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The abrdn Frontier Bond Fund: a decade on

November 2023

abrdn.com

Investors should note that, relative to the expectations of the Autorité des Marchés Financiers, this [UCITS] presents disproportionate communication on the consideration of non-financial criteria in its investment policy.

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Investment objective



Objective

The Fund aims to achieve a combination of income and growth by investing in bonds (which are like loans that can pay a fixed or variable interest rate) issued by companies, governments or other bodies, in Frontier Market countries.

The following risk factors apply:

Credit risk – The fund invests in securities which are subject to the risk that the issuer may default on interest or capital payments.

Interest rate risk – The fund price can go up or down daily for a variety of reasons including changes in interest rates, inflation expectations or the perceived credit quality of individual countries or securities.

Emerging Markets risk – The fund invests in emerging market equities and / or bonds. Investing in emerging markets involves a greater risk of loss than investing in more developed markets due to, among other factors, greater political, tax, economic, foreign exchange, liquidity and regulatory risks.

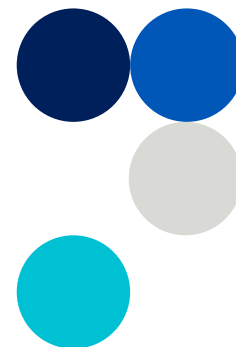
High Yield Credit risk – The fund invests in high yielding bonds which carry a greater risk of default than those with lower yields.

Asset Backed / Mortgage Backed Securities – The fund invests in mortgage and asset-backed securities (which may include collateralised loan, debt or mortgage obligations (respectively CLOs, CDOs or CMOs)). These are subject to prepayment and extension risk and additional liquidity and default risk compared to other credit securities.

Derivatives risk – The use of derivatives carries the risk of reduced liquidity, substantial loss and increased volatility in adverse market conditions, such as a failure amongst market participants. The use of derivatives may result in the fund being leveraged (where market exposure and thus the potential for loss by the fund exceeds the amount it has invested) and in these market conditions the effect of leverage will be to magnify losses.

To help you understand this fund and for a full explanation of risks and the overall risk profile of this fund and the share classes within it, please refer to the applicable Key Investor Information Document or Key Information Document available in the local language, and Prospectus available in English, which are available on our website abrdn.com. The Prospectus also contains a glossary of key terms used in this document. A summary of investor rights can be found in English on our website abrdn.com/corporate/legal.





Ten years ago, we launched the abrdn Frontier Bond Fund. At the time, it was only the second dedicated fund in this niche part of emerging markets (EM).

Our key marketing launch pitch remains the same today: frontier bonds offer high yields and diversification benefits across a range of assets with a low correlation to US Treasuries. We'd also add that it's not a crowded space: today there are only five frontier funds, each with a different approach to portfolio construction. Over the past decade, we've had our share of ups and downs. Overall, though, it's been a rewarding experience – demonstrating our ability to navigate this complex asset class and, importantly, deliver on performance.

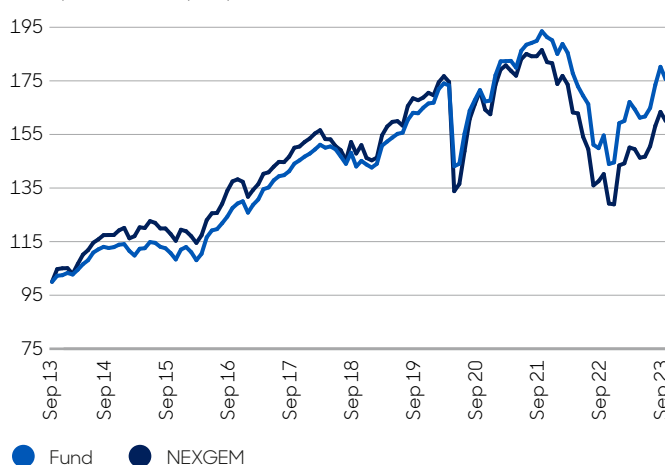
Volatility (%)

	1 year	3 year	5 year	Since inception
Fund	12.65	12.15	13.44	10.38
NEXGEM	13.21	13.43	16.53	12.68

Chart 1: Celebrating 10 years of performance success

The Fund has outperformed frontiers sovereign bonds with lower volatility

Monthly total returns (USD)



Source: JPMorgan, abrdn, 29 September 2023.

Past performance does not predict future returns. For illustrative purposes only.

