BB Healthcare Trust

Monthly News
August 2019

As at 08/31/2019	Value	1 Month (August)	YTD	Since Launch (ITD)
Share	125.00	-7.7%	8.3%	34.9%
NAV	123.60	-7.8%	8.3%	35.9%

Sources: Bloomberg & Bellevue Asset Management AG, 31.08.2019, NAV and share price returns are adjusted for dividends paid during the period (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.

Welcome to our monthly update. August: the Arcadian respite that precedes the end of summer. To be honest, this year seemed more like the end of days. Rather than feeling rested after a welcome break, we are battle hardened after several weeks of asymmetric warfare. Our strategy and tactics have been wanting, when pitted against that most amorphous and malevolent of foes – fear. The battle for short-term alpha has been lost. However, no campaign is won without losses and we remain confident that we are on the right course for the long term.

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.

Drained, Rinsed, Spun

Our frightful summer has continued without respite. August was a volatile month for healthcare (more of that anon) and the over-arching themes were again macro driven. August is typically a quiet time and overall volume levels were comparable to previous years, albeit more skewed to larger capitalisation companies, which made for a challenging trading environment. We will discuss these various factors in more detail below.

The bottom line is that we saw our worst month of relative performance since the Trust was incepted in December 2016. Our net asset value declined 7.8% to 123.60p. In contrast, the MSCI World Healthcare Index rose 0.2% in sterling terms (and declined 0.2% in dollars).

Healthcare did at least outperform the wider market during August, as macro-political concerns (trade, Hong Kong, bond yields, weak economic data) led investors to favour larger capitalisation, safe haven defensive assets over cyclical exposure. The wider MSCI World Index fell. 1.9% in sterling terms (and declined 2.2% in dollars).

The pace at which our capital losses mounted during the month was frankly dizzying and all the more frustrating for being nebulous rather than discrete in terms of the drivers. We shall attempt to explain some of the contributory factors below.

Hung out to dry

Our strategy is predicated on a concentrated portfolio with a long-term investment time horizon, which inevitably means that we will not alter our holdings to suit shorter-term market sentiment and expect to have a high active share versus healthcare benchmarks. As such, there will be periods where our positioning means that we will out/under-perform wider healthcare, absent any stock-specific issues.

For instance, had one simply replicated our sub-sector weightings using the MSCI World Healthcare Index's constituent stocks, the resulting portfolio would have underperformed the Index by around 3% during August. In broad terms, this positioning is generally the same one that drove the Trust's substantial outperformance through the first half of 2019; but it was not where people wanted to be these past few weeks.

Figure one below illustrates the Index's performance by sub-sector, sorted from best to worst. Our significant combined exposure to four of the five worst performing sub-sectors (Dental, Facilities, Managed Care and Diagnostics; combined exposure represented >42% of the portfolio at the end of July) hopefully offers a partial explanation for the underperformance during the month.

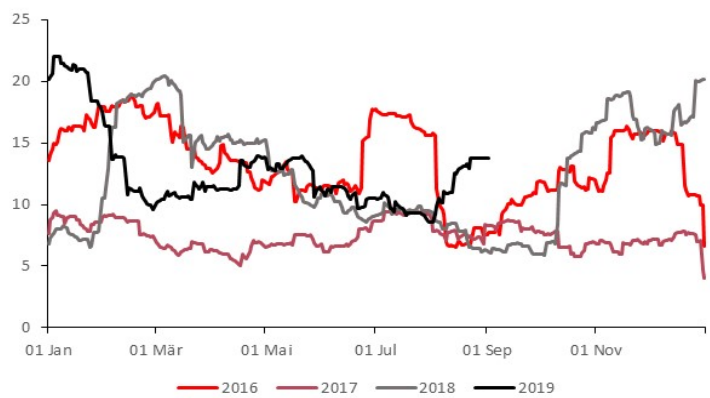
Only two sectors had meaningful changes to their weightings in the portfolio; both Specialty Pharma and Services declined. The former was due to performance, the latter due intentionally reduced exposure to one stock (Lonza) on valuation grounds.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Perf. (USD)	Perf. (GBP)
Healthcare Tech.	0.3%	9.4%	9.8%
Other Healthcare	1.3%	5.6%	6.0%
Distributors	2.9%	2.4%	2.8%
Biotech	9.3%	2.0%	2.4%
Med-Tech	16.2%	1.8%	2.2%
Tools	5.9%	0.9%	1.3%
Pharma	33.1%	0.6%	1.0%
Conglomerate	11.6%	-0.1%	0.3%
Services	1.7%	-0.6%	-0.2%
Healthcare IT	1.0%	-2.4%	-2.0%
Specialty Pharma	3.6%	-3.2%	-2.8%
Diagnostics	2.2%	-4.1%	-3.7%
Managed Care	8.9%	-7.4%	-7.1%
Facilities	1.2%	-8.2%	-7.8%
Generics	0.4%	-9.6%	-9.2%
Dental	0.5%	-9.7%	-9.4%

