BB Healthcare Trust

Monthly News
April 2019

As at 04/30/2019	Value	1 Month (April)	YTD	Since Launch (ITD)
Share	138.50	1.09%	17.53%	47.04%
NAV	134.89	-2.63%	15.79%	43.39%

Sources: Bloomberg & Bellevue Asset Management AG, 30.04.2019, NAV return is adjusted for dividends paid during 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 April update. Once again, we find ourselves reflecting on a period of significant healthcare volatility precipitated by US political manoeuvring, as the existential debate over the affordability of health insurance places itself at the centre of the November 2020 election debate. Reasoned analysis gave way to baser instincts and baleful quarrelling. As ever though, uncertainty and fear are the gateways to opportunity, as equanimity will surely return…

My name is Ozymandias, but you can call me Bernie

Does anyone even remember December's macro-driven sell-off? Having risen 3.4% in dollars during April, the MSCI World Index is currently <2% off the September 2018 highs and the dark magicians of equity strategy proclaim a cyclical upswing is once more underway. This is despite the fact that we are seemingly further away from a US-China trade deal and European economic data continues to weaken. The absurdity of such short-term sentiment gyrations is quite wearing and, as we go to press, the market is again in reverse gear.

Portrayed as both tediously certain and dependably non-cyclical, healthcare would inevitably struggle to keep up in such a "risk-on" environment. In the end, political issues overtook what would otherwise have been some manageable pressure from asset re-allocation. Instead, the sector declined materially during the month as an apocalyptic future of a single-payor national healthcare system drolly named 'Bernaggedon' was laid out before the market: The MSCI World Healthcare Index declined 2.6% (or -2.9% in sterling terms). The Trust managed to fare slightly better than the Index over the month, declining 2.6% to yield a month-end NAV of 134.93p.

As the table below illustrates, Managed Care (i.e. US insurance providers) bore the brunt of the pain in April and it is perhaps no surprise either to see Facilities (Hospitals) in the red. The sell-off in Pharma/Biotech is harder to rationalise and perhaps serves as an indicator that it is fear, not reason driving market sentiment.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Perf. (USD)	Perf. (GBP)
Biotech	9.6%	-4.3%	-4.6%
Conglomerate	12.0%	0.7%	0.3%
Dental	0.6%	9.9%	9.5%
Diagnostics	1.9%	0.6%	0.3%
Distributors	2.8%	0.4%	0.1%
Facilities	1.2%	-1.2%	-1.6%
Generics	0.6%	-3.8%	-4.2%
Healthcare IT	0.8%	11.9%	11.6%
Healthcare Tech.	0.2%	1.7%	1.3%
Managed Care	8.7%	-5.2%	-5.6%
Med-Tech	14.4%	-2.9%	-3.2%
Other Healthcare	1.1%	0.7%	0.3%
Pharma	35.4%	-4.6%	-4.9%
Services	1.6%	0.9%	0.5%
Specialty Pharma	3.6%	-0.7%	-1.1%
Tools	5.6%	0.1%	-0.3%

Source: Bloomberg/MSCI and Bellevue Asset Management. Weightings as of 31-03-19. Performance to 30-04-19.
*Note: DexCom is no longer in the benchmark, effectively removing the Health Tech sub-sector

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.

Haven't I seen this poem before?

The paradox here was that the reintroduction of Mr Sander's healthcare bill was not unexpected, nor its content surprising. This is merely a continuation of the rhetoric from the Democrats that has been evident since the mid-terms finished at the end of 2018. As regards the Sanders Bill specifically, he has been putting forward such bills since 2013 and something very similar was the centrepiece of his (unsuccessful) 2016 campaign to win the Democratic nomination.

Like many political idealists, the Vermont Senator has moderated somewhat over the years. Having talked of essentially nationalising the healthcare system ('the NHS model'), he now proposes a more mainstream government insurance model with continued private medical practice (more like Australia or Germany).

