Aberdeen Latin American Income Fund

Initiation of coverage

Brighter prospects in Latin America

Investment companies

Aberdeen Latin American Income Fund (ALAI) gives investors exposure to both Latin American equities and government debt, and offers a 4.9% dividend yield. The company is managed by Aberdeen Standard Investments' (ASI) global emerging markets equities and emerging market debt teams. They are cautiously optimistic on the prospects for Latin America in 2019 (favouring the region above other emerging markets), following a series of headwinds in 2018, including a stronger US dollar, rising interest rates, commodity price volatility and a number of important elections. The managers note that commodity prices are stabilising, there is potential for a weaker US currency as the benefits from stimuli and tax cuts fade, and inflation in Latin America is moderating so central banks are more dovish. An improving economic environment in Brazil could contribute towards more robust earnings estimates and higher equity valuations in the region.

12 months ending	Share price (%)	NAV (%)	Composite benchmark (%)*	MSCI EM Latin American 10/40 (%)	J.P. Morgan GBI-EM Global Diversified (Latin America) (%)
31/01/15	3.5	2.8	4.1	(0.3)	10.0
31/01/16	(31.3)	(27.2)	(23.0)	(25.5)	(19.7)
31/01/17	70.1	63.5	55.8	67.2	39.0
31/01/18	12.0	11.6	10.1	15.5	2.0
31/01/19	1.1	0.6	4.4	3.1	5.7

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling. *Composite benchmark is 60% MSCI EM Latin American 10/40 index and 40% J.P. Morgan Government Bond Index EM Global Diversified (Latin America carve-out).

Investment strategy: Equities and fixed income

ASI employs a team-based approach to investment, seeking high-quality securities at a reasonable price. Equities are selected following thorough fundamental research, and meeting with company managements is a key element of the investment process. The equity portion of ALAI's portfolio is tilted towards domestic consumer stocks, which have good potential to grow alongside economies in the region. Analysis of fixed income securities is also conducted on a bottom-up basis, with emphasis on the perceived prospects of individual countries.

Market outlook: Coming off a tough 2018

There were a series of macro events in 2018 that created serious headwinds for Latin America and other emerging markets. Many of these issues appear to be abating; in addition, valuations in the region look relatively attractive, which may provide opportunities for investors looking to diversify exposure away from developed markets, where prospects may be less favourable.

Valuation: Double-digit discount and 4.9% yield

ALAI is currently trading at a 11.6% discount to cum-income NAV, which compares with the 9.3% to 16.7% range over the last 12 months, and the range of average discounts over the last one, three and five years of 11.7% to 14.0%. The company has maintained its annual distribution for the last three financial years and currently offers a dividend yield of 4.9%.

11 February 2019

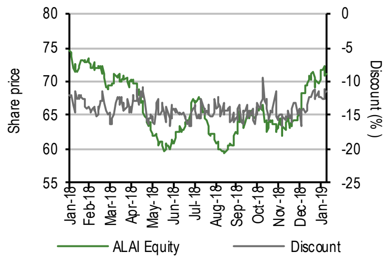
Price	**71.0p**
Market cap	**£42.1m**
AUM	**£53.6m**

NAV*	79.4p
Discount to NAV	10.5%
NAV**	80.3p
Discount to NAV	11.6%

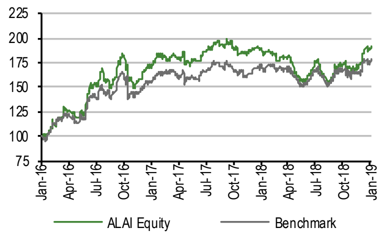
*Excluding income. **Including income. As at 7 February 2019.

Yield	4.9%
Ordinary shares in issue	59.3m
Code	ALAI
Primary exchange	LSE
AIC sector	Latin America
Benchmark	Composite benchmark

Share price/discount performance



Three-year performance vs index



52-week high/low	73.4p	59.2p
NAV* high/low	85.0p	68.7p

*Including income.

Gearing

Gross*	14.8%
Net*	12.7%

*As at 31 December 2018.

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Aberdeen Latin American Income Fund is a research client of Edison Investment Research Limited

Exhibit 1: Company at a glance

Investment objective and fund background

Aberdeen Latin American Income Fund (ALAI) aims to provide investors with a total return, with an above-average yield, primarily through investing in Latin American securities. While the portfolio is constructed without reference to any benchmark, the company measures its performance against a composite index (in sterling terms): 60% MSCI EM Latin American 10/40 index and 40% J.P. Morgan Government Bond Index EM Global Diversified (Latin America carve-out).

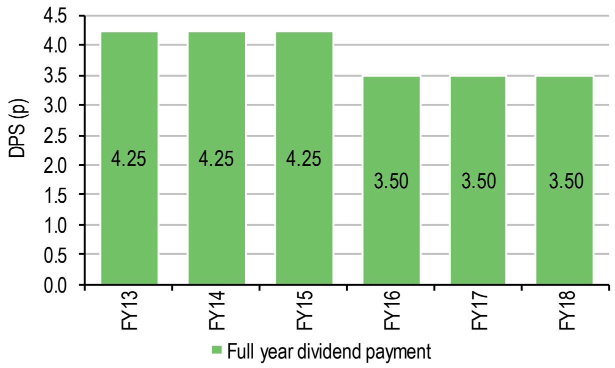
Recent developments

- 13 December 2018: Retirement of non-executive director Martin Adams at AGM.
- 13 December 2018: Declaration of 0.875p first interim dividend.
- 25 October 2018: Annual results ending 31 August 2018. NAV TR -18.8% versus benchmark TR -10.9%, share price TR -18.5%.
- 20 September 2018: Declaration of 0.875p fourth interim dividend.
- 29 June 2018: Declaration of 0.875p third interim dividend.

