EDISON

Aberdeen Asian Income Fund

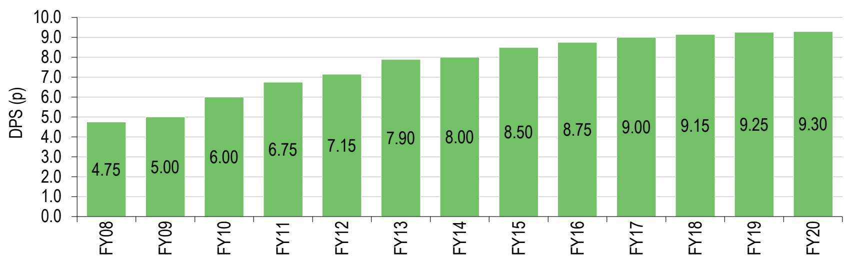
Income style and quality bias

Investment trusts
Asia Pacific Income

20 April 2021

Aberdeen Asian Income Fund (AAIF) may appeal to investors interested in income. While perhaps less well known than the UK equity income funds, AAIF yields 4.0%, the second highest of the four Asian income peers, and with a solid performance track record. The team targets the income and growth potential of Asia's most compelling and sustainable companies. Income seekers might gain core exposure to the Asia consumption-driven growth story complemented by structural dividend growth. The focus on high-quality businesses creates a relatively defensive tilt in regional equities. The manager expects the 'value' rotation that began in Q420 across Asia and boosted AAIF's performance, to continue in 2021.

AAIF has grown its dividend for 12 consecutive years since FY08



Source: Bloomberg, Edison Investment Research

Why invest for income in Asia and choose AAIF?

FY20 marks the 12th consecutive year that AAIF has increased the dividend, as the chart above illustrates. During this period the cumulative annualised growth rate (CAGR) was 5.7%. Despite the challenges of COVID-19 in 2020, the dividend (which was c 80% covered by portfolio income) grew 0.5% to 9.3p per share. The trust's revenue reserve is equal to c 50% of the annual dividend payment, as at end-December FY20. The board is committed to the progressive dividend policy and would use revenue and capital reserves accordingly.

The analyst's view

If inflation picks up in Asia, accompanied by rising input costs, those companies in AAIF's portfolio with stronger balance sheets and pricing power are well placed for continued outperformance. The trust had a very strong performance over the past 12 months (to end-March), posting 48.2% NAV total return and outperforming both the broad and high dividend yield indices by 3.7pp and 19.9pp respectively. TSMC and Samsung, the top two holdings in the portfolio with a combined weighting of c 21%, posted higher y-o-y 2020 earnings. Many other investees, such as Momo.com, a mobile-based social and entertainment platform often referred to as the 'Amazon of Taiwan' and a top 10 holding (2.6%), expect a swift earnings recovery in 2021. Such commercial robustness and financial strength should support AAIF's future dividend payout.

AAIF is trading at a 9.1% cum-fair discount, close to its three-year average of 9.4%, but wider than the 2.1% average discount of the four Asia Pacific income peers with a higher growth bias than AAIF. A reinstatement of investees' dividend payments and further rotation into quality and value could trigger a narrowing of the discount.

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Price	**232.0p**
Market cap	**£407.7m**
AUM	**£479.9m**
NAV*	253.3p
Discount to NAV	8.4%
NAV**	255.3p
Discount to NAV	9.1%

*Excluding income. **Including income. As at 19 April 2021.

Yield		4.0%
Ordinary shares in issue		175.7m
Code		AAIF
Primary exchange		LSE
AIC sector		Asia Pacific Income
52-week high/low*	237.0p	163.5p
NAV** high/low	263.4p	186.7p

Gearing

Net gearing at 16 April 2021	7.0%

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 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 (c 50% of full-year dividend) and capital reserves support continued dividend growth.

Bear points

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

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The manager's view and portfolio positioning

Fund manager Yoojeong Oh is excited about the near- and longer-term prospects of the shareholder-focused companies across Asia Pacific that AAIF holds in the portfolio. She expects them to generate strong long-term capital growth as well as rising income. The Aberdeen Standard (AS) team is known for its quality stock-picking approach and value tilt. Positive news on COVID-19 vaccine candidates in early November 2020 marked a shift in market focus from growth to value. Oh believes 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. At end-February 2021 the portfolio had 59 holdings, with most being steady income generators.

