BB Healthcare Trust

Monthly News
June 2018

As at 06/30/2018	Value	1 Month (June)	YTD	Since Launch (ITD)
Share	129.00	6.17%	11.57%	33.06%
NAV	125.41	2.74%	13.54%	29.46%

Welcome to the first World Cup edition of our Factsheet. These past weeks have brought many surprises on and off the pitch. Some were good (England through), some lamentable ('VAR'-seeking diving antics) and some hard to fathom (the North Korean "peace" summit and US trade policy). So much for a stable and quiet macro-political backdrop to quieten markets and allow us to enjoy the football in relative amity...

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.

So much for peace and quiet...

Like March, June saw a volatile few trading days into the month and quarter end. The adage "sell in May and go away" held for markets broadly; a torpid MSCI World Index declined 0.2% in dollars, erasing a gain of more than 2.5% in the latter half of the month as fears of US trade policy impacting earnings and global growth weighed on sentiment.

Healthcare was a relative safe haven; it outperformed the wider market in the early weeks of the month (rising >3%) and gave back less in the subsequent sell-off (in part due to the morosity of Large-Cap Pharma - the Pharma sub-index declined only 0.3% over the same period).

Sterling retreated further over the month, weakening 0.9% versus the dollar, and likewise saw a considerable amount of intra-month volatility and rising implied volatility on forward rates. The overall trend benefitted the reported NAV evolution.

Amid all this noise, the Trust's ex-income net asset value (NAV) rose 2.7% to 125.43p. In sterling terms, the MSCI World Healthcare Index rose 2.0%. We thus modestly outperformed our benchmark by 0.7% during the period.

It seems increasingly likely to us that we are in for a summer of volatility, as the storms of US trade policy, Brexit, European disagreements on migration and the US midterm elections create multitudinous opportunities to misinterpret or over-estimate the likely negative future impact of a policy or statement on consumer sentiment, economic growth and thus likely future equity returns.

The situation is exacerbated considerably when one of the key protagonists takes vacillation and cognitive dissonance to hitherto uncharted levels in the diplomatic sphere. We are quite sure President Trump fervently believes in something, but we have all but given up trying to understand what that actually is. At this point, one could reasonably conclude that he is either blind to, or wilfully inconsiderate of, the wider consequences of his actions as he pursues a narrow domestic agenda.

Football, more than just a game

The cautionary tale as a moral and ethical guide traces back to the earliest written histories and crosses all cultures. However, it's the world cup: we will eschew the collective canon of literary greats and instead consider our beautiful game as a metaphor for markets. What have the last few weeks taught us?

The popular Anglo-Saxon chant of "are you blind ref?" (note: other, less charitable, versions are also available) has been seldom heard in this competition, as the relentless march of technology spreads even into football with the introduction of the Video Assistant Referee (VAR).

Like many before, this road was paved with good intention. VAR would be a seldom-used backup technology for limiting errors in specific match-changing situations to reinforce, rather than undermine, the primacy of the referee. First tested by FIFA at the 2017 U20 World Cup (which England won, by the way), it was indeed used infrequently (only 12 times in 52 games).

Once fully deployed at the Confederations Cup, its unintended consequences soon became clear. These shortcomings were arguably not addressed (indeed, FIFA's Press Department reminds us of the White House) and the technology has thus had a visible impact on the group stages of this year's world cup (where it was used 335 times in 48 matches, 122 of which were mandatory goal checks).

Although we have seen fewer Red cards at this championship, players are making a lot more fuss over low-level fracas, with regular appeals for VAR review clearly being heeded. Even if unsuccessful, this introduces breaks of up to several minutes that can disrupt the momentum (handy if you are losing). The pressure this has placed on referees is clear (i.e. players arguing the ref is wrong and will see as much on playback) and it will be interesting to see how many support the technology over time.

With regard to the style of play, we are seeing more penalties and more corners. We are thus witnessing more set-piece goals and fewer from open play. Time will tell if this is ultimately a good thing and if standards of behaviour do improve. At the same time, football is a physical game with an element of contact fundamental to the sport and what we all really want to see is an unexpected goal on a counter-attack after a run up the pitch the dazzles with ingenuity and athleticism.