Forthcoming		Capital structure		Fund details	
AGM	December 2019	Ongoing charges	2.0% (FY18)	Group	Aberdeen Standard Investments
Interim results	April 2019	Net gearing	12.7%	Manager	Aberdeen Asset Managers
Year end	31 August	Annual mgmt fee	1.0%	Address	Sir Walter Raleigh House, 48–50 Esplanade, St Helier, Jersey JE2 3QB
Dividend paid	Jan, May, Jul, Oct	Performance fee	No		
Launch date	16 August 2010	Company life	Indefinite	Phone	0808 500 00 40
Continuation vote	None	Loan facilities	£8m	Website	www.latamincome.co.uk

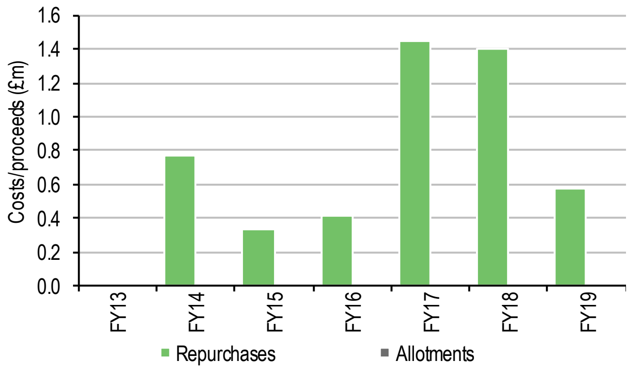
Dividend policy and history (financial years)

ALAI pays quarterly dividends in January, May, July and October.

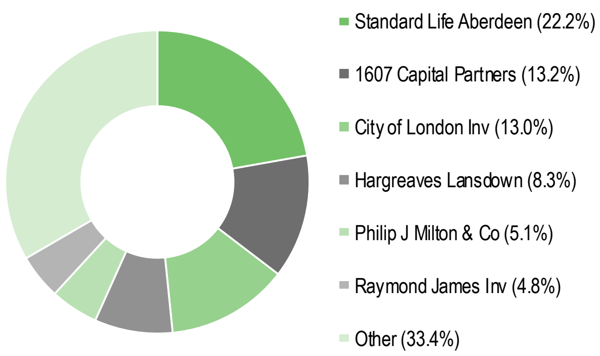


Share buyback policy and history (financial years)

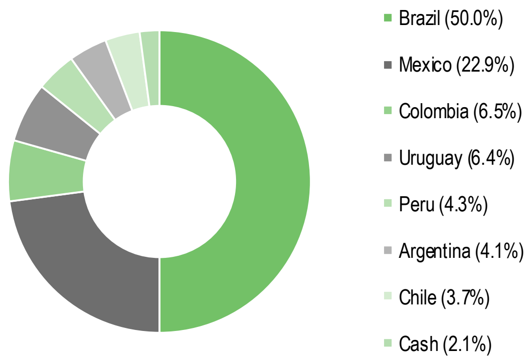
Renewed annually, the board has the authority to repurchase up to 14.99% and allot up to 10% of shares.



Shareholder base (as at 2 January 2019)



Portfolio exposure by geography (as at 31 December 2018)



Top 10 holdings (as at 31 December 2018)

Company	Country	Sector	Portfolio weight %	
			31 December 2018	31 December 2017*
Brazil (Fed Rep of) 10% 01/01/25	Brazil	Government bond	8.8	8.3
Colombia (Rep of) 9.85% 28/06/27	Colombia	Government bond	6.5	6.4
Banco Bradesco ADR	Brazil	Financials	4.9	3.7
Brazil (Fed Rep of) 10% 01/01/21	Brazil	Government bond	4.7	2.9
Itaú Unibanco ADR	Brazil	Financials	4.5	3.7
Mex Bonos Desarr Fix Rt 8.5% 18/11/38	Mexico	Government bond	3.3	3.2
Uruguay (Rep of) 4.375% 15/12/28	Uruguay	Government bond	3.3	N/A
Mex Bonos Desarr Fix Rt 10% 20/11/36	Mexico	Government bond	2.7	3.0
Lojas Renner	Brazil	Consumer discretionary	2.6	2.7
Brazil (Fed Rep of) 10% 01/01/27	Brazil	Government bond	2.5	N/A
Top 10 (% of holdings)			**43.8**	**40.2**

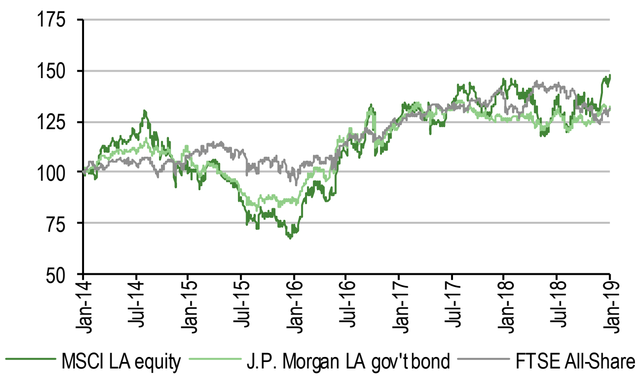
Source: Aberdeen Latin American Income Fund, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-December 2017 top 10.

