BB Healthcare Trust

Monthly News
February 2018

As at 02/28/2018	Value	1 Month (February)	YTD	Since Launch (ITD)
Share	108.50	-7.27%	-7.66%	10.16%
NAV	108.81	-3.19%	-3.07%	10.52%

Welcome to our February update from a snow-capped Bellevue Towers. Healthcare followed the broader market sell-off closely over the month and the pound lost a little ground as the realities of Brexit peregrinate to centre stage once more. Corporate reporting continued to dominate sentiment against a fairly benign political backdrop and, broadly speaking, updates have been positive...

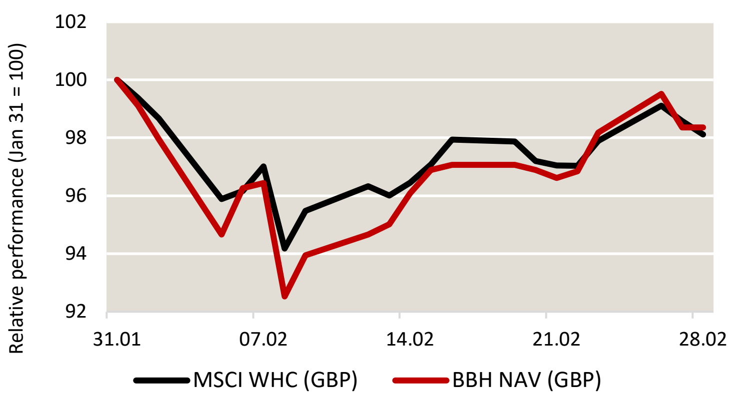
Summary

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.

Pop psychology

During February, the Trust's dividend-adjusted ex-income net asset value (NAV) declined 1.6% to 110.57p (the shares and NAV are trading ex the 1.75p final dividend as of February 22nd), modestly outperforming our benchmark by month's end.

In sterling terms, the MSCI Healthcare benchmark declined 1.9% over the month, outpacing the broader market's sell-off (the MSCI World Index declined 1.6% over the period). In local currency, Healthcare declined 4.7%, making the FX impact +2.8% for the month. We estimate the positive translational impact on our month-end NAV was also +2.8% in February. Figure 1 below illustrates the progression of the Net Asset Value over the period (adjusted for the ex-dividend effect):



Source: Bloomberg/MSCI and Bellevue Asset Management.

Once again, concerns over the supply chain and disruption from Amazon have weighed heavily on sentiment toward retail, wholesale (distributors), insurance (managed care) and pharmacy benefit managers (services). These areas account for >19% of our portfolio and their impact on the wider sector's overall negative monthly performance is evident in Figure 2.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Performance (GBP)	Performance (USD)
Biotech	11.1%	-4.2%	-6.9%
Conglomerate	12.8%	-3.6%	-6.3%
Dental	0.6%	-0.2%	-3.0%
Diagnostics	1.8%	1.7%	-1.2%
Distributors	2.0%	-5.0%	-7.6%
Facilities	1.1%	-1.3%	-4.1%
Generics	0.8%	-4.4%	-7.1%
Healthcare IT	1.2%	-0.1%	-2.9%
Managed Care	9.4%	-2.0%	-4.8%
Med-Tech	13.3%	-1.2%	-4.0%
Other HC	0.8%	8.4%	5.4%
Pharma	35.1%	-0.5%	-3.3%
Services	2.7%	-2.9%	-5.6%
Specialty Pharma	3.4%	-2.3%	-5.1%
Tools	4.1%	-1.9%	-4.6%

Source: Bloomberg/MSCI and Bellevue Asset Management. Performance is 30-11-17 to 28-02-18 and benchmark weightings are as of 30-11-17. BBH exposure as per 28-02-18

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

The psychological phenomenon of belief perseverance is well described. Put simply, it is the maintenance of a point of view despite all evidence to the contrary. This construct is ever more apposite in the 'post truth era' that we have unwittingly descended into, moving the discussion onto the 'backfire effect'.

This is where the presentation of evidence contrary to a previously held position has the unexpected effect of actually strengthening a person's belief in the already held (and factually unsupported) position. Although the geopolitical ramifications of exploiting such phenomena (e.g. US election campaigning, Russian troll farms and Brexit) are far more important than short-term investment returns, this subject is of some pertinence to our little Trust as well.

Perhaps the most challenging aspects of investing are the avoidance of confirmation bias and the maintenance of objectivity. Sometimes, you are just plain wrong and the right thing to do is to lick your wounds and move on. Admitting so is never easy and a post-mortem to establish if the errors are systematic is always an unpleasant, but valuable, experience.