Mirroring the NHS, care would be comprehensive (dental, vision, etc. included) and free at the point of care aside from prescription charges. This would make it one of, if not the most generous healthcare systems in the OECD. The mighty would indeed look on with jealous eyes and despair.

The plan would be phased in over four years, which seems incredibly ambitious. Costings are vague but there would be more taxes on corporations and the wealthy. There are various associated ancillary proposals to dramatically lower drug prices, but we shall ignore these as drug spending is not the major driver of healthcare cost inflation in the US and the proposals look completely unworkable, so we will not discuss these further.

As things stand today, the US government already provides $740bn in direct Federal subsidies to the current healthcare system. This figure is expected to almost double to $1.3 trillion by 2029. Total system wide expenditures are around $3.5 trillion today, paid for mainly out of private insurance and direct consumer expenditures. Government-administered programmes (Medicare, Medicaid, CHIP, Veterans and Defence) account for $1.4 trillion of spending, paid through a mixture of co-pays and State and Federal taxation and subsidies.

The decay of a colossal wreck

Shelley's famous poem (composed incidentally under the competitive tension of a wager with his compatriot Horace Smith; whose own sonnet of the same title is much inferior – even in the arts, competition can bring out the best in humanity) was itself based on the writings of Siculus, highlighting that cautionary tales on the recklessness of hubris stretch back Millennia.

Put simply, nothing lasts forever and it is often difficult to see the long-term consequences of actions taken today, even with the best of intentions. The market clearly sees the folly and risk in the Sanders plan to create a truly monumental legacy and it is worth trying to examine this in more detail. Unfortunately, this task is not so easy…

Sanders is seemingly no fan of literary classics, nor apparently of reading the news in his own home State. Had he taken more of a keen interest in

reading, he might have reflected on the abject failure of the most recent attempt to execute such a project – his home State's H202/S88 Bill of 2011, which established Green Mountain Care to serve all the State's residents. Green Mountain still exists, but the state wrangled for years as to how to institute the funding of the care programme through State taxes, essentially abandoning the objective of a single payor system by 2015 after the unpopularity of a proposed 150% increase in the State income tax rate to pay for it. As Virgil also noted aeons ago: the descent into hell is easy.

Perhaps we are being unfair though. Like all good (which is not to say honest) politicians, Kingmaker Sanders does not get too bogged down in details as to how 'Medicare for All' is to be paid for. Nor is the scale of what is to be attempted even clearly articulated. Make no mistake; this would be an epic undertaking of Herculean proportions.

Simple Government welfare re-organisations would pale compared to this task. For example, the UK's own disastrous phased roll-out of the laudable "simplification" known as Universal Credit left some people struggling to pay for food and housing. Obamacare's own rollout was highly problematic and fraught with second-order consequences that have condemned to the point where its replacement feels inevitable. One can only imagine the burden of human suffering that might occur if people cannot access medical care, or hospitals and clinics begin to close because they are no longer financially viable, or physicians quit the industry because they cannot make money.

The opposite could also happen - what if everyone could suddenly use the system unimpeded? There are 30-odd million Americans lacking adequate care. Even an armchair anthropologist can see that unfettered access to that previously denied would surely generate a bolus of demand that the system may not be able to cope with; something we see here in the UK each winter with the NHS, whose system is rationally setup for average rather than peak capacity.

The hand that mocked them

There are many facets to consider, but let us stick with the money for now. The Sanders plan does not nationalise infrastructure. Like Green Mountain, the government will pay the bills and you will apparently be free to choose your hospital and physician. This is all well and good, but the current system's reimbursement rates for base Medicare are lower than private insurance providers pay. This is tolerated because the private system takes up the slack. This, incidentally, is where the Clinton healthcare reform proposals floundered and where Obamacare's harnessing of the private sector was an attempt to learn from this mistake to create a hybrid system.