Market outlook: Relatively attractive equity valuations

Exhibit 2 (LHS) shows the performance of Latin American equities and government bonds (in sterling terms) along with the broad UK index over the last five years. Over this period, all three asset classes have broadly generated the same total return. However, this does not paint the whole picture, as there have been periods when Latin American assets have performed relatively better, such as from early 2016 to mid-2017, while performing poorly in 2015 and 2018. Global equity markets returned to more normal levels of volatility in 2018, following a particularly benign period in 2017; investor concerns included the pace of US interest rate rises and dollar strength, along with threats to global economic growth from the escalation of the trade dispute between the US and China. So far, corporate earnings have remained relatively robust; hence, share price weakness has led to more reasonable equity valuations. In terms of forward P/E multiples (Exhibit 2, RHS), Latin American shares are now trading at a 7pp discount to their five-year average, which is broadly in line with global equities. In absolute terms, Latin American equities are trading on a forward P/E multiple that is c 10% lower than for the global market; this is modestly wider than the c 8% average discount over the last five years.

Exhibit 2: Market performance and valuations (last five years)

Performance of indices (£-adjusted)

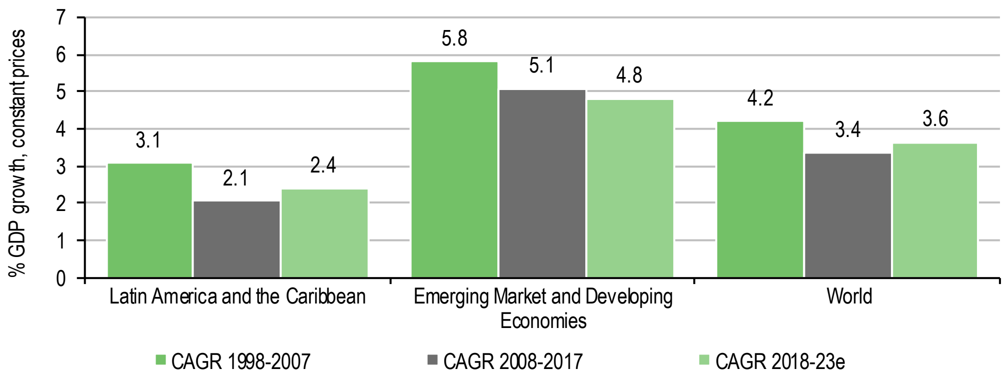


Datastream indices forward P/E valuations (x)

	Last	High	Low	Five-year average	Last as % of average
Latin America	12.8	15.7	11.6	13.6	93
Brazil	12.6	14.4	10.4	12.3	102
Mexico	13.2	20.0	12.3	17.0	78
US	16.3	19.0	14.8	17.0	96
UK	12.3	15.7	11.3	14.2	86
World	14.1	16.3	13.0	14.8	95

Source: Thomson Datastream, Edison Investment Research. Note: Valuation data as at 8 February 2019.

Exhibit 3: Global economic growth forecasts



Source: International Monetary Fund World Economic Outlook, October 2018

Global growth forecasts are shown in Exhibit 3. Data from the International Monetary Fund's January 2019 World Economic Outlook shows the prospects for economic output in Latin America are lower than for other emerging markets and the rest of the world. However, this does not mean that investors should not consider the region, as the long-term drivers of economic demand remain intact, such as a large and growing population, an increasing trend towards urbanisation and a high level of infrastructure spending. Some of the Latin American economies, such as Brazil, are in better shape than historically, due to higher domestic demand and lower inflation and interest rates, and within the individual countries there are attractively valued investment opportunities that can be identified by skilled active managers.

Fund profile: Broad equity and bond exposure

Launched on 16 August 2010, ALAI is a Jersey-incorporated, closed-ended investment company. It is listed on the Main Market of the London Stock Exchange. The company is managed by Aberdeen Standard Investments (ASI), which was formed by the August 2017 merger of Aberdeen Asset Management and Standard Life. ALAI's performance is benchmarked against a composite index (in sterling terms) made up of 60% MSCI EM Latin American 10/40 index and 40% J.P. Morgan Government Bond Index EM Global Diversified (Latin America carve-out). The 10/40 element of the equity segment of the benchmark adjusts the weights of constituents to constrain any single issuer to 10% of the index, and the sum of the weights of all issuers representing more than 5% of the index to 40%.

The company's portfolio is diversified across equity, equity-related and fixed income securities (at end-December 2018 the portfolio was split c 55% and 45% between equities and government bonds, respectively). The flexible investment policy enables the company to invest in a range of instruments, including equities, debt, convertible securities, warrants, depositary receipts and other equity-related securities. Investment guidelines dictate at least 25% of gross assets are held in equities, and at least 25% are held in fixed income investments. ALAI's portfolio is not constructed with reference to the benchmark, hence there are no restrictions on geographic, sector or market cap exposure. A maximum 15% of gross assets may be invested in a single company, and up to 25% of gross assets may be invested in non-investment grade (BB+/Ba1 or lower) government debt. Unlisted securities may be held at the manager's discretion if a listing is imminent, or if a company's listing ceases. The use of derivatives is permitted (up to 50% of gross assets) for efficient portfolio management and to mitigate risk. ALAI may gear up to 20% of net assets at the time of drawdown; at end-December 2018, net gearing was 12.7%.

The board uses a series of key performance indicators to measure ALAI's success:

- Performance – NAV and share price total return relative to the benchmark's total return;
- Share price discount/premium to NAV – the board aims to avoid large fluctuations in the discount relative to similar investment companies; and
- Dividends – the board aims to provide shareholders with an attractive yield.

