# Aberdeen Asian Income Fund

Initiation of coverage

## Finding attractively valued income opportunities

Investment companies

**Aberdeen Asian Income Fund (AAIF) aims to provide its investors with an attractive income, plus the potential for capital growth, by investing across the Asia Pacific region. The fund's target c 4.5% yield is fully funded from portfolio income. AAIF's investment process is bottom-up, with a strong focus on finding quality companies at attractive valuations. The managers meet all the companies they hold at least twice a year, and place great emphasis on understanding each company's balance sheet and growth drivers to ensure everything in the c 40–70 stock portfolio is worthy of its place. AAIF's quality and income focus means it has a natural bias to some more defensive areas, which could stand it in good stead in the current bout of market volatility. Its managers note that valuations in Asia are low in relation to Europe, North America and their own historical averages, and some individual stocks are very inexpensive versus history.**

| 12 months ending | Share price (%) | NAV (%) | MSCI AC Asia Pac ex-Jpn (%) | MSCI AC Asia Pac ex-Jpn HDY (%) | FTSE All-Share (%) |
|---|---|---|---|---|---|
| 30/11/14 | 4.5 | 6.4 | 8.7 | 11.0 | 4.7 |
| 30/11/15 | (19.6) | (13.3) | (7.7) | (12.1) | 0.6 |
| 30/11/16 | 29.7 | 30.2 | 30.8 | 32.1 | 9.8 |
| 30/11/17 | 15.4 | 14.7 | 21.6 | 14.2 | 13.4 |
| 30/11/18 | (4.3) | (1.3) | (2.9) | 2.4 | (1.5) |

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

## Investment strategy: Focus on quality and value

In common with other funds managed by Aberdeen Standard Investments Asia (ASI Asia), AAIF follows a well-defined investment process, focused on finding quality companies trading at attractive valuations. The bottom-up investment process is backed up by extensive fundamental research and the team meets with all its holdings at least twice a year. Environmental, social and governance factors are embedded in the process, as good governance is a key indicator of quality.

## Market outlook: Look beyond near-term uncertainty

Asian equity markets have been volatile in 2018 on the back of US-led trade disputes and a general rise in investor risk aversion, which has led to capital outflows from the region. However, there is fundamental support for Asia's long-term outlook, with GDP growth far higher than that of the developed world and a wealth of regional companies offering goods and services to increasingly affluent populations. While the immediate outlook may continue to be uncertain, a focus on quality, cash-generative companies could reward investors in the long term.

## Valuation: Discount wider in recent market volatility

At 14 December 2018, AAIF's shares traded at an 11.1% discount to cum-income net asset value. This was wider than the 12-month average, following a fall in stock markets in early December. The shares have broadly traded between a 5% and a 10% discount to NAV since April 2016 (averaging 9.1%, 8.3% and 5.3% respectively over one, three and five years), and the board actively manages the discount by buying back shares when it exceeds 5%. AAIF offers a dividend yield of 4.7%.

**18 December 2018**

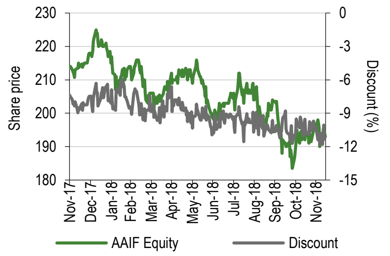
| | |
|---|---|
| **Price** | **193.0p** |
| **Market cap** | **£345.0m** |
| **AUM** | **£421.9m** |

| | |
|---|---|
| NAV* | 215.1p |
| Discount to NAV | 10.3% |
| NAV** | 217.1p |
| Discount to NAV | 11.1% |

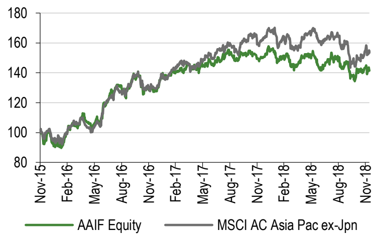
*Excluding income. **Including income. As at 14 December 2018.

| | |
|---|---|
| Yield | 4.7% |
| Ordinary shares in issue | 178.8m |
| Code | AAIF |
| Primary exchange | LSE |
| AIC sector | Asia Pacific ex-Japan |

### Share price/discount performance




### Three-year performance vs index




| | | |
|---|---|---|
| 52-week high/low | 225.0p | 183.5p |
| NAV** high/low | 241.7p | 207.8p |

**Including income.

### Gearing

| | |
|---|---|
| Gross* | 9.0% |
| Net* | 9.0% |

*As at 31 October 2018.

