2020

Q&A

Aberdeen Standard Investments

Aberdeen Asia-Pacific Income Fund, Inc. (FAX)

Specific to recent proxy vote results:

1. Why hasn't FAX completed any buybacks when discount hovers around 19%? What's our strategy on buybacks? We risk activist interest.

A widening in discounts is not unique to FAX, as most of the closed-end funds have experienced a widening of discounts during the recent market volatility. Share price has been rallying. Management does not feel buying shares into that is effective even when there is a wide discount. Prior to the share price rally, the buy-back activity was modest as we were focused on getting investment limitation changes which would improve earnings/risk profile to be followed by IR marketing push.

2. The fund is no longer required to hold at least 20% of the total assets in 'Australian debt securities'. Can you go into more detail as to why this investment policy was amended?

When the Fund was launched, the Australian bond market had a much higher yield than that of the US. In many ways, the higher yield offered insulation in the face of bouts of currency volatility. The positive yield differential in Australia's favour has declined over the years, and in early 2018 the interest rate differential turned negative.

Over the past 10 years of so, the Australian dollar has experienced a dramatic shift in its supportive drivers. Initially, it was well supported by the emergence of China, the commodities demand and a relatively higher yield than other G10 currencies. Many of these tailwinds have become headwinds, with additional domestic economic fragilities (before COVID) emerging with the RBA easing monetary policy to 0.75% and contemplating extraordinary measures. Extraordinary measures are now in place, with a yield target of 0.25% along the curve. The volatility of the AUD does tend to increase around escalations of trade tensions and now, in response to the corona-virus. In many ways it is still the "canary in the coal mine." Experience suggests that Australia's AAA credit rating has little bearing on the currency's volatility.

Targets are offered as opinion and are not referenced to past performance. Targets are not guaranteed and actual events or results may differ materially. Generally the credit ratings range from AAA (highest) to D (lowest). Where bonds held in the Fund are rated by multiple rating agencies (Moody's, Fitch and S&P), the lower of the ratings is used. This may not be consistent with data from the benchmark provider. Quality distribution represents ratings of the underlying securities held within the Fund, and not ratings of the Fund itself.

The requirement to maintain a minimum exposure to the Australian bond market meant the Fund would be required to have its largest currency concentration to a low yielding and highly volatile currency. This would have negative implications for the Fund's ability to sustain its distribution and the risk profile (volatility of the fund).

Removing the Fund's minimum exposure to the Australian bond market allows the Fund to seek better income opportunities within the Asian region, and to a limited extent beyond. For many bond markets in Asia, there are appealing structural trends that have been established by policy makers over the past 20 years. These include prudential fiscal and monetary policy management as well as broader microeconomic and capital market reforms. Notwithstanding the lower credit ratings, the long-run path for many countries has been positive. The region offers higher yields and, importantly, significant opportunities for diversity across countries, sectors and currencies. The Fund's ability to replace a concentrated risk in a low yielding volatile market, with a much more diverse higher yielding opportunity set is expected to improve the Fund's overall income generating capability and also its risk profile over the longer term.

3. With removing the 20% required allocation to Australia, do you anticipate maintaining any of that allocation moving forward? If not, where else will you look to invest?

Although the minimum allocation to Australia is removed we do anticipate retaining some exposure to the Australian market. A smaller allocation will help the Fund strike the balance between income generating capability and NAV volatility over the medium the longer-run. Despite the lower yield and currency volatility, the Australian market with its AAA rating is generally a very liquid market and so has appeal in portfolio construction considerations.

Reductions in Australia will result in increases in allocations to Asian bond markets and to a limited extent those markets outside the Asia-Pacific region. The latter is limited to 20% of the Fund.

While we envisage a reduction in the Australian debt exposure, it is worth noting that the new benchmark for the Fund under the proposal retains a 10% allocation to Australia, with EM exposure at 15%. Australia is still in the investment universe and an allocation to Australin debt is likely to continue going forward.

4. Shareholders approved the modification to eliminate the 10% maximum currency exposure to any one Asian currency (other than Korea). What is your view on foreign vs. U$D? Where will the rebalanced investments be allowed ?

