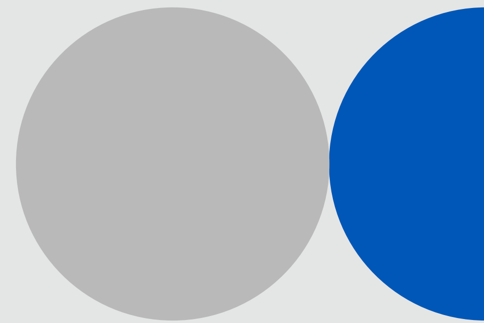
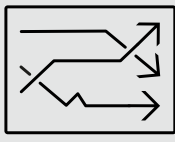
abrdn Asia-Pacific Income Fund VCC

Quarterly Commentary

Quarter ended July 31, 2023



Fund performance



The abrdn Asia-Pacific Income Fund VCC returned 2.73%[1] on a net value basis for the three-month period ended July 31, 2023, outperforming the -2.25% return of its blended benchmark.[2]

The portfolio outperformed its benchmark, with the overweights to the Indian and Indonesian markets within Asia, and Emerging-market (EM) debt ex Asia the principal drivers of outperformance. The overweight exposure to U.S. dollar-denominated Asian credit detracted value.

Inflation has returned to target in much of Asia, which has allowed central banks to pause rate hikes and arguably start thinking about when to cut interest rates. With the growth outlook in China continuing to weaken and global rates cycles peaking, the economic backdrop continues to move in a rates-supportive direction that should support Asian markets.

Improved risk sentiment helped drive positive returns from U.S. dollar-denominated Asian credit despite continuing woes in China's property market. EM debt delivered strong returns as distressed names made progress in securing funding and countries' debt was upgraded following positive reforms.

Top Ten Holdings

Holding	%
Indonesia 10.500% 15-Aug-2030	4.8
India (Govt of) 7.54% 2036	3.8
Indonesia Treasury 9% 2029	3.7
India (Govt Of) 7.26% 2029	3.7
Indonesia (Govt of) 6.5% 2031	3.6
India (Govt of) 7.1% 2029	2.8
Indonesia (Govt of) 8.25% 2029	2.7
Nota Do Tesouro Nacional 10% 2029	2.6
Mexico (Govt of) 10% 2024	2.5
Uruguay (Govt of) 8.25% 2031	2.1
Assets in top ten holdings	32.3

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.

[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 Company's blended benchmark comprises 50% Markit iBoxx Asian Local Bond Index, 25% J.P. Morgan Asia Credit Diversified Index, 15% J.P. Morgan GBI Emerging Market Global Diversified Index and 10% Bloomberg Ausbond Composite Index.

The Markit iBoxx Asian USD Bond Index family ("iBoxx ADBI") tracks the performance of U.S. dollar-denominated bonds from Asian based issuers.

The J.P. Morgan Asia Credit Diversified Index tracks the performance of actively traded U.S.-dollar denominated debt instruments in the Asia ex-Japan region.

The J.P. Morgan GBI Emerging Markets Global Diversified Index tracks the performance of liquid, fixed-rate, domestic-currency government bonds.

The Bloomberg AusBond Composite Index tracks the performance of the Australian debt market.

Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses are reflected. You cannot invest directly in an index.

Cumulative and annualised total return as of July 31, 2023 (%)

	NAV	Market Price	Performance Comparator
Since inception (p.a.)	6.27	5.49	6.55
10 Years (p.a.)	3.30	-0.65	4.29
5 Years (p.a.)	1.64	1.46	2.99
3 Years (p.a.)	0.87	5.20	-2.08
1 Year	13.47	12.95	7.14
Year to date	7.79	5.44	1.48
3 months	2.73	2.07	-2.25
1 month	1.00	0.68	1.20

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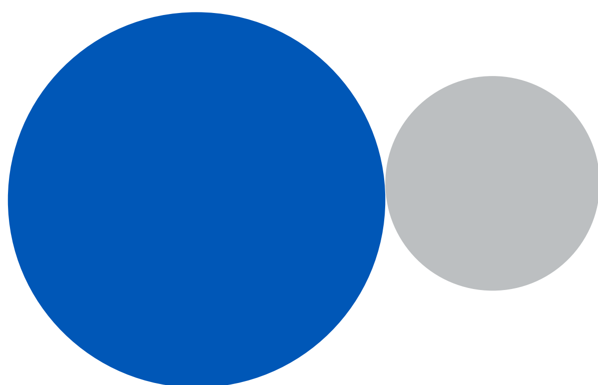
The Company is subject to investment risk, including the possible loss of principal. Returns for periods less than one year are not annualized. Total return based on net asset value reflects changes in the Company's net asset value during each period. Total return based on market price reflects changes in market value.

