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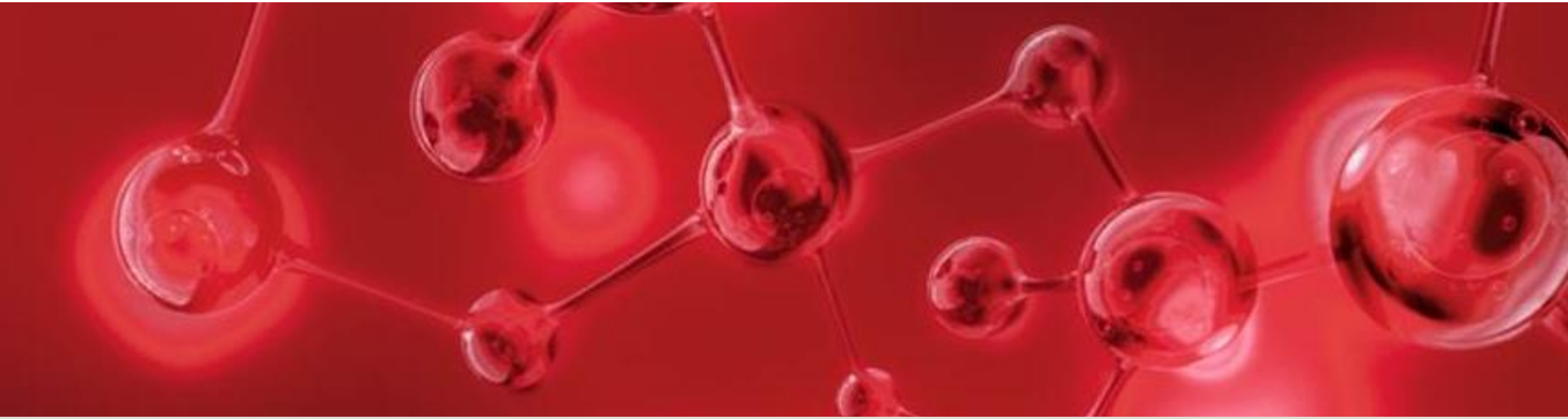
Kepler

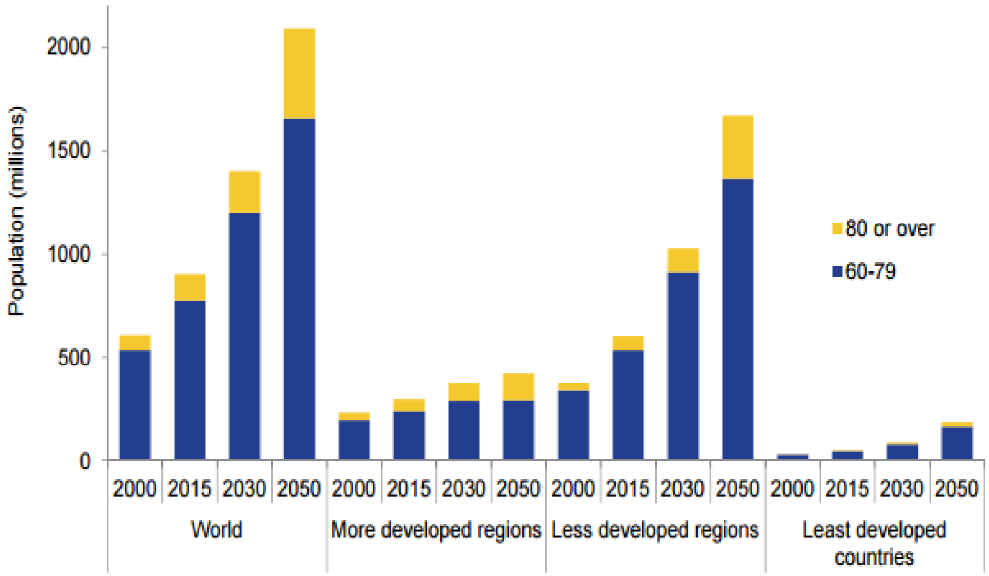


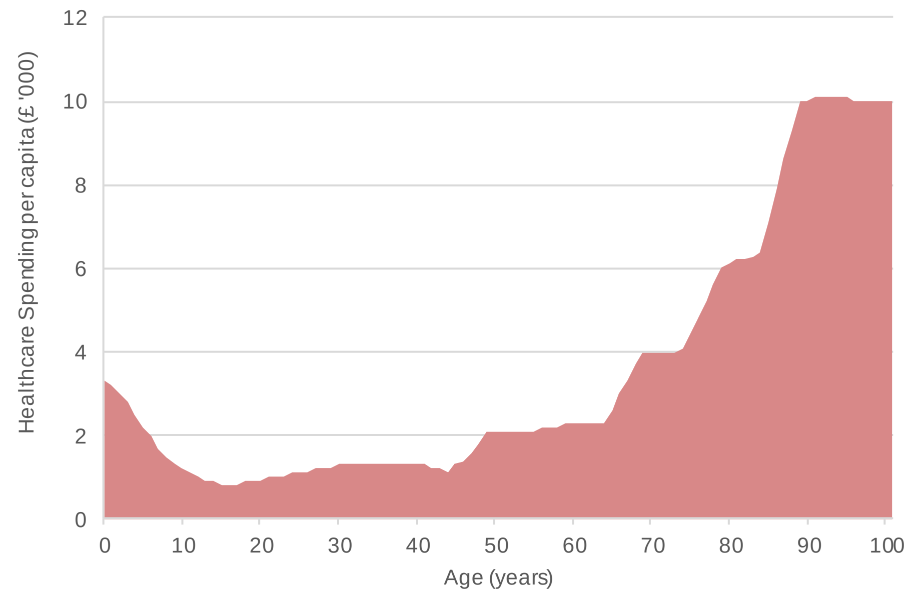
# *The Investment case for Healthcare and the wider implications of the COVID-19 pandemic*

February 2021

# *Healthcare: where else can one be certain demand will rise continually?*

*A growing and ageing population will sustain demand growth for the foreseeable future*




***The COVID-19 pandemic has not altered the wider demographic outlook, and thus the long-term demand picture for healthcare is unchanged. If anything, it has highlighted the need for greater investment in capacity and preventative medicine***

Sources: (LHS) United Nations (2015, includes projections). World Population Prospects: The 2015 Revision.
(RHS) United Kingdom – Office for Budget Responsibility, September 2016 publication.