Not unfairly, American politics gets a bad rap these days. However, one of its great institutions is the non-partisan Congressional Budget Office (CBO), whose mission is to "bolster Congress's budgetary understanding and ability to act" through the provision of formal written 5 or 10 year estimates of the spending and revenue impacts of virtually every bill approved by Congressional committees. It will also opine on (aka "score") proposed legislation at an early stage if asked, as was the case with single-payor healthcare.

The keenly awaited CBO report on single-payor healthcare was issued at the beginning of May and we hoped that it would enumerate the multitudinous challenges outlined above, putting paid (literally) to the fear that such a monumental transition was imminent. However, as is often the case in politics, we did not get what we expected.

The report does a commendable job of making this bill into an allegory of Pandora's Box, but this is unfortunately not yet clear enough for the market to climb down from DEFCON 2. Nonetheless, it is worth quoting a few choice remarks from its 34 pages when considering how likely it might be that Sander's proposal sees the light of day:

- *"Features of the single-payer system that would cause the largest changes from the current system could be phased in gradually to minimize their impact"*
- *"Establishing an interoperable IT system under a single-payer system would have many of the same challenges as establishing an interoperable IT system in the current health care system with its many different providers and vendors. The IT system would also need to overcome the challenges of interfacing across multiple state and federal agencies."*
- *"People who received an additional health care benefit for the first time would probably increase their use of that benefit, and that increase might be greater initially because of previously unmet health care needs."*
- *"Existing evidence indicates that people use more care when their cost is lower, so little or no cost sharing in a single-payer system would tend to increase the use of services and lead to additional health care spending, as well as more government spending."*
- *"A single-payer system could permit private insurers to deliver the benefits, much like the Medicare Advantage program does."*
- *"Two primary concerns of a single-payer health care system are the methods it would use to pay providers and set their payment rates, both of which would directly affect government spending, national health care spending, and providers' revenues."*
- *"Under the current health care system, the rates commercial insurers pay providers for most services are higher than Medicare FFS rates—sometimes substantially higher. CBO found that three major insurers' commercial payment rates for hospital inpatient admissions in 2013 were 89 percent higher, on average, than Medicare FFS payment rates for the same types of treatments or procedures."*
- *[Describing Medicare bundled FFS physician payment trial:] "When the program began [2016], participation was mandatory … In 2018, participation became voluntary for providers in about half of those areas. About a quarter of the providers in areas with voluntary participation opted to continue participating" [demonstrating that current payment rates are non-viable].*

More than one poem?

As with Shelley and Smith, there is more than one way to interpret a tale. Sanders' plan is but one of nine different Bills across the house and Senate that propose an expansion of Medicare in one form or another. They fall into three broad camps: expansion of the age range but maintaining the current public-private partnership; universal coverage by government (Sanders & Jaypal) and "buy-in" bills that would allow people or their employers the option to switch into the government programme on a voluntary basis.

This confluence of several disparate options is probably what led the CBO to shy away from trying to score any given proposal and rather consider the issues raised by all of them. There is also a Medicaid buy-in proposal, aimed squarely at improving coverage for lower income households (this is essentially one of the tenets of Obamacare, but States were allowed to opt-out of the proposed Medicaid expansion, which many Republican-led States chose to do).

Thoughts and actions

It is hopefully very clear from the preceding paragraphs (and indeed previous factsheets) that we see a rapid transition to a federally administered single payor system as a utopian folly and one can only hope that cooler heads prevail. What politician wants to return to their home state and take a victory lap for supporting the bill that closed the local hospital, made most people's coverage worse and dramatically increased waiting times for ambulatory care? We believe all of these are very real risks from trying to implement the Bernie Bill as proposed. In contrast, some of the other options seem both easier to implement and less likely to cause wholesale disruption.