Market review

Government bond yields rose over the quarter as data continued to point to core central banks having to hike interest rates further to reach their inflation targets. U.S. consumer price (CPI) inflation cooled to an annual rate of 3.0% in June from 4.1% in May to record the lowest rate in more than two years. This remains above the central bank's 2% target and the rebound to 3.2% in July reversed a year of slowing inflation readings.

Non-farm payrolls delivered mixed messages over the quarter. ADP payrolls of hiring by private U.S. businesses sent Treasury yields sharply higher as private hiring spiked to 455k in June – twice as many as expected – and again far exceeded expectations in July in printing 324k.



The Federal Reserve (Fed) paused its tightening cycle in June after 15 months of rate hikes although the updated dot plot indicated a preference for two more rate hikes. Hopes of policy breathing space were further dashed by a subsequent barrage of hawkish central bank moves and rhetoric that sent government bond yields higher as core markets braced for further rate hikes.

The Fed resumed its hiking path in July as it raised rates by 25bps. Fed Chair Jerome Powell reiterated that the central bank remains a long way from returning inflation to target, despite encouraging signs. Nevertheless, the Fed has become more data dependent and is nearing the end of its cycle. The European Central Bank (ECB) raised rates by 25bps in both June and July although President Lagarde said she had an "open mind" as to whether the ECB would need to raise interest rates further.

Markets reacted calmly to the expected interest-rate moves in the U.S. and Europe. Much more surprising was the loosening of the yield curve control policy by the Bank of Japan (BoJ) under its new governor, Kazuo Ueda. While the BoJ will keep its target for the 10-year Japanese government bond yield at around 0%, the central bank effectively raised interest rates by now allowing yields to rise above the 0.5% 'ceiling' to around 1%.

The 10-year U.S. Treasury yield surged above 4% in response to the shocks of the ADP payrolls and unexpected change in Japanese policy but eased back to end the quarter at 3.96%, 54 basis points (bps) higher over the quarter. The 2-year yield rose by 87bps to 4.88%.

Positive signs from the U.S. economy and the impact of OPEC+ supply cuts helped oil prices to strengthen, with the Brent gauge closing 7.6% higher at $85.6 a barrel, its highest level since mid-April.

Asia and its central banks are in a very different position to developed markets. Data in Asia has generally remained on the weaker side and growth pressures are more evident. Second-quarter GDP growth in Hong Kong slowed to a weaker-than-expected 1.5% year-on-year, a full 200bps behind expectations. Meanwhile, export data remains weak in Thailand and South Korea. Manufacturing purchasing managers' index (PMI) data showed that while India, Indonesia and Philippines have held up better, other economies appear more sluggish.

Price pressures continue to ease across Asia despite core inflation remaining sticky. Headline inflation rates have fallen to or close to target in many countries, which allowed most central banks to leave their policy rates unchanged over the period. The exception was Thailand, which has lagged the cycle and raised rates in May and July. China faces different price challenges. After quarter-end, its sputtering economy slipped into deflation (with both consumer and producer prices falling) and the central bank unexpectedly cut its key interest rate again after having cut rates in June.

China's second-quarter GDP of 4.5% was weaker than both the previous reading of 6.3% and the expected 4.8%. June industrial production fell to 3.5% from previously 4.4%. The year-to-date fixed asset investment, retail sales and property sales growth rates printed at 3.5% (from previously 4.4%), 4% (from 3.8%), and -0.9% (from -5.3%), respectively. Trade data deteriorated further with exports growth recording -12.4% from previously -7.5% while imports growth slowed to -6.8% from -4.5%.

Benchmark government bond yields in Asia mostly outperformed U.S. Treasuries over the quarter, with China (-12bps) and Indonesia (-28bps) leading performance. Indonesia's bonds were boosted by the unexpected downsizing of this year's net issuance by around a half. The Ministry of Finance also downsized weekly auctions despite strong incoming bids. India (+6bps), Malaysia (+9bps) and Thailand (+7bps) saw moderate rises in their 10-year yields while there were larger increases for Philippines (+27bps) and Singapore (+29bps). South Korea (+40bps) and Hong Kong (+66bps) underperformed.

Most Asian currencies depreciated against the Canadian dollar over the quarter as Asia's central banks mostly held policy while the Bank of Canada resumed rate hikes after briefly pausing in March and April.