The legends of Pele, Maradonna and Messi were not forged in a crucible of set pieces and one should always be mindful when changing the rules of a game as to what may happen next. As the ancient saying goes: be careful what you wish for. Somehow, though, we doubt Trump watches "soccer".

Beware the ghost of Smoot-Hawley

"Making America Great Again" is surely open to every US citizen's interpretation as to what (if anything) is wrong in the first place. In the President's mind, it seems to be about jobs. Employment is at record levels, but the US is apparently getting a raw deal on trade, which is hurting American workers. We agree that intellectual property abuse is rife and should be addressed, and offshoring jobs to low cost jurisdiction with poor employee rights is an undesirable 'race to the bottom', but we struggle with an equitable solution to these issues based on trade tariffs.

If history shows anything, it is that free trade between two countries benefits both parties in GDP growth terms. On the other hand, tariffs generally hurt GDP growth and are difficult to implement without second-order consequences. With regard to current US policy, such effects are being seen already, with Daimler announcing that retaliatory tariffs from China would cut demand for its US-made Mercedes SUV ranges, Toyota suggesting that proposed auto part tariffs could add 10% to the cost of its US-made Camry and Harley-Davidson announcing that it would move more production overseas to serve export markets.

These three examples from the vehicle sector could ultimately result in higher consumer prices, less hours available for American autoworkers at existing plants and potentially more jobs moving offshore to localise production. Is this really what the 'average Joe' wants?

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Surely some good news?

It is not hard to understand why such an obvious threat to corporate profit growth and consumer sentiment weighs on markets and currencies (cf. Brexit). As noted already, this nebulous overhang is unlikely to moderate any time soon. Defensive stocks tend to fare well in uncertain times and any sense that the rate cycle is slowing will help sentiment toward what we would call "dull growth" such as Pharma. Is healthcare a safer bet in the broader sense?

One might logically assume that healthcare goods and services would be insulated from potential tariffs since they serve such an essential need. However, this is not the case and a number of classes of medical devices, ingredients and consumables are on the proposed tariff lists. Many US/multi-national firms supply medical equipment from Chinese sites, as components or finished goods. A high proportion of generic ingredients are also sourced from China.

The impact of any changes at a company level will only become clear over time, as might any retaliatory actions from countries impacted by US tariffs; we imagine this will be a topic for discussion with management teams as Q2 reporting gets underway. At the sector level, one must be mindful regarding the importance of China is as a growth market for healthcare, given its large population and rapidly expanding middle class. We discuss our reaction to these observations at the end of Factsheet.

Sub-sector performance

The monthly performance by sub-sector is illustrated in the table below. Facilities stocks were hurt by concerns over slowing utilisation trends and equity performance was exacerbated by the high levels of debt at many hospital operators. Healthcare IT and Dental gave back some of the stellar gains YTD in what seemed to be a general 'risk-off' environment, although Biotech seemed to benefit from that classical positioning as 'defensive growth'.

Distributors were hurt by Amazon finally making the move into pharmacy through the PillPack acquisition (a company with a market share somewhere in the 0.2% range). We shall save readers from any further commentary on this tortured subject.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Performance (USD)	Performance (GBP)
Biotech	10.0%	3.8%	4.6%
Conglomerate	12.0%	-0.2%	0.6%
Dental	0.7%	5.7%	6.5%
Diagnostics	2.1%	2.0%	2.8%
Distributors	3.1%	-1.2%	-0.5%
Facilities	1.2%	-3.7%	-2.9%
Generics	0.8%	4.1%	4.9%
Healthcare IT	1.2%	-0.9%	-0.1%
Managed Care	9.5%	2.8%	3.6%
Med-Tech	14.0%	2.1%	2.9%
Other HC	0.9%	1.8%	2.5%
Pharma	34.5%	0.6%	1.4%
Services	2.6%	1.7%	2.5%
Specialty Pharma	3.5%	3.8%	4.6%
Tools	4.0%	0.4%	1.2%

Source: Bloomberg/MSCI and Bellevue Asset Management. Weightings as of 31-05-18. Performance to 30-06-18.

