BB Healthcare Trust

Monthly News
August 2018

As at 08/31/2018	Value	1 Month (August)	YTD	Since Launch (ITD)
Share	145.50	7.38%	27.73%	52.34%
NAV	146.27	10.74%	34.40%	53.25%

Welcome to our August update. As we move into autumn, the conference season recommences, offering many opportunities to meet with management teams and discuss the evolving outlook. The omnipresent theme of US politics looms over nervous markets and various governments (sadly including our own) vie for the title of most shambolic. As the Moirai contrive our destiny, healthcare has ostensibly become a generalist 'safe haven' once more...

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.

"Avoid popularity if you would have peace"

Over the month, the ex-income net asset value (NAV) rose 10.7% to 146.27p, materially outperforming the benchmark. The MSCI World Healthcare Index rose 4.1% in sterling and 2.8% in dollar terms. We estimate that FX contributed 1.3% to the evolution of the NAV over the period. Healthcare outperformed the wider market during August. By comparison, the MSCI World Index rose 2.4% in sterling and 1.0% in dollar terms.

Persons partial to divination (and those who read last month's factsheet) would doubtless profess little surprise at healthcare's outperformance, having endured innumerable commentary around a style shift (aka "factor" – whatever that means) from growth toward value given the macro-political outlook, potentially record-breaking bull market run and all-time highs from several equity indices. As noted above, popularity makes people nervous and equities seem mighty popular.

To some extent, we too are inclined to heed Lincoln's words, for popularity in stocks tends to lead to rising expectations and thus the risk of disappointment, especially when the healthcare bid appears to come from fast money and Prime Brokers have reported record flows into the sector from hedge funds in recent months. Much as we much prefer the road less travelled, a rising tide lifts us all.

Back to divination and indeed our own powers of perception. We thought the "setup" going into August would favour the big-cap blue-chips like pharma and the conglomerates, as these are the boring safe haven choices, whose size and liquidity make them an obvious home for voluminous 'flighty' money. Aren't those NASDAQ-listed small and mid-cap Biotech and Med-Tech stocks just another flavour of high-beta growth?

In general, investing into diversified 'blue-chip' companies is antithetical to our strategy and thus it might seem a pleasant surprise to have outperformed the benchmark to such an extent over this period. To paraphrase Lefty Gomez, we are happy to be lucky as well as good.

In the end, our bearish prognostications for wider healthcare during a phoenix-like restoration of the Pharma/Conglomerate axis proved wide of the mark. Yes, money has flowed into healthcare (from Technology) but it seems to have gone to other homes than we expected, as shown clearly in the table of sub-sector performance below. As such, we have benefitted greatly from a tailwind with our sectoral positioning, happily, into the areas that we have favoured with overweight positions.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Performance (USD)	Performance (GBP)
Biotech	10.3%	2.7%	4.0%
Conglomerate	11.9%	-1.4%	-0.1%
Dental	0.7%	7.0%	8.4%
Diagnostics	2.1%	3.7%	5.0%
Distributors	2.8%	9.2%	10.6%
Facilities	1.3%	5.4%	6.8%
Generics	0.8%	-0.1%	1.2%
Healthcare IT	1.1%	10.6%	12.1%
Managed Care	9.4%	6.1%	7.5%
Med-Tech	14.0%	3.2%	4.7%
Other HC	0.8%	4.8%	6.1%
Pharma	34.2%	1.6%	2.9%
Services	2.6%	5.4%	6.8%
Specialty Pharma	3.8%	6.7%	8.1%
Tools	4.2%	1.4%	2.7%

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

Does greatness require danger?

The word Machiavellian can be used to imply something of low cunning, but can also mean opportunistic. There are many reasons to argue that the diplomat's famous treatise should not be a guide to modern life and business, nor do we imagine that he had investments in mind when writing it.

Does greatness require danger?

That said, his wider argument that 'fortune favours the bold' or rather that only through great risk can great reward be amassed, is an intriguing concept with respect to investing. Turning things around, how should one reflect upon a period where returns have exceeded expectations in the absence of any thematic explanation, and what might it mean for future risk and reward?

Whilst our investment framework is long-term, we recognise the inefficiency of the market in the short-term and that all stocks will have inherent volatility. Thus, in addition to having a view on what the ultimate conclusion to our investment thesis looks like, we also take a view on the reasonable attribution of value over time, especially during periods where there is scant incremental news flow around which to re-evaluate the investment case. We thus stick within limits when buying and selling stocks and happily trade around these limits to manage shorter-term risk.