On the other hand, the market can be famously irrational despite all evidence to the contrary and the Amazon healthcare hysteria feels very much like that. Despite healthcare being the biggest sector of the US economy, Amazon has just chosen to pony up a billion dollars for a remote door control company. We can't speak for anyone else, but are all a long way from feeling comfortable with Apps unlocking our houses and turning the alarm off.

Healthcare is very complex and to reduce it to the simple premise that it can all be done much better by someone else without prior experience feels foolish to us. That said, disruptive innovation is coming; we happen to think it will emanate from within rather than outside and return to this point later.

What do we do when things go wrong?

It is evident in the public data that we underperformed our benchmark over the first two months of our Fiscal 2018 and it is all too easy to make flippant comments about the market being wrong. We thought it might be more interesting to provide some insight into how we respond to short-term setbacks when they arise, and how this impacted our capital allocations during February.

When the market reacts negatively to corporate updates or sell-side sentiment changes, we run through a checklist of questions around our previous 3+ year investment thesis to establish if the facts have changed.

Assuming this is not the case, we then determine if a short-term issue has altered our view of the current fair value for the stock. Just because you see long-term upside potential in something does not mean that it deserves to trade ever higher in a linear fashion, and it may well be that increased uncertainty or revisions to the outlook do indeed merit a lower price in the near-term. There is a right price for any asset at a given time that continually evolves. We try to be disciplined about managing our holdings around these levels.

In a scenario where the reaction feels reflexive rather than considered, we may choose to add to our holdings. Since we are typically fully invested, topping up in one name often involves profit taking in another and, again, we try to maintain that discipline around current fair values. Although we have the freedom to let our winners run, there are no sacred cows and we have at some point or another adjusted the majority of our holdings on such a basis.

An overall view on risk plays into this as well; for instance we have added to our holdings in Shire this month as its value has fallen further, but this has been largely from other large-cap pharma holdings. As a consequence, our overall exposure to that sub-sector has continued to fall since this is commensurate with our wider views on risk/reward and how we want to be positioned. Sometimes we end up taking no action because we do not see an obvious pair for such a trade that is overall positive for risk/reward.

Alternatively, we could increase gross exposure through an increase the level of gearing that we run. This is always a more considered discussion as borrowings compound risk as well as returns and also have a minimum term of six months. For instance, we chose not to draw down any borrowings in February, in part because we saw a reasonable probability that our 4.8% holding in AmerisourceBergen might be cashed out by M&A, given the speculation around a takeover by Walgreens. We typically sell out of stocks trading close to offer prices rather than hold until deal completion and that would certainly be the case with a transaction that would likely involve a protracted anti-trust process.

The final element of this process worthy of mention is the important contribution that comes from our Board. Although it is a non-executive function, we have purposely staffed it with significant healthcare investment experience and this is brought to bear in quarterly reviews of performance where the focus is inevitably much more on what went wrong than what went right. Again, we feel strongly this will only prove to be an asset to the Trust over the longer-term. In more general terms, we have a frequent dialogue with board members about the wider investment and macro-political environment in healthcare.

Developments within the Trust

We issued a further 2.8m shares during the month via the block-listing facility and we have continued the trend from last month of flattening the book by adding additional weightings to some of our smaller positions. Including the effect of the dividend liability, our leverage ratio grew to 7.3% at month's end although, as noted above, we did not draw down any additional borrowings during February.

In terms of the portfolio, we have continued to take advantage of price action where favourable and to build out our 'watch list' of prospective investments for the Trust. We added two new holdings in February – another smaller-cap therapeutics company and our first position in the Healthcare IT space (more below).

We have also exited two positions – Eli Lilly (Pharma) and Tenet (Facilities). Both of these were positions at the Trust's inception and have been positive contributors to the NAV evolution. In each case, we felt that the remaining potential upside was both less significant and would take longer to realise than other opportunities that we have evaluated and thus they became a source of funds. As an aside, 17 of our 30 current holdings (amounting to >74% of the invested value) are from the inception portfolio.

We will host our inaugural Annual General Meeting at 11am on 22nd March, at the offices of our legal advisors, Stephenson Harwood – 1 Finsbury Circus, London, EC2M 7SH (the nearest tube station is Moorgate). The investment team will provide an update on the Portfolio and we hope to see you there.

We have setup a dedicated email address for shareholders to submit questions: shareholder_questions@bbhealthcaretrust.co.uk and we will endeavour to respond in a timely fashion. In the meantime, we thank you for your continued support of the Trust.