The Benchmark is a market capitalisation-weighted Index encompassing most of the largest companies in healthcare. Per our definitions, the Index is 67% Mega-Cap, 30% Large-Cap and c3% Mid-Cap. With growth and size typically inversely correlated, generally the Large and Mid-Caps disproportionately contribute to the Index performance. In this context, it is noteworthy that the Mega-Cap companies were the best performers in June. This is indicative of a more risk-averse market positioning, as investors move up the liquidity curve.

Developments within the Trust

In light of the ongoing uncertainties described above, we felt it prudent to reduce our leverage ratio, which now stands at 3.2% of gross assets versus 8.4% at the end of May. This has been declining organically over recent months as the portfolio value has risen and we have not taken on additional borrowings pro-rata, but we are now also carrying a small amount of cash to reduce risk and to take advantage of interesting opportunities that may arise through the forthcoming reporting cycle. The Trust's premium to NAV averaged only 0.4% across the month, but ended the period north of 2%. We issued an additional 2.1m shares via the tapping programme.

The portfolio now consists of 29 companies versus 28 at the end of May. We have added two companies and exited our position in the Biotech company Incyte, which we have replaced with Alnylam. The latter is the first re-entry into the Trust. This Biotech company was an inception position that we exited in October 2017 on valuation grounds, having risen almost 200% from the Trust's launch.

Our probability-adjusted fair value was <$100 at that time, given various uncertainties. The company has continued its positive evolution from a promising platform and pipeline to a pre-commercial story and the competitive position is clearer too. Despite this, the share price is back toward ~$100 at the time of writing and our risk-adjusted fair value is now much higher, warranting re-inclusion into the portfolio.

Batten down the hatches?

The team is very mindful that our remit is to generate attractive risk-adjusted returns and we have concluded over recent weeks that market-level risk has increased considerably, and we have adjusted our position sizes within the existing holdings to reflect this. In addition to decreasing the leverage ratio, we have decreased our exposure to Health-Tech, Dental and Med-Tech and increased exposure to Pharma and Managed Care, where performance has lagged YTD and where we see much lower volatility and event risk, whilst continuing to hold stocks where we feel very confident there is significant, fundamental upside potential.

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	18.2%
Biotech	14.9%
Managed Care	11.2%
Specialty Pharma	8.7%
Pharma	8.1%
Diagnostics	7.9%
Dental	7.0%
Health Tech	6.9%
Healthcare IT	6.0%
Distributors	4.2%
Services	4.2%
Other HC	2.8%

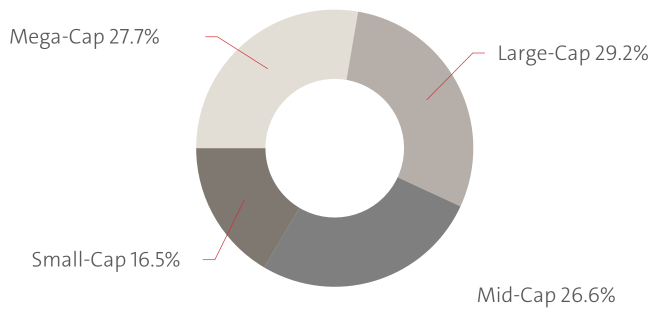
Source: Bellevue Asset Management, 30.06.2018

TOP 10 HOLIDINGS

Anthem	7.9%
Align Technology	7.0%
Illumina	6.3%
Teladoc	6.0%
Shire	5.1%
Intuitive Surgical	4.5%
Celgene	4.4%
AmerisourceBergen	4.2%
Lonza	4.2%
Dexcom	4.1%

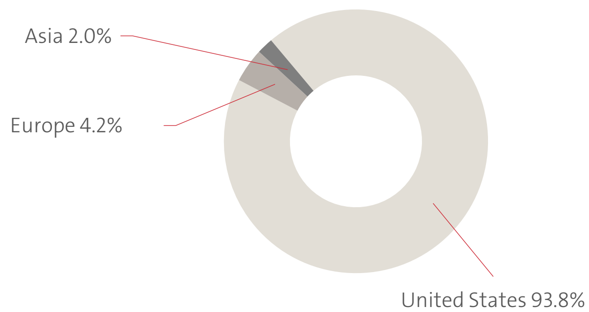
Source: Bellevue Asset Management, 30.06.2018

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 30.06.2018

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 30.06.2018

“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

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 353.6 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	274 127 562
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

CONTACT

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