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 performance (%)

	1 month	6 months	Year to date	1 year	3 years (p.a.)	5 years (p.a.)	10 years (p.a.)
Fund (gross)	0.01	9.24	9.07	21.45	1.28	3.57	n/a
Fund (net)	-0.07	8.70	8.26	20.24	0.29	2.55	n/a

Discrete annual returns – year to 30 September (%)

	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Fund (gross)	21.45	-25.07	14.17	0.57	14.03	n/a	n/a	n/a	n/a	n/a
Fund (net)	20.24	-25.80	13.05	-0.41	12.93	-1.24	11.17	17.74	-6.15	n/a

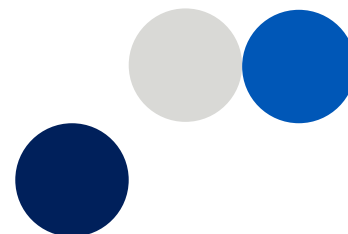
Performance Data: Share Class I Acc USD.

Source: Lipper. Basis: Total Return, NAV to NAV, net of annual charges, gross Income reinvested, (USD).

Costs may increase or decrease as a result of currency and exchange rate fluctuations. This may impact what you might get back. "Fund (Net)" refers to the actual unit price performance of the shareclass shown; "Fund (Gross)" adds back charges such as the annual management charge to present performance on the same basis as the Benchmark / Benchmark / portfolio constraining benchmark. All return data includes investment management fees, operational charges and expenses, and assumes the reinvestment of all distributions. The returns provided do not reflect the initial sales charge and, if included, the performance shown would be lower.

Past performance does not predict future returns.

The competitive landscape



As we highlighted, there are only five frontier market bond funds. This is no doubt due to the niche nature of the asset class.

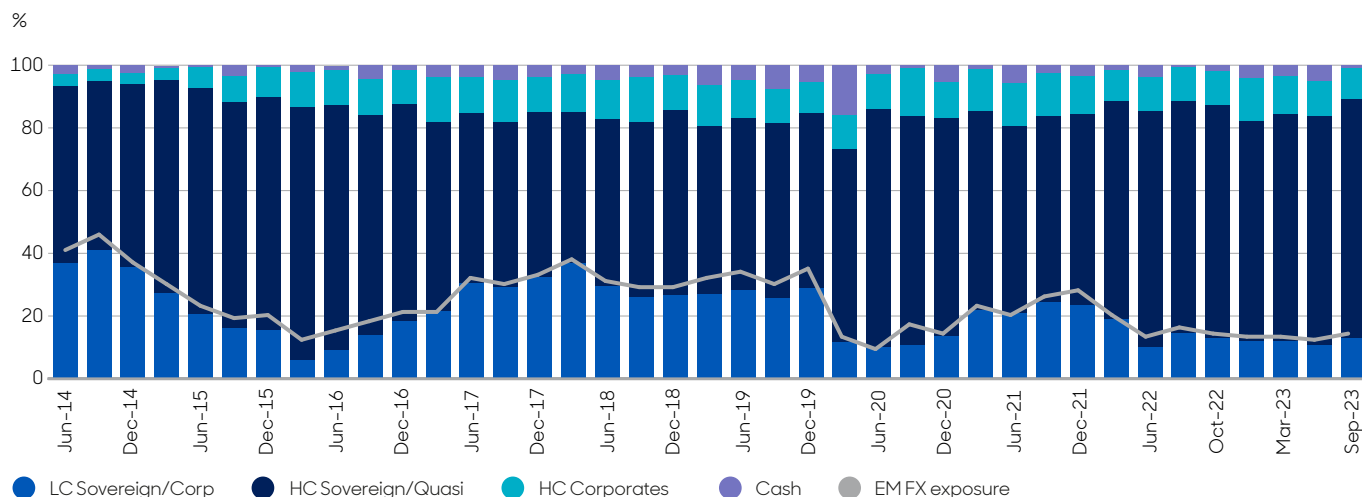
We have the most diversified approach of the available frontier bond funds, as we invest in hard-currency, local-currency and corporate bonds. Additionally, we've managed the Fund on a total return basis rather than against an active benchmark. That said, we've always stated that our target is to outperform mainstream EM hard- and local-currency indices by 200 basis points (bps) per annum – which we've accomplished over the discrete periods that matter to clients and fund selectors.

In terms of our investment criteria, we have a 10% country-cap limit, with no explicit target weights on hard- and local-currency bonds. Anything above a 5% weight is considered a high-conviction position. Typically, we've only applied this to a handful of countries at any given time. We have historically had an 80/20 split between hard- and local-currency bonds.

