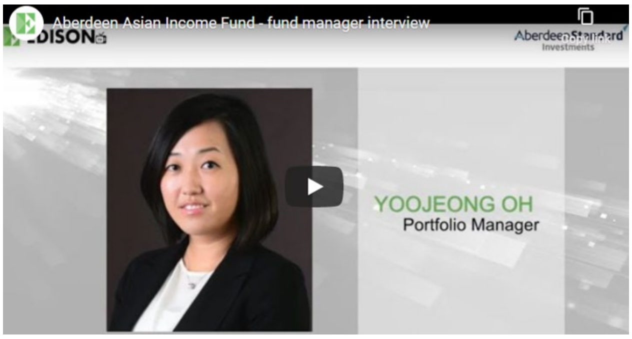
Aberdeen Asian Income Fund

Benefiting from focus on quality and income

Investment companies
Asia Pacific income

Aberdeen Asian Income Fund (AAIF) has recovered well from the widespread market sell-off driven by the coronavirus pandemic, although its focus on quality stocks with attractive dividends has held back returns relative to the broad Asian index, which is increasingly dominated by non-yielding Chinese internet companies. Portfolio manager Yoojeong Oh says the team has ridden the technology wave differently, with exposure to semiconductor companies that are supporting the cloud-based boom in working from home, as well as e-commerce stocks in high-yielding markets like Taiwan, and firms that benefit from green stimulus in Europe. While gearing (currently c 8%) was a drag in the March market falls, keeping it steady has helped boost returns in the recovery, and the fund is on track to deliver a 13th consecutive year of dividend growth, partly supported by reserves it has built up over the past decade.

Why invest for income in Asia? Portfolio manager video with Yoojeong Oh



Source: Edison Investment Research

The market opportunity

While many investors think of owning Asian stocks primarily for capital growth, in the last two decades dividends have become an increasingly important part of the investment case, driven by higher payout ratios and earnings growth. Underpinned by structural trends such as a growing middle class driving domestic consumption, Asia may be better placed for a faster recovery in earnings versus the West as pandemic fears ease, as was the case in 2009 following the global financial crisis.

Why consider investing in Aberdeen Asian Income?

- Broad-based income strategy, diversified by sector and geography and backed up by ASI Asia's quality-focused, research-intensive investment approach.
- The fund has outperformed the MSCI AC Asia Pacific ex-Japan High Dividend Yield index over both the short and long term.
- Strong revenue reserves (c 70% of full-year dividend) support continued dividend growth. The shares currently yield 4.4%.

Significant potential for discount to narrow

AAIF's current discount to NAV of 9.7% is wider than longer-term averages, providing significant scope to narrow should investors start to have more faith in companies' ability to reinstate and grow their dividends.

23 November 2020

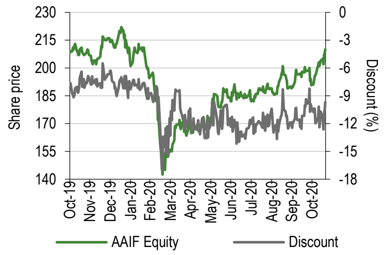
Price	**210.0p**
Market cap	**£369.2m**
AUM	**£445.4m**

NAV*	232.5p
Discount to NAV	9.7%
NAV**	232.5p
Discount to NAV	9.7%

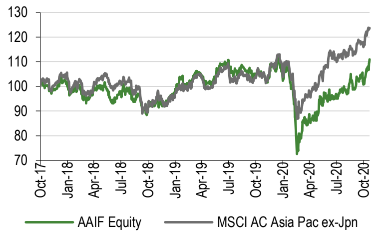
*Excluding income. **Including income. At 19 November 2020.

Yield	4.4%
Ordinary shares in issue	175.8m
Code	AAIF
Primary exchange	LSE
AIC sector	Asia Pacific Income

Share price/discount performance



Three-year performance vs index



52-week high/low	222.0p	142.5p
NAV* high/low	239.6p	169.6p

*Including income.

Gearing

Gross*	8.9%
Net*	8.3%

*At 13 November 2020.

