Aberdeen Asian Income Fund

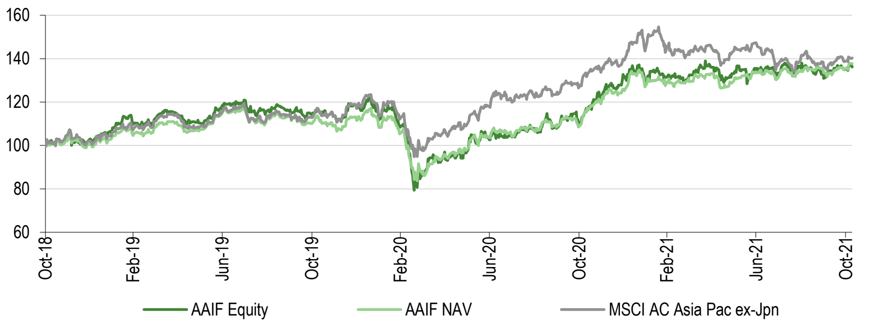
A winning dual investment strategy

Investment trusts
Asia Pacific income

10 November 2021

With a focus on income and growth, Aberdeen Asian Income Fund's (AAIF) dual investment strategy has proved successful. The team targets the income and growth potential of Asia's most compelling and sustainable companies. AAIF's 4.1% yield is competitive with its four Asian income peers. The focus on high-quality businesses creates a relatively defensive tilt in regional equities. Over the past 12 months (to end-October), AAIF posted a 24.3% NAV total return, outperforming peers and both the broad and high dividend yield indices, by 13.5pp and 7.7pp, respectively. AAIF's team believes the fund's focus on quality has helped deliver a consistently robust performance during the pandemic (see chart below).

AAIF's performance relative to the MSCI AC Asia Pacific ex-Japan Index



Source: Refinitiv, Edison Investment Research

Why invest for income in Asia and choose AAIF?

Income seekers can gain core exposure to the Asian consumption-driven growth story complemented by structural dividend growth. Following the 12th consecutive year of dividend growth in FY20 and an improving trend for income in its portfolio companies, the board aims to at least maintain the dividend in FY21. The FY20 dividend of 9.3p per share (up 0.5% year-on-year) was c 80% covered by portfolio income. At end June 2021, the company's revenue reserve was c 70% of the annual dividend payment. The board is committed to a progressive dividend policy.

The analyst's view

The abrdn team is known for its quality stock-picking approach and value tilt. Followed by the team since the company's launch in December 2005, this quality approach served investors well during a challenging 2020, protecting on the downside. The outperformance has continued into 2021, against a backdrop of increasingly negative sentiment towards Asian markets on the back of regulatory measures across a number of corporate sectors in China, particularly technology, property and education. This has contributed to AAIF's cum-fair discount widening to 12.9% compared to its three-year average of 9.6%. We believe there is scope for this to narrow, if investors rotate into quality and value. In addition, the commercial robustness and financial strength of portfolio investees should support AAIF's future dividend payout.

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Price	**226.5p**
Market cap	**£396.1m**
AUM	**£491.7m**

NAV*	259.0p
Discount to NAV	12.6%
NAV**	260.2p
Discount to NAV	12.9%

*Excluding income. **Including income. As at 8 November 2021.

Yield		4.1%
Ordinary shares in issue		174.9m
Code		AAIF
Primary exchange		LSE
AIC sector		Asia Pacific Income
52-week high/low	237.0p	201.0p
NAV high/low	263.4p	225.9p

Gearing

Net gearing at 5 November 2021	7.4%

Fund objective

Aberdeen Asian Income Fund (AAIF) aims to provide investors with a total return primarily through investing in Asia-Pacific securities, including those with an above-average yield, as well as to grow its dividends. Performance is measured against the MSCI AC Asia Pacific ex-Japan Index and the MSCI AC Asia Pacific ex-Japan High Dividend Yield Index (both in sterling terms), but no formal benchmark is used.

Bull points

- Diversified by sector and geography, the income strategy is managed by one of the most experienced Asia-based investment teams.
- Outperformed the MSCI AC Asia Pacific ex-Japan High Dividend Yield Index over both the short and long term.
- Strong revenue (over 50% of full-year dividend) and capital reserves support continued dividend growth.

Bear points

- The conservative quality approach resulted in a bottom-half ranking in the Asia income peers over the medium term.
- Wider than peers' discount.
- The income-focused strategy might lag non-yielding growth funds in bull markets.

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Edison profile page

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The manager's view

The abrdn Asian team is currently finding plenty of yield-generating opportunities from quality names in the region. Although the investment director Yoojeong Oh highlights a number of key risks such as renewed COVID-19 outbreaks, regulatory pressures – particularly from China – and inflation fears, she considers them manageable. The team expects dividend payouts to increase, with corporate earnings growth rebounding this year, led by the technology hardware sector. AAIF holds a number of market-leading companies in the sector, including TSMC and Samsung Electronics, and the team is optimistic about the dividend outlook for the portfolio in FY21.