However, there have been periods when we had a higher allocation to local-currency bonds, such as just before the pandemic peaked in 2020. We're the only manager of the five that has invested in frontier corporates, which speaks to our desk's broader skill set. Global Evolution has typically had a 40/60 split between hard currency and local currency. Meanwhile, GSAM (which entered the frontier field when it bought NN Investments in 2022) is 100% hard currency and LGT (which bought Aktia in 2021) is 100% local currency. American Beacon is the only US-based manager and is unique as the fund is co-managed by abrdn and Global Evolution.

Allocation history

Chart 2: abrdn SICAV I – Frontier Markets Bond Fund



Source: abrdn, 30 September 2023. For illustrative purposes only.

Diversification does not ensure a profit or protect against a loss in a declining market.

Performance



When we set up the Fund in September 2013, we said we would manage it on a total return basis rather than against a benchmark, with target returns in the high single-digit area.

Our target is to outperform mainstream EM hard-currency (EMBIGD) and local-currency (GBI-EM GD) indices by 200bps per annum. For regulatory purposes, however, we listed the JP Morgan NEXGEM Index as the benchmark in the prospectus.

We've consistently outperformed mainstream EM indices over the discrete periods important to our clients and fund selectors. We seek to outperform mainstream EM because investors who allocate to the Frontier Bond Fund (FBF) do so out of their EM risk budget. It's therefore vital to ensure they are compensated for taking the higher risk when investing in a dedicated frontier fund.

On that note, the Fund's volatility has been a little higher compared to the EMBIGD, but lower compared to the GBI-EM GD and NEXGEM Indices. We've always viewed the NEXGEM, which essentially consists of frontier issuers, as an imperfect index. The country weight has been based on the issuers' market capitalisation and therefore is skewed to a handful of large issuers. For example, Argentina once had a 14% weight in the index. That meant, even if we wanted to, we couldn't have replicated the position in the Fund due to the 10% country cap limit. Argentina was removed from the index a year or so after that due to index criteria. It's also unlikely it will be included again as it doesn't have some of the other key characteristics that define a frontier market, which are typically low to lower-middle-income countries. In contrast to the NEXGEM, the EMBIGD and GBI-EM GD are uniquely weighted indices that limit the weights of the larger issuers. This makes them more appropriate for managing against a benchmark.

Returns (annualised) (%)

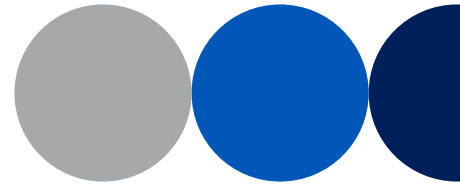
	1 year	3 year	5 year	Since inception
Fund	21.85	1.59	3.86	5.59
NEXGEM	22.63	-1.21	0.95	4.26

Sharpe Ratio

	1 year	3 year	5 year	Since inception
Fund	1.34	0.09	0.24	0.51
NEXGEM	1.34	-0.13	0.02	0.31



The case for frontiers



Investing in a dedicated frontier fund allows you to capture a range of diversification opportunities in 40-45 countries, with the highest yields in EM.

This compares favourably to your typical EM bond fund, which will only give you around 25% exposure to frontier bonds. A good example of the benefit of a dedicated frontier fund is to look at returns from 2023 to the end of the third quarter. During this period, our FBF gained 9.60%, while EM funds returned on average around a quarter of that, and the EMBIGD delivered 1.76%.

We've always emphasised that returns on frontier bonds have typically been driven by idiosyncratic factors. This helps explain the strong performance of our Fund in 2023, as distressed credits have been some of the top performers this year. Another argument for investing in frontiers is their low correlation to US Treasuries. This has been notable in 2023 amid a big backup in the US 10-year Treasury yield to 5% from 3.85% at the start of the year.

