DECEMBER 2022

Factsheet

London Stock Exchange (LSE)

Marketing document

Investment focus

Bellevue Healthcare Trust intends to invest in a concentrated portfolio of listed or quoted equities in the global healthcare industry. The investable universe for the fund 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 is no restrictions on the constituents of the fund's portfolio by index benchmark, geography, market capitalisation or healthcare industry sub-sector. Bellevue Healthcare will not seek to replicate the benchmark index in constructing its portfolio. The Fund takes ESG factors into consideration while implementing the afore-mentioned investment objectives.

Fund facts

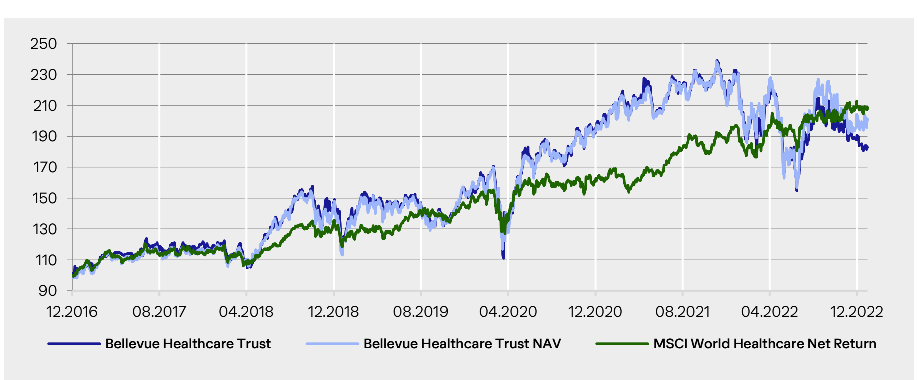
Share price	GBp 153.20
Net Asset Value (NAV)	GBp 168.15
Market Capitalisation	GBp 849.0 mn
Investment manager	Bellevue Asset Management (UK) Ltd.
Administrator	Sanne Fund Services (UK) Ltd.
Launch date	01.12.2016
Fiscal year end	Nov 30
Benchmark	MSCI World Healthcare Net Return
ISIN code	GB00BZCNLL95
Bloomberg	BBH LN Equity
Number of ordinary shares	586,783,083
Management fee	0.95%
Performance fee	none
Min. investment	n.a.
Legal entity	UK Investment Trust (plc)
EU SFDR 2019/2088	Article 8

Key figures

Beta	1.29
Correlation	0.76
Volatility	30.9%
Tracking Error	20.92
Active Share	95.28
Sharpe Ratio	0.52
Information Ratio	0.1
Jensen's Alpha	-1.63

Source: Bellevue Asset Management, 31.12.2022;
Calculation based on the Net Asset Value (NAV) over the last 3 years.

Indexed performance since launch



Cumulated & annualized performance

Cumulated

	1 M	1 Y	2 Y	3 Y	4 Y	5 Y	ITD
Share	-3.2%	-21.0%	-7.9%	19.0%	45.9%	53.1%	82.6%
NAV	-1.8%	-11.1%	2.4%	28.7%	62.0%	76.0%	100.6%
BM	-2.5%	5.8%	27.9%	41.0%	67.0%	81.7%	107.6%

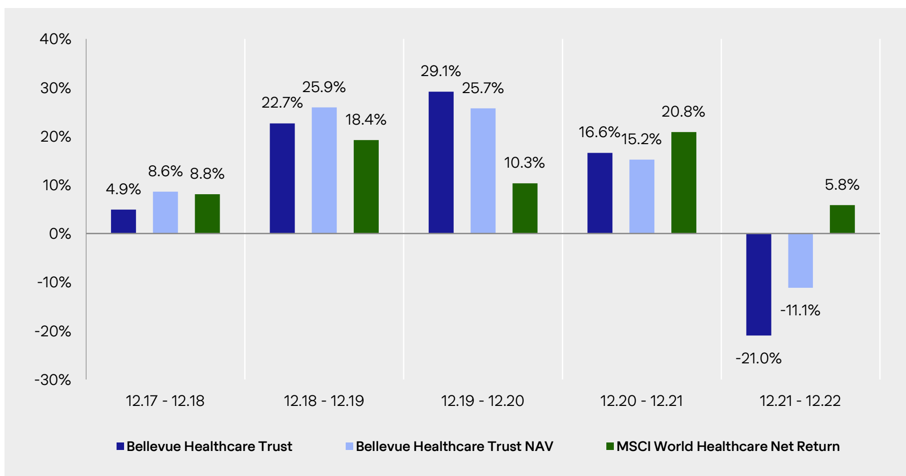
Annualized

	1 Y	3 Y	5 Y	ITD
Share	-21.0%	6.0%	8.9%	10.4%
NAV	-11.1%	8.8%	12.0%	12.1%
BM	5.8%	12.1%	12.7%	12.8%

Annual performance

	2017	2018	2019	2020	2021	YTD
Share	14.8%	4.9%	22.7%	29.1%	16.6%	-21.0%
NAV	12.7%	8.6%	25.9%	25.7%	15.2%	-11.1%
BM	9.4%	8.8%	18.4%	10.3%	20.8%	5.8%