The fund manager: Aberdeen Standard Investments

The managers' view: Improved sentiment compared with 2018

We met with Viktor Szabó, who works in ASI's emerging market debt team, and Brunella Isper, a member of its global emerging markets equities team. Szabó suggests that 2018 was an interesting year for all markets. At the start of the period, there was a general expectation for a synchronised global economic recovery, which led to strong performance by risk assets. US growth remained robust, helped by tax reform, but elsewhere economic activity did not live up to expectations. As a result, there were significant capital inflows into the US and away from other regions, and higher US treasury yields put emerging markets under significant pressure due to a stronger dollar. Other factors aligned to cause stress in emerging markets, such as weakness in commodity prices – which are an important driver to the Latin American economy – and a slowdown in China as the authorities work to rebalance from an investment-led to a consumption-led economy. There are also the ongoing trade disagreements between the US and China, which, if they continue, will have a negative impact on economic growth. In 2018, sentiment towards emerging markets was also negatively affected by currency crises in Argentina and Turkey, two countries that are particularly reliant on foreign capital.

Considering the outlook for Latin America in 2019, Szabó believes that US economic growth will slow. The Federal Reserve is likely to moderate the pace of interest rate hikes, the benefits from lower tax rates will fade, and, as the Republicans have lost control of the House of Representatives, stimulus policies are less likely to be enacted. The manager says that the magnitude of the US economic slowdown is important; if it is gradual, he expects emerging market growth to accelerate, led by Latin America. He expects a recovery in Brazil (with potential upside to consensus forecasts), which he says has experienced its deepest recession in history, and Argentina to exit recession, along with moderating growth in smaller economies such as Peru, Chile and Colombia.

Szabó compares the structure of Latin American economies with those in the past. He says that they are more healthy now as growth is broader, led by a higher weighting to personal consumption. While growth in Asia is currently higher than in Latin America, the manager believes this is due to Latin America's relative maturity, and the growth differential will narrow over time.

During 2018, some Latin American countries increased their interest rates in an effort to retain a positive differential compared with the US; however, the manager believes that rate hikes in the region are broadly complete. Another major feature in Latin America last year was a series of important elections, which led to volatility, but generally had market-friendly outcomes.

The manager says that the Mexican mid-year presidential election was a "real rollercoaster", with the market initially pricing in the possibility of an anti-establishment candidate winning; this duly happened as Andrés Manuel López Obrador (AMLO) was victorious. However, following the election the market rallied strongly, as his political party has sufficient representation in parliament to govern, and has outperformed expectations. The Mexican political system means that while the new president was elected in June 2018, he was not inaugurated until December. In the intervening months, his proposed policies found more favour with the electorate and investors, and when the 2019 budget was finally published in late December 2018, it was a positive surprise as all spending projects will take place over multiple years, putting less pressure on public finances.

Brazil has experienced significant political upheaval in recent years; Michel Temer was appointed president following the impeachment of his predecessor Dilma Rousseff in 2016. Temer worked hard to reform the social security system, but failed to see his policies enacted, and did not stand for re-election. A conservative candidate, Jair Bolsonaro, won the October 2018 presidential election. He has hired former investment banker Paulo Guedes as his economic tsar; this is reassuring for the market, as Guedes has liberal views on the economy, and social security reform is high on his agenda. Bolsonaro's election win caused a significant rally in Brazilian assets, mainly driven by local investors, who have a very important role within the country. Szabó notes that foreign investors have not yet participated in the upturn, but says that the global perception about Brazil has now improved. While the Brazilian market has rallied, the manager remains positive on the country's prospects based on continued economic recovery and reduced political risk.

The political calendar in Latin America looks much less busy in 2019. However, there are forthcoming local and presidential elections in Argentina. The country has experienced significant capital outflows from local investors, who lack confidence in the current administration. Due to the dire state of the country's finances, it has had a large support package from the International Monetary Fund, and stricter monetary policy has led to a stronger peso, while interest rates have started to decline from extremely high levels. Szabó also notes that in 2018 Argentina suffered a major drought, the worst in many, many years. This was negative for soybean exports, which provide one of the greatest sources of foreign currency. The manager expects a rebound in soybean exports in 2019, maybe by more than 40% if weather permits. He is hopeful that an improving economic environment will mean that incumbent Mauricio Macri – seen as a market-friendly candidate – will garner sufficient support to win the October 2019 presidential election.

Asset allocation

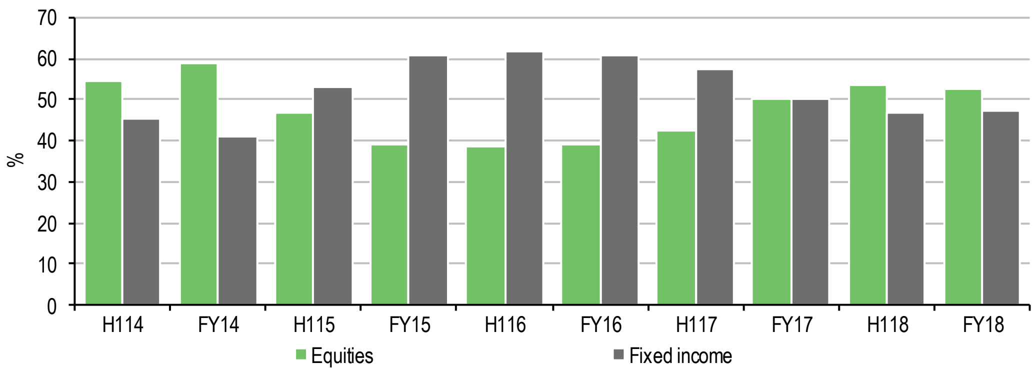
Investment process: Proprietary, fundamental research

ASI are long-term investors, with a team-based approach, seeking quality companies at reasonable valuations, that can be held for the long term. Quality is defined in terms of a company's management team and its capital allocation, its business focus, the strength of the balance sheet and its corporate governance track record. The strategy involves bottom-up, proprietary research, and regularly meeting company managements is a key element of the investment process.