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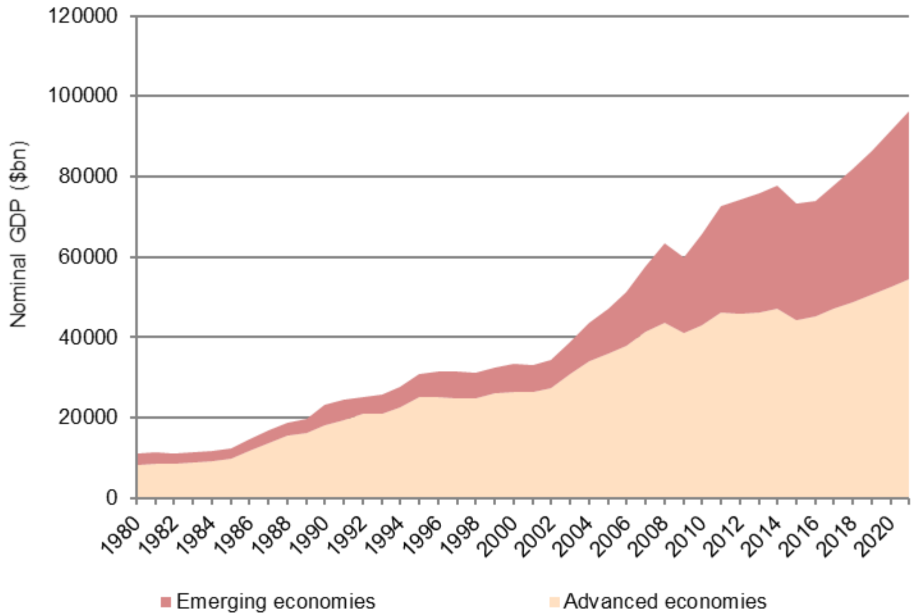
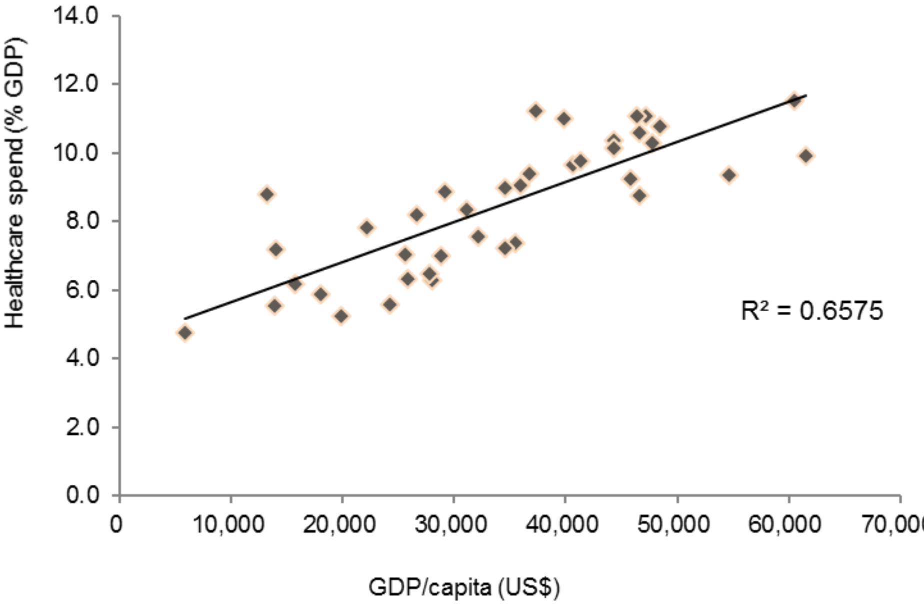
# Healthcare: a disproportionate beneficiary of rising wealth

*Once you have food in your belly and a roof over your head, you have time to worry about health*

**1 | The world is getting richer…**




**2 | GDP growth drives health spend…**




***Looking beyond the OECD, the economic trends in frontier markets are also very supportive for rising healthcare demand over the long term.***

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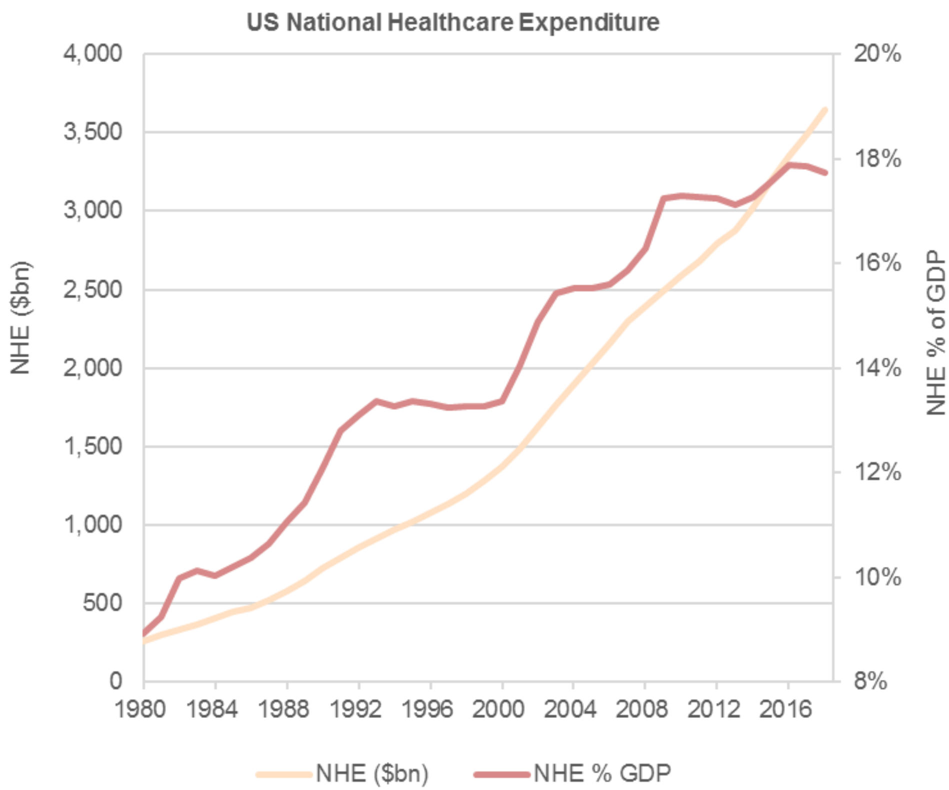
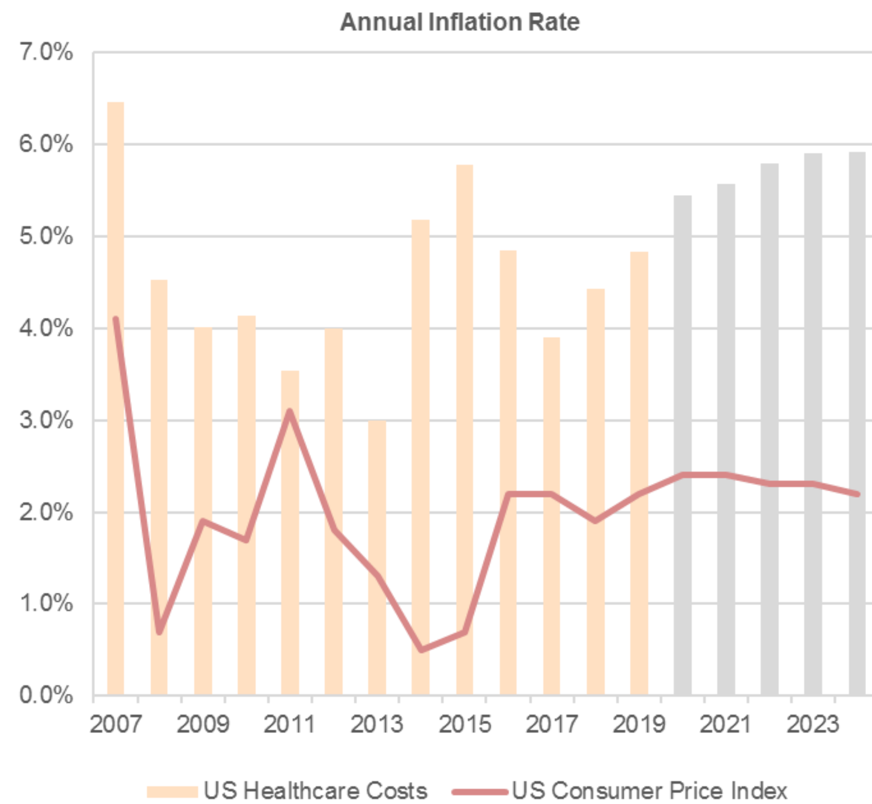
Sources: (1) IMF historical data and projections.
(2) OECD Stat database. GDP per capita and healthcare spending data is for 2015. US excluded since it is an outlier.