Rolling 12-month-performance 30.12.2022



Source: Bellevue Asset Management, 31.12.2022; all figures in GBp %, total return / BVI-methodology

Past performance is not a reliable indicator of future results and can be misleading. Changes in the rate of exchange may have an adverse effect on prices and incomes. All performance figures reflect the reinvestment of dividends and do not take into account the commissions and costs incurred on the issue and redemption of shares, if any. The reference benchmark is used for performance comparison purposes only (dividend reinvested). No benchmark is directly identical to the fund, thus the performance of a benchmark is not a reliable indicator of future performance of the Bellevue Healthcare Trust to which it is compared. There can be no assurance that a return will be achieved or that a substantial loss of capital will not be incurred.

Top 10 positions

Position	Weight
Sarepta Therapeutics	6.9%
Jazz Pharmaceuticals	6.2%
Option Care Health	5.9%
Axonics	5.7%
Insmed	5.3%
Charles River Labs	5.1%
Exact Sciences	4.5%
Apellis Pharmaceuticals	4.5%
Tandem Diabetes Care	4.4%
Silk Road Medical	4.3%
Total top 10 positions	52.9%

Sector breakdown

Sector	Weight
Focused Therapeutics	24.8%
Med-Tech	19.6%
Services	14.7%
Diagnostics	11.1%
Managed Care	6.3%
Diversified Therapeutics	6.2%
Tools	6.2%
Healthcare IT	5.4%
Health Tech	4.4%
Dental	1.2%

Geographic breakdown

Country	Weight
United States	95.1%
China	3.2%
Switzerland	1.2%
Canada	0.5%

Market cap breakdown

Market cap	Weight
Mega-Cap	11.5%
Large-Cap	23.3%
Mid-Cap	48.9%
Small-Cap	16.3%

Due to rounding, figures may not add up to 100.00%

Source: Bellevue Asset Management, 31.12.2022;
For illustrative purposes only. Holdings and allocations are subject to change. Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. Where the subfund is denominated in a currency other than an investor's base currency, changes in the rate of exchange may have an adverse effect on price and income.

Goodbye 2022, and quite frankly, good riddance. We are surely all bored and frustrated beyond words with this endless macro-driven vacillation. Somewhere along the way, company-specific fundamentals were cast aside and active equity managers have, broadly speaking, struggled to generate outperformance.

We must be mindful of morosity however. Every cloud has a silver lining and, in this case, it is the unarguable truth that there are a number of materially undervalued companies amidst the rubble of last year's underperformance. When it comes to healthcare, a calm, rational analysis of the world around us can only lead to the conclusion that little has changed, beyond an even greater urgency to fix a broken system.

In the end, the patient investor will be rewarded because the only way to beat an inflationary environment is to find dependable and visible growth that can outrun the erosion of monetary value that inflation creates. We think we know where plenty of that stuff lies...

Monthly review

The wider market

Santa seems to have left his festive cheer behind at the North Pole this year. Broadly speaking, markets ended the year in a funk, consumed again with macro-economic and geo-political uncertainties.

The MSCI World Index declined 4.3% in dollars (-5.6% in sterling) and the Grinches at the Federal Reserve did their level best at every opportunity to remind investors they would crush any signs of joy or relief with further rate increases until it was clear they were actually hurting companies and consumers alike. As if we are naughty school children, it seems we need to be taught a lesson, lest any irrational exuberance linger in the recesses of our minds.

For those of us that did get to indulge in some festive frivolity, the world feels like a very bizarre place, with a stark juxtaposition between the freezing 'have-nots' and the balling 'have-yachts' evident throughout.

Your managers were in New York City for an investor conference during the week of the annual Rockefeller Christmas Light ceremony. The place was rammed; one would struggle midweek to get into any destination restaurant or bar without reservations made weeks in advance and the temples of luxury on Fifth Avenue were seeing a brisk trade. Tourism was widely reported as 'back' despite the dollar's strength and gob-smacking rack rates for hotel rooms following a brutal pandemic-induced capacity reduction. It was sad to see so many landmark buildings left derelict.

London also felt very busy over Christmas. Even now, in mid-January, bars and restaurants are still seeing brisk trade and the sales shopping season feels strong. At the same time, we are all too cognisant that more and more people are struggling to meet basic needs amidst crippling energy costs and consequential rampant inflation. No wonder economists and investors are confused; the regional disparities must be glaring.

The sector-level performance for the MSCI World Index is outlined in Figure 1 below. We would note that the lamentable performance of the Automotive sector reflects the ongoing immolation of Elon Musk and the gradual return to earth of Tesla's valuation (41% sector weighting!)., Automotive fell only ~4.4% if Tesla is excluded. Tesla' de-rating has felt inevitable for a long time (and was discussed in the January 2020 factsheet).

