valuation.

- **Managed Care:** health insurers were in the eye of the storm in 2019 as the 'Medicare for All' debate took centre stage. Q4 2019 saw a significant recovery as the probability of the harshest iterations of this idea faded away. Nonetheless, investors are still nervous and valuations could rise further as the Primary campaigns progress (through a further row-back from Warren or more centrist candidates like Biden, Bloomberg or Buttigieg storming ahead). We have thus entered the year with considerable managed care overweight versus the benchmark, but this will likely decline if the sector continues its positive re-rating.

- **Med-Tech:** it is difficult to reduce such a broad swathe of companies to a few paragraphs of commentary. We are currently biased toward durable equipment vs. consumables, resonating with our views on the facilities sector described above (akin to re-tooling a factory for new production processes).

  Generally speaking, valuations are also less demanding at this end of continuum as well, especially versus the higher-technology end of consumer med-tech that better resonates with our wider investment approach than commoditised items such as large joint orthopaedics. We prefer more focused operators and generally see our exposure declining given overall valuation levels looking stretched, although we would likely be very active in the event of a market pullback.

- **Animal Health/Other:** we will not opine on this grouping as our investment mandate is around improving human health rather than animal health (eloquently described recently by someone as a "no pot, no pets" approach; there are now three Canadian-listed "medical marijuana" companies in the MSCI World Healthcare Index. We classify these into specialty pharma).

- **Pharma:** these days, the split of therapeutics companies into pharma, biotech and specialty pharma feels rather arbitrary and backward looking. Generally speaking, most innovative drugs would classify as (and indeed originate from) biotechnology or specialty pharma, making pharma more of a legacy grouping of leviathans from another age, whose crapulous appetite for M&A and woeful R&D returns tell of a failed strategy kept alive by prodigious cashflows.

  The contrast in investor sentiment versus biotech over the past year is surely all the more notable in light of these contrasting fundamentals. Will the pendulum swing back, or will the safe haven of those well defended cashflows remain alluring in an uncertain world? Generally we only like to invest in big pharma when valuation is very compelling and that still remains the case for Bristol-Myers (which, post completion of the Celgene deal is arguably more akin to a large-cap Biotech than a classical pharma stock in any event). A tough one to call, but we would think US pharma outpaces premium-valued European pharma over the year.

- **Services:** we expect to increase our exposure to the services space, around our wider theme of the 'democratisation of innovation'. If one accepts the previously posited paradigm that big pharma is rubbish at R&D, the future belongs to smart PhD students who can turn their idea into a clinical stage programme (which pharma will then license or buy for a tidy IRR).

  There is now an army of service providers to help with clinical trial design and management, animal disease models, contract manufacturing, sales and market support and so on. The volume growth opportunity for these service providers to the next wave of drug discovery innovators looks very positive, irrespective of the macro-political outlook.

- **Specialty Pharma:** this accounts for our largest exposure, alongside Diagnostics and is the reciprocal of the aforementioned bearishness on pharma. Therapeutics, in their various forms, account for roughly half the index's value in market capitalisation terms. With so much scientific innovation to come (the proportion of human diseases with known pathways but without drugs or with poorly effective treatments remains very high); the question is not 'should one invest in therapeutics' but rather 'how do I best invest in therapeutics'.

  For us, the approach is to concentrate on smaller, focused companies with clearly defined products or technologies that are not reliant upon presumed future R&D success beyond the visible late stage pipeline to justify valuation upside. Our increased weighting toward specialty pharma reflects the pivot away from Med-Tech as valuations have become more challenging and the corollary of opportunities thrown up by the previously discussed uncertainties overhanging biotech.

- **Tools:** this sub-sector covers laboratory equipment used in research and testing. We eschewed tools for most of the first three years of the Trust's life, feeling that longer-term growth expectations were on the high side. This was probably an overly cautious view, but our general sense is that the outlook is more reasonable moving forward and we have made our first foray into this area. We may well increase our exposure further if we think valuation is supportive. However, as with the Healthcare Technology sub-sector, we are not willing to compromise on our longer-term return objectives or take on increased risk just to broaden our exposures.