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

The active stock-picking strategy continues to result in wide divergences from the indices, as shown in Exhibit 1. China combined with Hong Kong remains the largest underweight (27.2pp and 21.5pp) for the MSCI AC Asia Pacific ex Japan and MSCI AC Asia Pacific ex Japan HDY indices, respectively. This difference principally stems from not owning Chinese internet stocks as most of them do not pay dividends. Nevertheless, there are a few high conviction Chinese holdings in the portfolio, including the cash-generative Ping An Insurance (top 10 holding, 3.0% weighting at 28 February 2021) and the property company, China Resources Land (top 10 holding, 2.2%).

Exhibit 1: Portfolio geographic exposure versus indices (% unless stated)

	Portfolio weight	Portfolio weight		MSCI AC Asia Pacific ex Japan		MSCI AC Asia Pacific ex Japan HDY	
Country/region	**28-Feb-21**	**29-Feb-20**	**Change**	**28-Feb-21**	**Versus index**	**28-Feb-21**	**Versus HDY index**
Taiwan	18.2	12.4	5.8	13.2	5.0	15.6	2.6
Australia	15.8	16.4	(0.6)	13.5	2.3	20.6	(4.8)
Singapore	15.5	21.8	(6.3)	2.0	13.5	N/A	N/A
South Korea	13.1	9.4	3.7	12.7	0.4	7.3	5.8
China	12.5	11.3	1.2	37.8	(25.3)	24.7	(12.2)
Thailand	5.6	8.0	(2.4)	1.8	3.8	N/A	N/A
India	5.3	3.4	1.9	8.8	(3.5)	N/A	N/A
Hong Kong	4.6	6.2	(1.6)	6.5	(1.9)	13.9	(9.3)
New Zealand	4.6	3.1	1.5	0.5	4.1	N/A	N/A
Japan	2.3	2.8	(0.5)	0.0	2.3	N/A	N/A
Indonesia	1.0	1.1	(0.1)	1.2	(0.2)	N/A	N/A
Malaysia	0.8	2.7	(1.9)	1.4	(0.6)	N/A	N/A
Philippines	0.0	0.0	0.0	0.6	(0.6)	N/A	N/A
Other	0.0	0.5	(0.5)	0.0	0.0	17.9	(17.9)
Cash	0.7	0.9	(0.2)	N/A	N/A	N/A	N/A
Total incl. cash	**100.0**	**100.0**		**100.0**		**100.0**	

Source: Aberdeen Asian Income Fund, MSCI, Edison Investment Research

Singapore's weighting has dropped to third versus first position (21.8%) 12 months ago, and is down 6.3pp y-o-y to 15.5%, principally due to market movements. The team owns three Singaporean banks (Oversea-Chinese Banking Corporation, DBS Group, within the top 10 holdings, 3.0% and 2.4% respectively, and United Overseas Bank). All three stocks were hit harder than the indices during the sharp correction in March 2020. Singapore remains the largest overweight at 3.5% versus MSCI AC Asia Pacific ex Japan and exposure is diverse by sectors and business models. Historically, the team has highlighted the quality of the Singaporean businesses it picked for AAIF, and the business cases for many investees stand. During 2020 the team increased its weighting to the Singaporean banks' basket, having added to DBS and positioning this portfolio segment for the recovery in 2021. These investments have paid off well ytd, with the share prices recovering strongly with the three banks posting a c 30% total return (TR) over the past six months to end-March 2021, compared to c 10% TR for the MSCI Asia Pacific ex Japan index. The team is hopeful that the banks' dividends will be restored in 2021. Another notable holding is Venture (top 10, 3.0%), a leading technology company in the electronic manufacturing space. It supplies components to Illumina that makes genome sequencing machines. Venture also produce COVID-19 diagnostic kits and supplies developers of 5G technology. Venture was one of the very few companies that raised dividends in 2020, being a beneficiary of supply chain shifts.

Only selective Australian businesses, known for their dividend generosity, pass the team's quality checks and this results in a 4.8pp underweight to the high yield index, but a 2.3pp overweight to the MSCI AC Asia Pacific ex Japan Index. Among the Australian companies that AAIF invests in are Rio Tinto (top 10 holding, 3.2%), which the team regards as a proxy for China and the emerging markets' secular growth story, AusNet Services, an energy delivery service provider, and Commonwealth Bank of Australia, a diversified bank, servicing both corporate clients, including small and medium size enterprises, and individuals.

Taiwan is another notable overweight relative to the indices at 5.0pp and 2.6pp respectively. The team initiated investment in a number of Taiwanese companies. For example, Taiwan's GlobalWafers is a key raw material supplier into both TSMC and Samsung Electronics and generates resilient cash flows at the premium end of the wafer supply market. Other geographic overweights are New Zealand (4.1pp), Thailand (3.8pp) and Japan (2.3pp).