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Edison profile page

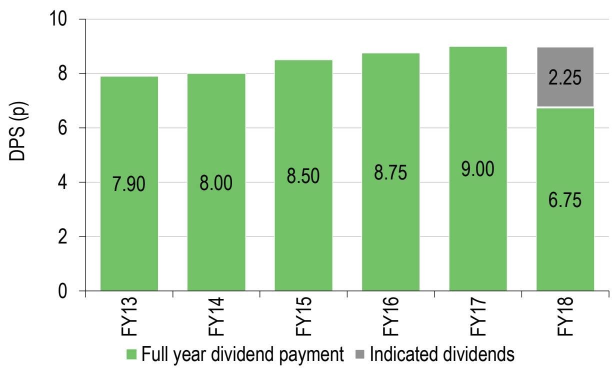

***Aberdeen Asian Income Fund is a research client of Edison Investment Research Limited***

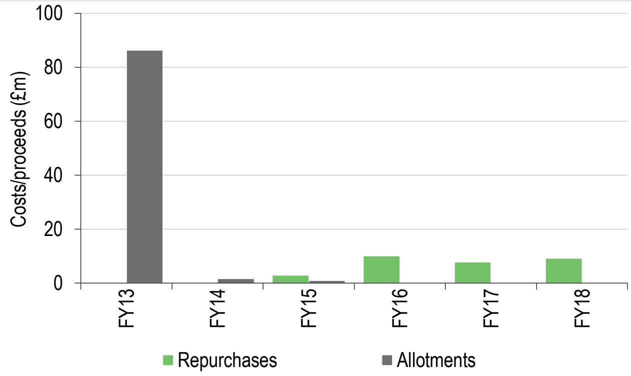
## Exhibit 1: Company at a glance

| Investment objective and fund background | Recent developments |
|---|---|
| AAIF aims to provide investors with a total return primarily through investing in Asian 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 Asia Pacific ex-Japan index, in sterling terms. | ■ 17 October 2018: third interim dividend of 2.25p declared in respect of year ending 31 December 2018, payable on 16 November.<br>■ 17 August 2018: results for the six months ended 30 June. NAV TR -3.3% and share price TR -6.8% versus -1.7% for both the MSCI AC Asia Pacific ex-Japan and MSCI AC Asia Pacific ex-Japan High Dividend Yield indices (currency adjusted). |

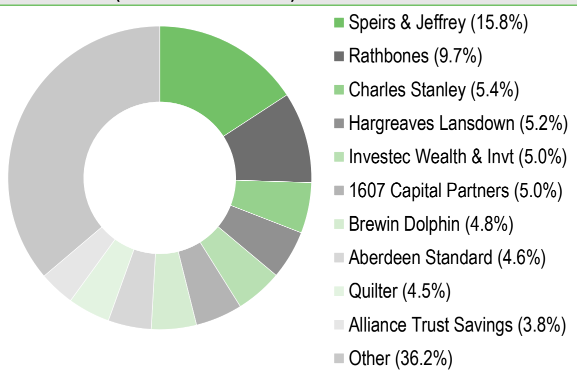
| Forthcoming | | Capital structure | | Fund details | |
|---|---|---|---|---|---|
| AGM | May 2019 | Ongoing charges | 1.09% | Group | Aberdeen Standard Investments |
| Annual results | April 2019 | Net gearing | 9.0% | Manager | Aberdeen Standard Investments Asia |
| Year end | 31 December | Annual 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 with Scotiabank | Website | www.asian-income.co.uk |

| Dividend policy and history (financial years) | Share buyback policy and history (financial years) |
|---|---|
| Dividends are paid quarterly, in May, August, November and February. The board's aim is to seek to grow the company's dividends. | 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%. |

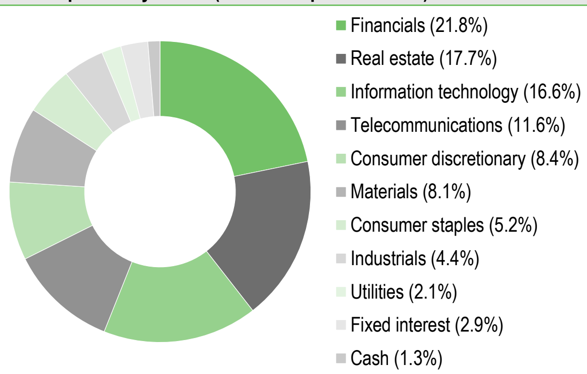



**Shareholder base (as at 5 October 2018)**




**Portfolio exposure by sector (as at 30 September 2018)**




**Top 10 holdings (as at 31 October 2018)**

| | | | Portfolio weight % | |
|---|---|---|---|---|
| **Company** | **Country** | **Sector** | **31 October 2018** | **31 October 2017*** |
| Taiwan Semiconductor Manufacturing | Taiwan | Information technology | 4.7 | 4.0 |
| Samsung Electronics | South Korea | Information technology | 4.5 | 2.6 |
| HSBC | Hong Kong | Financials | 3.9 | 3.7 |
| Venture Corporation | Singapore | Information technology | 3.7 | 5.3 |
| Oversea-Chinese Banking Corp | Singapore | Financials | 3.3 | 3.1 |
| Tesco Lotus Retail Growth | Thailand | Consumer staples | 3.2 | 2.5 |
| Taiwan Mobile | Taiwan | Telecom services | 2.9 | N/A |
| Spark New Zealand | New Zealand | Telecom services | 2.6 | N/A |
| Singtel | Singapore | Telecom services | 2.6 | 3.0 |
| China Mobile | China | Telecom services | 2.6 | N/A |
| **Top 10 (% of portfolio)** | | | **34.0** | **31.9** |

Source: Aberdeen Asian Income Fund, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in October 2017 top 10.

## Market outlook: Fundamental support for Asian growth

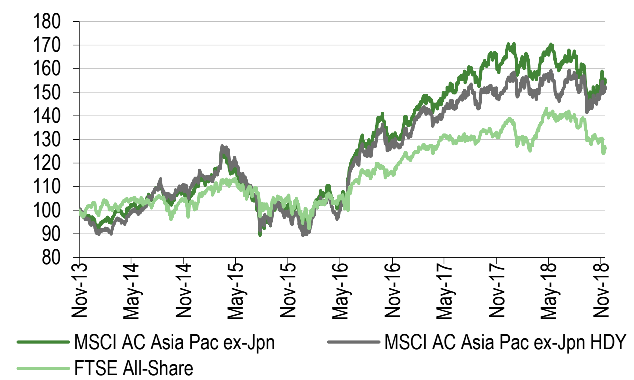
Sterling investors have enjoyed good returns from equity investment in the Asia Pacific region over the past five years (Exhibit 2, left-hand chart), far outstripping the total return from the domestic FTSE All-Share index. Although Asian markets can be more volatile over short periods (partly as a result of the fickleness of foreign capital flows), there are strong fundamental factors underpinning their long-term growth. As shown in the right-hand chart of Exhibit 2, forecast economic growth for the region over the next five years, although somewhat slower than in the last 10 years, is well ahead of the global average and multiple times the rate of expected growth in developed markets.

