BB Healthcare Trust

Monthly News
December 2017

As at 12/31/2017	Value	1 Month (December)	YTD	Since Launch (ITD)
Share	117.50	-1.05%	14.85%	19.30%
NAV	112.26	-2.71%	12.72%	14.02%

Welcome to our December update. The January blues have descended on Bellevue Towers and it's not just the over-indulgences of the festive season. The last few weeks of 2017 were fundamentally quite challenging as the market sought to digest tax reform and re-position ahead of the year-end, struggling to maintain the positive momentum of the past 12 months. Not so much a 'Santa rally' as a Hedge Fund house party...

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.

Factor schmactor...

The Trust's ex-income net asset value (NAV) declined 2.71% to 112.26p. In sterling terms, the MSCI Healthcare benchmark declined 0.24%. This month, the continued strengthening of sterling was only a modest headwind – when measured in dollars, the benchmark declined 0.13%. This was our second-worst relative monthly performance (after May 2016, at the height of the Trumpian healthcare shenanigans in Washington) and we would contextualise this month versus our total return of 14.9% for 2017 versus 9.4% for our benchmark Index over the same period.

As Figure 1 illustrates, our largest sub-sector weightings were in the sectors with adverse performances during the period and we reflect on some of the factors that have contributed to negative short-term sentiment below.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Performance	BBH exposure
Biotech	10.8%	-0.4%	16.0%
Conglomerate	13.1%	0.4%	0.0%
Dental	0.6%	-12.3%	8.5%
Diagnostics	1.7%	-1.4%	6.9%
Distributors	1.9%	4.2%	4.7%
Facilities	1.1%	4.6%	2.3%
Generics	0.7%	19.5%	2.7%
Health Tech	0.1%	-1.9%	5.8%
Healthcare IT	1.2%	-3.2%	0.0%
Managed Care	9.5%	-3.3%	7.2%
Med-Tech	13.4%	-2.2%	24.1%
Other HC	0.7%	-0.5%	5.1%
Pharma	35.4%	0.6%	10.3%
Services	2.3%	8.4%	0.0%
Specialty Pharma	3.4%	-0.2%	6.3%
Tools	4.2%	-1.1%	0.0%
	100.0%	-0.24%	

Source: Bloomberg/MSCI and Bellevue Asset Management. Performance is 30-11-17 to 29-12-17 and benchmark weightings are as of 30-11-17. BBH exposure as per 29-12-17

The Aristolean idiom that nature abhors a vacuum is surely nowhere truer than on the sell-side, where the need to ascribe a fundamental rationale to the shorter-term gyrations of the market has become an industry in itself.

One can find entertainment value in these pieces; this month's contribution to the annual buzzword bingo bucket-list was 'factor rotation'. Apparently, growth is 'out' and value is 'in'. Who knew it was so simple? You should ding your winners and hoover up some detritus before it's all re-rated. Growth is 'so' November 2017. Happily, the investment banks can sell you all manner of derivative and ETF basket products designed to prosper from these emerging factor trends.

As we noted in our October missive, short-term over-simplifications of complex issues may be in vogue, but this is something that we believe is an unhelpful distraction and will continue to ignore in terms of how we evaluate our long-term holdings. Even with some handy extra characters, not everything in life should be condensed into a Tweet!

Healthcare remains a growth industry and on the NASDAQ (our most important marketplace for prospective holdings), earnings momentum is still the strongest performing factor strategy over more than a decade (#sticktoyourknitting).

Taking a more considered view, it is unarguable that multiples are high relative to historical norms in a number of attractive areas and many a stock may need to grow into its multiple to some extent. Since we are not in the business of assessing our investments on short-term multiples, such observations matter little; the key questions remain the same:

- Firstly, what does the medium-term cashflow look like and what are we paying for this? We continue to apply very cautious medium-term assumptions and believe that our portfolio is well positioned to show substantial future free cashflow generation and on this basis, looks attractively valued versus the broader healthcare space.

- Secondly, one must be cognisant that the same forward multiples that drive these 'cheap vs. expensive' debates are predicated on earnings forecasts, so is the market likely to be under or over estimating future earnings power? When it comes to our premium rated holdings such as Align, Intuitive Surgical and Illumina, we see the longer-term thesis as intact and would expect earnings forecasts on average to beat market expectations.

On a sub-sector level, Med-Tech has suffered in part because of the failure of tax reform to address the re-appearance of the Med Device Tax that helps to fund Obamacare (2.3% on US sales, equivalent to an 1.3-1.5% gross margin hit for the typical company and about $2bn for the industry overall). This was presumed to be a foregone conclusion and many sell-side analysts had not baked a return of the tax in 2018 into models after its 2016-17 suspension expired. Whilst this may yet be addressed in a subsequent budget bill, it was a sting in the tail as the market digested the tax reform impact.

Healthcare IT and Health Tech have been caught up in the same factor-related argument around Tech which seemed to run out of steam in December after a stellar 2017 (the MSCI World Tech Index was up 37% in 2017 and the IT sub-sector of the Healthcare Index was up 30%).

Although the drivers of demand growth for the healthcare IT assets are somewhat different to those for more consumer-led stocks and equally the risks of regulatory over-reach around market dominance arguments are probably not relevant beyond the fabled 'FAANG' bellweathers, the Healthcare IT stocks are contract suppliers in much more limited segments where the barriers to entry are harder to quantify in our opinion and locking in some profits after such a strong relative performance versus wider healthcare seems more than fair.

