BB Healthcare Trust

Monthly News
May 2020

Marketing document

As at 05/31/2020	Value	1 Month (May)	YTD	Since Launch (ITD)
Share	160.00	11.1%	12.7%	60.0%
NAV	159.35	10.4%	10.7%	74.8%

Sources: Bloomberg & Bellevue Asset Management (UK) Ltd., 31.05.2020, NAV and share price returns are adjusted for dividends paid during the period (but not assuming re-investment). Full performance data is on page 4.

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 May update. The aphorism "sell in May and go away" seems apposite, although the 'going away' bit is rather wishful. The equity narrative continues to evolve toward recovery, with cyclicals and consumer discretionary sectors leading the market up as defensives fall back out of favour. Simply put, the market mantra is that the worst is now behind us. This fantastical narrative reminds us of the Wizard of Oz film: "Ding-dong, the wicked witch is dead. Wake up, you sleepy head, rub your eyes, get out of bed. Wake up, the wicked witch is dead!".

Summary

BB Healthcare Trust Ltd 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) Ltd.

Schiller or Shiller – does it really matter?

Our long-suffering readers will doubtless be thrilled to discover this month's missive is both of typical brevity and blissfully lacking in SARS-CoV-2 science. One must of course comment on key developments, but let us enjoy the abeyance. Instead, we can focus once more on our investment thoughts, especially since the market seems at something of a crossroads.

We will leave aside the existential question of whether or not your managers are curmudgeonly buggers (we will happily accept the moniker): we do not readily partake of anyone's Kool-Aid and are never happier than when questioning everything. We all secretly want to channel our inner Victor Meldrew...

Right now, we feel there is a groundswell of positive sentiment; the glass very much half-full. It would be wonderful to believe the brotherhood of humanity had indeed triumphed over this viral foe and that which lay ahead was joyous and bountiful, as Schiller's famous ode foretells.

It is equally valid to consider the work of Nobel Laureate Robert Shiller: markets are not efficient and traders transact as much on emotion as they do on evolving fundamentals. Exuberance is understandable, but not necessarily rational. What is it that we really face? The beginning of the end, or merely the end of the beginning? It really matters, especially as the market is recovering back toward high levels when measured against historical long-term averages. As we have observed before, the air is already pretty thin up here.

Dance while the music plays

For those who managed to make it through last month's weighty retrospective to the part that was actually about the market's and our own performance, we noted our growing caution in the face of the market's rapid recovery. This was compounded by the general unwillingness of sell-side analysts to cut revenue and earnings forecasts toward what we considered to be 'worst reasonable case' levels. We also noted the closing days of April saw the beginnings of a rotation away from defensive growth like healthcare toward early cyclical and consumer discretionary names.

Broadly speaking, this trend continued through May, with the MSCI World Healthcare Index rising 6.1% in sterling terms, versus 6.9% for the parent MSCI World Index. Looking at the leadership across the S&P500 in the US and Stoxx 600 in Europe over the past month, it very much reflects the "return to normal trade".

Whilst there were a few healthcare names in the best performers list on both sides of the Atlantic, their top 15s included names such as TUI Travel, Trainline, Cineworld, Pandora, JD Sports, L Brands (Victoria's Secret & Thomas Pink), Lowes (DIY) and a number of US homebuilders.

It was very much a game of two halves in terms of relative performance, with the MSCI Healthcare Index leading the wider market over the first two weeks (delivering a 4.6% positive return vs. 1.7% for the MSCI World Index).

This reversed in the second half of the month, with healthcare advancing only 1.7%, versus 5.3% for the MSCI World.

A high proportion of the S&P500 is now trading above its 50-day moving average. To those devotees of chart-based divination (how did this ever secure the moniker "technical analysis"?), this is considered a rare and most auspicious auguration. In more colloquial parlance: it's a sign "the market's gonna rip".

It is almost as if the late-cycle trepidations of 2019 are long forgotten. Surely it is reasonable to question the economic foundations of this burgeoning "post-Covid" rally (even before we consider negative macro consequences of potentially worsening Sino-US relations) and mass unemployment? We will return to this question.