The sheer size of the recent policy actions by the US Federal Reserve, especially its balance sheet expansion appears to overwhelm similar actions by other central banks around the world. The provision of ample US dollar liquidity may lead to a depreciation of the US dollar for an extended period, especially as economic activity stabilises and those countries with policy capacity, like those in Asia, support the recovery efforts. Nevertheless, the US dollar is still the world reserve currency and will be supported in times of heightened uncertainty.

The rebalance of investments allowed will be:

- Up to 25% exposure in investment grade countries and currencies in Asia Pacific region.
- Up to 15% exposure in non-investment grade countries and currencies in Asia Pacific region.
- Max of 20% in aggregate outside of Asia Pacific region and no more than 10% in any country or currency (excluding the US dollar).

5. Will the portfolio maintain above investment grade credit quality with the shareholder approved changes? What is the actual risk profile post-changes? Can you speak to both sovereign vs. corporate? What's our strategy on the non-rated holdings?

The Fund will maintain no more than 35% of the portfolio in non-investment grade issues at the time of purchase.

While the reduction in the exposure to the Australian market will see the average credit quality of the portfolio deteriorate to an extent, we believe it will not be a material reduction and envisage the average credit quality of the assets to remain investment grade. Many of the core Asia Pacific markets are investment grade. We continue to seek diversity, while actively seeking appealing risk-adjusted income generating opportunities.

ASI has a well-resourced and experienced team that is well placed to identify the risks and navigate the risks inherent in doing so.

The majority of local currency investments are in sovereign or sovereign-linked/quasi sovereign bonds. Many of the local currency denominated sovereign bond issues which are held by the portfolio are unrated even though the credit ratings agencies do have issuer/ sovereign credit ratings for those sovereigns. As the issues are unrated, they are reported in the Factsheets as unrated.

One of the key outputs of the fundamental credit analysis is a Fundamental Credit Assessment. This is a forward looking indication of credit quality typically targeting a 12 month time horizon. It is complemented by a Fundamental Credit Trend, which provides details on the stability of a company's credit profile. Regardless of whether rated by third-party rating agencies or not, ASI undertakes credit analysis for all issuers.

With respect to the US dollar denominated holdings, within Asia these will comprise sovereign, quasi-sovereign and corporate exposures, while those outside Asia will predominantly be sovereign issuers.

6. Discuss the use of leverage and thoughts to draw or pay down in volatile markets ?

Leverage is used strategically by the Fund to support its income generating capability. Over the medium-to-longer term leverage has contributed positively to the performance of the net asset value of the Fund, but in the short-term can magnify the volatility of the performance of the Fund's assets. The Fund continues to benefit from a positive interest rate differential between the interest income on the investment portfolio and cost of the leverage.

In view of the dramatically deteriorating market conditions and degree of uncertainty experience in March 2020, the Fund reduced the amount of leverage used, thereby maintaining its compliance with its loan covenants while building a degree of flexibility / capacity to withstand further market volatility or to take advantage of opportunities as economic and market conditions stabilise.

In an ideal world, the Fund would deploy leverage to take advantage of value opportunities in dislocated markets, but so large and rapid was the move in March that the capacity to draw additional leverage was limited by the need to maintain compliance with loan covenants. In paying down the leverage during March, the Fund liquidated positions in the more liquid (and less dislocated) markets, such as Australia and other Asian local currency sovereign markets, where central banks were actively participating or providing liquidity. Subsequently, we have added to the leverage to take advantage of some price dislocations in the higher quality Asian credit markets.

The Fund's use of leverage exposes the Fund to additional risks, including the risk that the costs of leverage could exceed the income earned by the Fund on the proceeds of such leverage. Additionally, in the event of a general market decline in the value of the Fund's assets, the effect of that decline will be magnified in the Fund because of the additional assets purchased with the proceeds of the leverage.

7. Generally discuss the downgrade by Fitch and whether you think the fund's holdings remain liquid in light of the market contraction.

Management remains focused on meeting the Fitch Basic Maintenance Tests.