Source: Bloomberg/MSCI and Bellevue Asset Management. Weightings as of 30-06-19. Performance to 31-07-19.

As noted previously, volatility was very high during August. With all the caveats around short-term measures of volatility nothwithstanding, the monthly figures for August since our 2016 launch are enlightening: 2016: 7.7%, 2017: 8.7%, 2018: 6.0% and 2019: 15.5%. The Index's recent volatility is even more apparent if one looks at a rolling series of 30-day volatility, as Figure two illustrates.



Generally speaking, volatility declines into the summer months. 2016's spike in volatility was caused by comments made by Hilary Clinton during her 2016 Presidential campaign. 2019 is similar in many ways, again with macro-political debates (in which we would include trade) as the most obvious factor driving current uncertainty regarding sentiment to healthcare.

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Volatility is not always a bad thing; if you are long into a rising market then it can help (cf. January 2019), but of course the reverse is also true. Amongst our small-cap holdings (which in our world of global healthcare equates to stocks with market capitalisations below $2bn), we saw a combination of price volatility, low volumes and limited risk appetite.

Delicates, do not press

We were searching for an apposite nomenclature to describe current sentiment in such an environment and we landed upon "ambiguity aversion", an economic theory to describe a situation when people favour known risk over uncertain risk, even when the choices may not be rational. For example, choosing to own a larger stock in preference to a smaller stock not because it is the better choice, but because it is easier to sell if the market rolls over and closer to the benchmark as well, helping to secure one's relative performance in difficult circumstances.

In such circumstances, the market is like a ratchet, with stocks moving lower, but seemingly unable to catch a bid, even when valuation looks supportive. Our small-cap holdings accounted for 21% of the portfolio at the end of August and declined a weighted average of -4.6% over the month.

Volatility was not limited to our smaller-sized holdings however; we also saw the delicate sentiment extend to some of our larger holdings:

Despite delivering a strong Q2 update at the end of July, Teladoc (10.1% of the portfolio as of end July) fell foul of a "short seller" report that saw the shares decline >14% over a couple of days in mid-August. We won't dignify this report with a detailed rebuttal, beyond noting that we disagree with both the content and materiality of the points made, as do most of the analysts who wrote on the stock in the aftermath. What is interesting is that the stock failed to recover in the subsequent weeks, another clear example of the lack of appetite for perceived rising uncertainty; this is even more apparent from its strong performance in early September on confirmation of a well-flagged upside in 2020 from a contract with United Health.

Likewise Align (8.0% of the portfolio as of end July) fell ~12% on mounting concerns over potential disclosures from its erstwhile collaborator turned litigant, Smile Direct Club (SDC), which filed documentation in mid-August for a potential IPO. The market knows that SDC has dramatically increased the intensity of its promotional activities over the past few quarters; what might management say is coming in the future regarding its limited overlap to Align's customer base?

Again, the surprise for us has been the lack of a recovery in the stock now that the picture is clearer. As much as we like the dental market in general and the clear aligner opportunity in particular, we will not be participating in the SDC IPO. Based on the limited information currently available, we would not feel comfortable owning SDC for the next few years, based on its cashflow outlook and financing situation post IPO proceeds. Its consumer-credit driven model is also much less attractive to our minds than the practitioner-led business of Align, especially if the US economy does roll over.