She highlights that Asia has not seen inflation to the same extent as many developed markets are starting to experience. Asian countries did not loosen their monetary policy to the extent that developed markets did. Oh believes that the easing of the pandemic and full reopening of Asian economies will be a trigger for increased inflation. She believes that if inflation does pick up in Asia, AAIF's investment policy of holding companies with strong balance sheets, low debt and pricing power should leave the portfolio well placed for continuing outperformance. Oh explains that on the contrary, higher rates would benefit stronger financial stocks, including banks and insurers, where AAIF also has exposure (see portfolio section below).

The manager seeks high-quality companies with strong balance sheets, sustainable cash flow generation and the ability to support consistent growth in both profits and dividends, and these may be found across a range of markets. These businesses capture structural shifts in technology, healthcare, urbanisation and infrastructure investment trends, as well as demand from Asia's burgeoning middle class for wealth management and investment services.

Portfolio

At end-September 2021, the portfolio had 61 holdings, the majority of which are steady income generators.

Exhibit 1 illustrates the active stock-picking strategy, as the portfolio remains differentiated relative to the MSCI AC Asia Pacific ex-Japan Index. China combined with Hong Kong has been underweight throughout the life of the fund and remains the largest underweight by 24.8pp relative to the MSCI AC Asia Pacific ex-Japan Index.

Exhibit 1:Portfolio geographic exposure versus the index* (% unless stated)

	Portfolio weight			MSCI AC Asia Pacific ex-Japan	
Country/region	**30 September 2021**	**30 September 2020**	**Change (pp)**	**30 September 2021**	**Versus index (pp)**
Taiwan	20.3	16.5	3.8	14.5	5.8
Australia	18.2	17.2	1.0	14.5	3.7
Singapore	15.9	16.2	(0.3)	2.0	13.9
China	10.1	11.8	(1.7)	33.1	(23.0)
Korea	9.5	11.1	(1.6)	12.8	(3.3)
Thailand	6.1	6.9	(0.8)	1.7	4.4
India	6.5	5.4	1.1	11.4	(4.9)
Hong Kong	4.5	4.2	0.3	0.5	(1.8)
New Zealand	4.4	4.3	0.1	6.3	3.9
Japan	1.9	2.6	(0.7)	0.0	1.9
Indonesia	1.0	0.7	0.3	1.2	(0.2)
Malaysia	0.1	1.8	(1.7)	1.3	(1.2)
Philippines	0.0	0.0	0.0	0.6	(0.6)
Other	0.0	0.3	(0.3)	0.0	0.0
Cash	1.5	1.0	0.5	0.0	
Total incl. cash	**100.0**	**100.0**		**100.0**	

Source: AAIF, MSCI, Edison Investment Research. Note: *MSCI AC Asia Pacific ex-Japan Index.

The absence of zero-yielding Chinese internet stocks from the portfolio has protected it from recent market downturns. In particular, it did not and does not invest in Alibaba and Tencent. In combination, these two companies accounted for more than 7% of the MSCI AC Asia Pacific ex-Japan Index at end-September 2021 (see Exhibit 2) and have fallen by 43% and 17%, respectively, over the past year.

The Chinese names that AAIF invests in, albeit outside its top 10 holdings, include those perceived by the team to be quality property companies: China Resources Land (2.0% weighting at 30 September 2021), China Vanke (0.8%) and Ping An Insurance (0.5%). Oh explains that China Resources Land and China Vanke are blue-chip names in AAIF's portfolio, with strong balance sheets and relatively low debt. Both these companies fund their developments from profits on the existing real estate portfolio, and hence the team considers them to be prudent investments. The manager highlights the focus by China Resources Land on environmental, social and governance (ESG) practices, including respecting minority shareholders. Oh noted that the investee managers were forward thinking and early adopters of ESG best practice in consultation with abrdn. China Resources Land is trying to get an MSCI ESG rating that would, in its view, add to its credibility and improve its investment profile in the eyes of both Chinese and foreign investors.

