abrdn Japan Equity Fund

Quarterly Commentary

Quarter ended April 30, 2024

Fund performance

The abrdn Japan Equity Fund returned 1.48[1] on a net asset value basis for the three-month period ended 30 April 2024, outperforming the 0.71% return of its benchmark, the Tokyo Stock Price Net Index (TOPIX).[2]

The Japanese equity market rose only modestly in U.S. dollar terms, underperforming global markets in aggregate, as the yen continued to weaken against the dollar. However, in local-currency terms, the market rallied along with other global markets over the period, supported by expectations that interest rates in the U.S. and Europe would begin to fall, and thereby boost economic growth across the world. There was some disappointment for investors by the end of the period, nevertheless, with comments from the major global central banks suggesting that rate cuts could be delayed as inflation levels generally remained too high for comfort. Additionally, higher U.S. yields on expectations of fewer rate cuts by the U.S. Federal Reserve (Fed) on the back of sustained inflationary pressures weighed on growth and quality stocks in the Japanese market, with the MSCI Japan Quality Index underperforming its parent index, MSCI Japan, over the quarter.

The continuing weakness in the yen has been a key feature of the quarter, a period in which the yen has fallen from approximately 147 to 158 against the U.S. dollar and has touched 34-year lows, as well as spiking above 160. This has come about despite 'verbal intervention' and subsequent monetary intervention (just after the end of the period) from the Japanese authorities to support the currency.

The weaker yen has certainly boosted the share prices of the large exporting and overseas sales companies that make up a large portion of the Japanese index over the medium-to-long term; but at the same time, it has reduced fund returns for unhedged dollar investors. There is some speculation too that the persistent weakness in the yen may force the Bank of Japan to raise interest rates again in the near term, owing to the risks of rising imported inflation—a notable concern for Japan given its reliance on imported raw materials and energy. This may have some negative impact on the market, although we believe the negative effects would only be felt in the short term, given the still very low nominal level of interest rates in Japan.

Electrical and semiconductor-related stocks were well represented among our top performers. Our stock selection in the information technology (IT) sector was positive, despite the overall sector not performing that well during the quarter. Hitachi was one of our strongest-performing positions, as the company's energy division is expected to benefit from continued investments in renewable energy and power grids. Shares in Fuji Electric also did well, rising by over 23%, on investor expectations that demand for its power semiconductors will rise on the back of rising adoption of hybrid electric vehicles. Tokyo Electron contributed strongly on better-than-expected results and an upgrade to the current year's guidance. Insurance company Tokio Marine was the Fund's strongest performer, however, rising on expectations that higher bond yields will be positive for its investment portfolio.

Conversely, stock selection was notably weak in materials, consumer staples, and communication services, although the underweight exposure to the latter sector was a positive factor. Looking at individual stock detractors for the quarter, Nippon Paint was one of the Fund's weakest-performing positions, falling on investor concerns that higher

[1] **Past performance is no guarantee of future results. Investment returns and principal value will fluctuate and shares, when sold, may be worth more or less than original cost. Current performance may be lower or higher than the performance quoted. Net asset value return data include investment management fees, custodial charges and administrative fees (such as Director and legal fees) and assumes the reinvestment of all distributions.**

[2] The Tokyo Stock Price Net Index is a market capitalization-weighted index of large- and mid-sized companies listed on the Tokyo Stock Exchange. Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses are reflected. You cannot invest directly in an index.

raw material costs and slower economic growth in China might affect the company's earnings. Ibiden also detracted, owing to concerns of a slowing recovery in demand for general servers. In addition, Chugai Pharmaceutical fell at a double-digit pace, largely on the back of profit-taking.

In terms of key portfolio trades, we introduced a few new holdings across sectors. In consumer discretionary, we initiated a position in electric-wire maker Sumitomo Electric Industries. For the mainstay automotive wiring-harness business, the company has become the top player globally and now accounts for a quarter of the global market share. The company is equally competitive in high-voltage, direct-current power cables that are expected to become increasingly important in reducing losses during electricity transmission. As for financials, a new investment was established in MS&AD, one of three top insurers that operate in Japan's property and casualty insurance market, which remains an oligopoly. The management team has been proactive in streamlining the company's operations. At the same time, we look for the push by Japan's Financial Services Agency to divest cross-shareholdings to unlock substantial excess capital at the company.