As Asian economies grow and disposable incomes rise, demand for consumer goods and services increases, which is beneficial to companies providing them. The need for better infrastructure and more housing for growing populations can be positive for industrial companies in areas such as construction, as well as utilities, telecommunications and energy. In addition, more affluent societies have a greater need for financial products and services, which fuels growth for banks, insurance companies and other financials.

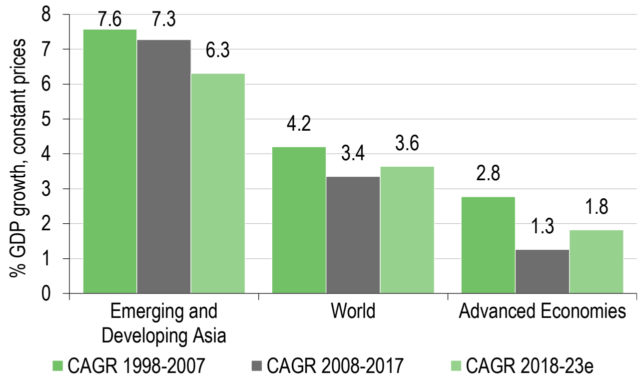
While the current picture may be clouded by uncertainty over US-driven trade tariffs, particularly with regard to China, Asia offers a wealth of home-grown companies trading in their domestic markets and across the region, on which tariffs will have a limited impact. Valuations in Asia ex-Japan, as measured by the 12-month forward P/E multiple, are slightly below their 10-year average and are c 10% lower than the global average. However, with volatility likely to persist in the near term, amid political noise and fears over the impact of higher interest rates on the US economy and the dollar (to which many Asian currencies are pegged), investors may prefer to take a selective approach to investment in the region, focusing on cash-generative companies whose long-term growth potential is supported by an attractive dividend yield.

**Exhibit 2: Market performance and valuation**

**Total return performance of Asia Pacific and UK equities over five years**




**International Monetary Fund GDP growth rates and forecasts, 1998 to 2023**




Source: Thomson Datastream, IMF World Economic Update (October 2018), Edison Investment Research

## Fund profile: Targeting high income and growth in Asia

AAIF was launched in December 2005 as a Jersey-incorporated, London-listed closed-end investment company. It aims to achieve total returns from income (c 4.5% pa target dividend yield, funded solely from portfolio income) and capital growth, by investing principally in listed companies across the Asia Pacific region, although it also holds some high-yielding fixed income securities (currently less than 3% of the portfolio) issued by companies whose equities do not offer an attractive dividend yield. It is managed by a team based in ASI Asia's Singapore head office, with input from investment teams based around the region. AAIF is managed according to ASI Asia's well-established, quality-focused investment process. It measures its performance with reference to the MSCI AC Asia Pacific ex-Japan index (although it may invest in Japan), and the MSCI AC Asia ex-Japan High Dividend Yield index. However, the bottom-up investment process and AAIF's focus on quality companies with attractive dividend yields means portfolio weightings may diverge widely from those of the index. AAIF is a member of the Association of Investment Companies' Asia Pacific Excluding Japan sector. The fund has a flexible approach to gearing (up to a working limit of c 15% of net assets) and actively manages its discount to NAV through share buybacks.

## The fund manager: ASI Asia

### The manager's view: Backing the domestic growth story

Yoojeong Oh, one of AAIF's portfolio managers, highlights the positive demographic factors in many Asia Pacific markets, particularly those in South-East Asia where the portfolio has a higher weighting than the MSCI AC Asia Pacific ex-Japan index. She points out that the International Monetary Fund's GDP growth expectations for emerging and developing Asia, at 6.3% a year for 2018–2023, are much more exciting than the 1.8% per year growth forecast for developed economies. Income, population and middle-class growth are all positive influences on overall economic growth and are supportive of domestic consumption, a key focus for the AAIF portfolio. Conversely, the fund is underweight North Asian exporters to Europe and the US, which have lower growth rates.

Although AAIF has significantly less direct exposure to China than the index (see Exhibit 3), Oh says the fund accesses Chinese retail consumer growth through companies that are listed in Hong Kong and Singapore, as these markets are more transparent and have better levels of corporate governance. It does have some direct exposure to the Chinese consumer through holdings such as SAIC Motor (A shares), which, in addition to being the Chinese brand owner for General Motors and Audi, also has its own mid-end domestic car manufacturing business and offers a good yield as well as growth potential. However, Oh says A-shares are unlikely ever to be a large position in the fund, because of structural rules in the Chinese A-share market that make it less attractive than elsewhere.

Given the focus on domestic consumption growth, Oh admits that import/export tariffs between the US and Asia are a factor. However, she explains that AAIF has limited exposure to US exports, as the key overweight area of South-East Asia is more of a domestic manufacturing and growth story. Even in China, the reliance on the US is less than historically, given an increase in intra-Asian trade. AAIF has limited exposure to industrial stocks, which are currently among the most affected by the trade dispute; Oh also points out that if punitive tariffs are applied to items such as sports shoes and consumer electronics, this will ultimately hurt the US consumer more than the Asian manufacturers of these goods.

AAIF partly focuses on providing investors with a high income, meaning a good starting yield is an important consideration in any investment. However, Oh says dividend growth is also important and has been a significant factor in some recent investment decisions, such as the purchases of LG Chemical, Ping An Insurance and Infosys (see Current portfolio positioning). 'Some utilities and banks are paying 5–6% yields, but we want a growth angle too and we get it from companies like these,' she says. The team favours Ping An partly for its online business, which has been operating for over a decade and now has 22 million users across three platforms. 'Having that direct access to consumers is more and more important for financial companies,' says Oh.