In terms of the Trust's NAV evolution, the three most significant positive contributors this month (and their local currency performance) were Teva (Generics, +28%), AmerisourceBergen (Distributors, +8%) and Celgene (Biotech, +4%). All three stocks share the common theme of having been over-sold on negative news during Q4 17.

This month's largest negative contributors were Align (Dental, -15%), Intuitive Surgical (Med-Tech, -9%) and Illumina (Diagnostics, -5%). It is noteworthy that the three worst performers are highly rated stocks, but also worth remembering in all three cases that they are the incumbent player in nascent markets where we are decades from seeing a maturation of demand for the products and services offered in each case. Yes, all three face competition and their market share may fall over time, but if the markets they serve continue to expand at double-digit rates, then all will continue to be well. The protective value (market share-wise) of incumbency in technology-based products is a whole other story, but one that increasingly seems to favour those most rapidly accumulating data.

Developments within the Trust

We issued a further 2.1m shares during the month via the block-listing facility. In terms of the portfolio, we have exited one position (Gilead) and added one new biotechnology holding (a small position that we would expect to increase over time), so we continue to have 27 stocks in the Trust.

We have evaluated a number of new potential holdings in recent months, but feel that the timing is not right for several stocks that could ultimately enter the portfolio during 2018 (on valuation or risk/reward). As such, our 'watch list' of potential investments is currently longer than usual.

History shows that the period around the JP Morgan Healthcare conference, where companies often set out their stall for the coming year, can be a period of heightened volatility, offering interesting entry points into certain stocks. We have thus kept a cash buffer on hand going into this period, in order that we can act decisively if and when such opportunities arise. As a consequence, our leverage ratio had declined to 2.9% by month's end.

With regard to Gilead, our decision to close the position was based more on near-term risks increasing than valuation and it is a stock that we may well re-visit in due time. As we have described before, Gilead is a curate's egg – its three key assets (HIV, HCV and pipeline) have very differing prospects and our main concern is how consensus forecasts have evolved for these respective parts over the past few months.

Whilst the market clearly appreciates that HCV is in decline, the rate of decline is more uncertain than ever as the company notes that it "has worked with payors to ensure… …patient access", i.e Gilead has matched Abbvie on lowering prices. The loss of incremental HCV revenues has an effect beyond just the top-line; influencing the gross margin and cost structure as well.

Put simply, we no longer feel comfortable with current expectations on the top-line or gross margin as we move into 2018 and see better risk/reward for our capital elsewhere. Maintaining a long-term investment horizon is important, but equally one must be cognisant of, and reactive to, increased risk and its attendant impact on likely overall returns.

Roll on 2018

With tax reform behind us and the individual mandate repealed, it should be a quieter political backdrop in Washington and we can thankfully devote more time thinking about longer-term demographic and technological drivers than anything else. Drug pricing may well recur as a theme (that and Amazon takes over everything) but we feel relatively under-exposed to the risks there with our current portfolio.

As the news here in the UK reminds us, societal demand for healthcare as a service continues to rise inexorably and its inefficiencies are crippling. Technological change offers both hope and financial redemption for payors and for these two simple reasons, we expect the future to be very bright indeed.

We wish you all a happy, successful and, most importantly, healthy 2018.

Paul Major, Daniel Koller and Brett Darke

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SUB SECTOR BREAKDOWN

Med-Tech	24.1%
Biotech	16.0%
Pharma	10.3%
Dental	8.5%
Managed Care	7.2%
Diagnostics	6.9%
Spec. Pharma	6.3%
Health Tech	5.8%
Other HC	5.1%
Distributors	4.7%
Generics	2.7%
Facilities	2.3%

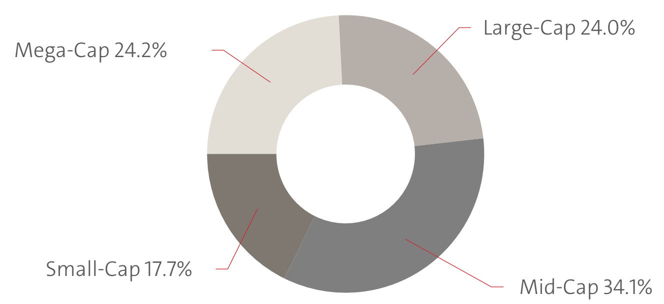
Source: Bellevue Asset Management, 31.12.2017

TOP 10 HOLIDINGS

Align Technology	8.5%
Anthem	7.2%
Illumina	6.2%
Celgene	6.1%
Shire	5.6%
Intuitive Surgical	5.2%
Walgreens Boots	5.1%
AmerisourceBergen	4.7%
Eli Lilly	4.7%
Hologic	4.1%

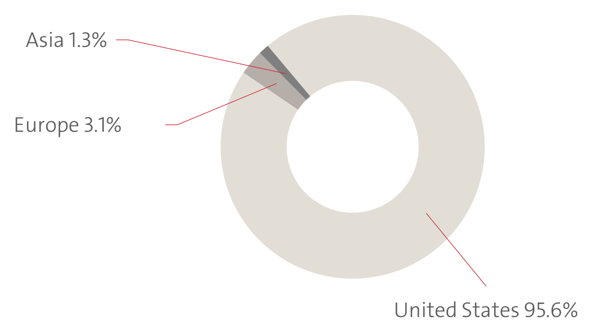
Source: Bellevue Asset Management, 31.12.2017

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.12.2017

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.12.2017

"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 307.5 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	261 669 268
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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