Elsewhere, we introduced two industrials names. DMG Mori is a global leader in five-axis machining centers and mill turns. Its direct-sales model helps the company better address customer needs and provide the maintenance service needed. This has enabled the company to capture the rising demand related to supply-chain diversification and labor shortages in Europe and other developed markets. The management team continues to execute well on its strategy of stabilizing earnings growth against the cyclical end-market, by focusing on topline growth from product mix improvement and higher value-added as opposed to capacity expansion. The other was Itochu, which is a leading trading house with a broad-based portfolio and good track record of investments, enabled by a clear set of investment criteria and process. Only a quarter of earnings is linked to natural resources prices, in particular iron ore, with the rest being diversified across textile, food, general products, retail, and machinery. This results in a relatively high quality of earnings among the trading houses.

In IT, we initiated a position in testing equipment maker Espec. The company is the global leading supplier of environmental test chambers, which enable auto-parts and electronic components suppliers to test the durability of their products under severe temperature and humidity conditions. We believe the company will benefit from rising research and development spending by global corporates and its efforts to improve profitability.

Finally, in materials, we added Mitsubishi Gas Chemical. The company has a good track record of understanding customer needs to develop new products by leveraging on its core technologies, such as catalysts, synthesis, polymer science, and biotechnology. As a result, 40% of the company's products have the largest market share globally, and 90% of its products were developed in-house. These include low-cost, high-thermal resistance bismaleimide-triazine (BT) resin laminate used for chip packaging and optical resin polymer used in high-end smartphone lens. We believe that it is trading at an attractive valuation against its long-term outlook.

We sold our position in Kansai Paint on governance concerns. Kansai Paint issued ¥100 billion of zero-coupon convertible bonds (CBs), resulting in a potential net dilution of 7%. This was despite the company's strong cash flows and its ability to borrow from financial institutions. This is the second time that the company had issued CBs, raising concerns yet again about the quality of its management and the board's governance. We also exited TechnoPro Holdings in light of more attractive opportunities elsewhere. The company, a leading temp staffing agency for IT engineers in Japan, has seen increased turnover in recent quarters as a result of a more fluid job market. While a tighter job market is positive for placing its engineers across Japan, it has also led to the company incurring higher expenses to reduce attrition. We also divested Daiseki in view of better options elsewhere.

Top 10 Fund holdings (as of March 31, 2024)

Toyota Motor Corp	5.9
Hitachi Ltd	5.4
Tokyo Electron Ltd	5.3
Mitsubishi UFJ Financial Group Inc	4.9
Tokio Marine Holdings Inc	4.2
Shin-Etsu Chemical Co Ltd	3.7
Keyence Corp	3.4
Pan Pacific International Holdings Corp	3.2
Fuji Electric Co Ltd	3.0
Sony Group Corp	2.9
Percent of Portfolio in Top Ten	**42.0**

Source : abrdn 03/31/2024.

The above tables summarize the composition of the Fund's portfolio, expressed as a percentage of total assets.

Holdings are subject to change and are provided for informational purposes only and should not be deemed as a

recommendation to buy or sell the securities shown. Figures may not always sum to 100 due to rounding.

Cumulative and annualized total return as of March 31, 2024 (%)

	NAV	Market Price	TOPIX Index (Net TR)
Since inception (p.a.)	2.42	1.87	n/a[3]
10 Years (p.a.)	6.31	5.62	6.61
5 Years (p.a.)	5.83	5.09	7.09
3 Years (p.a.)	-1.47	-2.81	3.26
1 Year	21.74	22.32	23.86
Year to Date	11.31	10.46	9.89
3 Months	11.31	10.46	9.89
1 month	3.03	2.47	3.13

[3] There is no since inception figure for the Tokyo Stock Price Index (Net) because the inception date of the Index is December 29, 2000.