Tesla is not, and never was, a tech company. It's a car company that makes what are now quite dated EVs that still suffer from poor build quality. It has been trying to sell them at prices people are no longer prepared to pay because they now have better quality options from Audi, BMW, Mercedes etc. There are very few car companies that won't discount their wares (Ferrari, Porsche et. al.) and Tesla has now joined everyone else in trying to shift a mass market product by whatever meand necessary, including discounting. In our opinion, the stock still has a very long way to fall and the product is a long way off of competing with its peers on build quality and desirability.

Our January 2020 missive also called out Beyond Meat as a meme stock. It seems appropriate to call this one out too during the nauseating marketing wheeze that is "Veganuary". Beyond Meat has lost 89% of its value since that time and is expected to see revenues about 20% lower in 2023 than in 2021, losing sales across all areas of its business.

Is any sensible person surprised? If you don't like meat, why would you want to eat a "burger" when there are so many other culinarily interesting things you can do with plants as a source of protein? If you don't wish to condone animal suffering, then why are you going to give your money to McDonalds and Burger King just because your particular food choice only murdered a beetroot or two? You are still propping up the meat industry.

McDonalds quietly withdrew its Beyond Meat "McPlant" products in the US in July 2022. Burger King's "Impossible" plant-based range is still available, but the company no longer highlights the sales growth of the range, which is telling, and in stark contrast to a few years ago.

The whole point of the comments in 2020 was that investors should not rush to judgement on the world changing rapidly and, in the process, re-cast the investment universe as if the future was now a foregone conclusion. Life is rarely so simple. This point seems very apposite again today, as we discuss in the Musings section.

Sector	Monthly perf (USD)
Household & Personal Products	1.7%
Insurance	1.1%
Utilities	0.0%
Telecommunication Services	-0.6%
Pharmaceuticals, Biotechnology	-0.7%
Capital Goods	-0.9%
Food, Beverage & Tobacco	-0.9%
Consumer Durables & Apparel	-2.0%
Healthcare Equipment & Services	-2.3%
Materials	-2.5%
Banks	-2.7%
Commercial & Professional Services	-3.1%
Energy	-3.5%
Real Estate	-3.6%
Consumer Services	-4.8%
Transportation	-5.0%
Diversified Financials	-5.1%
Software & Services	-5.8%
Retailing	-6.8%
Food & Staples Retailing	-7.6%
Media & Entertainment	-8.1%
Semiconductors & Semiconductor Equipment	-9.6%
Technology Hardware & Equipment	-10.3%
Automobiles & Components	-19.5%

Source: Bellevue Asset Management, 30.12.2022

Beyond this comment on Automotive, the wider performance feels unsurprising, with discretionary and capex plays lagging and defensives generally faring better. January has gotten off to a similar start, with the same macro worries capping the month's highs around the same levels seen in early December. Broadly speaking, the market hasn't gone anywhere for two months now, but at least it's not going down further...

Healthcare

One would expect the aforementioned dynamic to be relatively favourable to a classically defensive sector like healthcare, and so it proved to be. However, relative outperformance and absolute value creation are not the same thing; the sector still saw a decline of 1.3% in dollars (-2.5% in sterling).

The sub-sector performance data for December is summarised in Figure 2 below and we would make the following observations. The healthcare IT sub-sector weakness was broad-based and appears to have been driven primarily by a cross-read from the broader Nasdaq/Tech weakness seen in the market. Animal Health stocks dragged down "Other Healthcare" as signs of financial stress at the consumer level are now impacting petcare-related purchases; this has traditionally been a very resilient sector in an economic downturn.

Managed Care and Distributors have done incredibly well during 2022 and it makes complete sense to us for investors to reduce exposure given valuations relative to the wider sector, market and history and the human tendency to reassess everything at the beginning of each year. It would optimistic to bet on these two sub-sectors leading the pack again in 2023, especially as there are various potential headwinds to Managed Care as procedure patterns normalise.

The positive performance in Dental, which was driven by Align Technology, is also noteworthy. We struggle to understand why the market would be getting more comfortable with this stock given what we think are ongoing deteriorating forward indicators of new patient demand. It will be interesting to see how it fares after FY results (and 2023 guidance) on 1 February.

	Weighting	Perf (USD)	Perf (GBP)
Dental	0.4%	4.5%	3.2%
Generics	0.4%	2.4%	1.1%
Facilities	1.0%	0.8%	-0.5%
Diversified Therapeutics	37.2%	0.5%	-0.8%
Diagnostics	1.5%	-0.5%	-1.8%
Med-Tech	12.6%	-0.9%	-2.1%
Conglomerate	11.9%	-1.6%	-2.9%
Tools	8.3%	-2.2%	-3.5%
Healthcare Technology	0.9%	-2.3%	-3.6%
Distributors	1.6%	-2.4%	-3.7%
Focused Therapeutics	8.4%	-3.0%	-4.2%
Managed Care	12.0%	-3.2%	-4.5%
Services	2.1%	-3.2%	-4.5%
Other HC	1.3%	-5.8%	-5.6%
Healthcare IT	0.6%	-13.7%	-14.8%
Index perf		**-1.3%**	**-2.5%**

Source: Bloomberg/MSCI and Bellevue Asset Management (UK) Ltd. Weightings as of 30.11.2022. Performance to 30.12.2022.