# *Sickness does not correlate with the economy; demand is inexorable*

*The upward growth in health spending has proven unstoppable. This will change, but slowly.*



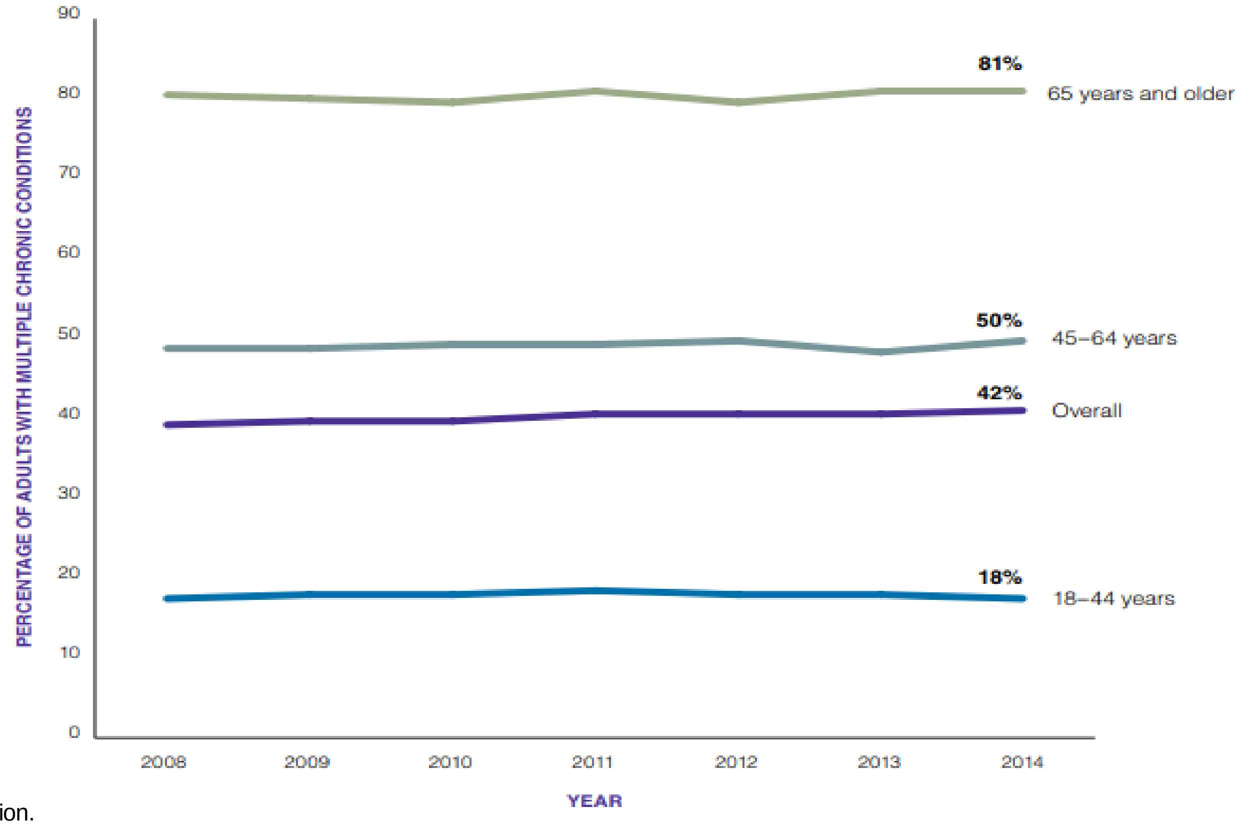




***Leaving aside the important point that society cannot afford ever rising healthcare costs, the simple fact remains that its characteristics support above GDP growth***

Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group.

# *Why is the cost of care so high and demand increasing relentlessly?*

*Because we can successfully address ever more complex medical needs*




Source: RAND Corporation.