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Edison profile page

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Exhibit 1: Company at a glance

Investment objective and fund background

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. Within its overall investment remit, the company aims to grow its dividends. While the portfolio is constructed without reference to any benchmark, the company measures its performance 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).

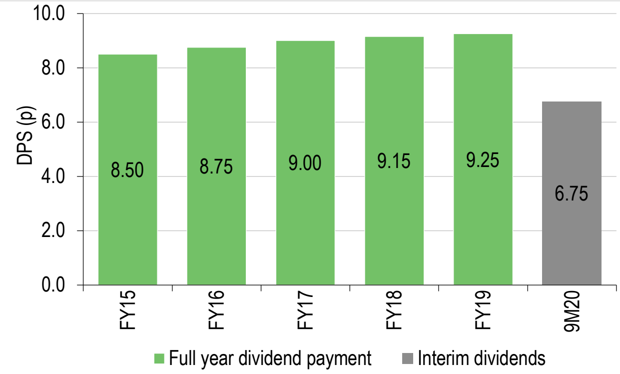
Recent developments

- 13 October 2020: Third interim dividend of 2.25p announced (flat year-on-year). The board remains keen to continue AAIF's long-term record of dividend growth and will consider using reserves where necessary.
- 12 August 2020: Results for the half year ended 30 June. NAV TR -6.5% and share price TR -12.8% compared with +0.8% for the MSCI AC Asia Pacific ex-Japan Index and -7.0% for the MSCI AC Asia Pacific ex-Japan High Dividend Yield Index. Net revenue return of 3.97p per share (-16.1% y-o-y).

Forthcoming		Capital structure		Fund details	
AGM	May 2021	Ongoing charges	1.07%	Group	Aberdeen Standard Investments
Final results	April 2021	Net gearing	7.9%	Manager	Aberdeen Standard Investments Asia
Year end	31 December	Annual mgmt fee	0.85%	Address	1st Floor, Sir Walter Raleigh House, 48-50 Esplanade, St Helier, Jersey, JE2 3QB
Dividend paid	Quarterly	Performance fee	No		
Launch date	December 2005	Company life	Indefinite	Phone	0808 500 0040/+44 (0) 20 7618 1444
Continuation vote	None	Loan facilities	£50m (£36.5m drawn)	Website	www.asian-income.co.uk

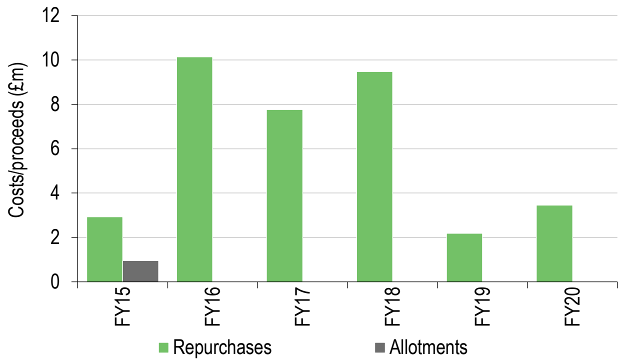
Dividend policy and history (financial years)

Dividends are paid quarterly, in May, August, November and February. The board's aim is to grow the company's dividends.

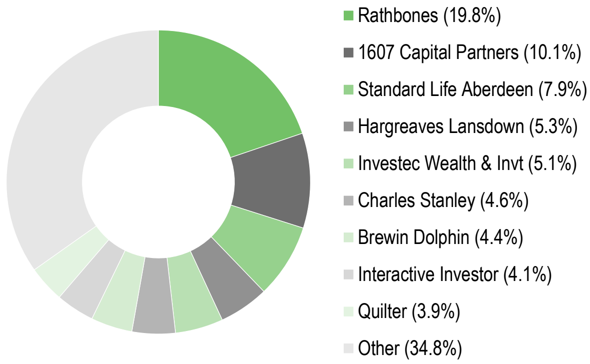


Share buyback policy and history (financial years)