January is always one of our busiest months as we work on year end reports and deal with the data deluge that is the JP Morgan Healthcare Conference. Sometimes, the comments made at this event can set the tone for the whole year, so one must pay attention to the myriad of pre-announcements and strategic updates that pour forth in the days preceding the event and during the conference itself.

Generally speaking, we had a positive conference for our portfolio companies. However, the wider event was not really very inspiring and there were a number of perfectly reasonable cautious comments from management teams regarding potential headwinds, none of which are "new" (COVID variant waves, China, hospital capex, labour shortages, US drug pricing around the Inflation Reduction Act, etc.) and there was not an obvious bullish theme around an M&A renaissance. To summarise, there is nothing to be concerned about, but there is also nothing to compel a generalist investor who is sitting on the sidelines with regard to healthcare exposure to rush into the sector.

The Trust

During December, the Trust's Net Asset Value declined 1.8% in sterling (-0.5% in dollars), outperforming the MSCI World Healthcare Index by 0.7%. The impact of FX on the NAV progression was modest this month (-1.2%), which was in line with our estimate for the FX impact on the MSCI World Healthcare Index (-1.3%). The evolution of the NAV is illustrated in Figure 3:

Source: Bellevue Asset Management, 30.12.2022

Focused Therapeutics was far and away the largest positive contributor to the overall performance, with Tools, Services and Managed Care the main detractors. The evolution of the portfolio is summarised in Figure 4 below and we would make the following comments:

December was characterised by an unusually low level of trading activity; there were no active additions to the portfolio holdings during the month and a limited amount of selling down positions that were concentrated in a few names in the Focused Therapeutics and Diagnostics sub-sectors. The vast majority of the movements in exposures thus represent divergent performance.

	Subsectors end Nov 22	Subsectors end Dec 22	Change
Dental	1.2%	1.2%	Increased
Diagnostics	10.5%	11.1%	Decreased
Diversified Therapeutics	6.3%	6.2%	Decreased
Focused Therapeutics	24.3%	24.8%	Increased
Healthcare IT	5.4%	5.4%	Unchanged
Healthcare Technology	3.9%	4.4%	Decreased
Managed Care	7.0%	6.3%	Decreased
Med-Tech	19.3%	19.6%	Increased
Services	15.3%	14.7%	Increased
Tools	6.5%	6.2%	Increased
	100.0%	**100.0%**	

Source: Bellevue Asset Management, 30.12.2022

The investment portfolio remains unchanged, with the same 29 holdings. As noted in the November factsheet, we were holding some cash to meet the anticipated outflow related to the Redemption facility that occurred in mid-December. As a consequence, the gearing ratio increased from a low figure of 3.8% at the end of November to 7.4% at the end of December, which is in line with our 'mid to high single-digit' ambition.

December was a complex month in terms of how the Trust's shares traded. In addition to the redemption, we saw significant selling in the market by a few holders who did not take advantage of the redemption facility. Trading volumes through late November, December and early January were very elevated compared to normal levels for the year end (when trading is typically quiet) and this led to an expansion of the NAV discount, which reached a high of -9.7% during December and averaged -7.1% during December, compared to an average of -4.2% over the prior three months (end August to end November).

In addition to the annual redemption mechanism, the Trust has a share buyback programme in place. This is managed on an arm's-length basis by our broker, JP Morgan. The parameters for the buyback have not been disclosed, but were triggered during December and the Trust repurchased a total of 2.3m shares during the month. The programme has remained active during January and, at the time of publication, the discount rate had fallen back into line with our two closest investment trust peers.

Manager's Musings

Mais c'est la même chose!

Having committed to writing discursive and expansive factsheets, we do worry about iterance and inanity. Nobody wants to read the same old diatribe, no matter how many novel re-phrasings it may contain, and yet we are also mindful of the persistent and pervasive macro-led dynamics that have influenced the performance of the portfolio and our actions as investment managers.

There is no getting away from the challenges that we have faced over the last 15 months and we have highlighted the arbitrary nature of market moves and significant size factor effects (i.e. SMID healthcare underperforming its Large-Cap and Mega-Cap brethren) and generally irrational price movements.

Consequentially, we have been much more introspective in our actions. This has manifested itself in a lower level of portfolio variance during the calendar year; indeed, the 29 companies in the portfolio are unchanged since early May 2022 (weightings have moved of course, but no stocks have been added or exited). Rather than describe this in qualitative terms once more, we will instead describe the portfolio's evolution across the year in quantitative terms.