The South Korean won gained 2.25% while the Hong Kong dollar fell by 2.04%, the Indian rupee by 3.80%, the Philippine peso by 2.09%, the Singapore dollar by 2.33% and Thai baht by 2.95%. The worst performers were the Malaysian ringgit (-4.30%) and Indonesian rupiah (-6.08%).

The JPMorgan Asian Diversified Credit Index (JADI) returned 0.37% over the quarter as positive returns in June and July offset weakness in May. Tightening spreads were the principal driver of returns as the index spread tightened by 27bps to 231bps and offset the drag of rising U.S. Treasury yields. High-yield bonds (total return 2.8%) outperformed investment-grade (-0.16%). Consumer (total return 2.1%), infrastructure (1.9%) and metals & mining (1.2%) were the top-performing sectors while real estate (-8.7%) lagged.

Frontier sovereigns were notable outperformers, with Pakistan's bonds returning 52.1% and Sri Lanka's 33.7% on increasing support from the International Monetary Fund (IMF) and other lenders. China lagged as its bonds returned -1.7%, underperforming on the drag of a property market that continues to deteriorate. July saw the combined sales of the top 100 developers contract by 33.1% year-on-year. Announcements by the regulator of the extension of supportive policies rolled out in 2022 were unable to support sentiment. The difficult conditions in the sector were reflected in idiosyncratic events, with Central China Real Estate (CENCHI) halting all offshore payments in June to explore a debt restructuring. July saw a rollercoaster for Dalian Wanda as the developer was thought to be short $200m for an upcoming $400m bond maturity but then met the redemption on time. After quarter-end, Country Garden missed coupon payments totaling $22.5m on two dollar bonds maturing in 2026 and 2030.

Primary market activity by emerging-market corporates dropped materially in July to $13bn, the slowest supply month this year, of which Asia was the most active region in printing $7bn. Year-to-date gross supply is down 13% from the previous year and at a similar level to 2011.

EM debt performed strongly over the quarter as more optimistic risk sentiment combined with the outperformance of distressed names making progress in their prolonged efforts to achieve debt sustainability. EM central banks coming to the end of their hiking cycles also contributed to strong performance in local-currency assets.

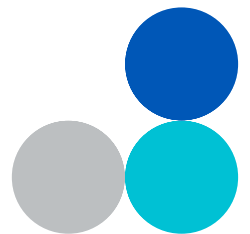
In hard-currency debt the JPMorgan EMBI Global Diversified Index returned 3.59%, with high-yield bonds (total return 7.98%) outperforming investment-grade (-0.41%). Argentina (38.0%), Pakistan (52.9%) and Ukraine (81.7%) performed strongly on external financial support. The IMF will give Argentina up to $10.8bn in loans for the rest of the year to help the country navigate a turbulent period ahead of presidential elections. Pakistan was given an immediate disbursement of $1.2bn after the IMF approved a $3bn standby arrangement. In Ukraine, the IMF approved the first review of the extended fund facility that enables the disbursement of $890m to be used for budget support. That brings total drawings so far to $3.6bn. Sri Lanka (total return 33.4%) will have a first review in September of the IMF bailout approved in March.

In local-currency debt, the JPMorgan GBI-EM Global Diversified Index (unhedged in U.S. dollar terms) returned 4.55%. Several Latin American countries performed strongly as the central banks in Brazil, Colombia and Mexico were able to hold interest rates as inflation fell, while Uruguay cut rates on easing price pressures. Brazil and Uruguay were further boosted by Fitch upgrading their debt, in the case of Brazil to BB from BB- and for Uruguay to BBB, in recognition of important economic and fiscal reforms. Turkey's bonds returned -24.8% as investors were disappointed by the pace of central bank rate hikes following the switch to more conventional policy to tackle high inflation.

Outlook

As the growth outlook in China continues to weaken and global rates cycles peak, central banks in Asia can arguably start thinking about when to cut interest rates. With the economic backdrop in Asia continuing to move in a rates-supportive direction, markets should retrace recent weakness. We see value returning to Asian FX amid a gentle pick-up in volatility after quarter-end and some seasonal weakness in currencies since the start of August.

In credit, there remain attractive opportunities within the high-yield segment – our preference remains subordinated paper from stronger issuers (such as financials) and issuers that benefit from strong, utility-like cash flow.



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Concentrating investments in the Asia-Pacific region subjects the Company to more volatility and greater risk of loss than geographically diverse funds.

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