Past performance is no guarantee of future results. Investment returns and principal value will fluctuate and shares, when sold, may be worth more or less than original cost. Current performance may be lower or higher than the performance data quoted. NAV return data includes investment management fees, custodial charges, bank loan expenses, and administrative fees (such as Director and legal fees) and assumes the reinvestment of all distributions. abrdn Inc. (the "Adviser") became the Fund's adviser on January 06, 2014. For periods prior to that date, the returns reflect performance information from a prior, unaffiliated adviser. The Fund is subject to investment risk, including the possible loss of principal. Returns for periods less than one year are not annualized.

abrdn Japan Equity Fund distribution rates as of March 31, 2024 NAV (unaudited) and market price

Net Asset Value per share	$7.47
Market price	$6.23
Discount to Net Asset Value	16.60%

Market review

Japanese equities rallied over the period (in yen terms), underpinned by strong corporate earnings, driven largely by the country's exporters which have materially benefited from the weaker yen. Signs of economic recovery and increasing evidence that Japan is emerging from its decades-long period of deflation also boosted the stock market. Investors were also encouraged by news that had emerged in January from the Tokyo Stock Exchange that a substantial amount of companies listed on its exchange were considering taking steps to improve capital efficiency and governance in an effort to boost their stock prices. The TOPIX (Net) rose by 0.71% over the period in U.S. dollar terms.

Having achieved a new all-time high of over 39,000 in February, the bellwether Nikkei 225 Index continued to rise and climbed above 40,000 towards the end of March, before easing back in April. The latter month saw some profit-taking from investors after the very strong run since the beginning of the year, as well as more hawkish comments from the Fed and concerns about BoJ tightening.

A key development over the quarter was that after months of speculation, the BoJ tightened its monetary policy for the first time in 17 years, increasing its benchmark short-term interest rate from -0.1% to a range of 0% to +0.1%. While this shift was modest, it was a highly symbolic move and marked the beginning of the end of the BoJ's long-standing ultra-loose policy stance. BoJ Governor Kazuo Ueda later hinted that further tightening may be required, owing to significant wage pressures. This reflected several large companies and major unions awarding their workers some of the highest wage increases for decades.

On the economic front, initial GDP figures indicated that Japan had fallen into a recession in the second half of last year. However, the final figure for the fourth quarter of 2023 was revised to growth of 0.1% quarter on quarter from a decline of 0.1%, meaning Japan ultimately avoided a recession. The BoJ's Tankan Survey indicated a slight slowdown in economic conditions for the first quarter of the year, with the headline large manufacturers' diffusion index falling to 11 from 12 in the previous quarter. The yen was weaker against the U.S. dollar, peaking above 160, before recovering a little, despite the threat of intervention from the Ministry of Finance. Meanwhile, consumer confidence continued to recover, as evidenced by the consumer confidence index, which hit a near five-year high of 39.5 in March.

Outlook

We remain optimistic on the market, due to several positive structural changes currently under way in Japan. Most notably, as inflation has continued to set in, we believe that the deflationary mindset is gradually changing. Higher prices are becoming more entrenched, resulting in a firmer domestic outlook for companies. This contrasts with the recent past, when rising costs could not be fully offset by passing on higher prices to end-customers. Meanwhile, a shortage of labour is putting upward pressure on wages, raising the possibility of the economy entering a virtuous cycle of growth. Geopolitics is also putting Japan in the spotlight; 'friend-shoring' has led to rising investment from global semiconductor companies in the country. These bode well for the prospects of Japan's companies and its economy.

It is also encouraging that Japanese corporates continue to place a strong emphasis on profitability, alongside the return of excess capital to shareholders. This has been accelerated by the TSE's proposals for reforms. Increasingly, companies have embraced measures such as return on invested capital and return on equity, and they have been divesting assets that do not meet their hurdle rates. Companies are also setting targets on reducing cross shareholdings and using these proceeds to reinvest in their businesses or to reward shareholders. Alongside a backdrop of weaker growth, we believe that it is important to focus on companies with firm fundamentals that are also embracing these changes, which will allow them to better tackle this challenging period and, over time, outperform their peers.

Important Information

Past performance is no guarantee of future results.

Closed-end funds are traded on the secondary market through one of the stock exchanges. The Company's investment return and principal value will fluctuate so that an investor's shares may be worth more or less than the original cost. Shares of closed-end funds may trade above (a premium) or below (a discount) the net asset value (NAV) of the Company's portfolio. The net asset value (NAV) is the value of an entity's assets less the value of its liabilities. The market price is the current price at which an asset can be bought or sold. There is no assurance that the Fund will achieve its investment objective. Past performance does not guarantee future results.

International investing entails special risk considerations, including currency fluctuations, lower liquidity, economic and political risks, and differences in accounting methods; these risks are generally heightened for emerging market investments. Concentrating investments in the Japan region subjects the Fund to more volatility and greater risk of loss than geographically diverse funds.

Equity stocks of small and mid-cap companies carry greater risk, and more volatility than equity stocks of larger, more established companies.

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