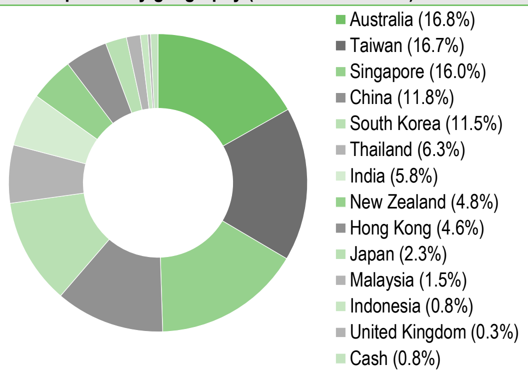
Renewed annually, the board has the authority to repurchase up to 14.99% of AAIF shares or allot up to c 10% of shares. Shares may be repurchased when the discount to NAV exceeds 5%.



Shareholder base (at 20 October 2020)



Portfolio exposure by geography (at 31 October 2020)



Top 10 holdings (at 31 October 2020)

Company	Country	Sector	Portfolio weight %	
			31 October 2020	31 October 2019*
Taiwan Semiconductor Manufacturing Co	Taiwan	Information technology	9.9	6.1
Samsung Electronics	South Korea	Information technology	9.0	6.1
Venture Corporation	Singapore	Information technology	4.3	3.6
Ping An Insurance	China	Financials	3.1	2.8
Oversea-Chinese Banking Corporation	Singapore	Financials	2.8	3.3
AusNet	Australia	Utilities	2.7	N/A
Waypoint	Australia	Real estate	2.6	N/A
Rio Tinto	Australia	Materials	2.5	N/A
LG Chemical	South Korea	Materials	2.5	2.5
Taiwan Mobile	Taiwan	Communication services	2.5	2.8
Top 10 (% of portfolio)			**41.9**	**36.6**

Source: Aberdeen Asian Income Fund, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-October 2019 top 10.

The fund manager: Yoojeong Oh and ASI Asia team

The manager's view: Dividends remain key to returns

Yoojeong Oh, an investment director in the Aberdeen Standard Investments Asia team with responsibility for AAIF, explains that the fund's investment strategy of finding high-yielding stocks that can generate both capital gains and dividend growth is underpinned by the growth of a dividend culture in Asia-Pacific markets. In the past decade, she says, dividends have contributed c 50% of the total return from Asian markets, driven by rising payout ratios as well as underlying earnings growth. However, she cautions that the extraordinary policy responses (both fiscal and monetary) to the coronavirus pandemic may currently be masking the true picture of some of the underlying growth indicators the team looks for, such as corporate capital expenditure and demand growth that is not dependent on stimulus. 'In terms of investment themes, we are still trying to digest what happens when the stimulus is removed and interest rates normalise,' she says.

One of the major economic effects of COVID-19 in Western markets has been the widespread cancellation or reduction of dividends, either because of evaporating earnings during lockdowns, or as a result of regulatory pressure. Oh says that while there have been some examples of this in Asia, it has not been on anything like the same scale, and of c 60 companies in the AAIF portfolio, only four have completely cut or suspended their dividends. Two of these were mandated to do so by regulators; in the case of the other two, Oh says New Zealand Airports has net cash on its balance sheet and has acted purely out of caution given the collapse in passenger numbers. Meanwhile, Chinese restaurant operator Yum China suspended its dividend ahead of a capital raise for a new secondary listing in Hong Kong, 'but they are sitting on cash so we don't see an issue with them reinstating it.' Other than these, the manager says there have been widespread dividend increases across the region, even in Australia, where petrol station operator Waypoint REIT increased its June dividend by more than 3% compared with its December 2019 payout. Convenience Retail Asia, which operates Circle K stores in Hong Kong, kept its regular dividend flat but paid a large special dividend, and still has cash on its balance sheet equivalent to c 15% of its market capitalisation. Petrochemical and EV battery supplier LG Chem recently increased its dividend on the back of record third-quarter operating profits, and has committed to a payout ratio of 30% or higher.