Topsy-turvy

For now let us assume the current positive sentiment toward consumer re-engagement will continue for some time. Where does this leave defensives in general and healthcare specifically? The logical conclusion would be a continuation of the pattern that emerged in April – underperformance versus the wider market and leadership within the group from the more consumer-discretionary areas (Dental, Animal Health, Med-Tech (elective and consumer-oriented versus big ticket items). This is generally opposite to our view of appropriate positioning based on confidence in the currently assumed consensus revenue outlook and valuations).

During May, the Trust's ex-income NAV rose 10.4% to 159.35p, outperforming the MSCI World Healthcare Index, which increased 6.1% in sterling terms (it rose 3.9% when measured in dollars). Our cautious positioning (net cash, less exposure to elective surgery and dental) probably hurt our performance over the month to some degree; lack of leverage in the early part of the month when our preferred stocks performed well and the more cautious positioning in the latter part of the month, when the aforementioned sub-sectors assumed leadership and Biotech/Specialty Pharma underperformed. We continued to re-allocate capital toward these two sub-sectors as the month went on, so our weightings to these areas have actually increased versus the end of April.

The table overleaf summarises the sub-sector performance during May. We have added two additional columns this month to illustrate the divergent performances during the first and second halves of the month.

The Healthcare Technology names (diabetes wearables Dexcom and Insulet) are notable. They served as a classic defensive hiding place up until the middle of May and look very stretched valuation-wise (frankly, they were pricey before the Covid dynamic took hold). It makes sense these would be an early source of funds for a rotation into cyclicals. Facilities and Dental were the obvious beneficiaries of the "healthcare is re-opening to elective treatment" trade, as was the veterinary equivalent via Animal Health stocks.

Smaller capitalisation Biotechnology (and, to lesser extent, Specialty Pharma) were another source of funds, having done well in recent weeks The XBI (US Biotech ETF) had recovered all its Covid-19 losses by late April, and had pushed on another 7.5% by mid-May to an all-time high.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Perf. (USD)	Perf. (GBP)	Perf. H1 May	Perf. H2 May
Biotech	9.7%	3.9%	6.1%	6.7%	-0.6%
Conglomerate	11.5%	0.7%	2.9%	2.5%	0.5%
Dental	0.4%	11.8%	14.2%	-3.1%	17.8%
Diagnostics	2.0%	10.9%	13.3%	8.5%	4.4%
Distributors	2.6%	7.5%	9.8%	3.4%	6.3%
Facilities	0.9%	0.4%	2.6%	-4.9%	7.9%
Generics	0.4%	10.3%	12.7%	2.2%	10.3%
Healthcare IT	1.1%	10.3%	12.7%	2.8%	9.8%
Healthcare Tech.	0.8%	7.6%	9.9%	22.7%	-10.4%
Managed Care	9.0%	3.8%	6.0%	3.7%	2.3%
Med-Tech	14.3%	2.4%	4.4%	3.0%	6.1%
Animal Health	1.3%	4.9%	7.2%	-0.7%	7.9%
Pharma	34.5%	2.7%	4.9%	5.3%	-0.3%
Services	1.9%	9.6%	11.9%	6.6%	5.1%
Specialty Pharma	3.6%	-1.6%	0.3%	2.1%	-1.9%
Tools	6.2%	6.6%	8.9%	6.2%	2.5%
Index perf.		**3.9%**	**6.1%**	**4.6%**	**1.7%**

Source: Bloomberg/MSCI and Bellevue Asset Management (UK) Ltd. Weightings as of 30-04-20. Performance to 31-05-20.

Moving forward, we will be modifying our sub-sector classification system. Instead of having Pharma, Specialty Pharma and Biotechnology, we will consolidate these into two new categories – Focused Therapeutics and Diversified Therapeutics. Hopefully the logic is self-explanatory from the title.

Market capitalisation is not a consideration here, it will be based on what the business does in terms of revenue mix. The classification by the index providers between Biotechnology and Specialty Pharma seems rather arbitrary these days (for instance, the NASDAQ Biotech Index includes companies from both categories) so we think this categorisation better reflects our thought process and stock allocation decisions.

Looking at the current MSCI World Healthcare constituents, all of the current Biotech names will go into the Focused category apart from Amgen, whose products span multiple therapeutic categories and scientific approaches, so it will go into Diversified. The majority of Specialty Pharma companies will also go into the Focused group, although Jazz Pharmaceuticals will move into the Diversified category. The majority of the Pharma names will go into the Diversified category, although Lundbeck will move into Focused. We will provide a reconciliation for our sub-sector holdings next month to allow shareholders to make a comparison from May to June.