Valuation is another key consideration and the team closely monitors companies (both existing holdings and the 10–15 stocks on its watchlist) for opportunities to invest following share price weakness. Oh points out that in the period of global stock market volatility in March 2018, Singapore was the third-cheapest market in Asia. 'We know the quality of the companies, and when external factors drive them down we are happy to add to, for example, Oversea-China Banking Corporation

(OCBC), Venture or DBS,' she says. Conversely, while Taiwan is one of the region's highest-yielding markets, valuations have been less attractive. 'A lot of the companies on our subs bench are in Taiwan, and when we feel that valuations are at a level that will compensate us for the risk, we may buy,' says the manager. 'We are happy to wait – things do come down to your price point if you are patient.' With regard to Taiwan, Oh says the team prefers to focus on stocks that are 'at the top of the food chain,' such as Taiwan Semiconductor Manufacturing. While there are many Taiwanese IT suppliers in the investment universe of ASI Asia's small-cap funds, they are seen as too volatile for AAIF, as their cash flows quarter-on-quarter depend on orders on which there is very little visibility.

Looking ahead, Oh says that politics – as well as trade disputes, there are several forthcoming elections – and policies are likely to continue to influence Asian markets in the near term. Investor sentiment across the globe has turned more cautious and a potential slowdown in Chinese consumer spending could have an impact on economic growth across Asia, given the increasing importance of intra-regional trade. However, corporate fundamentals appear resilient, with many of AAIF's holdings still seeing encouraging levels of earnings growth, buoyed by structural themes such as growing demand for better-quality products and services from increasingly affluent populations.

# Asset allocation

## Investment process: Focus on quality at the right price

AAIF is managed from Aberdeen Standard's Singapore office, the firm's Asia Pacific regional hub, by the Asian equity team, which is led by managing director Hugh Young and head of equities Flavia Cheong. Adrian Lim, Yoojeong Oh and Chris Wong are senior investment managers on the AAIF team. ASI Asia has six offices in Asia ex-Japan, with 48 fund managers running a variety of regional and single-country mandates.

ASI Asia follows a well-established, research-intensive investment process, centred on identifying quality companies that are undervalued by the market. To assess quality, the team looks at a company's management team and its track record, how the company is managed and corporate governance factors such as how it treats minority shareholders. It seeks companies with strong enough balance sheets to support them through a business cycle – so that, for example, they can weather periods of falling demand for their products or services.

Companies that pass the quality tests form the universe of stocks from which ASI Asia constructs its portfolios. Portfolio managers in offices around the Asia Pacific region feed ideas back to the Singapore office for potential inclusion in regional funds. Each stock is analysed to gauge if it represents good value at its current share price. Those that are deemed expensive are placed on a watchlist and regularly reviewed. The assessment of price is based on factors such as key financial ratios, stock market conditions, the peer group and business prospects. Because of the income focus, AAIF's managers also seek companies that are supported by an attractive dividend yield. However, stocks that do not currently pay a dividend may be included if there is a plan in place to introduce or reinstate dividends in the near future. Oh gives the example of South32, which was non-dividend paying when it was spun out of BHP Billiton, but had net cash on its balance sheet and a key management milestone to begin paying dividends within its first 12 months of trading.

ASI Asia will not invest in a company until it has met its management and this process continues after an investment is made, with company meetings at least twice a year. Between meetings, the managers follow company results and newsflow, with information entered into an in-house database that all the regional offices can access. Oh says the database has more than two decades of information, and is a key benefit in terms of being able to track what companies have said and done.

As well as equities, the portfolio may include fixed-income securities. All the bonds that AAIF owns are issued by companies in which ASI Asia is an equity investor, so the team knows the balance sheet and the management. Bonds are held for yield enhancement, so tend to offer high coupons, and are typically issued by companies that are outside AAIF's remit because they do not pay attractive dividends. Oh gives the example of a bond issued by India's ICICI Bank, which yields 9% versus less than 1% for the equity.

AAIF's managers build a portfolio of c 40–70 holdings from an investable universe of c 150–200 stocks. Currently AAIF has 61 positions, with another c 10–15 good quality companies with a dividend tilt on its 'subs bench'. To ensure all holdings can contribute meaningfully to returns, new positions tend to come in at c 0.5% of net assets, with a view to building to 1.0% within a few months. Oh says a 2.0% position would symbolise good conviction on a company's growth potential and the sustainability of its income. Some higher-conviction positions have a higher weight – for example, Taiwan Semiconductor Manufacturing and Samsung are both over 4.0% – but anything over 5.0% is liable to be trimmed to maintain portfolio balance. Although there are no top-down or index-based constraints on geography, industry or company size, the managers seek to hold a diversified portfolio.

Environmental, social and governance factors are built into the investment process and ASI Asia's portfolio managers vote all their shares in all their holdings in all their funds. By attending shareholder meetings they gain the chance to build a relationship with the directors and the management of their holdings. This can be an important factor in improving corporate governance and build a picture of the strategic direction of a business, which is crucial for a long-term buy-and-hold investor. Oh says that travelling to company AGMs, even in countries where ASI Asia does not have an office, has enabled the team to improve corporate governance practice at the companies it holds, where boards may not have been aware of best practice in other jurisdictions. 'If you fix these things while there isn't a problem, it's good for everyone,' she explains.