What this means for AAIF's own dividend is that, while the fund may need to dip into its revenue reserves for the first time, it should be able to deliver a 13th consecutive year of dividend growth in FY20. Currently three dividends have been declared, and at a total of 6.75p per share they are flat compared with the first three quarters of FY19. However, Oh points out that the fund has reserves equivalent to 70% of the FY19 dividend, and with portfolio income only down 16% in the first half of the year and likely to see a recovery in the second half, the board has said it is 'keen' to surpass the 9.25p per share paid last year.

Looking ahead, Oh says that while the outperformance of technology stocks is continued evidence of the growth and momentum investment style that has driven markets in recent years, a key theme for 2021 could be a reversal of this trend. While stocks with attractive yields usually outperform in a low interest rate environment, this has not been the case in 2020; the manager feels this may be because 'investors do not trust the yields given the dividend cuts around the world'. With dividend payments resuming at pace, this perception may change, leading to attractive opportunities in some Asian income stocks that are trading at very attractive valuation multiples. Indeed, positive news on COVID-19 vaccine candidates in early November has already seen a change in market focus from growth to value. However, Oh adds that the current environment underlines the need for a broad-based dividend strategy, rather than having a 'barbell' portfolio where a fund's dividends are reliant on a handful of high-yielding names to generate income.

Portfolio: Taking advantage of COVID-19 disruption

At 31 October 2020 there were 62 holdings in AAIF's portfolio, compared with 66 a year earlier. Portfolio concentration has risen over the past 12 months, with increases in the top two stocks, Taiwan Semiconductor Manufacturing (TSMC) and Samsung Electronics (now c 19% of the portfolio compared with c 12% a year ago), helping to drive the percentage of the portfolio in the top 10 stocks up to 41.9%, versus 36.6% at 31 October 2019 (Exhibit 1).

The management team focuses on identifying high-quality companies that are trading below their intrinsic worth, but that have long-term growth potential and strong balance sheets that can support regular and growing dividends. As shown in Exhibit 2, this can lead to wide divergences in geographical exposures versus the MSCI AC Asia Pacific ex-Japan Index. Around half the portfolio (compared with c 27% of the index) is invested in the higher-yielding markets of Australia, Taiwan and Singapore, with a dramatically underweight position (-29.4pp) in China, which makes up more than 40% of the index. AAIF can also invest in non-index countries such as Japan (currently 2.3% of the portfolio). The small weighting in the UK (0.3%) represents a holding in London-listed but Asia-focused bank Standard Chartered.

Exhibit 2: Portfolio geographic exposure vs MSCI Asia Pacific ex-Japan (% unless stated)

	Portfolio end-September 2020	Portfolio end-September 2019	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Australia	16.8	18.4	(1.6)	13.2	3.6	1.3
Taiwan	16.7	10.5	6.2	12.1	4.6	1.4
Singapore	16.0	20.5	(4.5)	2.0	14.0	8.0
China	11.8	10.7	1.1	41.2	(29.4)	0.3
South Korea	11.5	8.6	2.9	11.3	0.2	1.0
Thailand	6.3	8.0	(1.7)	1.6	4.7	3.9
India	5.8	3.3	2.5	7.8	(2.0)	0.7
New Zealand	4.8	3.0	1.8	0.6	4.2	8.0
Hong Kong	4.6	7.4	(2.8)	6.6	(2.0)	0.7
Japan	2.3	3.8	(1.5)	0.0	2.3	N/A
Malaysia	1.5	2.7	(1.2)	1.6	(0.1)	0.9
Indonesia	0.8	0.9	(0.1)	1.3	(0.5)	0.6
United Kingdom	0.3	0.6	(0.3)	0.0	0.3	N/A
Philippines	0.0	0.0	0.0	0.7	(0.7)	0.0
Cash	0.8	1.6	(0.8)	0.0	0.8	N/A
	100.0	**100.0**		**100.0**		

Source: Aberdeen Asian Income Fund, Edison Investment Research

Oh notes that AAIF's portfolio turnover for FY20 is likely to be a little above the historical average (at c 15–20% compared with c 10–15% over the long term), although this reflects 'refinements' to the portfolio as a result of the COVID-19 pandemic, rather than any wholesale change. Positions in hospitality-focused REITs in Singapore have been closed, and the team has sold two of its three Australian banks, with only Commonwealth Bank of Australia now held.