Regular readers will be aware that our investment focus is on multi-year return potential. As a consequence, we have reacted to what we consider to be a temporal aberration in value determination to re-orient the portfolio toward those companies where we see the greatest opportunities based on tried and tested valuation assumptions that have worked over a long period of time.

We are all painfully aware how much the share prices of many of our holdings 'evolved' over 2022. However, the stock market is an imprecise mechanism for price discovery and the expression of value, especially in the shorter-term (if it wasn't, there would be no need for portfolio managers or wealth advisers). The key question then is how much the fundamentals have evolved over this period of time and thus whether or not 2022 represents a fantastic opportunity or the emergence of a new normal. Let us consider this question in more detail…

Fundamentals – deteriorating or not?

The best way to determine if fundamentals are changing is via a like-for-like comparison of expectations for investee companies over time. 23 of the 29 stocks in the portfolio at the end of December 2022 were also owned at the end of December 2021. These represented 87.9% and 82.1% of the portfolio's gross exposure at these respective time points. As regular readers will be aware, we carry detailed internal models for all investee companies and these are continuously updated to reflect news flow, corporate actions, results reporting, foreign exchange rates etc.

Previous versions of these models are archived and we have gone back and compared various outputs from our internal models as at the 2021 and 2022 calendar year end, focusing on our FY2023 and FY2024 revenue forecasts, our fair values and upside to year-end share prices and also the implied reverse discount rate (i.e. what discount rate does one need to apply to our base case forecasts to generate the year end share price as the fair value for the stocks). In each case, we have aggregated the results by the relative portfolio weightings at each time point to give a single point estimate for the portfolio.

Healthcare is a tightly regulated sector driven by demographic trends and characterised by long development timelines. Whilst it contains many complexities, it actually tends to evolve rather slowly and transparently. There may be the odd surprise here and there (a drug has unexpected side effects and gets pulled or a clinical trial fails despite all previous data being positive), but these tend to impact forecasts for one or two companies rather than the whole sector. It is unsurprising then that between the end of 2021 and 2022, our FY2023 and FY2024 revenue estimates barely changed (-2.7% and +0.2% respectively).

The aggregate upside to fair value versus the year end share price stood at 33.2% at the end of 2021 and 57.8% at the end of 2022. These two values align conceptually; if the output of the models did not change much (per the revenue forecasts), then neither will the overall fair value and thus the upside to fair value would grow as share prices fall (recall the Trust's calendar year end NAV represented a negative total return over 2022 of -11.1% and a number of our holdings saw their share prices punished very severely over the course of the year).

What about the implied discount rate (reverse DCF) analysis? At the end of 2021, this stood at 11.4% and had fallen to 10.3% by the end of 2022. This decrease in the aggregated reverse discount rate is primarily due to the evolution of the portfolio toward

stocks with higher terminal contributions (i.e. the portfolio has increased its skew toward companies that are not currently cashflow positive and reflects our active management approach of recycling profits from winners (typically Diversified Therapeutics, i.e. "big pharma" and Managed Care during 2022) into those companies with the most attractive risk/reward profiles (i.e. SMID healthcare which fell out of favour over these past 15 months).

It is worth noting that these fair values include probability adjustments to cashflows arising from any drugs or medical devices that have yet to receive a regulatory approval in the United States or Europe and thus often represent a much higher discount rate to the underlying forecasts than the valuation output from our base case scenario implies.

In summary, the portfolio has evolved, but there is no evidence that the fundamentals for the companies that we continue to invest in have deteriorated to any meaningful extent and certainly not in a manner that is commensurate with the share price movements that many of them have experienced.

Using broadly constant assumptions (again, discussed in more detail below), the upside to base case fair value from current share prices has increased by almost 75% (from 33.2% to 57.8%), so why wouldn't we continue to own the same securities?

One might try to counter that continuing with the same valuation assumptions is erroneous in the current inflationary environment and we will consider that in due course. Given that we are also using the aforementioned probability discounts, the important point to note is that an implied discount rate of 10.3% is still materially above any commonly conceived equity security discount rate (as described in the following section), presuming of course that many of the widely accepted methods for 'calculating' these discount rates are not flawed in and of themselves (also considered in the following section).

The question then is: how should one be thinking about inculcating the risk of persistently higher inflation and contemporaneously higher interest rates into portfolio construction decisions?

What is in the price?

If one were an MBA student, now would be a good time to waffle on about the efficient market hypothesis and how share prices are, in effect, the sum of all fears. What assumptions are discounted in the current scenario? MBA types also love a bottom-up theory to justify an approach, so will often apply an equity market risk premium over a risk-free rate.

That risk-free rate will typically be the sovereign bond yield of the country of domicile. Such rates are also presumed to reflect the geo-political risks of investing in these markets because the liquidity in the bond market is such that it is considered to be truly efficient. The evidence does support this contention – we can see in real-time that the bond market effectively discounts geopolitical risks.

Recent examples include the yield spike on UK Gilts after the Truss/Kwarteng delusional "mini-budget" when the 10-year gilt yield increased 44% in seven days and brought down that administration, or the yield on Ukrainian 10-year paper, which was stable around 7% through most of 2021 and now stands at ~33% because Russia is pummelling the country back to the stone age and the economy is tragically in ruins.