ASI Asia's portfolios are conservatively run, with an emphasis on 'buy and hold'. However, Oh points out that while complete exits may be relatively rare, the AAIF team actively manages position size, particularly where a stock has had a good run, as a higher share price usually means a lower dividend yield. Portfolio turnover is low, at typically c 14–15% a year, implying an average holding period of six to seven years. The managers would not delay a sale if it was on the grounds of concern over a company's prospects, but would weigh up whether to wait for a dividend if a payment date was approaching. Oh says the team would be less likely to time a purchase around a regular dividend payment, although they 'try to angle for the big events,' such as disposals of non-core assets that would result in a capital return to shareholders.

AAIF may use gearing, subject to a working limit of 15% and a hard limit of 25%. Gearing is applied across the whole portfolio where the managers feel there are attractive opportunities that will provide returns in excess of the cost of borrowings. Borrowings may be drawn in a variety of currencies. While the fund does not hedge foreign exchange risk on an ongoing basis, it may occasionally match its borrowings with specific foreign currency investments.

Unlike some of its peers, AAIF has not historically used derivatives to boost portfolio income (for example, by writing options over stocks it wishes to sell at a certain price, which generates income in the form of premiums). However, a change to the investment policy approved at the May 2018 AGM means the fund now has the ability to write put and call options, provided there is sufficient liquidity in the underlying stock within the portfolio. The managers have not yet used this facility.

## Current portfolio positioning

At 31 October 2018, there were 61 holdings in AAIF's portfolio, the large majority of which (c 98% of the total) were equity investments. The number of holdings was the same as a year previously, although there was some change in the make-up of the portfolio over the period. The top 10 holdings currently account for 34.0% of the total, a slight rise in concentration from 31.9% at 31 October 2017.

As shown in Exhibit 3, Singapore is the largest country exposure and the largest overweight, at 20pp above the MSCI Asia Pacific ex-Japan weighting. Oh says the high weight in Singapore reflects the market's high dividend yield, the country's transparency and openness – which gives some surety in terms of corporate governance and disclosure – and its status as a gateway to South-East Asia. She gives the example of OCBC, which is one of the three biggest banks in Singapore, but derives a large part of its earnings from Indonesia, Malaysia and China, where it bought Wing Hang Bank in 2014. Thailand is another overweight, whereas Japan makes up 4.2% of the portfolio but is absent from the index. The largest underweights are in China (although the c 18pp underweight position reduces to c 10pp if the big internet stocks, which do not pay dividends, are stripped out), South Korea and India. The latter two markets are both low yielding and thus offer fewer stocks that fit AAIF's investment criteria.

**Exhibit 3: Portfolio geographic exposure vs MSCI AC Asia Pacific ex-Jpn (% unless stated)**

| | Portfolio end-October 2018 | Portfolio end-October 2017 | Change (pp) | Index weight | Active weight vs index (pp) | Trust weight/ index weight (x) |
|---|---|---|---|---|---|---|
| Singapore | 23.3 | 26.6 | (3.3) | 3.3 | 20.0 | 7.1 |
| Australia | 19.0 | 19.2 | (0.2) | 18.1 | 0.9 | 1.0 |
| China | 10.4 | 6.7 | 3.7 | 28.5 | (18.1) | 0.4 |
| Hong Kong | 10.3 | 11.2 | (0.9) | 9.1 | 1.2 | 1.1 |
| Taiwan | 7.7 | 6.5 | 1.2 | 11.2 | (3.5) | 0.7 |
| Thailand | 7.0 | 9.1 | (2.1) | 2.4 | 4.6 | 2.9 |
| South Korea | 6.5 | 2.6 | 3.9 | 13.2 | (6.7) | 0.5 |
| Malaysia | 4.9 | 6.2 | (1.3) | 2.3 | 2.6 | 2.1 |
| Japan | 4.2 | 4.3 | (0.1) | 0.0 | 4.2 | N/A |
| New Zealand | 3.2 | 2.3 | 0.9 | 0.6 | 2.6 | 5.3 |
| India | 1.7 | 0.9 | 0.8 | 8.2 | (6.5) | 0.2 |
| United Kingdom | 0.7 | 1.3 | (0.6) | 0.0 | 0.7 | N/A |
| Other | 0.0 | 1.9 | (1.9) | 3.1 | (3.1) | 0.0 |
| Cash | 1.1 | 1.2 | (0.1) | 0.0 | 1.1 | N/A |
| | **100.0** | **100.0** | | **100.0** | | |

Source: Aberdeen Asian Income Fund, Edison Investment Research

In sector terms, at 30 September 2018, AAIF's portfolio had large overweights in the high-yielding telecom and real estate sectors and a large underweight in information technology, although Oh points out the portfolio has a higher weighting than the index in electronic equipment; it is again its lack of exposure to internet stocks that causes AAIF's below-index position in the wider IT sector. Domestic consumption growth is a theme across the portfolio and AAIF had in-line to overweight positions in consumer discretionary and consumer staples stocks. These areas provide a degree of insulation from the impact of US-driven trade tariffs. There was no exposure to energy or healthcare.

In H118 (to 30 June), AAIF initiated seven new positions and exited the same number of holdings. Sales included companies where the managers felt planned capital expenditure would dampen returns. Oh gives the examples of two cement companies, Lafarge Malaysia and the Indonesian Indocement Tunggal Prakarsa. She says the current point in these companies' business cycles – when they have to start investing to ensure capacity and competitiveness with big multinational companies – is not the right time to own them. Conversely, there were companies on similar valuations with better near-term growth and income prospects, such as LG Chemical and Infosys.

Both of these new holdings are not especially high yielding, but offer good dividend growth prospects. LG Chemical is a Korean chemical company that is cash generative, has a strong balance sheet and benefits from structural demand from China. Oh says it is valued like a chemical company, but is in fact one of the biggest players in the booming electric vehicle market because of its exposure to batteries. AAIF took a position via the higher-yielding preference shares; the company is generating dividend growth of c 15% a year while still reinvesting in its battery business.