Back from the future

Perhaps because it is such an emotive subject, there is often a reluctance to talk about healthcare as an industrialised process. For the prospective investor and politicians, this has some interesting consequences. For instance, there is a continuous focus on drug prices but little discussion about the wider challenges to efficient access or how doctors' time gets used. In the end though, healthcare provision is a sausage machine and we are the meat filling.

In the industrial world, debottlenecking is a well-established process to understand where flow limiting steps exist and thus how a process can be optimised to cut costs and improve productivity. If one were to take such an approach to the broad question of how society can deliver better care for an affordable price, it would not start with cutting drug prices: around 80% of volumes are cheap generics and a 10% cut to drug costs would reduce overall expenditures by less than 1%. This is not to say they are not too high in some circumstances, merely that it is probably the wrong place to focus for maximal societal gain.

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We have spent a lot of time applying this approach to the healthcare industry, beginning from the premise that the current system is irretrievably broken and no longer fit for purpose. What might the delivery mechanism look like 10-20 years from now if one were trying to re-imagine the process with the bottlenecks removed? The key issues to our mind are the pressures on primary care services and access thereof and the over-use of expensive physician services to provide follow-up care that could be done in an out-patient setting. In addition, there is the ever-present challenge of trying to ensure that limited resources are allocated to those patients where the benefit will be felt most greatly, particularly in the prevention setting.

Coming back to the subject of Amazon, the issues summarised above are principally data and logistical problems that technology can help to solve, which is very much Amazon's forte. They are messy though, with the need to integrate all manner of vendors and providers and understand how to make use of all this data whilst respecting user's privacy. This is arguably less familiar ground for a retail-oriented company.

Software-based products are increasingly appearing within our portfolio, with Healthcare IT and Health Tech now accounting for 8.6% of our gross exposures and we expect both the number of investments and proportion of the portfolio accounted for by the broader theme of 'software as a service to enhance productivity' to rise further over time.

To be clear though, we remain uninterested in the larger software vendors who manage data for healthcare providers. We are only interested in disruptive technologies that offer new opportunities to deliver healthcare in a more efficient manner and that change practice in a way that will be tangible to the patient/consumer and physician (i.e. front office not back office). However, we are still a long way from buying into the Amazon argument.

Paul Major, Daniel Koller and Brett Darke

SUB SECTOR BREAKDOWN

Med-Tech	22.8%
Biotech	17.6%
Specialty Pharma	10.8%
Managed Care	9.7%
Dental	8.1%
Health Tech	7.0%
Diagnostics	6.4%
Pharma	5.0%
Distributors	4.8%
Other HC	4.6%
Healthcare IT	1.7%
Services	1.6%

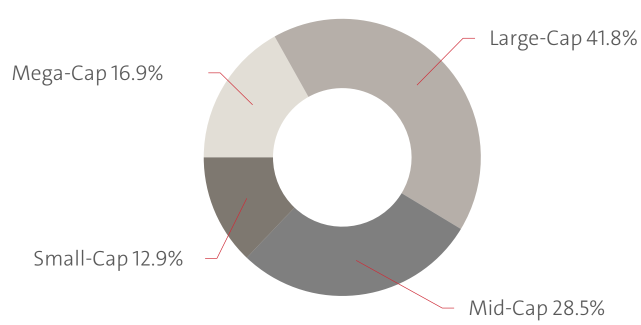
Source: Bellevue Asset Management, 28.02.2018

TOP 10 HOLIDINGS

Align Technology	8.1%
Anthem	7.2%
Illumina	5.3%
Celgene	5.0%
Shire	5.0%
AmerisourceBergen	4.8%
Walgreens Boots	4.6%
Intuitive Surgical	4.5%
Dexcom	4.4%
Hill-Rom Holdings	3.8%

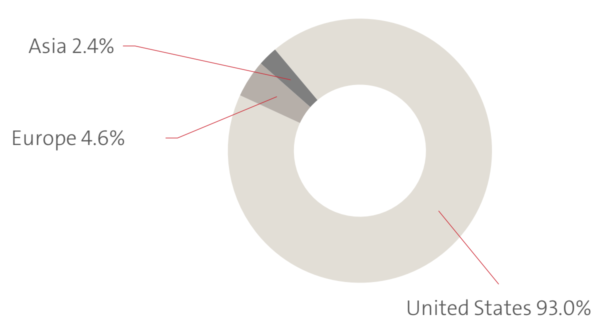
Source: Bellevue Asset Management, 28.02.2018

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 28.02.2018

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 28.02.2018

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

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INVESTMENT FOCUS

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

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 288.3 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	265 699 768
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

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