Notwithstanding>50% (as at May 31, 2020) of the portfolio being invested in non-USD denominated assets, the quality of these assets remains of a high standard and integral to the ongoing functioning of the capital markets in the local jurisdictions. As a result, almost all of these non-USD denominated assets are eligible for official direct repurchases or as collateral for repo facilities at the central banks.

8. Will the investment policy changes help narrow the discount and improve the overall NAV and share price performance? What discount management tools are being utilized/considered?

Management believes that, when sustainable, maintaining a stable distribution in order to provide investors with a regular and predictable cash flow is beneficial to the level of premium/discount experienced by shareholders.

The disadvantage of a stable distribution is the potential for the erosion of the Fund's assets over time. The Fund has experienced earnings pressure due to the protracted period of low global bond yields. In April 2019, in order to better align with the Fund's earnings, the Board approved a cut to the monthly distribution from 3.50 cents per share to 2.75 cents per share starting with the distribution payable in April 2019.

The investment policy changes strike a balance between supporting the income generating capability and improving the overall risk profile through greater diversification across a number of vectors of risk (countries, currencies, interest rate markets, sector and issue exposures).

9. How are we taking advantage of the current global market situation and more specifically the lower interest rates?

Going into the crisis many Asian sovereign and corporate issuers were in relatively better shape than their global peers. While all credit markets experienced a pronounced sell-off due to the covid-19 economic and market dislocations, the Asian markets were relatively better performers. Following the provision of US dollar liquidity, market conditions have greatly improved, but Asia has lagged. Relatively speaking, we continue to see strong fundamentals and valuations that will likely support performance for the Asian credit market over the medium-term.

10. Do we foresee the Fund reducing its distribution again in the near future? Has the Fund improved in earning the distribution since last April's reduction?

The investment policy changes strike a balance between supporting the income generating capability and improving the overall risk profile through greater diversification across a number of vectors of risk (countries, currencies, interest rate markets, sector and issue exposures).

General questions addressing FAX's current positioning and outlook

1. In light of the Covid-19 situation in the region, what is the mood of management among the companies you have been speaking to?

Many companies are cautious and are redoubling their efforts to proactively manage and strengthen their balance sheets. Companies and sovereign policy makers across the region have been actively engaging the investment community to provide ongoing updates despite the challenges of telecommuting.

2. Are there any other sectors that are particularly vulnerable? Resilience? Impact on portfolio?

The economic lock-downs have been particularly disruptive to the consumer discretionary sector (retail, tourism, airlines etc). While the Fund does have exposure to those sectors, the focus on diversity means the exposure to certain issues facing outsized challenges is relatively small / manageable and unlikely to materially impair the capital or income generation for the Fund.

The energy sector around the world has come under pressure in recent times. While Asia has its fair share of energy-related issuers, many of these are government related entities and given their strategic importance to the state, remain resilient.

3. From your perspective, how does the closed-end fund structure help you effectively manage the portfolio?

More predictable cash-flows. This allows investment decisions to look through near term storms to identify medium to longer-term opportunities that support the objective of the Fund.

4. What would you say to clients to give them comfort that they should invest in Asia-Pacific fixed income?

The region is incredibly diverse. The region suffered an existential shock in the late 1990s that forced painful economic adjustments. As a result of these adjustments, reforms and prudential policy making, Asian economic fundamentals are robust and the regional economies and bond markets will likely remain resilient.

Swift action by central banks and a commitment to lower-for-longer will support local bond markets.

For more than two decades, Asian governments have maintained fiscal prudence. This has created ample fiscal capacity to support the economies during the period of heightened economic uncertainty and to support the recovery thereafter. Take Singapore as a case in point, fiscal support in 2020 amounts to almost 20% of GDP. This is funded, not from an increase in debt, but from previous fiscal surpluses and from its own national reserves.

Asian currencies are relatively more stable than their emerging market and G10 counterparts, supported by better external balances and high foreign-exchange reserves.

We, therefore, see value across markets as volatility subsides, bond markets recouple with fundamentals , and investors begin to look through the near-term growth weakness towards the shape of the recovery.