We should also note the situation in Managed Care (i.e. US health insurance underwriters). Anthem and Humana are also top 10 holdings and together represented 17.1% of the portfolio at the end of July and these stocks declined c11% and c5% respectively during August. There seem to be two main drivers of lower sentiment: the political backdrop and concerns over medical utilisation rates.

We detailed the rationale for the significant increase in our Managed Care holdings in our April factsheet. Put simply, the Damoclean "Medicare for All" proposals espoused by Bernie Saunders and backed by Elizabeth Warren (but not by Joe Biden) are unworkable. These are gambits to win over voters in the Democratic Primaries to decide who will challenge Trump in the 2020 election.

At some point, the tenuous nature of the proposals will be recognised and the overhang that bedevils the Managed Care sector will lift it from current valuations that are approaching levels unseen since the financial crisis (when the book of business was more skewed to commercial and there were rightly fears of mass unemployment in the US).

However, recent weeks have seen some polls suggest that Warren and Saunders had narrowed the gap between themselves and the leader, Biden, in the race for the Democratic nomination and this has again pressured the sector. Should we be worried?

On the one hand, we understand the correlation between the nomination and the likely manifesto that will try and be followed over the coming four years. On the other hand, the unworkable nature of the bills as they stand and the practicalities of securing control of the Senate in 2020 to push through contentious legislation (recall that only half the seats are notionally up for grabs every two years, and a number of these would be considered 'safe seats') are substantial, tangible obstacles.

There seems to be some anecdotal evidence from various sell-side surveys that hospital utilisation trends have improved; i.e. there are more sick people than normal at this time of year. Of course, this can be interpreted as a leading indicator of worse medical expense trends after mixed trend reports at Q2 (most of which were credibly explainable), just as people fret about the underwriting cycle turning negative; not-for-profit insurers (which we estimate account for around a third of underwriting capacity) have built up sufficient reserves to begin to compete on price. This would of course represent a doubling down on unwise practice; if you think expense trend will worsen, would you really cut rates? We seem to recall a not dissimilar argument this time last year. Plus c'est la même chose and all that...

The challenge we face at this moment is that sentiment is so delicate that no one wants to press the other (rational) side of the argument. Bearish theses, no matter how stale or how unlikely, gain traction and lead to asymmetric perceptions of risk and reward.

Permanent Press

What are we to do? Risk mitigation should clearly be as important a facet of the Portfolio Manager's role as seeking alpha, otherwise we are just swinging for sixes like the last innings of a T20 match (we can't all be Ben Stokes). On the other hand, there is a mandate to be respected; one that says we will be fully invested and take a long-term, fundamental view.

With the "benefit" of hindsight (perhaps the most disingenuous phrase ever to be uttered, or was it "Brexit means Brexit"), would we have managed things differently? It is hard to say. Perhaps there are lessons to be learned around more active position management – should one take off some risk if you are not highly convinced of the opportunity for near-term consensus expectations to be beaten?

An (admittedly unscientific) review of such an approach would not really have helped us in July or August. We are not looking at our holdings thinking that multiple theses have been broken by recently disclosed information or events, so we probably wouldn't have made different stock selection decisions either. The long-term fundamentals are intact.

Another aspect of managing risk is gross exposure. We have committed to running an average level of gearing in the mid-to-high single digits (i.e. gross = 105-110% of net). We have been trying to reduce this gradually over recent months, but the reduction in the gross value has impeded progress. We made a more decisive effort to achieve this during August and finished the month with a leverage ratio of 1.4%, versus 7.5% at the end of June.

In the end, the unsatisfactory conclusion is that we, and thus the Trust's shareholders, have been incredibly unfortunate over recent months. It remains our objective to deliver outperformance over the longer term and we will press on, humbled but not hamstrung.