However, the choice of risk-free rate is not as easy as it once was. Most of the companies we invest in these days are truly multi-national. They borrow in whatever country and currency optimises their net financing costs and hedge currency risk, using debt interest to depress profits in the most egregiously taxed jurisdictions and increasing profits and inter-company dividend flows where tax is least problematic. In general, revenues (and thus geopolitical risk as regards impact on the company's future prospects) are now global.

For us, it still makes sense to focus on US Government bonds for the risk-free rate since the US is still the single largest market for healthcare (and thus the largest source of operating cashflows for the portfolio companies), the centre for healthcare innovation and the predominant domicile and reporting currency for the portfolio.

The risk-free rate is the easy part, one should use the Government bond yield over a duration that reflects the expected holding period of the equity securities. In our case as expected long-term holders, we might choose the US 10-Year Treasury Bill (or even the 20-Year). In the current environment, the choice matters little, as their current yields are very close: 3.5% and 3.8% respectively.

The market risk premium is the amount by which the expected return on a market portfolio exceeds the risk-free rate. It represents the financial compensation (i.e. higher profit) investors expect for taking on the additional risk of investing in a market portfolio as opposed to a risk-free investment. Historically, this was calculated through backsolving, by looking at historical equity market dividend returns and comparing them to bond yields.

This is arguably no longer a valid approach; dividends are less popular than they used to be (especially in the US) and most of the positive return from the S&P 500 over the past two decades has come from companies that do not pay dividends (tech, biotech, etc.). Furthermore, the globalisation of the economy has broken down the association of the dividend income stream to the domicile of the company.

How then do we get any validation of a market risk premium assumption? We utilise the tried and tested consensus approach; the market must be discounting whatever figure is most accepted. This can be determined by surveys of academics and finance professionals and there are some robust and publicly available datasets one can scrutinise. Our preferred series is that from Pablo Fernandez at IESE Business School, which has been running since 2007.

The US Pepperdine Graziadio Business School survey series is also interesting (to us, anyway). This is much smaller in terms of respondents but more granular in terms of respondent type and also contains other interesting data points. It has also been running since 2004.

We include the most recent series in Figure 5 below (it is backward-looking so will always lag current risk-free rates if they are moving). The important thing to note from the Fernandez series is that perception of the market risk premium has not really changed very much over the past decade or so (10-year range is 5.3-5.7%).

Some readers may think this is incorrect (the world feels a much riskier place to do business these days, especially if you are exposed to autocratic regimes like China) but that does not really matter overmuch; the market will reflect the consensus view of the participants and this survey confirms that they will continue to behave as if the risks have not changed and thus will continue to believe this remains a perfectly reasonable expectation of future investment returns.

United States	2022	2021	2020	2019	2018
Risk-fee rate	2.7%	1.8%	1.9%	2.7%	2.8%
Market risk premium	5.6%	5.5%	5.6%	5.6%	5.4%
Discount rate	8.3%	7.3%	7.5%	8.3%	8.2%

Source: P Fernandez et. al; IESE Business school, SSRN journal May 2022

Some Wall-Street analysts will erroneously backsolve equity discount rates using a WACC (weighted average cost of capital) derived from the Capital Asset Pricing Model ('CAPM'), which is a project finance tool and not appropriate for valuing public shares as it will tend to increase equity valuation as the proportion of a company's enterprise value accounted for by debt rises (we accept that it may have value for infrastructure and utilities companies if these are a pure play with regulatory protection on cashflows).

Any leverage buyout whizz will of course tell you that in their models, the risk premium rises with the debt level, as does the cost of debt (think about mortgage rates and loan to value parameters as a proxy). Rarely though do you see sell-side models take account of this reality. Leaving aside the comment about leverage impacts, one could argue that a discount rate of around 9% for the broad market feels about right given where inflation expectations are.

Is healthcare a special case and how do we think about it?

Should healthcare be higher or lower than the market on average? Given that total shareholder returns for the S&P 500 Healthcare Index meaningfully exceed those of the broad S&P500 Index on a 5, 10, 15 and 20 year view we would suggest the answer must be lower (that is what a backsolve would tell you). In addition, the growth of healthcare expenditure in the US bears no relation to growth of the economy; it is classically defensive and thus subject to less economic risk. The Beta of the S&P 500 Healthcare Index is also less than one when compared to the parent index.

Since inception, our approach to all of this has been to construct a proprietary matrix of discount rates that vary by the size, developmental stage and sub-sector (we characterise all companies into 16 separate sub-subsectors based on end customer type, rather than the widely used GICS system) and include additional risk premia for over exposure to certain markets where the regulatory or geo-political situation is more complex (MENA, China, India, etc.). These assumptions were based on extensive back-testing over various time periods. We also apply a range of normalised and terminal growth rates depending on similar variables.