ALAI is managed based on inputs from ASI's global emerging markets equities and emerging market debt teams, who communicate regularly to consider portfolio positioning. They discuss findings from company meetings and recent trips undertaken, combining macro and micro inputs from the fixed income and equity teams, respectively; they also debate the appropriate level of gearing based on their outlook for investment returns. The allocation between equity and debt will vary depending on which asset class offers the best value and opportunities. A more positive view on the Latin American region is expressed via a higher equity than fixed income weighting. Country and sector weightings will also change over time depending on the managers' level of conviction.

Risk management is integral to the investment process; ASI has an independent performance and risk team to ensure that funds adhere to their respective guidelines, and that managers are aware of their risk exposures.

Exhibit 4: Portfolio exposure (last five financial years)



Source: Aberdeen Latin American Income Fund, Edison Investment Research

Regarding ALAI's equity investment process, Isper explains that there is an emerging markets (ex-Asia) team of 20 fund managers – 15 based in London and five in São Paulo. The process is research-intensive and includes bottom-up company analysis. All 20 team members spend most of their time visiting companies and undertaking proprietary research, which is deemed crucial to stock selection and to gain a thorough understanding of a company's business.

The manager explains that essentially there are three pillars to the process:

- Fundamental research, which involves assessing the quality of businesses' operations, and includes meeting people on the ground to fully understand each company's business model. The approach is disciplined and patient, as it may take a manager a long time to build up an adequate level of knowledge. ASI ensures that the managers undertake several meetings with a potential investee firm before initiating a position. Isper explains that analysis of a company's financials is not overcomplicated. Once a manager identifies a good business, they undertake financial forecasts for a few years out and compare a company's ratios with those of its industry, regional and global peers to determine its relative value. Isper believes that ASI's broad resources provide a competitive advantage in company analysis.

- Disciplined approach when buying and selling – the managers' fundamental analysis includes valuation targets. They take their time and do not rush, waiting for stock market volatility to enable them to buy good companies at attractive valuations, or to sell when a company's valuation is extended. The managers invest for the long term; ALAI's equity turnover is c 15% pa, which implies a seven-year holding period, although Isper notes that many of ALAI's holdings have been in the portfolio for more than 10 years.
- Isper explains that ASI is an active, but not activist shareholder – company engagement is seen as a core part of the due diligence process. When building knowledge on companies, the managers look for business quality, assessing the strength of the management team, how robust the operating environment is, and also considering economic, social and governance (ESG) factors. Isper says that the governance aspect has been embedded into the research process for many years, allowing closer relationships with management teams and helping to achieve better treatment for minority shareholders. ALAI's managers undertake deep analysis of a company's ESG risks, adopting a holistic approach to research in order to uncover non-financial risks. This part of the process can be time-consuming, but the manager explains that there is always something within a portfolio company or potential investee firm that can be enhanced. The managers try to attend as many company AGMs as possible, to build closer relationships with their leadership teams. Engagement is seen as an important day-to-day part of portfolio management, and when issues arise, ALAI's managers need to engage more and push for improvement. A recent example is meeting with Vale's management team following the Brumadinho dam collapse in January 2019.

Szabó says that the debt investment process is quite similar to the equity approach. He explains that both ASI's global emerging markets equities and emerging market debt teams are well resourced, with the majority of the debt managers based in London, focused on both corporate and government debt. Analysis is on a bottom-up basis, with emphasis on the perceived prospects of each individual country. The debt team have good contacts on the ground and undertake regular country visits. They look for relative value opportunities and build ALAI's debt exposure accordingly. The fund only invests in government or quasi-government issuers, rather than corporate debt. Szabó explains that large-cap corporate bonds in Latin America can be 'super illiquid', typically held by local banks and investors, which would expose ALAI to significant liquidity risk. All of the fund's investments are made in local rather than hard currencies. It is possible for the managers to hedge or take forward currency positions. Szabó stresses that, in line with its equity positions, ALAI's fixed income positions are held for the long term.

ASI's fixed income team is responsible for generating the bulk of ALAI's income, so investments are biased to higher-coupon issues. This ensures that the fund's equity managers can focus on selecting companies for their capital appreciation potential rather than just focusing on their income.

Current portfolio positioning

At end-December 2018, ALAI's active share was 54.8% (59.9% a year earlier). This is a measure of how a portfolio differs from its benchmark, with 0% representing full index replication and 100% no commonality. The company's top 10 positions are shown in Exhibit 1; they are relatively concentrated, making up 43.8% at end-December 2018, compared with 40.2% a year before. Within the top 10 are seven government bond and three Brazilian equity holdings:

- Banco Bradesco ADR – a privately held bank, with a strong brand name, robust loan growth and a well-regarded management team.
- Itaú Unibanco ADR – the largest privately held bank in Brazil. It has good growth prospects, and is well capitalised with high-quality assets.
- Lojas Renner – a large clothing retailer with its own credit financing division. The company has expanded its operations into Uruguay and launched a home furnishing brand (Camicado).