Infosys (bought in H218) is AAIF's first equity investment in India. Oh says that as a house, ASI has a lot of exposure to India, but because dividend yields tend to be low, AAIF has previously only invested in fixed-income securities, where much higher yields are available. Infosys, an IT services company, had a relatively high yield (for an Indian company) at purchase of 2.4% excluding the special dividend. The company has net cash on the balance sheet and has increased its dividend payout policy from 50% of net income to 70% of free cash flow, but the managers were able to take advantage of a depressed share price as a result of the strong US dollar and anti-immigration rhetoric from the US administration (Infosys is a major exporter of Indian IT workers to America). Infosys's interim dividend payment was up 8% y-o-y, and AAIF's managers forecast a double-digit increase in the final dividend, based on free cash flow generated year to date.

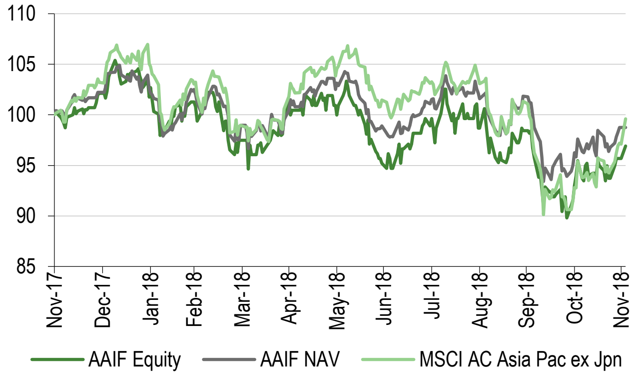
AAIF invests across the market capitalisation spectrum, as illustrated by another recent purchase, the New Zealand Stock Exchange operator NZX. At NZ$280m (c £150m) it is certainly at the smaller end of the size scale, but offers an attractive dividend yield of c 6.9% and has recently been through a restructuring that Oh says will help its future growth plans. At the other end of the spectrum, Hong Kong-listed Ping An insurance (like NZX, added to the portfolio in H118) has a market cap of HK$1.369tn (c £137bn). Oh says it is a relatively new position across ASI Asia's portfolios; previously, the managers did not favour Ping An's banking business, but it has recently cleaned up its balance sheet, brought in a new management team, introduced stricter credit scores and reduced non-performing loans. Oh says the new focus on profitable rather than super-aggressive growth fits better with ASI's quality criteria and has enabled the team to gain exposure to Ping An's insurance business, which operates both through an agency model and increasingly online, through three direct-to-consumer platforms.

Other recent purchases include China Resources Land and BHP Billiton. Other sales include Westfield, the Australian property company that was taken over by Unibail Rodamco (Oh says the team wants to keep its real estate exposure focused on Asia, whereas Unibail Rodamco Westfield's exposure is predominantly European and US), and Thai telecom company Advanced Information Services. The position in Singapore mid-cap tech components company Venture Corporation – previously AAIF's largest holding – has been trimmed. Oh says the firm's share price doubled in 2017, bringing the holding to c 6.5% of the portfolio, so the team took profits to avoid overexposure to a relatively small company that had become highly valued and whose yield had fallen as a result.

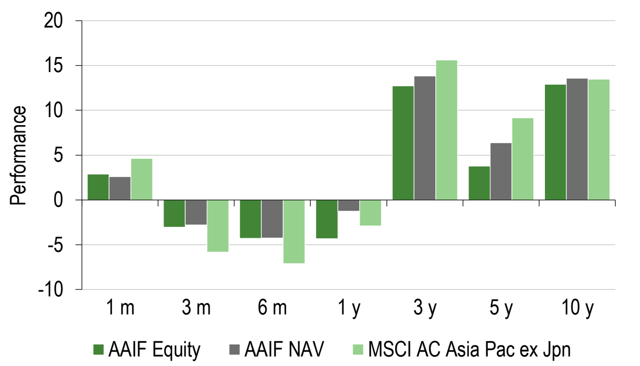
## Performance: Defensive qualities boost relative returns

**Exhibit 4: Investment company performance to 30 November 2018**

**Price, NAV and index total return performance, one-year rebased**




**Price, NAV and index total return performance (%)**




Source: Thomson Datastream, 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 | (1.6) | 3.0 | 3.0 | (1.5) | (7.3) | (22.4) | (4.9) |
| NAV relative to MSCI AC Asia Pac ex-Jpn | (1.9) | 3.2 | 3.0 | 1.7 | (4.5) | (12.2) | 0.9 |
| Price relative to MSCI AC Asia Pac ex-Jpn HDY | (0.1) | 0.3 | (1.3) | (6.6) | (7.4) | (20.2) | (12.9) |
| NAV relative to MSCI AC Asia Pac ex-Jpn HDY | (0.4) | 0.5 | (1.3) | (3.6) | (4.6) | (9.7) | (7.6) |
| Price relative to FTSE All-Share | 4.6 | 3.3 | 3.7 | (2.9) | 16.8 | (6.9) | 31.2 |
| NAV relative to FTSE All-Share | 4.3 | 3.5 | 3.7 | 0.2 | 20.3 | 5.4 | 39.1 |

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-November 2018. Geometric calculation.

So far 2018 has seen negative returns for sterling-based investors in Asian equity markets, as trade tariffs have weighed on sentiment and risk aversion has increased across the globe. AAIF's focus on quality, dividend-paying companies with strong balance sheets has helped its NAV performance versus the headline MSCI AC Asia Pacific ex-Japan index over three, six and 12 months (Exhibits 4, 5 and 6), although it has lagged the High Dividend Yield version of the index over most periods (Exhibit 5), and trailed the recovery in the both indices in November. Absolute returns have been strong over three and 10 years, with share price and NAV total returns of c 13–14% a year, although the five-year numbers are weaker. Oh notes that over the past five years, quality and value as style factors have been out of favour, while growth and momentum have driven markets. Relative performance has been helped in recent months by AAIF's relatively low exposure to technology stocks (particularly Chinese internet stocks), the resilience of the materials sector and geographical positioning versus the index, with overweights in markets that have held up well (such as Singapore and Thailand), and underweights in those that have performed less well, such as India and China.