As things stand today, the blended impact of this approach is that our fair values are generated using a weighted average discount rate of 8.0% (range 7.0-9.0%). The terminal value component (2030+) accounts for 47% of the fair value and the weighted average terminal growth rate is 1.8% (range 0.0-3.0%). As noted previously, these base case scenarios include probability weightings as well and generate aggregate upside to fair value of 57% compared to the share prices at the end of December 2022.

Some readers may argue that 8% is too low in the current inflationary environment. Perhaps we should use a higher value? This would be justified if one were to argue that interest rates were likely to stay at current levels in perpetuity. To quote the prolific Prince (the talented and now departed singer-songwriter, not the whingy one all over the papers currently) “forever is a mighty long time”. There are strong arguments in favour of an ageing global population depressing interest rates (cf. Japan) and thus we believe, as many economists do, that global growth will slow in the near-term and remain sluggish for the longer-term.

In the interests of academic fairness though, we have run a simplistic version of the exercise. A 100bp increase in the overall discount rate (i.e. from an average of 8.0% to 9.0% without changing any other assumptions, which surely would have to be the case if inflation were baked in), our fair value upside would decline by 14.4% (i.e. it would be 43% above the year end figure).

Whilst we do not have the time to do a detailed analysis of each company line by line to consider a structurally higher inflation scenario just for this factsheet, most of the companies that we invest in have market leading positions in their respective fields and consequential pricing power. Generally speaking, additional costs from labour, raw materials or running costs have been passed on in the form of higher prices. Thus, were we to undertake such a detailed analysis, it would probably result in higher revenue forecasts, broadly stable margins and thus higher net operating cashflows.

We also have much sympathy with the argument that, at the very least, a higher discount rate should be accompanied by a commensurate increase in the terminal growth rate (this trend was picked up in the most recent Pepperdine Graziadio Business School survey, where terminal growth rates had risen to an average of 3% due to elevated inflation assumptions).

One should probably adjust the normalised growth rate too, but again this gets too complex for this particular exercise. If we make the same 100bp adjustment (so the net terminal growth also moves from +1.8% to +2.8%), then the fair value upside falls from +57% to +52%.

As a final reminder, these figures represent upside to where we think fair value sits today, not at some indeterminate point in the future. Moreover, we expect the portfolio to accrete returns on an annualised double-digit rate so if nothing else happens and the share prices do not improve, that +57% would become at least +63% next year and so on and so on. This might be a growth portfolio, but it now feels very much like a value portfolio to us.

Out of the darkness and into the light

The founding investment proposition of the Bellevue Healthcare Trust can be summarised thus: the healthcare systems of the developed world are fundamentally broken. They are no longer fit for purpose and must be re-imagined and re-engineered to meet the needs of an ageing population burden with chronic (i.e. incurable) diseases.

The companies offering the tools, products and services that will enable this transition are not going to be provided by the large healthcare conglomerates and mega-cap winners of yesteryear, but rather by a new generation of focused, operationally geared companies that are probably off the radar for many generalist investors.

The drivers of adoption are the same demographic demand drivers as for all healthcare services, allied to a compelling additional driver of economic need. We have to bend the healthcare cost curve and improve productivity for frontline staff if we are to have a hope of keeping up with demand.

Let us recapitulate this narrative relative to current evidence. Readers must try not to view these solely through a UK/NHS prism. Whilst the current situation here is awful and the polemics rage about who is to blame and why this is happening, the same signs of stress and excess death are also evident in Germany, Spain, France and the United States, for instance, where healthcare funding (as both a percentage of GDP and on a per capita basis) has been higher over the past decade:

- Has the demand outlook for healthcare diminished in any apparent way in recent years? No.
- Are healthcare systems keeping up with demand and continuing to offer acceptable levels of service? No.
- Are staffing levels managing to scale up to meet this demand? No, quite the opposite in fact.
- Is healthcare expenditure rising faster than GDP in developed countries and still failing to bridge these gaps? Yes, and this is unaffordable, especially if we go into a recession.
- Has the regulatory environment changed in any meaningful way that represents a sustained increase in business risk for healthcare companies? No. At the margin, some funding mechanisms and/or regulatory approaches need work (e.g. home healthcare, social care, human factor testing for US medical products), but overall the situation is largely unchanged.
- Can we continue in this vein for any reasonable length of time? No, the systems will collapse or the electorate will push back on the funding costs.
- Thus, is there any reason to think that the core investment thesis of the Trust is broken in any way? The logical conclusion surely must be: No.

Even if you are more bearish than we are on long-term inflation, the Trust objectively provides operationally geared exposure to a portfolio of undervalued companies that will help to deliver an

urgent and necessary transformation of healthcare. At some point in time, the market will once again appreciate these virtues and re-rate these companies. We are not happy with the recent investment returns but we are happy to stay the course and, in the meantime, continue to buy shares in the Trust for our personal accounts, as we have been doing throughout 2022 and which has continued into 2023.