In the context of the recent period, this has resulted in a sizeable amount of profit taking and a high level of cash on hand by month's end. Just because the market edges higher, the trading limits remain the same. The keen-eyed will note that Dexcom is no longer listed in our top 10 holdings and indeed it is no longer in our portfolio – we have sold our entire position.

Fundamentally, nothing has changed. We still love the product and we continue to expect solid growth and an increasing share of Type 1 diabetic patients moving to CGM usage. During August though, the shares went from $95 to $144 (+52%). It is very difficult for us to justify a price north of $120 without recourse to materially higher CGM growth rates. Whilst we saw a solid Q2 performance (although our own forecasts for Q2 were already well ahead of consensus), we do not feel that the evidence to support sustainably higher structural growth or meaningful penetration beyond Type 1 is there.

Perhaps we are wrong; many on the sell-side seem more than happy to impute much higher medium-term and even terminal growth rates compared to a few months previously. We are content to sit on the sidelines whilst the answer to this question unfolds. Meanwhile, many other potential investment opportunities sit in front of us and, as we work through our due diligence over the conference season, we are confident that we will find many avenues to deploy our Dexcom gains, without needing to change our investment approach.

That said, we are not averse to re-entering the stock if the valuation and implied growth once again lie within acceptable parameters. Such was the case with Alnylam (another high quality, long-term growth story), which we re-entered in June, having previously sold out for similar implied valuation reasons. This has proven already to be a profitable stratagem; the shares rose 29% during August. Coming back to the Prince; we don't see that outsize risks need to be taken to deliver performance, quite the contrary in fact; we will not bend our forecasts to fit the prevailing narrative.

Developments within the Trust

The Trust's premium to Net Asset Value returned for much of the second half of the month and we were able to issue an additional 3.5m shares through the tapping programme.

Shareholders received their 2.0p dividend in respect of the H1 2018 period and we are targeting a further 2.0p payout for the second half of the year.

As noted above, we exited our Dexcom position, leaving us with 28 companies in the portfolio. We have yet to fully reinvest the proceeds from this sale and, as such, the leverage ratio declined from 4.7% at the end of July to 3.5% at the end of August.

What might the Autumn bring?

As the summer fades, there is much to appreciate in temperate Blighty. The beauty of the low sun in the morning and the colours of the leaves. Some may applaud the return of Strictly Come Dancing. Inevitably, there are downsides. We can marvel once more at how the aforementioned leaves can bring the rail system to its knees; X-Factor will again return and Brexit will reach its 'denouement' (we might as well utilise something French whilst we can)...

Then there are the US mid-term elections, where campaigning began in earnest with July's primaries. Given the parlous state of political discourse there, one can but shudder at what this misbegotten spectacle may ultimately bring, with healthcare likely to be everyone's favourite punch-bag. Should investors be concerned with respect to healthcare? In the 2016 Presidential race, the US Healthcare Index fell 13% from its early August high to its low a few days before the election.

US S&P500 Healthcare Index

Source: Bloomberg, Bellevue Asset Management, 31.08.2018

However, the consequences are more nuanced. Let us not forget that the US Constitution was forged under the yoke of British oppression and was designed to have checks and balances on the branches of government to oppose future tyranny. Put simply, it's very difficult to get anything done.

Coming back to the elections, there are really only three potential outcomes; the Republican's maintain overall control of all three branches (status quo), they lose one (probably the House) or they lose both the House and the Senate. In option two, it will undoubtedly be harder for the White House and the wider Republican Party to carry out its legislative agenda, potentially rendering 'The Donald' a lame Duck. In any event, history shows that post mid-term Administrations are less typically productive.

In option three, one might fear a more left-wing healthcare agenda that pushes toward a single payor system, per Bernie Sanders. However, the President can wield veto power over Congress and so we would not see legislation undesired by Trump signed into law. That said, a Democratic sweep with a subsequent strong attempted agenda could create the impression of an adverse environment under any future tripartite Democratic administration. How concerned should we be about this notion?