***What do we do now? "the species that survives is the one that is able to adapt to and to adjust best to the changing environment in which it finds itself" – Charles Darwin***

# *BB Healthcare Trust – a different approach for a changing world*

*Investing into the inexorable change in the care paradigm*

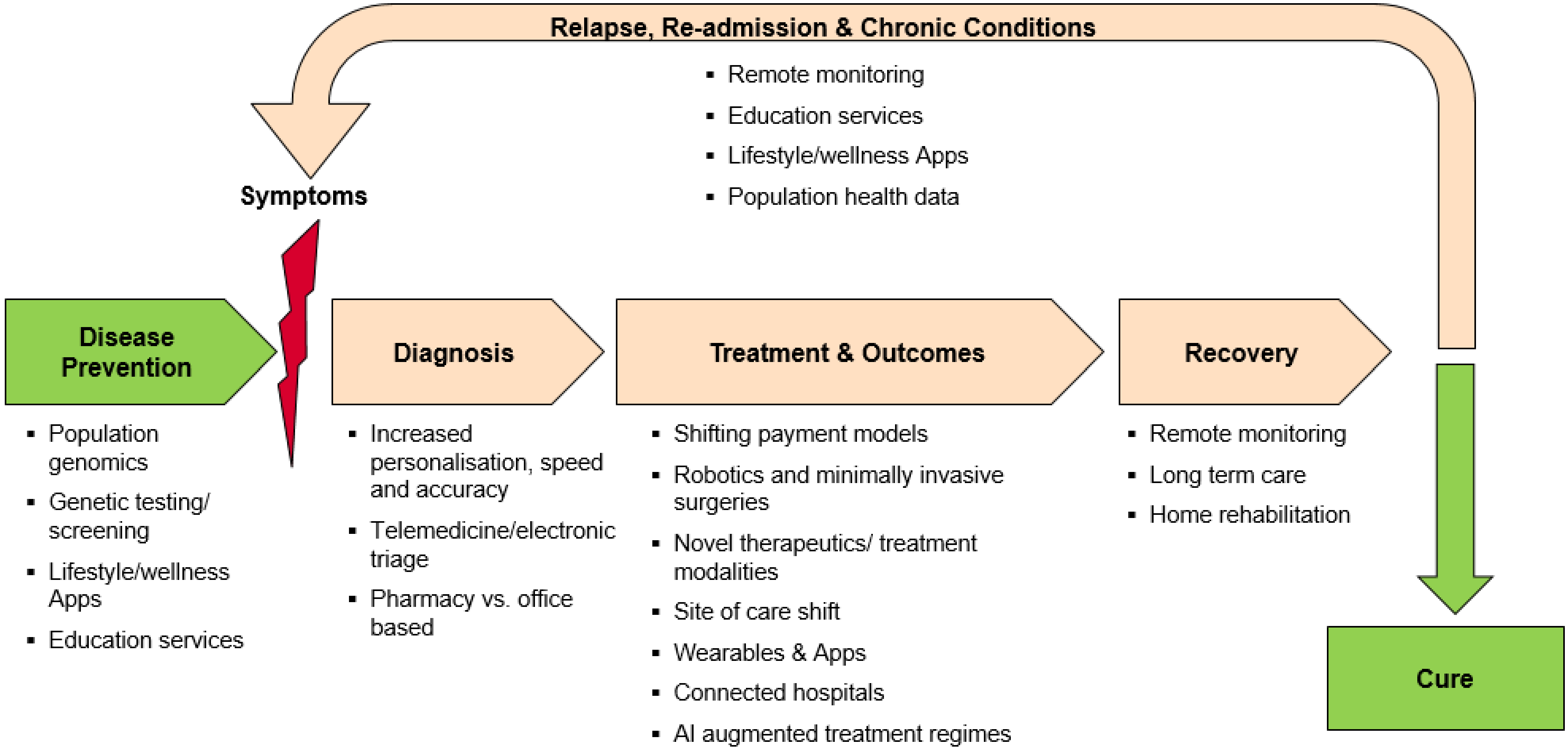
**We believe emphatically that healthcare provision is the secular growth story of our age, but that opportunity can no longer be viewed in isolation from the affordability crisis that all developed economies are now wrestling with. How does one best approach that from an investment standpoint?**

We set out a number of objectives when putting the Trust together:

- To create a concentrated, yet diversified and highly operationally geared portfolio of exposures to the areas of healthcare that would benefit from an inevitably changing paradigm (see next slide).
- To follow a long-term investment approach with relatively low portfolio turnover and to be unconstrained as to what we could own across geographies, sub-sectors and market-cap (i.e. bottom up, best ideas).
- To wrap this in a permanent capital vehicle using a best-in-class discount control mechanism (an annual redemption option), providing capital growth and the ability to pay a recurring dividend.
- To attract a highly skilled and engaged non-executive board and to maximise the alignments of their interests with those of shareholders through share-based compensation.
- Transparent investment mandate (highly liquid portfolio, no private companies) and competitive fee structure (95bps mgmt. fee, no perf fees).
- To deliver, over the longer-term, sector leading returns for our investors.

# Fixing healthcare – where to invest?

*BBH's portfolio aims to provide exposure to key aspects of tackling the cost challenge*




Source: Bellevue Asset Management.

# *These innovations won't be coming from the likes of Glaxo…*

*How a selection of BB Healthcare's investments address the need for system change*

**Novel therapeutics/ treatment modalities**

ESPERION The Lipid Management Company
insmed
Alnylam PHARMACEUTICALS
Bristol Myers Squibb
align
VERTEX