Exhibit 2: Top 10 holdings versus the MSCI Asia Pacific ex-Japan Index

Company	Country	Industry (GICS)	Portfolio weight % 30-Sept-21	Top 10 index*	Country	Industry (GICS)	Index weight 30-Sep-21
TSMC	Taiwan	Information technology	8.3	TSMC	Taiwan	Information technology	6.3
Samsung Electronics (pref)	South Korea	Information technology	7.2	Tencent	China	Communication services	4.2
AusNet Services	Australia	Utilities	3.6	Samsung Electronics	South Korea	Information technology	3.7
Momo.com	Taiwan	Consumer discretionary	3.5	Alibaba	China	Consumer discretionary	3.4
Oversea-Chinese Banking Corporation	Singapore	Financials	3.4	AIA Group	Hong Kong	Financials	1.7
Venture Corporation	Singapore	Information technology	3.1	Commonwealth Bank of Australia	Australia	Financials	1.7
DBS Group	Singapore	Financials	3.0	Meituan Dianping	China	Consumer discretionary	1.6
BHP Group	Australia	Materials	2.5	Reliance Industries	India	Energy	1.2
LG Chemicals	South Korea	Materials	2.4	CSL	Australia	Healthcare	1.8
Infosys	India	Information technology	2.3	BHP Group	Australia	Materials	1.0
Top 10 (% of holdings)			**39.3**				**26.6**

Source: AAIF, MSCI. Note: *MSCI Asia Pacific ex-Japan Index.

Singapore is AAIF's largest country weighting compared to the MSCI AC Asia Pacific ex-Japan Index (13.9pp, see Exhibit 1). The team continues to own three Singaporean banks (Oversea-Chinese Banking Corporation, DBS Group, within the top 10 holdings, 3.4% and 3.0% respectively, and United Overseas Bank (1.6%) – outside the top 10). Historically, the team has highlighted the quality of the Singaporean businesses it picked for AAIF, and the business cases for the investees stand. The team correctly anticipated that the banks' dividends would be restored in 2021, as all three banks did. Another notable Singaporean holding is Venture (top 10, 3.1%), a leading contract manufacturer in the electronics space. It supplies machine components to Illumina, a leading Singaporean research and genome sequencing company. Venture was one of the companies that raised dividends in 2020, being a beneficiary of supply chain outsourcing; it continues to pay a dividend in 2021, and the abrdn team expects it to be at a similar level to the 2020 dividend payment.

Taiwan (20.3% of the portfolio) and Australia (18.2%) remain two countries with the largest weightings in the portfolio, as their listed companies continue to offer a good selection of high dividend paying stocks. BHP (top 10, 2.5%) and Rio Tinto (1.9%), both diversified miners benefiting from their exposure to China, AusNet Services (top 10, 3.6%), an energy delivery service provider, and Commonwealth Bank of Australia, a diversified bank, are among selected Australian businesses. Momo.com (top 10, 3.5%), a Taiwanese consumer-focused e-commerce services company, has been a strong performer for AAIF (see the performance section on page 4). India

(6.5%) is the second largest underweight (4.9pp) to the MSCI AC Asia Pacific ex-Japan Index, as the team finds more dividend growth stocks elsewhere in Asia.

Performance

AAIF outperformed the MSCI AC Asia Pacific ex-Japan HDY Index (arguably a better comparator for AAIF than the broad market index due to the company's high-income focus) over all the periods shown, on a net asset value (NAV) total return (TR) basis, as Exhibit 4 shows. The company recovered better than the MSCI AC Asia Pacific ex-Japan Index from the March 2020 lows and outperformed both indices in the 12 months to end-October 2021, posting 24.3% NAV TR. Solid performances from differentiated high-conviction stocks across the technology field, including Samsung (7.2% of the portfolio at end-September 2021 vs 3.7% in the index), Momo.com (3.5%), Venture Corporation (3.1%) and Infosys (2.3%), contributed materially to outperformance.

Exhibit 3: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI AC Asia Pacific ex-Japan (%)	MSCI AC Asia Pacific ex-Japan HDY (%)
31/10/17	10.7	11.8	17.7	12.5
31/10/18	(8.5)	(5.3)	(8.4)	(2.5)
31/10/19	14.4	10.1	12.8	7.9
31/10/20	(3.7)	(1.5)	12.2	(8.4)
31/10/21	22.5	24.3	9.5	15.4

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

The company's NAV consistently outperformed the MSCI AC Asia Pacific ex-Japan HDY Index over one, three and six months as well as one-year and three-year periods, on a TR basis, as Exhibit 4 illustrates.

Exhibit 4: Share price and NAV TR performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI AC Asia Pac ex-Jpn	0.3	(0.0)	4.0	11.9	(2.6)	(8.6)	(15.3)
NAV relative to MSCI AC Asia Pac ex-Jpn	(0.6)	1.7	6.3	13.5	(2.7)	(4.5)	(1.5)
Price rel to MSCI AC Asia Pac ex-Jpn HDY	1.9	(0.6)	2.4	6.2	18.3	9.2	(1.2)
NAV rel to MSCI AC Asia Pac ex-Jpn HDY	1.0	1.2	4.7	7.7	18.2	14.0	14.8

Source: Refinitiv, Edison Investment Research. Note: Data to end-October 2021. Geometric calculation.