Exhibit 5 shows ALAI's portfolio breakdown. There has been very little change in its structure over the 12 months to end-December 2018, with c 55% invested in equities, c 45% in government bonds, and 64 holdings.

Exhibit 5: Current portfolio breakdown

	Portfolio end-December 2018	Portfolio end-December 2017	Change
Equity exposure (%)	54.2	53.9	0.3pp
Fixed income exposure (%)	45.8	46.1	(0.3)pp
Number of holdings	64	64	0

Source: Aberdeen Latin American Income Fund, Edison Investment Research

ALAI's geographic exposure is shown in Exhibit 6. Over the last 12 months, the notable change is 4.9pp higher exposure in Brazil.

Exhibit 6: Total portfolio breakdown by geography (% unless stated)

	Portfolio end-December 2018	Portfolio end-December 2017	Change (pp)
Brazil	50.0	45.1	4.9
Mexico	22.9	22.4	0.5
Colombia	6.5	7.2	(0.7)
Uruguay	6.4	7.7	(1.3)
Peru	4.3	4.7	(0.4)
Argentina	4.1	4.3	(0.2)
Chile	3.7	5.5	(1.8)
Cash	2.1	3.1	(1.0)
	100.0	**100.0**	

Source: Aberdeen Latin American Income Fund, Edison Investment Research

All of ALAI's equity investments are based on bottom-up stock selection. During 2018, there were four new equity holdings and three complete disposals. Isper explains that most activity in the portfolio is booking profits or adding to positions on weakness (typically in a range of 10–30bps), taking advantage of market moves. The four new positions are:

- **IEnova** operates gas pipelines and liquid petroleum gas (LPG) storage facilities. Its stock price was weak in the run-up to the Mexican presidential election as investors had concerns about tighter regulation of their businesses. However, while IEnova's businesses are regulated, it enters into private contracts, so the company is less prone to government interference. It also signs long-term, take-or-pay contracts in US dollars, which provide a level of stability. IEnova is a division of US-listed Sempra Energy, which is a large North American energy infrastructure company, providing financial strength and deep knowledge to its subsidiary.
- **Notre Dame Intermédica** is a vertically integrated company, whose operations include healthcare plans and hospitals. The manager explains that the company can provide customers with a very strong value proposition, in terms of low cost and good-quality service. It is the third-largest player in a fragmented market, with opportunities to grow both organically and via acquisitions, supported by strong demand for healthcare services in Brazil. ALAI initiated its position in Notre Dame Intermédica via a secondary offering at a discount to the prevailing market share price, following a divestment by a large shareholder.
- **Petrobras** is the Brazilian state-owned oil company. ALAI held a position in this stock in the past, but sold out in 2014 due to concerns that the company was not being managed in the best interests of shareholders, the threat of government intervention, and also because of question marks over the strength of its balance sheet. The managers have continued to track Petrobras's progress since ALAI's position was sold, as it has the strongest asset base versus its peers in Latin America. Its prospects were reassessed once again following Bolsonaro's presidential election win. The managers are impressed with the company's growth profile and note improving operating efficiency over the last two years. They believe that Petrobras is also demonstrating a higher level of discipline with regard to capital allocation, and is strengthening its balance sheet. The managers comment that the new government appears to be more business friendly and less actively involved in state-owned companies. They initiated a position

in Petrobras in October, around the time of the presidential election, when the company was trading at an attractive valuation compared with the average of its global peers.

- **Raia Drogasil** is the largest pharmacy chain in Brazil, with a greater than 20% share of a fragmented market. It has above industry average margins and sufficient capital to fund organic growth, as well as making select acquisitions.

The three disposals were: Bancolombia, which was sold to fund the position in Petrobras and had experienced a series of operational missteps; Brazilian retailer Hering, where the managers had low conviction in the company's business prospects; and Iguatemi, a shopping mall operator. ALAI also holds a position in Multiplan, a similar Brazilian real estate company, which the managers believe has superior upside potential. All three holdings were sold following a period of relative share price outperformance.

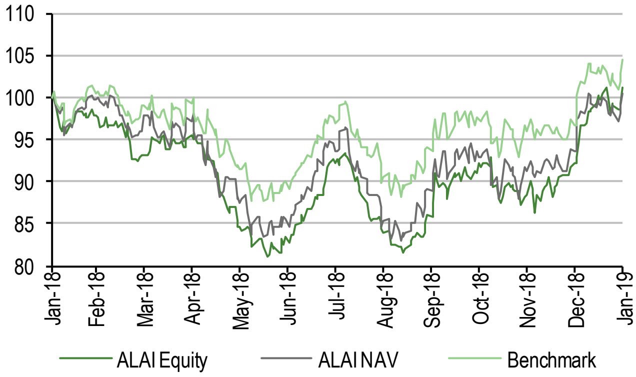
In terms of ALAI's government bond exposure, compared with the bond index in its composite benchmark, the fund is overweight Argentina, Brazil and Uruguay, and underweight Colombia, Mexico and Peru. There is no exposure to Chile as the available yields are relatively low.