**Increased diagnostic personalisation, speed and accuracy**

CareDx
GenMark Dx
illumina

**Connected hospitals**

Hillrom
PHILIPS

**Telemedicine/ electronic triage**

Teladoc HEALTH

**Shifting payment models**

evolent HEALTH
Anthem
Humana

**Remote monitoring & wearables**

dexcom CONTINUOUS GLUCOSE MONITORING
fitbit

**Robotics, MIS & AI augmented treatment regimes**

INTUITIVE
WRIGHT

**Improving system efficiency**

Lonza
charles river

**Population genomics and screening**

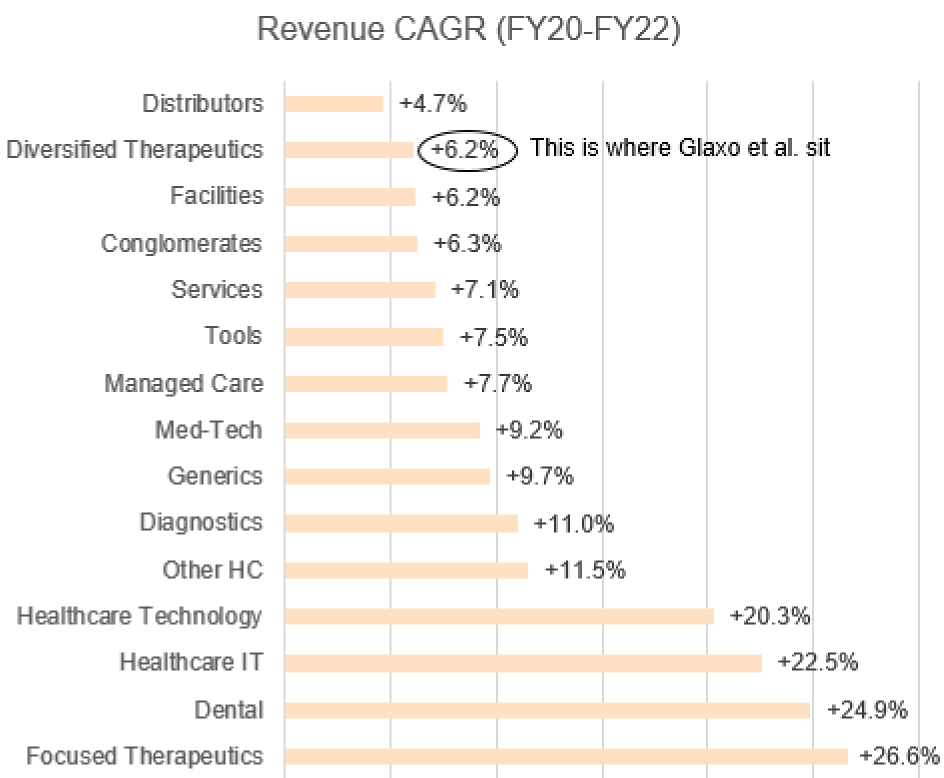
PACBIO
illumina

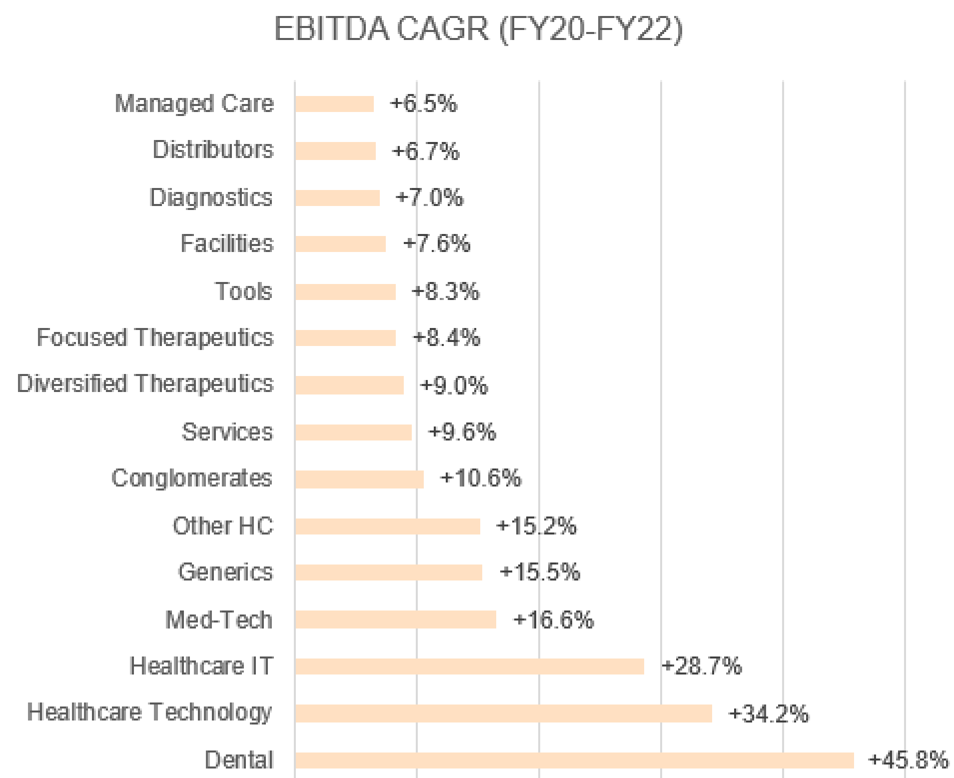
## *Our investments readily address multiple areas of the cost challenge*

Source: Bellevue Asset Management.
Note: Not all of the companies above are included in the current BBH portfolio, but have all been holdings of BB Healthcare Trust at various points during its life.

# *Innovating to solve the cost problem opens up myriad opportunities*

*Growth is pivoting away from 'classical' areas toward new approaches*




***All other factors being equal, it is a truism that higher growth sub-sectors should deliver substantially higher total returns over time***

Source: MSCI and Bloomberg. Data as of 11 January 2021.

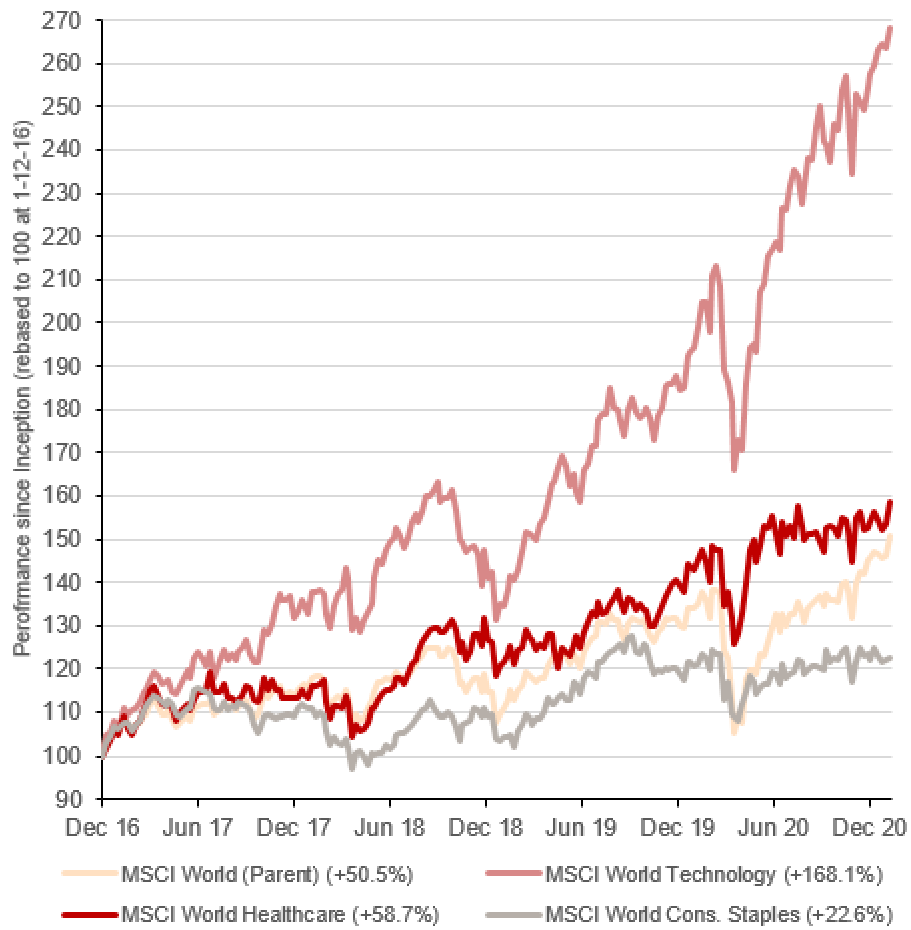
# How are we doing? BB Healthcare's performance