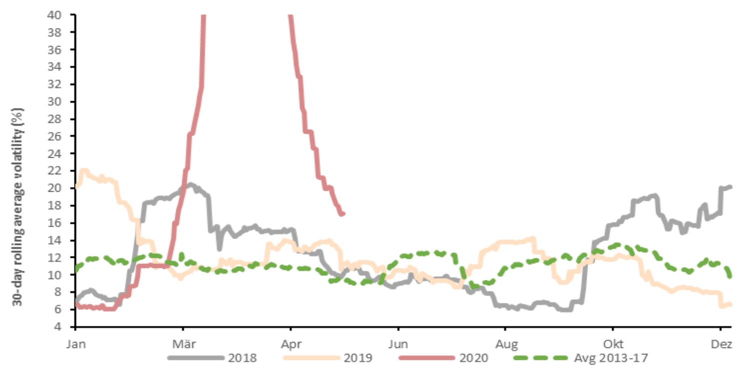
Recalcitrant ruminations

In a world where the debate over active versus passive asset management continues to rage, the pressure on active managers to 'do something' is ever present and some may feel this burden twice as acutely following periods of challenging performance, which can increase the risk of 'style drift'.

A few chancers still manage to eke out a living on active fees from what amounts to benchmark hugging, but there is little moral or intellectual satisfaction in taking someone's hard-earned cash for deciding to be +/-100 basis points of Glaxo - you are paying us to make meaningful decisions informed by proper research.

Undoubtedly, the last few years have been tough for active managers due to extraordinary levels of volatility (see chart below). Few funds have 130+ positions like our benchmark index for instance and this will likely compound one's exposure to systematic volatility. Even against this multi-year backdrop, the Covid-19 market turmoil has been unprecedented and it would ruin the rest of the chart if we showed the peak, so we can just say it was, quite literally, "off the charts".

In this environment, the right decision on the wrong day can be incredibly painful at the moment. At some point, the macro-dominated thematic will abate. When reviewing what has transpired over the past few months, we think it is important to i) consider investment returns from any given strategy over a multi-year period and not rush to judgement on short-term performance through this recent turmoil) and ii) not change a strategy that has proven that it can deliver longer-term performance just because the market is seeming that it wants to follow one style or approach to investing over another.



Source: Bloomberg, Bellevue Asset Management (UK) Ltd.

Right now, the informational edge is hard to come by and the macro narrative dominating markets is antithetical to conviction at the stock-specific level. Many a great business is being overlooked in the rush to gain exposure to a macro trend. Likewise, some businesses are still as structurally challenged today as they were six months ago (do you really want to own a shopping mall operator on a 5-10 year view?). A fast buck might be on offer from following the short-covering or punting on some mean reversion, but these are trades, not investments and that is not what we are mandated to do on your behalf.

We think healthcare will continue to be a challenging relative performer versus the wider market over the next few weeks. What to do? We think the right answer is actually 'very little'. Appearing busy is no substitute for effective decision-making. Contrawise, one should not mistake apparent inactivity with actual indolence.

We continue to analyse reams of data and add companies to our watchlist. Under various scenarios of how market sentiment and stock-specific events and price action unfold, several companies could be added to the portfolio. Indeed, two stocks are closer to entry today than they have been for six to nine months; forbearance can be a virtue. That said, one cannot sit on the fence forever. What would bestir our conviction? Let us first ponder where our reticence stems from...

Not gone and not forgotten

The Damoclean spectre of Covid-19 still haunts the market. Right now, the welcome loosening of restrictions and euphonius flummery that passes for political leadership in many countries points inexorably to further improvements in consumer sentiment. Here in the UK, Rishi Sunak even mentioned pubs re-opening in July. However, if you listen to Wetherspoon's contumacious founder, Tim Martin, it will be more like a trip to the set of Casualty than a wistful evocation of the country pub of one's youth. In August, the furlough scheme will begin to roll back and we fear that a tragically large number of people will find their job has, in fact, been lost and a trip to the pub may be a treat beyond the reach of many.