Additions to the portfolio since the onset of the pandemic include APA Group, an Australian gas distributor that sold off heavily in March. Oh says the team had been looking at the company for a long time but had previously considered it to be too highly valued; it was on AAIF's buy list with a target price, and a position was initiated when the share price fell to meet the target. It has since recovered well, up c 32% from its March 2020 low point. Also previously considered too expensive was Hong Kong Exchanges & Clearing, which Oh says should see renewed earnings growth as the initial public offering (IPO) market recovers. The exchange could be a beneficiary of trade tensions between the US and China, as Chinese internet stocks listed in the US move back to Asia; this would be cash-generative for Hong Kong Exchanges and would therefore support its continued dividend growth. A new holding in Singapore-based CapitaLand (a shopping centre-focused property firm) was partly funded by a reduction in the holding in Shopping Centres Australasia. Oh – who is based in Singapore – says trading in the city state's flagship retail area of Orchard Road is holding up well despite COVID-19 restrictions. The same is true in Hong Kong, where the team has added to AAIF's position in Hang Lung Properties, which owns high-end shopping centres in mainland China; for example, the manager says, luxury goods firm Louis Vuitton has reported a 60% increase in demand in its Chinese stores. She adds that while these stocks have sold off heavily, they should be among the first to recover once air corridors fully reopen.

In September, AAIF initiated a new position in Taiwan-based Accton Technology Corp, which specialises in supplying high-speed networking switches to multinational companies including Amazon and Facebook. 'We like Accton for its edge in research and development, alongside a broad product portfolio,' noted the team in AAIF's September 2020 factsheet.

Performance: Benefiting from positive structural trends

Exhibit 3: Five-year discrete performance data

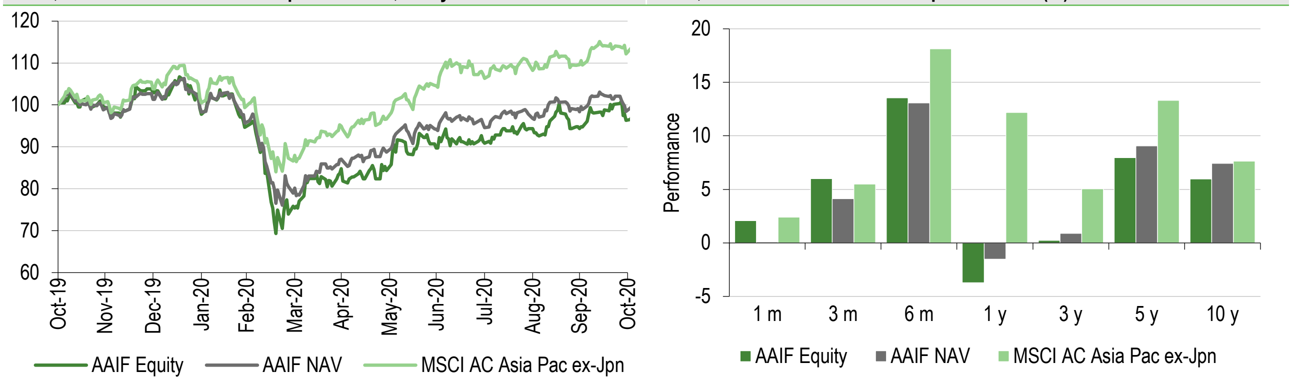
12 months ending	Share price (%)	NAV (%)	MSCI AC Asia Pac ex-Jpn (%)	MSCI AC Asia Pac ex-Jpn HDY (%)	CBOE UK All Companies (%)
31/10/16	31.5	34.6	37.0	32.9	12.8
31/10/17	10.7	11.8	17.7	12.5	13.6
31/10/18	(8.5)	(5.3)	(8.4)	(2.5)	(1.6)
31/10/19	14.4	10.1	12.8	7.9	6.9
31/10/20	(3.7)	(1.5)	12.2	(8.4)	(20.2)