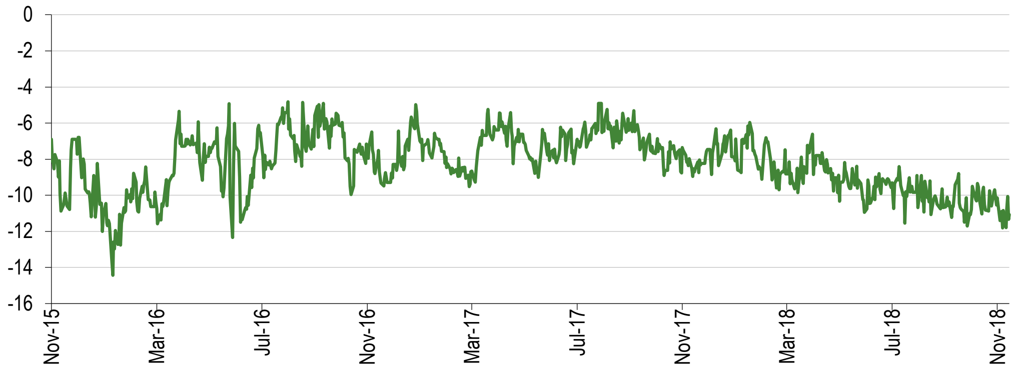
**Exhibit 6: NAV TR performance relative to MSCI AC Asia ex-Japan index over three years**


Source: Thomson Datastream, Edison Investment Research

## Discount: Broadly stable but wider than peers

Having traded broadly at a premium to NAV from mid-2010 to mid-2015, AAIF's shares have more recently traded at a discount (Exhibit 7), in contrast with its income-focused peers (Henderson Far East Income and Schroder Oriental Income; see Exhibit 8). At 14 December 2018, the share price discount to cum-income NAV stood at 11.1%, having traded broadly in a range of a 5% to a 10% discount since April 2016. Over one, three, five and 10 years, AAIF's shares have traded at average discounts of 9.1%, 8.3%, 5.3% and 1.7%, respectively. The fund manages its discount by buying back shares when the discount exceeds 5%, in normal market conditions. AAIF's managers attribute the fund's discount to the close peers (both of which have tended to trade on average at a premium or close to par) to its lower weighting in China and its greater focus on the less favoured Singapore market. However, given that all three funds focus on generating an attractive income from a portfolio of Asian equities, there is potential for AAIF to rerate to a level more in line with its close peers should appetite for investment in the region increase.

**Exhibit 7: Share price discount to NAV (including income) over three years (%)**




Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

AAIF is a Jersey-registered, London-listed closed-end investment company with one class of share. At 14 December 2018, it had 178.8m ordinary shares in issue, with an additional 16.2m held in treasury. Renewed annually, the board has the authority to repurchase up to 14.99% of the shares in issue, or allot shares up to c 10%, to manage a discount or a premium. Shares may be repurchased when the discount to NAV exceeds 5% and the board aims to avoid large fluctuations in the discount/premium to NAV relative to other similar investment companies investing in the region. Over the last 12 months, 4.6m shares (2.5% of the total) have been bought back into treasury, at a cost of £9.3m.

The fund is geared using bank loans, and has a £40m unsecured, three-year revolving multicurrency facility with Scotiabank Ireland (arranged in April 2017), and a £10m fixed, three-year facility with Scotiabank Europe, arranged in March 2018. At the end of H118 (30 June), the whole of the £10m facility was drawn (with an interest rate of 2.179%), and c £25.9m of the £40m facility was drawn, made up of US$7.2m (with an interest rate of 3.036%) and HK$213m (with an interest rate of 2.398%). This represented gross gearing of 8.9% (net gearing of 7.5%). The level of borrowing was largely unchanged (£36.8m) at 31 October, when net gearing stood at 9.0%. The end-October gearing figure is higher than end-June because of the sell-off in global equity markets during the autumn, which reduced AAIF's total assets.

AAIF's investment manager is Aberdeen Private Wealth Management (APWML), which sub-delegates portfolio management to ASI Asia. AWPML is paid an annual management fee of 0.85%, paid quarterly and based on the rolling monthly average NAV of the company over the previous six months. The annual fee was reduced from 1.0% with effect from 1 June 2016. Fees are charged 40% to revenue and 60% to capital, in line with the expected split of returns. There is no performance fee. Ongoing charges were 1.09% at end-FY17 (FY16: 1.19%).

## Dividend policy and record

AAIF pays dividends quarterly, in May, August, November and February. Since FY17 the four interim dividends have been paid in equal amounts; prior to this, the first three interims were equal and the fourth interim dividend was larger. For FY17, four quarterly payments of 2.25p made up a total dividend of 9.0p, a level the AAIF board expects to be maintained for FY18 (so far three interim dividends of 2.25p have been declared). Total dividends have increased in each of the last five years, with a compound annual growth rate of 4.7% (well above the rate of UK inflation) from FY12 to FY17. AAIF's managers are keen to stress that dividends are funded completely by portfolio income from share dividends and (to a limited extent) bond coupons, rather than being augmented by option-writing or partial returns of capital. Dividends have been fully covered by income in each of the last five financial years (in FY17, the revenue return per share was 9.58p), and the company has added to its reserves each year. The revenue reserve (based on the figure at end-H118 minus the second interim dividend payment) is currently c £11.4m, which equates to c 5.9p per share, or roughly two-thirds of the FY17 dividend. This should allow the dividend to be maintained at the current level even if portfolio income in FY18 is lower. Based on the current share price and the last four dividends, AAIF has a dividend yield of 4.7%, broadly in line with its informal target yield of 4.5%. It is the second highest-yielding of the three income-focused peers (see Exhibit 8).