Performance: Strong three-year absolute returns

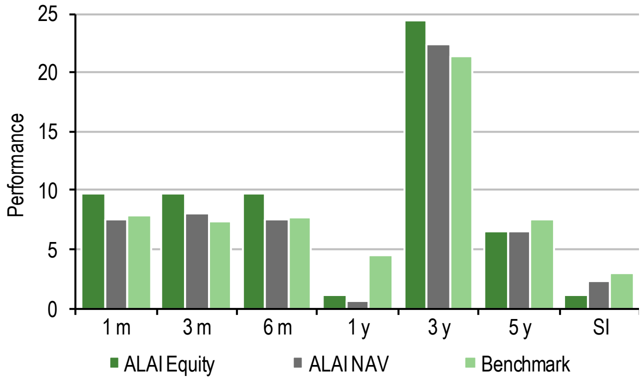
In FY18 (ending 31 August), ALAI's NAV and share price total returns of -18.8% and -18.5%, respectively, trailed the benchmark's -10.9% total return, with underperformance in both equities and fixed income. Within equities, asset allocation and its associated currency effects made a positive contribution to performance, but this was outweighed by stock selection, primarily in Brazil. ALAI did not hold a position in Petrobras, which performed relatively better over the period. Some of the company's positions performed poorly, such as food producer BRF, which was affected by a combination of execution missteps and negative external factors, including export bans and pressure from high grain prices. These have affected the company's cash generation and resulted in a deterioration in its balance sheet. In 2018, a new board of directors appointed a fresh executive management team and announced a strategy to turn the company around. The new strategic plan aims to improve the company's profitability through a number of operational initiatives and reduce its debt via asset sales. Despite these positive developments, the managers reduced ALAI's holding in BRF during the year on valuation and risk-management grounds. The holding in Mexican airport operator Asur added to performance; it is undergoing a development programme, which the manager believes will be accretive to the company's future prospects. Within fixed income, there was a positive contribution from the fund's Uruguayan inflation-linked bonds, which was more than offset by declines in Argentine and Brazilian government bonds.

Exhibit 7: Investment company performance to 31 January 2019

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised. Note: SI is since fund inception on 16 August 2010. Composite benchmark is 60% MSCI EM Latin American 10/40 index and 40% J.P. Morgan Government Bond Index EM Global Diversified (Latin America carve-out).

Exhibit 7 shows ALAI's absolute returns. While it has generated single-digit NAV and share price total returns over one and five years and since the fund's inception, over three years, returns have been robust. The company has generated annual NAV and share price total returns of +22.4% and +24.4%, respectively (benchmark total return +21.4% pa).

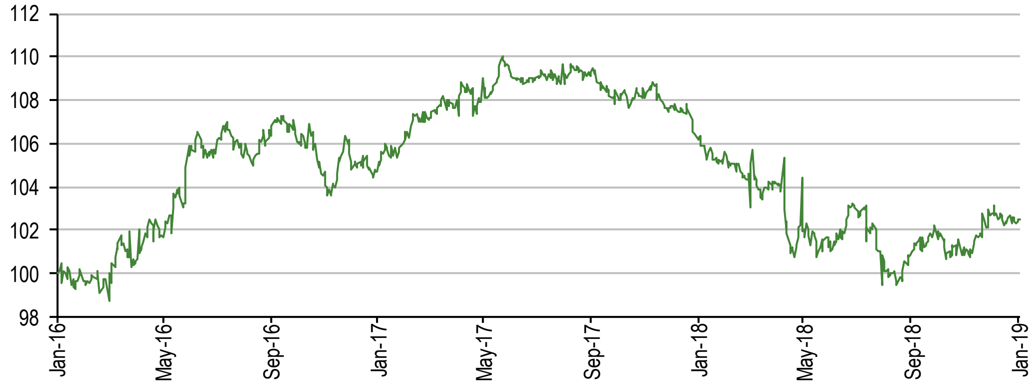
Exhibit 8: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	SI
Price relative to benchmark	1.6	2.2	1.9	(3.1)	7.6	(4.6)	(13.8)
NAV relative to benchmark	(0.3)	0.8	(0.2)	(3.7)	2.5	(4.3)	(5.1)
Price relative to MSCI EM LA 10/40	(1.5)	1.2	(0.8)	(1.9)	(3.2)	(7.4)	(5.0)
NAV relative to MSCI EM LA 10/40	(3.4)	(0.3)	(2.8)	(2.4)	(7.8)	(7.1)	4.7
Price relative to JP Morgan LA gov't bond	6.5	4.0	6.5	(4.3)	28.5	3.3	(21.0)
NAV relative to JP Morgan LA gov't bond	4.5	2.5	4.3	(4.9)	22.3	3.6	(13.0)
Price relative to FTSE All-Share	5.3	11.2	19.8	5.2	49.9	4.3	(41.9)
NAV relative to FTSE All-Share	3.2	9.6	17.3	4.6	42.8	4.7	(36.0)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-January 2019. Geometric calculation.

ALAI's relative returns are shown in Exhibit 8. Its NAV has outperformed the benchmark over three months and over three years, while its share price has also outperformed over one and six months. For UK investors, it is interesting to note the company's significant outperformance compared with the FTSE All-Share Index over three and six months and over three years.

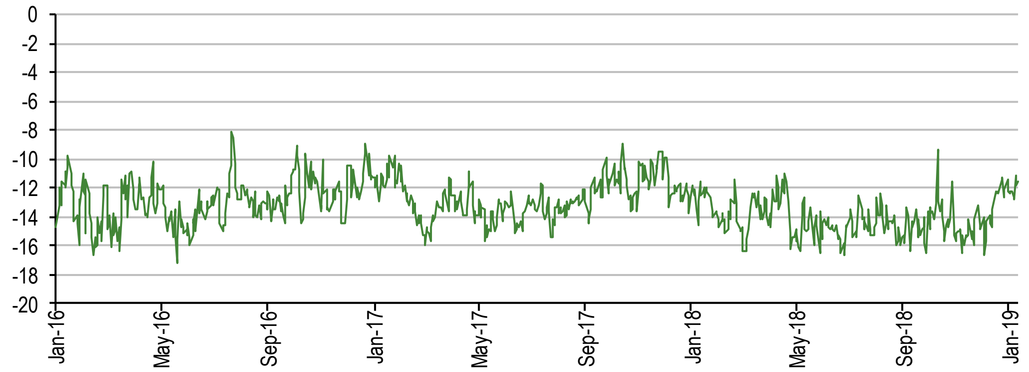
Exhibit 9: NAV total return performance relative to benchmark over three years