The BBH team are not ideologically right wing, nor do we fail to see the shortcomings of a system that allows tens of millions of people to fall through the cracks. Rather, we see all too clearly the realities of all the healthcare systems around the world struggling with the same issues and the incredible complexity of managing them. Sweeping changes are not the way forward; gradual transition is the workable solution and the learnings of the private sector should not be ignored.

The market's reaction to the renewed Medicare for All push (which began in February with a House version of Sander's idea authored by Rep. Pramila Jaypal) has predictably been a sell-off in insurance stocks. This was followed by contagion into related service providers (i.e. those who sell services to Managed Care), then hospitals and hospital capex plays (those who sell kit to hospitals). Clearly, the health system would defer non-essential capex (big-ticket items like shiny new CT machines) if under financial pressure. However, when you see the contagion spread to companies like Becton Dickinson, who are more in the consumables end of the spectrum, you have to think it has all gone a bit far.

We have thus added to our positions in Humana and Anthem (health insurance), Teladoc (IT supplier to health insurance customers) and Hill-Rom (durable hospital equipment). As of end April, Managed Care accounted for 15.8% of the portfolio, versus 10.9% at the end of January, the month preceding the beginning of the insurance sell-off. At that time, Managed Care accounted for 9.2% of the benchmark. Its underperformance over recent weeks means that it now accounts for only 8.6% of the Index.

This is a sizeable bet, but one that is very much supported by any objective analysis; managed care took the pain earliest (and hardest) and is likely to lead any subsequent recovery. The Chart below is a slide from a recent presentation, illustrating the impact of the 1992 Clinton election campaign, which was centred on healthcare reform and mandatory insurance purchase to achieve national coverage. The key point here is that, once the impracticalities of the proposals were laid bare in the summer of 1993, it was rapidly obvious the plan could not work. Some thirty years on, legislative timelines have contracted and the tendency is to come with detailed proposals upfront, but we see many parallels in the ultimate outcome.

The lone and level sands stretch far away

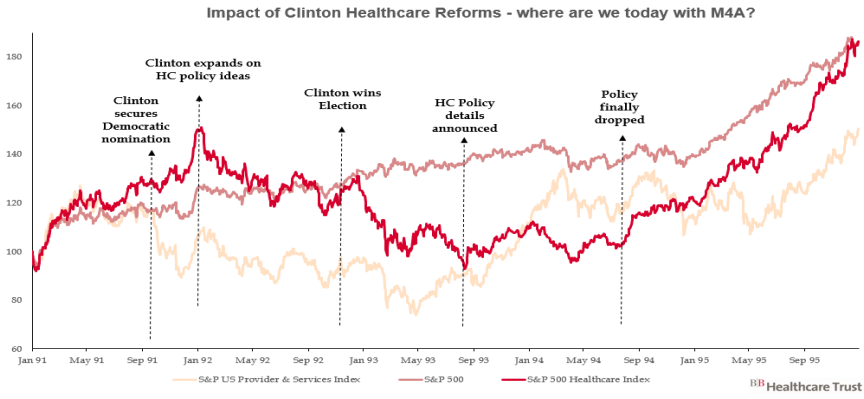
The distribution chain has been an ongoing source of frustration. Its lacklustre performance can be attributed to the twin fears of drug pricing reform and Amazon entry and we maintain that neither is the material risk the market fears. That said, we are realistic that sentiment will not change in the short-to-medium term, whereas we can see the debate around managed care evolving quite rapidly.

Walgreens Boots has been particularly vexing. The original thesis was centred upon the differential margins in the US and non-US frontline retail businesses. In 2016, our inception year, the EBIT margin of the US and ex-US pharmacy businesses stood at 6.4% and 8.7% respectively. The retail offers are very different, with Boots a wellness and beauty focused offer and legacy Walgreens more like a pound shop, although there is an amusing irony in being able to buy a packet of cigarettes whilst you pick up your emphysema medication.