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

AAIF's share price and net asset value (NAV) have recovered well from the Q120 market sell-off, with total returns of +36.5% and +29.4% respectively from the low point on 23 March to the end of October, compared with +33.3% for the MSCI AC Asia Pacific ex-Japan Index. With the broad market having fallen less sharply during the sell-off, AAIF has underperformed over the 12 months to 31 October (Exhibit 3), with negative total returns compared with a gain of 12.2% for the index. However, the recent market rotation towards more value/cyclical stocks, sparked by positive news of a COVID-19 vaccine, has helped push AAIF's NAV total return into positive territory over the 12 months to 11 November 2020 (see Exhibit 7). Of note, AAIF has outperformed the MSCI AC Asia ex-Japan High Dividend Yield Index in both share price and NAV total return terms over three, six and 12 months and three, five and 10 years, with only marginal NAV underperformance over one month to 31 October 2020 (Exhibit 5). Given the focus on high dividends, this index is arguably a better comparator for AAIF than the broad market index, and the fund's sustained outperformance suggests its focus on quality companies has been a success versus a grouping that may include stocks whose yields are only high because the market perceives them as unsustainable.

Exhibit 4: Investment company performance to 31 October 2020

Price, NAV and index total return performance, one-year rebased | **Price, NAV and index total return performance (%)**



Source: Refinitiv, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

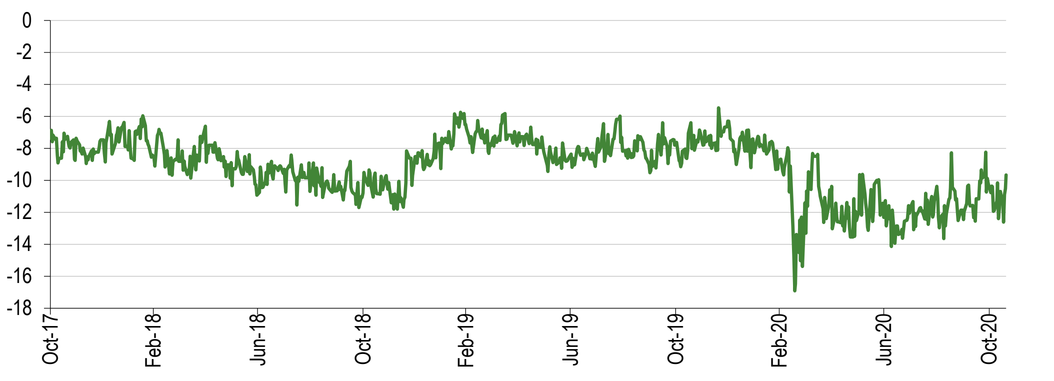
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI AC Asia Pac ex-Jpn	(0.3)	0.5	(3.9)	(14.2)	(13.1)	(21.5)	(14.3)
NAV relative to MSCI AC Asia Pac ex-Jpn	(2.2)	(1.3)	(4.3)	(12.2)	(11.4)	(17.4)	(2.0)
Price rel to MSCI AC Asia Pac ex-Jpn HDY	1.6	6.7	15.7	5.1	4.5	1.8	2.8
NAV rel to MSCI AC Asia Pac ex-Jpn HDY	(0.4)	4.8	15.2	7.5	6.5	7.1	17.6
Price relative to CBOE UK All Companies	6.5	10.5	17.1	20.7	20.0	36.4	17.3
NAV relative to CBOE UK All Companies	4.4	8.6	16.6	23.4	22.3	43.5	34.1

Source: Refinitiv, Edison Investment Research. Note: Data to end-October 2020. Geometric calculation.