*We have delivered against our stated performance targets*

FE fundinfo Crown Fund Rating

| % Total Return(1) | Since Inception | Rolling 3 Year | Rolling 3 Year (annual eq.) | Calendar YTD |
|---|---|---|---|---|
| BBH Share Price | 113.8% | 95.0% | 24.9% | 7.9% |
| BBH NAV | 112.1% | 93.0% | 24.5% | 8.2% |
| Benchmark | 68.0% | 50.9% | 14.7% | 1.3% |
| | | | | |
| **Relative to b.m.** | | | | |
| BBH Share Price | +45.8% | +44.1% | +10.2% | +6.6% |
| BBH NAV | +44.1% | +42.1% | +9.8% | +6.9% |

- The Trust has two specific return objectives (as disclosed in the Annual Report) which are:
  - To beat the total return of the MSCI World Healthcare Index (in sterling) on a rolling 3 year period. ✓
  - To seek to generate a double-digit shareholder return per annum over a rolling 3 year period. ✓
- Since Q3 '19 our net financial leverage has been below our stated longer term average of between 5 and 10% of NAV due to elevated macro uncertainties.

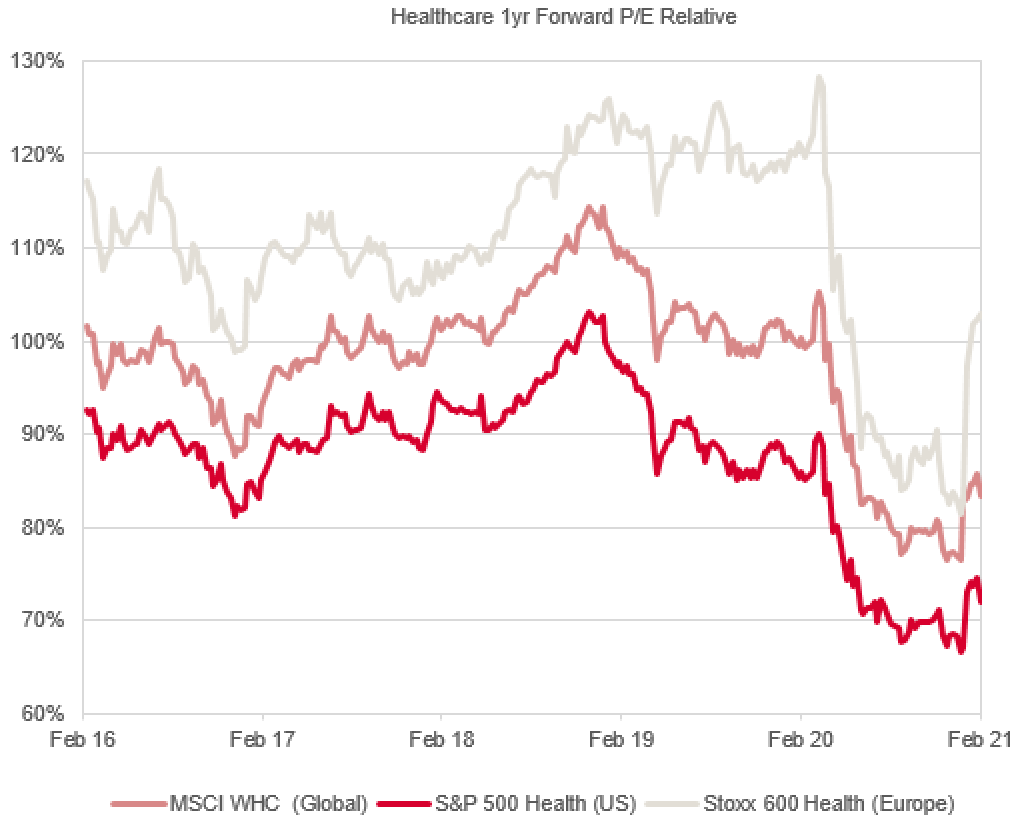


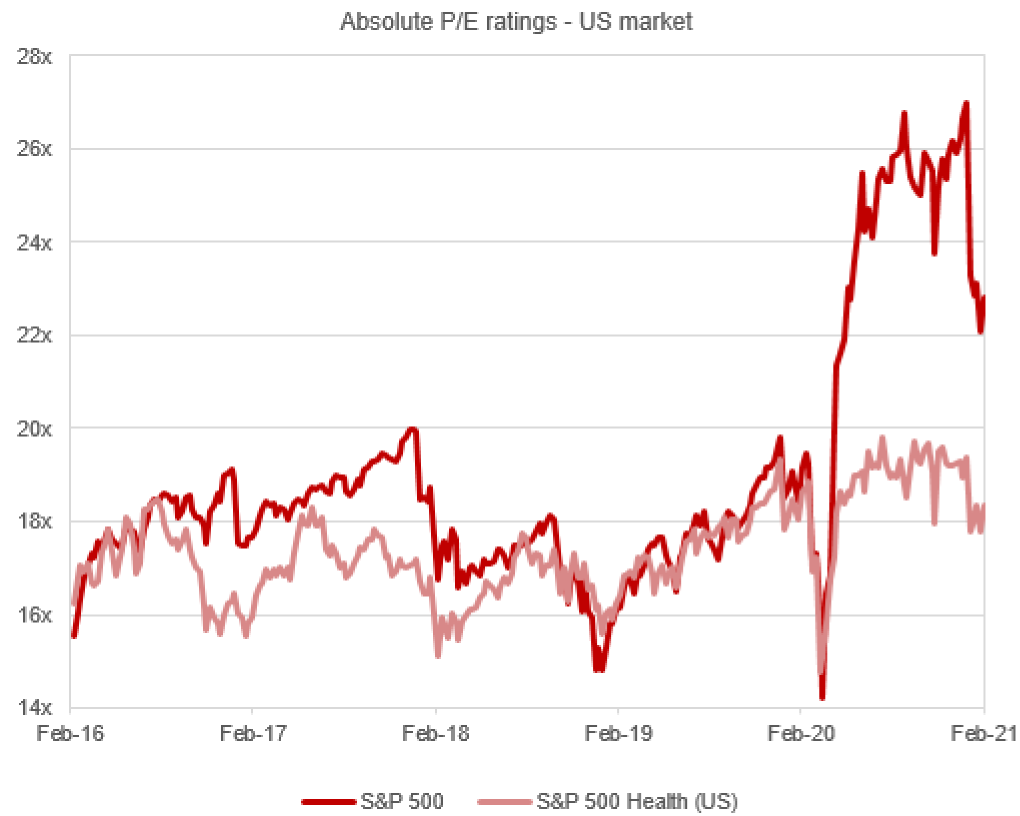

(1) Source: Bloomberg. All performance figures are calculated as total return with dividends being reinvested in the relevant security, calculated in GBP and with the relevant period ending on 5 February 2021.

(2) Source: Bellevue Asset Management. Financial leverage is calculated as at month end. Average calculated as the arithmetic average since inception on 1 December 2016, currently being 2.4%.

# Valuations (1) - relative continues to be very supportive

*Positive long-term fundamentals intact, but healthcare not insulated from near-term challenges*




***US relative valuation remains very attractive versus the wider marketplace being driven by the significant re-rating of a narrow set of tech companies***

Source: Bloomberg. Data is 5 years to 5 February 2021. Relative to MSCI World, S&P 500 and Stoxx 600 Indices.
Average relative figures last 5 & 10 years - EU: 110% & 111%, US: 87% & 94%, Global: 98% & 102%.

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# *Today's Macro environment at a glance*

*Brexit is "done" & Trump is gone, but the bedevilling macro of COVID-19 is far from over*

- **The glass is half full:** COVID mortality has declined, vaccines are here and we will soon have vaccinated the vulnerable, allowing restrictions to begin to be eased. Government stimulus and support will allow the economy to rapidly recover. We could see re-opening underway in Q2 and a rapid GDP acceleration in H2 21.
  - **Buy, buy, buy:** This backdrop, allied to historically low bond yields and uncertainty over asset classes such as commercial property (what is the future of retail & office spaces?) makes equities the place to be for the coming year. You want to be pro-cyclical, risk-on.