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As we have noted before, the war-like rhetoric of Boris "call me Winston" Johnson is unhelpful. To paraphrase a truly great man: "Never in the field of human non-conflict has so much been done by so many so that a few can take credit and visit Barnard Castle. All hearts go out to those who actually did the work to keep us safe. Rarely has so much nonsense come out of one person's mouth, but it is okay because we can always blame the science".

Why is it unhelpful? Nature is like the bond market – it always wins. Viruses do not disappear, you merely reach an accommodation where vaccination or immunity means the effective reproduction rate (RE) is so low that the virus cannot spread. As the emergent polio epidemic in Pakistan shows, viral outbreaks will return if allowed.

A bit more honesty about the inherent uncertainties of scientific advice and the (perfectly acceptable) realpolitik of saving the economy being weighed in decisions would empower everyone. This notion of keeping us completely safe all of the time is utter nonsense – life is a calculated risk and each of us must accept this.

So what is our accommodation to be? Vaccination? Not yet. Social distancing in perpetuity? As we all now know, lack of social contact is neither easy nor desirable to sustain. Multiple waves with non-trivial mortality amongst the elderly to be accepted as part of life? (for those who think this a crass statement, that is the reality of the situation we live with every winter due to influenza and let's not even get started on the multitudes of other medical conditions that burden society with excess premature mortality year upon year and yet garner ne'er a mention by the media or politicians). Society has already decided this is not an acceptable price to pay for economic freedom.

Given the points made above, the assumption of a sustainable return to something most of us would recognise and welcome as "normal" over the coming months just does not seem credible at this juncture. Why then is the stock market so willing to presume this?

The killer from Shiller

Even with all of the above being noted, we are not worried about the long-term outlook for revenue and earnings growth from our portfolio holdings. The drivers of our investment decisions are underpinned by long-term demographic trends and inexorable structural changes in society. However long SARS-CoV-2 circulates, these changes will still persist.

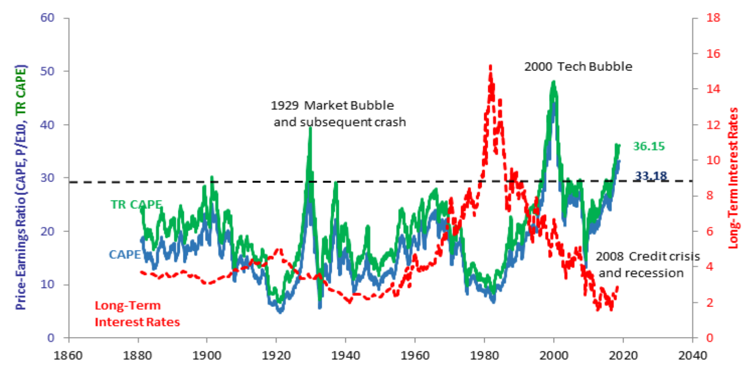
Our concerns lay much more with the wider equity market and the risk of another disorderly sell-off. The triggers for this could be secondary waves of infection and related re-imposition of restrictions with the attendant economic setbacks. Undoubtedly, it will be harder to impose a second lockdown but the population will surely be twice as fearful after such an event as they are now.

Whilst it is true that consumer surveys around the world attest that the vast majority of consumers are keen as ever to return to previous norms and spend their money and free time in the same manner (if permitted), there is still a minority of hold-outs that suggest an economy working at 80-90% of capacity is the most likely outcome over the next year or two. Such a scenario curtails business investment and risks accelerating deflationary pressures, which can be recessionary in their own right.

We come back to Prof. Shiller, who is kind enough to publish his datasets online. We have reproduced some of this opposite. His long-term analysis of valuation and its relationship to interest rates and the wider economic cycle does rather suggest that cyclically-adjusted PE's above 30 are a warning sign that market valuations are high. How inflated things actually are will be impacted by the prevailing yield environment. Real yields are very low but not unprecedented.

As we have noted, the market's structure has changed dramatically in recent years with tech stocks driving a significant portion of real earnings growth and the cyclicality of these companies is yet to be determined and arguably very low; they are closer to utilities in many ways. Nonetheless, it is difficult to look at the picture below and not be very nervous.

If something does go awry, there is little fundamental valuation support at these levels and so the fall will likely be significant. The passive nature of most asset management strategies and the overwhelming use of algorithms to discover prices will further exacerbate downside volatility. And yet, as Q4 2018 and the recent sell-off have shown us, these things rarely persist for long. Investors can rest assured that ennui has not set in and we stand ready to act if an opportunity presents itself, as we did in March.