In terms of drivers of recent performance, Oh notes that gains for the broad index have been driven particularly by the strong performance from technology and healthcare stocks. AAIF has little exposure to healthcare as, unlike Western pharmaceutical companies whose back books of cash flow-generating brands support healthy dividend yields, Asian healthcare companies are more likely to be involved in contract research or manufacturing, or are earlier-stage biotechnology companies that are not yet profitable. However, while AAIF also does not own non-yielding Chinese internet giants Alibaba and Tencent, it has seen strong performance from technology stocks in its portfolio such as LG Chem (South Korea) and Momo.com (Taiwan). Chemical company LG Chem makes batteries for electric vehicles, so has benefited from fiscal stimulus in Europe aimed at boosting the green economy. Momo.com is an e-commerce company that has been in AAIF's portfolio since 2018; unlike its large Chinese peers, it pays an attractive dividend, and its share price has more than doubled since the Q120 market sell-off. The fund's two largest holdings, TSMC and Samsung Electronics, have also contributed positively to performance; Oh notes that both are beneficiaries of COVID-19 given their strong position in cloud computing and data servers, which form the backbone of work-from-home IT infrastructure. While TSMC has benefited from supplying components to the new generation of Apple iPhones, Samsung is enjoying a stronger market position thanks to sanctions against its Chinese competitor, Huawei. Furthermore, the manager expects some more value-orientated areas that have done less well, such as banks and real estate, to come more into focus going into 2021.

Valuation: Scope for discount volatility to abate

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



Source: Refinitiv, Edison Investment Research

After widening out to a decade-high discount to cum-income NAV of 16.9% in the coronavirus-induced equity market sell-off in March, AAIF's valuation has settled into a range wider than longer-term averages, and stood at 9.7% on 20 November 2020, compared with a one-year average of 10.4%, and averages over three, five and 10 years of 9.2%, 8.6% and 3.5%, respectively. The discount had narrowed from a c 8–12% range in 2018 to a c 6–10% range in 2019, reaching a three-year narrowest point of 5.5% in December 2019, before news of the coronavirus outbreak in China. Having seen a higher level of volatility since the Q120 market lows, there is scope for AAIF's discount to settle into a narrower range, particularly if positive performance trends are sustained and/or investors continue to move away from the 'growth at any price' mentality that has recently dominated global equity markets. The board regularly buys back shares to help manage the discount and has repurchased c 1.8m shares (c 1.0% of the share base) so far in FY20, at a cost of c £3.4m.

Peer group comparison

AAIF is a member of the Association of Investment Companies' Asia Pacific Income sector, which is made up of funds that aim to provide investors with an attractive income, whether this is generated from portfolio dividends or paid out of capital reserves. Of the four funds in the peer group, AAIF is most similar to Schroder Oriental Income (SOI); Henderson Far East Income (HFEL) tends to target higher-yielding companies, while JPMorgan Asia Growth & Income (JAGI) invests predominantly for growth but pays a set distribution of 1% of NAV each quarter.

In NAV total return terms, AAIF ranks third over one, three, five and 10 years. However, it is important to note that JAGI's chart-topping performance over one, three and five years has been assisted by large holdings in Chinese internet stocks Alibaba and Tencent (together c 19% of the portfolio), which do not pay attractive dividends and are therefore not held by the three peers that invest for income. While this means they may lag a strongly rising market, a strategy focused on owning cash-generative business paying good dividends may be better suited to less exuberant market conditions, as witnessed by both SOI's and AAIF's 10-year returns.

As the smallest fund in the peer group, AAIF has the second-highest ongoing charge, but does not have a performance fee. It has the highest level of gearing (discussed on the front page), and the second highest dividend yield, an attractive 4.4%.

Exhibit 7: AIC Asia Pacific Income sector at 20 November 2020*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
Aberdeen Asian Income Fund	**369.2**	**7.1**	**11.8**	**71.2**	**120.0**	**1.1**	**No**	**(9.6)**	**110**	**4.4**
Henderson Far East Income	447.4	(5.0)	1.5	54.4	77.0	1.1	No	2.1	100	7.3
JPMorgan Asia Growth & Income	442.2	19.3	26.2	126.6	122.3	0.7	No	2.3	100	3.4
Schroder Oriental Income	652.5	8.0	15.8	75.3	160.2	0.9	Yes	(7.0)	105	4.3
Sector average (4 funds)	**477.8**	**7.4**	**13.8**	**81.9**	**119.9**	**0.9**		**(3.1)**	**104**	**4.8**
AAIF rank in sector	**4**	**3**	**3**	**3**	**3**	**2**		**4**	**1**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance to 19 November 2020 based on ex-par NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

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