- **The glass is half empty:** The pandemic is far from over. Both bonds and equities are very expensive relative to history and there is little room for disappointment. The assumption of rapid vaccination supporting rapid re-opening is now a broad consensus and thus priced in, so the risk is to the downside. We could see downward revisions to GDP forecasts in the coming months, pressuring equities. COVID 'Wave 4' in late 21/early 22 is likely, but morbidity hard to predict (could be low)
  - **Hedge hedge hedge:** Equities may do well in the near term, but a balanced approach to risk appetite and GDP/economic sensitivity is warranted. Invest in the same stocks and sectors in 2021 as you did in 2020, at least for now.

***Simply put: if you are investing in equities today, you are to a large extent playing this re-opening trade. This begs a number of beguilingly simple questions: How much 'normalisation' do you think the market is currently pricing in? Are you happy with that? Is the risk to that on the upside or the downside?***

# COVID-19 Vaccination drive

## What do we know?

- As of today, there is peer reviewed data in leading medical journals on four vaccines and preliminary data on a further two:

| SARS-CoV-2 Vaccines | | | | | |
|---|---|---|---|---|---|
| | | Cold | Approved | | |
| | Doses | Chain | US | EU | UK |
| Astra/Oxford | 2 | Normal | - | ✓ | ✓ |
| Pfizer/ BionTech | 2 | Ultra Cold | ✓ | - | ✓ |
| Moderna | 2 | Cold | ✓ | - | ✓ |
| Sputnik V | 2 | Normal | - | - | - |
| J&J(1) | 1 | Normal | Awaiting approval | | |
| Novavax | 2 | Normal | Awaiting submission | | |

- Of these six, five have primary efficacy >80% (J&J only 68%) against canonical SARS-CoV-2 ("D614 & D614G"), which is excellent (flu vaccine efficacy ~65% in a good year).
- All have shown reduced efficacy against the 'Kent' ("B117") and newer "variants of concern"; with "E484K", "N501Y," "K417N or T" mutations. Novavax efficacy >80% for Kent variant.
- E484K + 501 and 417 variation: efficacy looks too low for comfort with all these vaccines and a new vaccine will be needed ASAP.
- Across the vaccinated cohorts for clinical trials of all these vaccines, there are ZERO confirmed cases of hospitalisation or death from COVID-19.
- Vaccines are designed to protect the vaccinated. Thus far, the evidence on the reduction of transmission is unclear, but the body of evidence is growing. Until there is clarity, the herd immunity concept is not valid and social distancing will remain important.
- Potential issues around variant "booster" vaccinations such as antigenic sin that mean these things are not certain to work. As such, these strategies will need to be evaluated in clinical trials. Completing these will take us to a Q4 21 rollout timeframe.

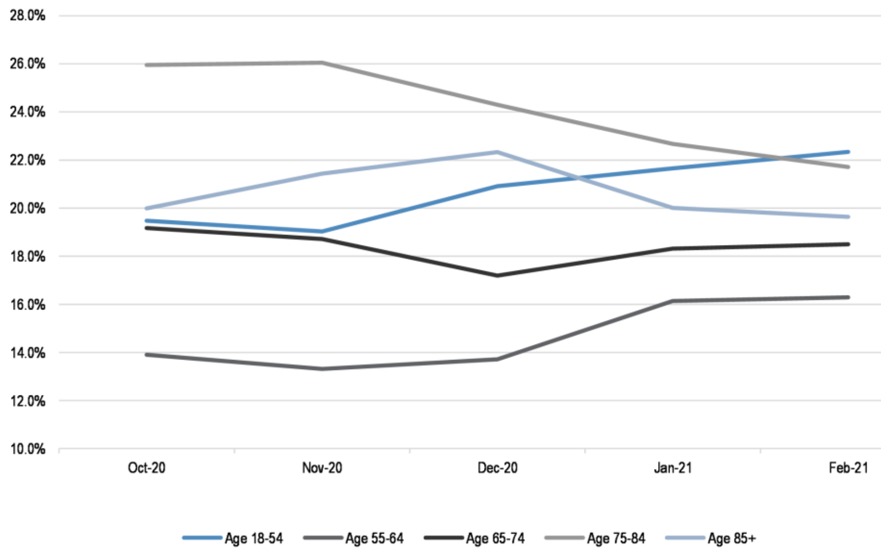
***These vaccines can eliminate symptomatic disease and thus turn SARS-CoV-2 into a manageable pathogen. However, we can't pop the champagne just yet…***