Developments within the Trust

The portfolio remains unchanged for several months now in terms of holdings (28 stocks in the portfolio), although we have re-weighted the book to flatten its profile a little. Despite the aforementioned sell-off in smaller cap names, we are loath to chase these until there is some stabilisation of sentiment (in the sense that the market stops veering from one "style factor" to another) and have thus been very selective as to where we have increased exposure. We have reduced our holding in Lonza, which has dropped out of the top 10, owing to a full valuation and consensus profit forecasts that are rising faster than we feel comfortable with.

As noted previously, the vicissitudes of market sentiment have been both unpredictable and incendiary and we have thus reduced our gearing. We will happily re-deploy gross leverage when we feel more confident in the medium-term macro-political outlook being the fundamental driver of sentiment.

Despite these turbulent times, we continued to issue new shares during the month via the tapping programme and in relation to the scrip dividend paid out during the month. In total, we issued 8.4m new shares, 0.6m of which were in relation to the dividend.

We thank you all for your continued support of the Trust during what has been a challenging few months. We always appreciate the opportunity to interact with our investors directly. We would remind readers that they can submit questions regarding the Trust at any time via:
shareholder_questions@bbhealthcaretrust.co.uk

As ever, we will endeavour to respond in a timely fashion.

Paul Major and Brett Darke

B|B Healthcare Trust

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Standardised discrete performance (%)		
12-month total return	**Aug 18 - Aug 19**	**Dec 16 - Aug 19***
NAV return (inc. dividends)	-11.1%	35.9%
Share price	-14.1%	25.0%
Share price (inc. dividends)	-9.7%	34.9%
MSCI WHC Total Return Index	6.8%	41.3%

Sources: Bloomberg & Bellevue Asset Management AG, 31.08.2019

NAV return and share price returns are adjusted for dividends paid during period where started (but not assuming reinvestment)

*Trust incepted on 2 December 2016. Therefore 12 months of perfromance data does not exist for the calendar year.

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

Managed Care	18.4%
Diagnostics	13.4%
Biotech	13.3%
Med-tech	11.7%
Specialty Pharma	11.6%
Healthcare IT	11.3%
Dental	7.5%
Pharma	6.5%
Facilities	2.8%
Services	2.2%
Health Tech	1.3%

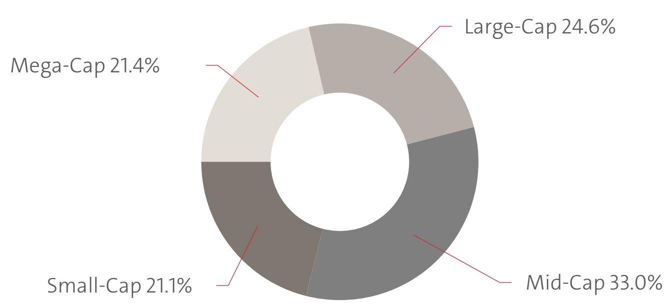
Source: Bellevue Asset Management, 31.08.2019

TOP 10 HOLIDINGS

Anthem	8.8%
Teladoc	8.6%
Illumina	7.5%
Align Technology	7.5%
Humana	7.3%
Bristol Myers Squibb	6.5%
Intuitive Surgical	3.8%
Livanova	3.0%
Insmed	3.0%
Esperion	3.0%
Total	**59.1%**

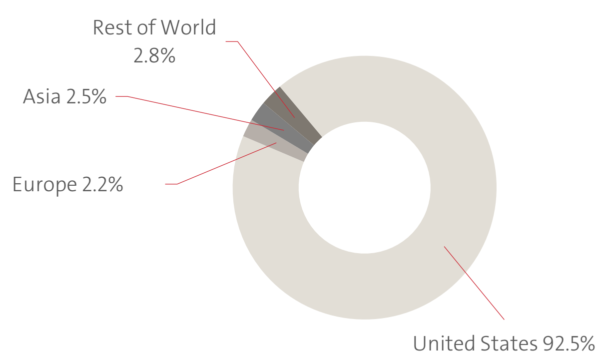
Source: Bellevue Asset Management, 31.08.2019

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.08.2019

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.08.2019

"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 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 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 528.8 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	423 359 089
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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