Source: Thomson Datastream, Edison Investment Research

Discount: Trading within a range

Exhibit 10: Share price discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

ALAI generally trades within a range of a c 10% to c 16% discount. The current 11.6% discount to cum-income NAV compares with the 9.3% to 16.7% range over the last 12 months, and compares with the average discounts of 14.0%, 13.2% and 11.7% over the last one, three and five years, respectively. There is scope for the discount to narrow if there is improved investor sentiment towards the outlook for Latin America.

Renewed annually, the board has the authority to repurchase up to 14.99%, and allot up to 10% of issued shares in order to manage a discount or premium. It continues to buy back shares opportunistically; during FY18, c 2.0m shares (3.2% of the end-FY17 share base) were repurchased at a cost of £1.4m, which was 0.4% accretive to NAV. So far in FY19, a further 1.4% of ALAI's shares have been bought back (0.9m at a cost of £0.6m).

Capital structure and fees

ALAI is a Jersey-registered investment company with one class of share; there are currently 59.3m ordinary shares in issue, with a further 6.1m held in treasury. The company has a three-year £8m, multi-currency, revolving credit agreement with Scotiabank (Ireland) of which £6.5m is drawn; the company is not permitted to have fixed, long-term borrowings. At end-December 2018, net gearing was 12.7%.

Aberdeen Standard Fund Managers (ALAI's alternative investment fund manager, AIFM) is paid an annual management fee of 1.0% of the company's NAV, calculated monthly; it is charged 40% and 60% to the revenue and capital accounts, respectively. There is an agreement with the manager that ALAI's ongoing charge ratio (OCR) will be capped at 2.0%. In the event that fees are above this level, the manager will rebate part of its management fees to bring the OCR down to the stated threshold. Following the FY18 year-end, £22,318 has been repaid by the manager; hence the FY18 OCR was at the 2.0% cap, which was modestly higher than 1.98% in FY17.

Dividend policy and record

ALAI pays quarterly dividends in January, May, July and October. The 3.5p distribution paid in FY18 was in line with the prior two financial years (having been rebased from 4.25p in FY16 due to the depreciation of Latin American currencies); at present, the board has no plans to change the level of dividend payments. Revenue per share of 3.78p meant that the FY18 dividend was 1.08x covered (1.36x in FY17). After allowing for the payment of the final interim dividend, at end-FY18, ALAI had revenue reserves of £1.7m, which is equivalent to c 80% of the last annual distribution. Based on its current share price the company offers a 4.9% dividend yield.

Peer group comparison

Exhibit 11: Selected peer group as at 8 February 2019*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Aberdeen Latin American Income	42.1	0.4	84.3	32.4	(11.6)	2.0	No	113	4.9
BlackRock Latin American	189.6	5.9	101.2	48.1	(12.6)	1.1	No	110	5.0
Average	**115.9**	**3.1**	**92.8**	**40.3**	**(12.1)**	**1.6**		**112**	**5.0**
ALAI rank	**2**	**2**	**2**	**2**	**1**	**1**		**1**	**2**
Open-ended funds									
Aberdeen Latin American Equity	137.9	0.0	97.9	42.4		1.6			0.7
Fidelity Latin America	1,082.4	0.6	77.3	34.3		1.9			0.6
Schroder ISF Latin American	199.2	3.2	80.9	29.4		1.9			2.6
Templeton Latin America	818.6	4.3	83.5	25.1		2.3			0.9
Threadneedle Latin America	429.3	(0.1)	69.7	16.9		1.7			1.0
Average	**533.5**	**1.6**	**81.9**	**29.6**		**1.9**			**1.2**

Source: Morningstar, Edison Investment Research. Note: *Performance as at 7 February 2019. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

There are just two companies in the AIC Latin America sector; ALAI is considerably smaller than its peer. Its NAV total returns rank second over the periods shown. Both funds are trading on similar discounts. ALAI has a higher-than-average ongoing charge, owing to the impact of fixed costs on a small fund, and a modestly higher level of gearing. Following the introduction of BlackRock Latin American's higher distribution policy, both companies have a broadly similar dividend yield, although they have very different investment strategies.

To enable a wider comparison, we also compare ALAI to a selection of open-ended funds that invest in Latin American equities (although its government bond exposure makes it unique). Its NAV total returns are above average over three and five years, while lagging over the last 12 months. ALAI's dividend yield is a considerable 3.7pp higher than the open-ended fund average.

The board

There are currently three independent, non-executive directors on ALAI's board. Richard Prosser has been the chairman since launch in 2010; he is a chartered accountant and holds a number of directorships including at Estera Trust, along with property companies, hedge funds and investment management companies. George Baird has also been on the board since launch; he has a background in law and accountancy, and holds several non-executive directorships in the Channel Islands. Hazel Adam is the newest director, having joined the board on 27 April 2018. Adam was previously an executive director on the emerging markets equity desk at HSBC, and prior to that held a similar role at Goldman Sachs International. A fourth director, Martin Adams, stood down at the December 2018 AGM, having served as a non-executive director since launch.

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