Developments within the Trust

As of end December, the portfolio was unchanged over the month, comprising 30 equity investments plus the Alder CVR .The leverage ratio declined to 0.6% from 0.9% in November as the portfolio valuation increased; our trading activity was relatively muted. We did not issue any shares through the tapping programme during the month.

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@bbhealthcaretrust.co.uk

As ever, we will endeavour to respond in a timely fashion. Happy new year to you all.

Paul Major and Brett Darke

BB Healthcare Trust

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Standardised discrete performance (%)

12-month total return	1 year Dec 18 - Dec 19	3 year Dec 16 - Dec 19	Since Inception
NAV return (inc. dividends)	25.6%	52.1%	56.7%
Share price	18.8%	37.9%	42.0%
Share price (inc. dividends)	22.5%	47.5%	51.9%
MSCI WHC Total Return Index	18.4%	40.9%	47.2%

Sources: Bloomberg & Bellevue Asset Management AG, 31.12.2019

NAV return and share price returns are adjusted for dividends paid during period where started (but not assuming reinvestment)

Note: 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

SUB SECTOR BREAKDOWN

Specialty Pharma	17.4%
Diagnostics	17.2%
Managed Care	14.5%
Biotech	10.5%
Med-Tech	9.7%
Healthcare IT	9.6%
Dental	6.8%
Pharma	6.5%
Services	3.0%
Facilities	2.3%
Tools	2.1%
Health Tech	0.4%

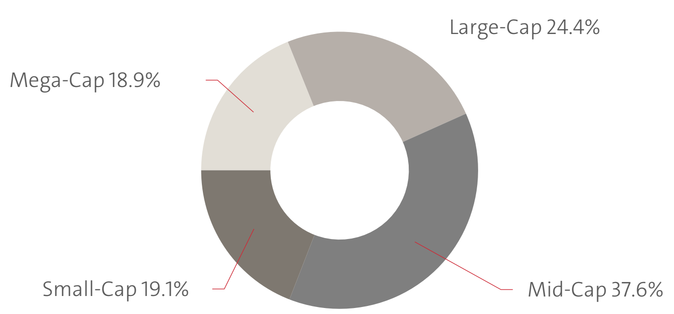
Source: Bellevue Asset Management, 31.12.2019

TOP 10 HOLIDINGS

Illumina	7.3%
Anthem	7.2%
Align Technology	6.8%
Bristol Myers Squibb	6.5%
Teladoc	6.3%
Humana	5.4%
Esperion	5.3%
Insmed	4.5%
Jazz Pharmaceuticals	3.3%
Evolent Health	3.3%
Total	**55.9%**

Source: Bellevue Asset Management, 31.12.2019

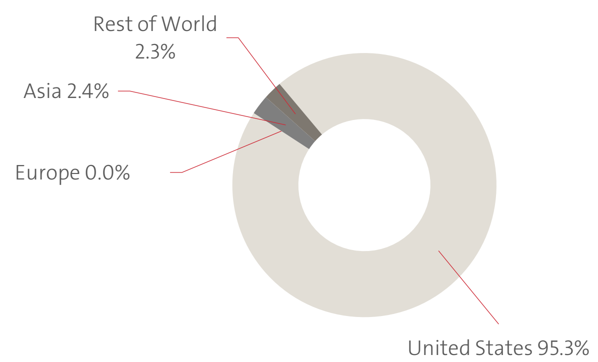
MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.12.2019

"Mega Cap >$50bn, Large Cap >$10bn, Mid-Cap $2-10bn, Small-Cap <$2bn."

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.12.2019

"two companies representing ~5% 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 targets a dividend payout equal to 3.5% of the prior financial year-end NAV
- BB Healthcare has an experienced management team and strong board of directors

MANAGEMENT TEAM

Paul Major

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 620.6 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	433 957 062
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

CONTACT

Simon King
Phone +44 (0) 20 3036 0700
Mobile: +44 (0) 7384 343 046
Email: ski@bellevue.ch

Mark Ghahramani
Phone +44 (0) 20 3326 2981
Mobile: +44 (0) 7554 887 682
Email: mgh@bellevue.ch

24th Floor, The Shard
32 London Bridge Street
London, SE1 9SG
www.bbhealthcaretrust.com