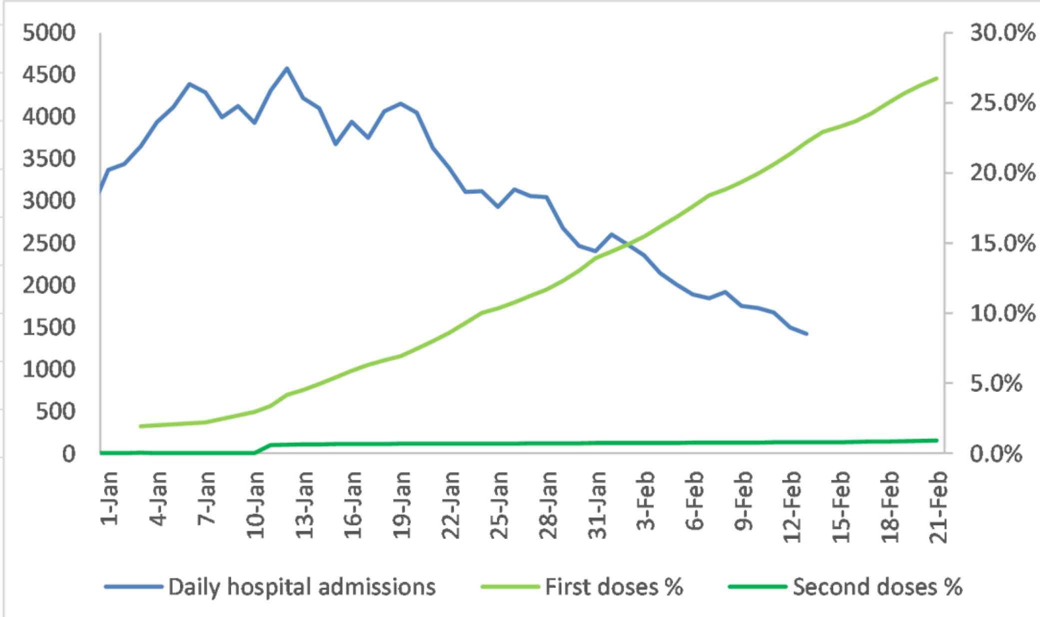
(1) Two dose version under evaluation to boost efficacy.

# COVID-19 Vaccination drive

## *Early signs on key morbidity parameters in the UK*

- Lockdown impact may well be responsible for the inflection in the charts, but it arguably affects all age groups equally (or are the elderly more likely to follow rules?) and thus cannot fully explain the separation in the charts for hospitalisation:




- Ergo, vaccinations look to be having a positive impact on the burden of disease, which is what we need. Ultimately, asymptomatic or mild infections do not matter and we can all live with those. Data from Israel is similarly positive/supportive,

- How quickly we can come out of all of this in part depends on media and politicans focusing on what matters – illness not cases. A world of ongoing COVID cases but minimal hospitalisations and deaths is fine. A world free of COVID is simply not a realistic goal.

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# COVID-19 Vaccination drive

## *What should we worry about?*

- Around one third of the population in developed countries is over 50, and it is around 25% for the world as a whole. That is ~1.7bn people who are obviously clinically vulnerable to COVID-19. These people will require 3.4bn shots in the near-term. There simply is not enough vaccine available for this to be a realistic prospect in 2021.Thus, we will continue to see elevated rates of hospitalisation and death in various countries for some time to come.
  - International pressure to share vaccine allocations once the over 50s are “done” will increase. As we have seen with EU, this could get politically ugly.

- Variant strains will continue to emerge; this virus is still adapting to humans. If vaccination cannot go faster than evolution then we will lose the race; already likely that Astra/Oxford recipients will get an interim Kent/SA booster, probably before end 2021.
  - Variant risk is going to place significant pressure on international travel; foreign holidays may be tricky.
  - That said, variants are massively overplayed by the media; really don’t worry about these overmuch from health/risk POV.

- Leaving aside “escape mutations” like SA variant, we have no idea how long vaccinations convey protection for. Renewed COVID waves in the next few years cannot yet be ruled out.

- Regardless of the reality (99%+ of all COVID cases are non-fatal and long-COVID is very real but the risk is still not quantified), people are scared of this bug. Normality can only return IF people are willing to re-engage with pre-pandemic norms. They will need to feel reassured. This means materially lower reported cases, hospitalisations and deaths. How much lower does it need to go? We don’t really know and much depends on the media (god help us all).

***SARS-CoV-2 vaccination likely to become a recurring event, with multivalent shots against emerging variants of potential concern, possibly combined with flu shots***

# Our conclusions

*In our hearts, we want to believe that normality is just around the corner but our heads say 'no'*

- **Its obvious why people want to be bullish**: this has been an execrable 12 months for many and we are social creatures at heart. Wanting something to be so sadly does not make it so.
- **Real yields are now less than zero and many classes of property assets have significant uncertainties in a post pandemic world**: if you are not a bull of equities, then what else is left to invest in? Plus, there is the seemingly unending flow of fiscal stimulus to support markets.
- **In a historical context, the price of growth for the overall market is not cheap:** That does not mean a correction is imminent, but it is surely something to be mindful of if there are risks of disappointment around the timing and execution of a 'return to normal'.
- **That said, healthcare has never looked cheaper on a relative basis versus the wider (now very technology led market) <u>and</u> it is one of the few sectors where we can be very confident of revenue and earnings growth in 2021.**
- **The question then is a simple one: how much 'normalisation' do you think the market is currently pricing in?** Is the risk to that on the upside or the downside?
- **Rather than being fully pro-cyclical, risk-on and eschewing defensives, we think allocating some capital to defensive areas like healthcare still makes sense in 2021, especially if you are riding the multi-decade theme of profound change (as we are at BBH) rather than simply playing the demographic volume trend.**

***We continue to see opportunities to make positive returns in the short-term as the market transitions to a post-COVID mindset. Turning to the long, term, healthcare demand growth is intractable, since it is demographically driven***

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