## Peer group comparison

There are 15 funds in the AIC's Asia Pacific Excluding Japan sector, with a range of mandates encompassing income, growth, and both larger and smaller companies. AAIF is one of three funds specifically targeting a higher level of income; the others are Henderson Far East Income and Schroder Oriental Income. (JPMorgan Asian does not invest for income, but has a high distribution policy partly funded from capital.)

**Exhibit 8: AIC Asia Pacific ex-Japan sector as at 11 December 2018***

| % 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 (ex-par) | Net gearing | Dividend yield |
|---|---|---|---|---|---|---|---|---|---|---|
| **Aberdeen Asian Income** | **347.8** | **(1.6)** | **51.6** | **39.8** | **240.0** | **1.1** | **No** | **(10.6)** | **109** | **4.6** |
| Aberdeen New Dawn | 245.1 | (3.5) | 60.4 | 49.4 | 246.7 | 0.8 | No | (13.3) | 111 | 2.0 |
| Aberdeen Standard Asia Focus | 350.1 | (2.1) | 43.3 | 35.6 | 409.1 | 1.2 | No | (14.0) | 110 | 1.3 |
| Edinburgh Dragon | 674.3 | (3.0) | 57.4 | 50.6 | 226.7 | 0.8 | No | (10.1) | 104 | 1.1 |
| Fidelity Asian Values | 275.7 | 0.2 | 58.1 | 74.5 | 302.5 | 1.2 | No | 0.6 | 103 | 1.4 |
| Henderson Far East Income | 424.9 | (3.3) | 43.2 | 42.1 | 169.8 | 1.1 | No | 2.9 | 105 | 6.5 |
| Invesco Asia Trust | 185.4 | (8.9) | 58.3 | 76.5 | 294.2 | 1.0 | No | (11.3) | 100 | 2.1 |
| JPMorgan Asian | 308.6 | (4.2) | 76.7 | 80.8 | 218.2 | 0.7 | No | (12.9) | 100 | 4.8 |
| Martin Currie Asia Unconstrained | 128.7 | (5.9) | 53.0 | 42.9 | 128.0 | 1.1 | No | (13.6) | 100 | 2.3 |
| Pacific Assets Trust | 328.5 | 4.4 | 52.8 | 81.3 | 309.7 | 1.3 | No | (2.0) | 100 | 0.9 |
| Pacific Horizon | 176.4 | (11.9) | 57.7 | 60.2 | 248.8 | 1.0 | No | 0.9 | 104 | 0.2 |
| Schroder Asia Pacific | 685.4 | (9.3) | 63.4 | 79.9 | 343.7 | 1.0 | No | (10.0) | 100 | 2.3 |
| Schroder Asian Total Return Inv. Co | 307.1 | (5.0) | 67.8 | 90.5 | 252.1 | 1.0 | Yes | 3.4 | 101 | 1.4 |
| Schroder Oriental Income | 604.2 | (2.0) | 48.5 | 64.5 | 380.0 | 0.8 | Yes | 0.8 | 106 | 4.1 |
| Scottish Oriental Smaller Cos | 280.8 | (7.5) | 36.0 | 44.2 | 456.4 | 1.0 | Yes | (13.8) | 100 | 1.2 |
| **Sector average (15 funds)** | **354.9** | **(4.2)** | **55.2** | **60.8** | **281.7** | **1.0** | | **(6.9)** | **104** | **2.4** |
| **AAIF rank in sector** | **6** | **3** | **11** | **14** | **11** | **5** | | **9** | **3** | **3** |

Source: Morningstar, Edison Investment Research. Note: *Performance to 10 December 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

AAIF's NAV total returns are above the peer group average over one year, and below average over three, five and 10 years. Within the subgroup of income funds, it ranks first of three over one and three years, third over five years and second over 10 years. Ongoing charges are broadly average and there is no performance fee. Whereas funds targeting a high level of income have typically tended to trade on small discounts or premiums to NAV, AAIF is unusual in having a wider discount (c 11%) than the sector average (c 7%). Gearing is above average and AAIF's yield is the third-highest in the sector. The three income funds make up three of the top four highest-yielding funds in the peer group.

## The board

AAIF has six non-executive directors, five of whom are independent of the manager. Charles Clarke has served on the board since March 2012 and became chairman in May 2018, following the retirement of Peter Arthur. He is Jersey residentially qualified, a chartered accountant and a former senior partner of KPMG, who previously worked for the firm in Malaysia. Krystyna Nowak joined the board in May 2015 and became senior independent director when Clarke was appointed chairman. She is a partner at executive recruitment firm Ridgeway Partners, and previously worked for Citibank in the Far East. Mark Florance has been a director of AAIF since May 2017 and became chairman of the audit committee following Clarke's appointment as chairman. He is resident in Singapore and is a corporate finance specialist, currently serving as managing director of SEA Strategic, a company involved in strategic consulting in private equity. Ian Cadby, who joined the board in May 2016, has a background in investment management and was formerly group CEO of hedge fund manager Ermitage. The newest independent director, Nicky McCabe, was appointed in May 2018. She was previously head of product and investment trusts at Fidelity International. Hugh Young, managing director of Aberdeen Standard Investments Asia, has served on AAIF's board since the fund's launch in 2005. He is resident in Singapore and is responsible for all the Standard Life Aberdeen Group's operations in Asia. Young is deemed non-independent because of his role at AAIF's manager.

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