Source: Yale University, Bellevue Asset Management (UK) Ltd.

The 2000 tech bubble shows that over-valuation trends can last for a long time and corrective events are seldom predicted by anyone. We are not saying that one should exit the market, buy some gold and hide it under the bed. We are merely pointing out that a cautious approach seems warranted until we have clarity on the medium-term outlook (e.g. demonstrable efficacy in the over 55s from a vaccine or expectations for economic and consumer activity that reflect a sub-capacity scenario as the base case).

Hold on tight, it could be a bumpy ride. Nevertheless, the long-term structural opportunity for material capital returns in healthcare is undiminished and one cannot say that with any conviction for large swathes of the wider economy at this stage.

Developments within the Trust

As noted previously, we maintained a generally cautious stance, retaining a net cash positon. This has risen as a percentage of gross assets to 4.9%, versus 4.5% at the end of April.

Befitting the previously described narrative, we have exited one of our diagnostics holdings on valuation grounds, taking the active portfolio to 29 stocks plus the Alder CVR. As ever, we continue to evaluate a number of exciting new companies for potential entry into the portfolio, but those twin forces of high consensus expectations and high valuations prevent us from taking action at this point.

We issued a further 7.2 mn shares through the tapping programme.

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.

Paul Major and Brett Darke

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Standardised discrete performance (%)

12-month total return	1 year May 19 - May 20	2 years May 18 - May 20	3 years May 17 - May 20	since inception
NAV return (inc. dividends)	24.1%	37.8%	56.1%	74.8%
Share price	19.0%	31.7%	41.6%	60.0%
Share price (inc. dividends)	22.6%	39.0%	52.5%	72.4%
MSCI WHC Total Return Index	26.7%	39.9%	44.2%	62.9%

Sources: Bloomberg & Bellevue Asset Management (UK) Ltd., 31.05.2020

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	25.7%
Managed Care	15.2%
Biotech	15.0%
Diagnostics	12.4%
Med-tech	9.2%
Pharma	7.3%
Healthcare IT	5.5%
Services	4.9%
Tools	3.9%
Dental	0.9%

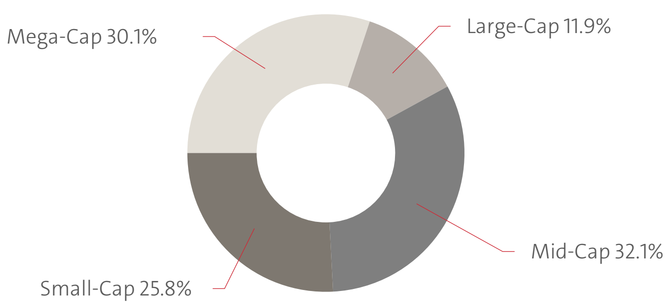
Source: Bellevue Asset Management, 31.05.2020

TOP 10 HOLIDINGS

Esperion	7.7%
Bristol Myers Squibb	7.3%
Anthem	7.1%
CareDx	4.9%
Charles River	4.9%
Insmed	4.7%
Hill-Rom Holdings	4.7%
Humana	4.6%
GW Pharmaceuticals	4.4%
Evolent Health	4.3%
Total	**54.6%**

Source: Bellevue Asset Management, 31.05.2020

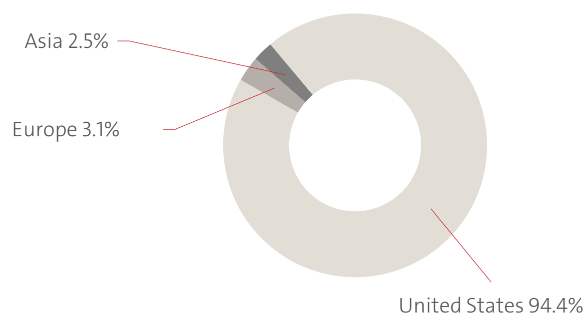
MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.05.2020

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

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.05.2020

"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 group ("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 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 735.8 million
ISIN	GB00BZCNLL95
Investment Manager	Bellevue Asset Management (UK) Ltd.; 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	450 050 000
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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