"Only Thing We Have to Fear Is Fear Itself"

Markets are often irrational and newspapers are not shifted from their stands by headlines saying "Nothing bad is happening". Ironically, the quote above is another former President - Franklin D. Roosevelt: the first President to propose and then endeavour to bring forward universal healthcare in the US as part of the 1933 "New Deal" (in another irony, it was the sainted American Medical Association who stopped him and arguably continued to campaign against welfare-based healthcare entitlements through to the 1960s).

What Sanders actually proposes is Medicare for all. Medicare, of course, is a government-funded insurance scheme (mainly for the over 65s) that uses private providers to deliver care and already "funds" one dollar in five of US health costs. Sanders is simply suggesting everyone gets it. He wants Medicare to negotiate lower drug prices, but this is already happening in the private sector anyway; it's just a good electoral soundbite. Medicare can be topped up with additional benefits funded by the consumer – Medicare Advantage. This is the fastest growing category of health insurance product in the United States and it is hard to see this option being taken away.

The alternative model to government insurance schemes (beloved in France, Germany and Australia) is of course the leviathan model here in the UK. It is hard to imagine any right-thinking politician looking to replicate this model. So what actually should we be concerned about? Any reduction in the number of people with health coverage of any sort is negative since it slows elective procedure growth and increases the risks that hospitals suffer losses from patients who cannot pay for care. Lower revenues mean less money for investment. Universal coverage takes us in the other direction.

We are not even going to try to pretend that Sanders policy rhetoric becoming reality would not cause an overhang, rather we are saying this would likely be an opportunity for the sort of companies we want to invest in than a threat to longer-term growth. If you continue to focus on the trifecta of making doctors lives easier, improving patient outcomes and lowering overall healthcare costs (through proven cost-effectiveness) then you will continue to find willing buyers for your products across the globe.

Much of the rest is noise and bluster, uttered by politicians whose main goal is to get elected or re-elected for the next four years, often safe in the knowledge there will be someone to blame for failing to deliver on the hopes of change that they promise. Whatever happens, the cost structure of the US healthcare system is unsustainable and ultimately needs to change, but that again is where we see the investment opportunity.

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

SUB SECTOR BREAKDOWN

Med-Tech	18.4%
Biotech	17.3%
Managed Care	11.2%
Specialty Pharma	9.5%
Diagnostics	9.0%
Pharma	7.1%
Dental	7.1%
Healthcare IT	6.8%
Services	4.4%
Distributors	3.9%
Other HC	2.8%
Health Tech	2.4%

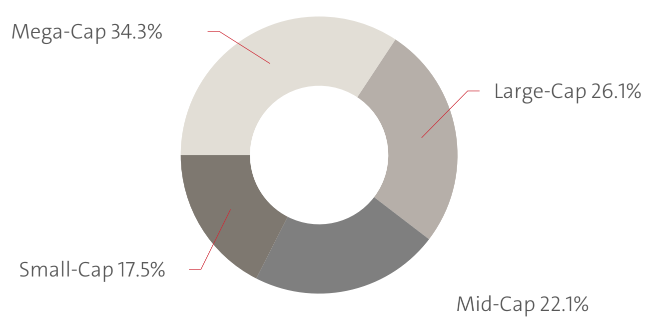
Source: Bellevue Asset Management, 31.08.2018

TOP 10 HOLIDINGS

Anthem	7.8%
Align Technology	7.1%
Illumina	7.1%
Teladoc	6.8%
Celgene	4.8%
Intuitive Surgical	4.7%
Lonza	4.4%
Shire	4.0%
Amerisourcebergen	3.9%
Humana	3.4%

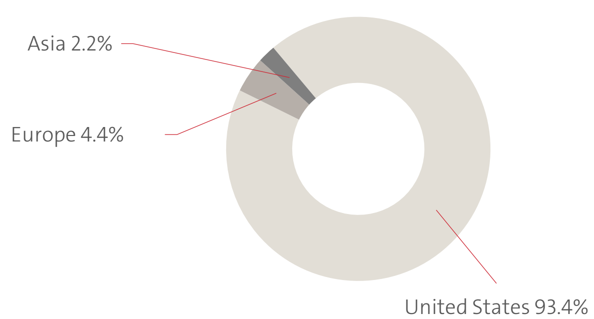
Source: Bellevue Asset Management, 31.08.2018

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.08.2018

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.08.2018

"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

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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 417.5 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	280 173 313
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

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