At the start of the factsheet, we referenced our comments from three years ago and repeated the observation that the world rarely changes quickly and the stock market can be faddish. No doubt some very lucky/clever people have made a lot of money out of Tesla and Beyond Meat by timing their trades well or by shorting them. That said, they went up very far for a long time before reality began to bite.

We are in an unusual position with innovative healthcare at the moment. The market chooses not to see the value at this time, but we know the end user demand is there and that the products work. We can also see and, unlike Tesla boosters, choose to see the competitive dynamics for what they are and factor them in. Three years from now, we fully expect to look back on this moment for what it is – a huge opportunity.

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@bellevuehealthcaretrust.com

As ever, we will endeavour to respond in a timely fashion and we thank you for your continued support during these volatile months.

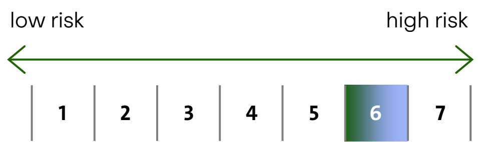
Paul Major and Brett Darke

Objective

The fund's investment objective is to achieve capital growth of at least 10% p.a., net of fees, over a rolling three-year period. Capital is at risk and there is no guarantee that the positive return will be achieved over that specific, or any, time period.

Risk Return Profile

This product should form part of an investor's overall portfolio. It will be managed with a view to the holding period being not less than three years given the volatility and investment returns that are not correlated to the wider healthcare sector and so may not be suitable for investors unwilling to tolerate higher levels of volatility or uncorrelated returns.



The risk indicator assumes you keep the product for 5 years. The actual risk can vary significantly if you cash in at an early stage and you may get back less.

The summary risk indicator is a guide to the level of risk of this product compared to other products. It shows how likely it is that the product will lose money because of movements in the markets or because the fund is not able to pay you.

This fund is classified as 6 out of 7, which is a medium-high risk class. This rates the potential losses from future performance at a medium-high level, and poor market conditions will likely impact the capacity to pay you.

The portfolio is likely to have exposure to stocks with their primary listing in the US, with significant exposure to the US dollar. The value of such assets may be affected favourably or unfavourably by fluctuations in currency rates.

This fund does not include any protection from future market performance so you could lose some or all of your investment.

If the fund is not able to pay you what is owed, you could lose your entire investment.

Target market

The fund is available for retail and professional investors in the UK who understand and accept its Risk Return Profile.

Chances

- 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 fund offers a combination of high quality healthcare exposure and a 3.5% dividend yield.
- Bellevue Healthcare Trust has an experienced management team and strong board of directors.

Inherent risks

- The fund invests in equities. Equities are subject to strong price fluctuations and so are also exposed to the risk of price losses.
- Healthcare equities can be subject to sudden substantial price movements owing to market, sector or company factors.
- The fund invests in foreign currencies, which means a corresponding degree of currency risk against the reference currency.
- The price investors pay or receive, like other listed shares, is determined by supply and demand and may be at a discount or premium to the underlying net asset value of the Company.
- The fund may take a leverage, which may lead to even higher price movements compared to the underlying market.

Management Team

Paul Major
Portfolio Manager
since inception of the fund

Brett Darke
Portfolio Manager
of the fund since 2017

Awards

Sustainability Profile – ESG

Exclusions:	[X] Compliance UNGC, HR, ILO	[X] Controversial weapons
	[X] Norms-based exclusions	
ESG Risk Analysis:	[X] ESG Integration	
Stewardship:	[X] Engagement	[X] Proxy Voting

CO_2 intensity (t CO_2/mn USD sales):	30.0 t (low)	MSCI ESG coverage: 100%
MSCI ESG Rating (AAA - CCC):	A	MSCI ESG coverage: 100%

Based on portfolio data as per 30.12.2022 (quarterly updates) – ESG data base on MSCI ESG Research and are for information purposes only; compliance with global norms according to the principles of UN Global Compact (UNGC), UN Guiding Principles for Business and Human Rights (HR) and standards of International Labor Organisation (ILO); no involvement in controversial weapons; norms-based exclusions based on annual revenue thresholds; ESG Integration: Sustainability risks are considered while performing stock research and portfolio construction; Best-in-class: systematic exclusion of "ESG laggards"; MSCI ESG Rating ranges from "leaders" (AAA-AA), "average" (A, BBB, BB) to "laggards" (B, CCC). Note: in certain cases the ESG rating methodology may lead to a systematic discrimination of companies or industries, the manager may have good reasons to invest in supposed "laggards". The CO_2 intensity expresses MSCI ESG Research's estimate of GHG emissions measured in tons of CO_2 per USD 1 million sales; for further information c.f. www.bellevue.ch/sustainability-at-portfolio-level

Important information

This document is only made available to professional clients and eligible counterparties as defined by the Financial Conduct Authority. The rules made under the Financial Services and Markets Act 2000 for the protection of retail clients may not apply and they are advised to speak with their independent financial advisers. The Financial Services Compensation Scheme is unlikely to be available.

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