A long-term plan to refurbish stores and essentially turn 'Walgreens' into 'Boots' is ongoing. Back in 2016, the maths suggested a successful transformation could take the group's profits 25% higher and, as it is, WBA is a veritable cash machine. In the end, we have seen margins fall; faster ex-US than in the US, but overall profits are declining. This rather trumps the fact that the margin gap is narrowing! As the debate over what the future 'front door' of healthcare will look like, Walgreens remains on our watch list and we are likely to revisit this story at some point in the future, but we got the timing on this one wrong.

Other developments within the Trust

After these developments, we have 27 holdings in the portfolio. Our watch list continues to expand, but there appears to be something of a scarcity premium being applied to quality assets in the areas we are most keen to make investments, so we have not added any new companies to the book since early January. Hopefully, opportunities will present themselves over the coming months, but we are not prepared to pay more than we think something is worth to gain an additional exposure. At month's end, the leverage ratio stood at 9.9%. The changes described above have increased the concentration of the portfolio, with the Top 10 now accounting for >63% of the gross exposure. We issued an additional 7.1m shares through the tap programme during April.



With leverage having been around the 10% level already, the additional capital to increase exposure to managed care has come from ongoing tap issuance and a re-balancing of the portfolio. We have trimmed our holdings in Align, which has done very well in recent weeks and sold down our stakes in the distribution end of the healthcare supply chain, reducing our stake in AmerisourceBergen and exiting Walgreens Boots.

We appreciate the opportunity to interact with our investors directly and 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

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Standardised discrete performance (%)		
12-month total return	**Apr 18 - Apr 19**	**Dec 16 - Apr 19***
NAV return (inc. dividends)	25.1%	45.0%
Share price	25.3%	38.5%
MSCI WHC Total Return Index	14.3%	27.9%

Sources: Bloomberg & Bellevue Asset Management AG, 30.04.2019

NAV return is adjusted for dividends paid during period (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	15.8%
Diagnostics	13.7%
Biotech	13.5%
Healthcare IT	11.3%
Med-tech	10.9%
Dental	10.7%
Specialty Pharma	10.3%
Services	6.0%
Pharma	4.4%
Health Tech	2.4%
Distributors	1.0%

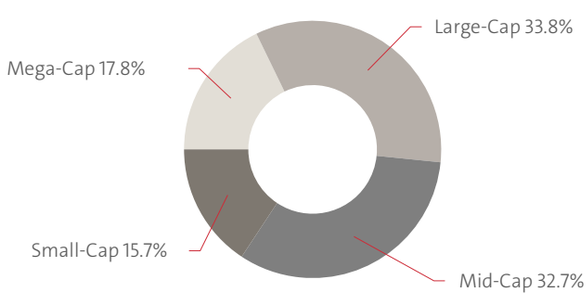
Source: Bellevue Asset Management, 30.04.2019

TOP 10 HOLIDINGS

Align Technology	10.7%
Anthem	10.0%
Teladoc	9.2%
Illumina	7.7%
Lonza	6.0%
Humana	5.8%
Bristol Myers Squibb	4.4%
Intuitive Surgical	3.4%
Hill-Rom Holdings	3.1%
Alnylam Pharmaceuticals	3.0%

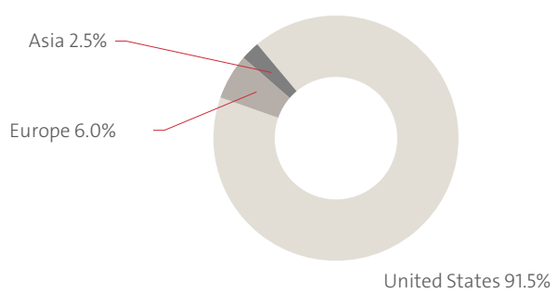
Source: Bellevue Asset Management, 30.04.2019

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 30.04.2019

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 30.04.2019

"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

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 524.5 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	371 640 819
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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