Performance

AAIF outperformed both the MSCI AC Asia Pac ex-Japan and the MSCI AC Asia Pac ex-Japan HDY in two of the three last discrete years, on an NAV TR basis, as Exhibit 2 shows. The trust recovered better than the MSCI AC Asia Pac ex-Japan Index from the March 2020 lows and outperformed both indices in the past 12 months to end-March 2021, posting a 48.2% NAV TR. Sizeable holdings in and timely additions to a number of value stocks across the sectors, including semiconductors and Singaporean banks, boosted performance.

Exhibit 2: 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 (%)
31/03/17	35.6	32.0	36.2	35.2	22.6
31/03/18	2.6	2.5	7.9	7.1	1.2
31/03/19	6.7	5.2	4.2	4.9	6.2
31/03/20	(22.9)	(18.4)	(10.7)	(12.5)	(19.1)
31/03/21	53.6	48.2	42.9	23.6	26.6

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

As we mentioned in our 23 November 2020 report on the company, given the focus on high dividends the high dividend yield index is arguably a better comparator for AAIF than the broad market index. The company's NAV consistently outperformed the MSCI AC Asia Pac ex-Japan HDY Index over six months, one year, three, five and 10-year periods, on a TR basis, as Exhibit 3 illustrates.

Exhibit 3: 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	1.7	(1.4)	7.0	7.5	(5.0)	(10.1)	(2.5)
NAV relative to MSCI AC Asia Pac ex-Jpn	3.4	2.6	5.2	3.7	(4.3)	(11.9)	5.8
Price rel to MSCI AC Asia Pac ex-Jpn HDY	(3.6)	(6.6)	3.2	24.3	11.4	7.0	10.5
NAV rel to MSCI AC Asia Pac ex-Jpn HDY	(2.0)	(2.9)	1.5	19.9	12.2	4.8	19.9
Price relative to CBOE UK All Companies	(3.5)	(4.9)	3.0	21.3	16.2	30.3	19.7
NAV relative to CBOE UK All Companies	(1.8)	(1.1)	1.3	17.1	17.0	27.6	29.8

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

A comparison with the other four Asia Pacific income peers, shown in Exhibit 4, reveals AAIF's improving relative performance. Its NAV TR exceeds the sector average over one year. The team's quality income strategy bore the fruits of a robust performance amid economic and geopolitical uncertainty. AAIF ranks third by NAV TR over one year, having outperformed JPMorgan Asia Growth & Income (JAGI). Two racy top five JAGI holdings, Alibaba and Tencent, have corrected in the past few months amid a visible sell-off of Chinese stocks. This correction followed the robust performance of China growth and tech equities during 2020 and the negative news flow about increasing political tensions between the West and China in Q121. Despite being a growth mandate, Invesco Asia (IAT) trust introduced a new enhanced dividend policy in September 2020, so we have included it in our peer group table.

Exhibit 4: 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	398.9	48.2	27.6	72.7	132.4	1.1	No	(9.8)	107	4.1
Henderson Far East Income	474.6	22.9	8.9	48.2	85.1	1.1	No	2.2	100	7.0
Invesco Asia Ord	260.1	67.4	47.4	124.6	192.9	1.0	No	(6.1)	100	3.9
JPMorgan Asia Growth & Income	481.5	46.6	41.6	134.0	135.7	0.7	No	2.3	100	3.1
Schroder Oriental Income	748.4	50.3	31.3	82.6	173.5	0.9	Yes	(3.1)	105	3.7
Sector average (5 funds)	**472.7**	**47.1**	**31.3**	**92.4**	**143.9**	**1.0**		**(2.9)**	**102**	**4.4**
MSCI AC Asia Pacific ex Japan HDY		25.0	13.3	56.7	84.9					4.4
Rank in sector	4	3	4	4	4	2		5	1	2

Source: Morningstar, Edison Investment Research, Bloomberg. Note: *Performance data to 31 March 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.

The total dividend for FY20 amounts to 9.30p (2019: 9.25p). In the absence of unforeseen circumstances, the board intends to declare three interim dividends of 2.25p per ordinary share 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. Aside from revenue reserves (at end-December 2020) amounting to c 50% of the annual dividend payment, AAIF has £223m of capital reserves that the board could draw upon in the years of income shortage from the holding companies within the portfolio.

In the year to 31 December 2020, about £3.3m from the revenue reserves has been used (about 20% of the FY20 dividend payment), as the COVID-19 pandemic affected the level of dividends that were received from portfolio companies during 2020. The net revenue reserve at 31 December 2020, adjusted for the payment of the 4th interim dividend that occurred after the year end, amounted to £7.8m (c 4.4p per share, or just over 50% of the annual dividend payment) and any decision as to whether this will be utilised in 2021 (and by how much) will be taken at the time of each of the quarterly dividend declarations.

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