Relative to the other four Asia-Pacific income peers, shown in Exhibit 5, AAIF has seen the highest NAV TR over the year to end-October 2021. Its defensive and dual income and growth strategy has protected investors' returns during the volatile markets in Asia over the past 12 months. AAIF's NAV TR also exceeds the sector average and both MSCI AC Asia Pacific ex-Japan and MSCI AC Asia Pacific ex-Japan HDY indices over one year. A lower China weighting as well as ownership and overweight positions in more balanced technology companies were beneficial to its performance relative to peers, who were more exposed to aggressive technology stocks and China. Two high beta top 10 JPMorgan Asia Growth & Income (JAGI) and Invesco Asia Trust (IAT) holdings, Alibaba and Tencent, have corrected in the past 12 months amid a significant sell-off of Chinese stocks. This followed previous strong outperformance of China tech. AAIF ranks third by NAV TR over three and five years, behind these two trusts.

Exhibit 5: Country specialist – Asia Pacific equity income peer group

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 years	NAV TR 5 years	NAV TR 10 years	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield (%)
Aberdeen Asian Income	**396.1**	**24.3**	**35.7**	**43.6**	**138.2**	**1.0**	**No**	**(13.1)**	**107**	**4.0**
Henderson Far East Income	449.5	9.4	12.5	17.5	101.0	1.1	No	(0.9)	105	7.9
Invesco Asia Ord	241.3	19.3	49.1	61.9	198.4	1.0	No	(9.1)	100	4.2
JPMorgan Asia Growth & Income	440.6	9.7	43.6	68.8	176.7	0.7	No	(1.7)	102	4.2
Schroder Oriental Income	698.7	18.8	32.7	37.6	176.6	0.9	Yes	(5.6)	103	4.0
Sector average (5 funds)	**445.2**	**16.3**	**34.7**	**45.9**	**158.2**	**0.9**		**(6.1)**	**103**	**4.8**
Rank in sector	**4**	**1**	**3**	**3**	**4**	**2**		**5**	**1**	**5**

Source: Morningstar, Edison Investment Research, Bloomberg. Note: Performance data to 31 October 2021 based on cum-fair NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Dividend policy and record

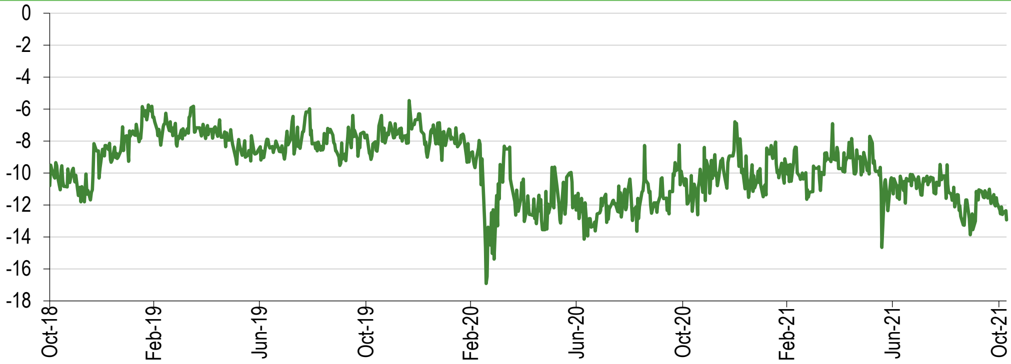
The investment philosophy of AAIF's management team is to find good quality companies that offer both capital growth and an attractive dividend yield over the long term.

On 12 October 2021 the company announced a third interim dividend for the financial year ending 31 December 2021 of 2.25p per share. The total dividend for H121 (ending 30 June 2021) amounts to 4.5p (H120: 4.5p). In the absence of unforeseen circumstances, the board intends to at least maintain the dividend of 9.3p per share paid in FY20, in respect of FY21 (to 31 December 2021). A decision on the level of the fourth interim dividend will be made post the period end, in January 2022.

The board remains keen to continue AAIF's long-term record of dividend growth and aims to use reserves, accumulated since the launch of the company, where necessary (£244.8m of capital reserves and £11.4m of revenue reserves, equal to approximately 0.7x annual dividend payment, at end-June 2021).

Valuation: Affected by sentiment

Exhibit 6: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Having recovered from a decade-high discount to cum-income NAV of 16.9% in March 2020, AAIF has traded at an average discount of c 10.4% over the past 12 months. This is 0.8pp wider than the three-year discount average of 9.6%. We believe the recent widening of the discount was caused by the deteriorating sentiment towards Asian stocks, in the light of the latest regulatory events in China. Nevertheless, the relatively low exposure of AAIF to China, coupled with its strong performance over the past 12 months, could see the discount narrowing. The board regularly buys back shares to help manage the discount and has repurchased c 0.9m shares so far in FY21, at a cost of c £2.1m.

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