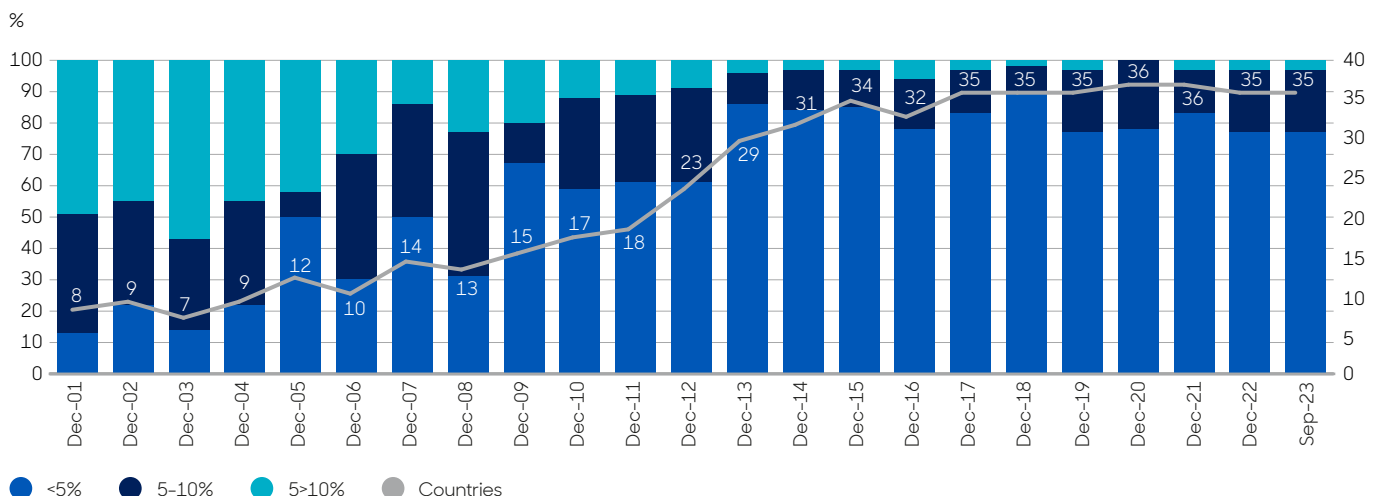
When we launched the Fund in 2013, there was a case to be made that frontier issuance was scarce and there were only a handful of managers that had the necessary expertise to navigate the market. That narrative has shifted, as frontier issuance has increased over the past

15 years while yield curves have extended out to 30 years. This was partly due to the low yields in developed markets that prompted a steady search for yield. Improving fundamentals and a growing familiarity with the asset class have also contributed to the increased appetite for frontier bonds.

Over the last few years, however, frontier issuers have largely lost market access due to high US Treasury yields. On a positive note, issuers have secured cheaper International Monetary Fund (IMF) lending in the absence of commercial financing. And, aside from Kenya and Pakistan, there are no large pending maturities due in 2024. This should mitigate default risk in the short term. Nonetheless, we acknowledge that credit risk has deteriorated and there could be more credit events in the coming years following a limited number of historical defaults (with five over the past three years). We also believe that current spreads overstate the default risk in the majority of issuers in our Fund.

Frontier Eurobonds issuers doubled in ten years

Chart 3: JPM NEXGEM Index



Source: abrdn, 30 September 2023. For illustrative purposes only. Diversification does not ensure a profit or protect against a loss in a declining market.

Looking ahead

The term 'frontier markets' is unlikely to shed the view that these are high-risk countries. However, we've sought to push back on that perception by emphasising the elevated political and economic risks in mainstream EM markets.

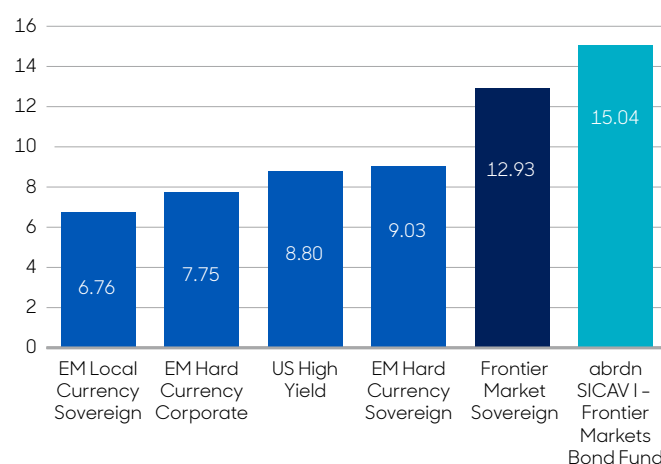
Furthermore, we would add that investors in the FBF are compensated for the so-called higher risks in frontier markets.

On a historical basis, investing in frontier markets with NEXGEM yields in the 12-16% area has resulted in strong returns on a three-year forward-looking basis. That's not to downplay the risks. As we previously stated, we're likely to see further credit events in the coming years as the fallout from the pandemic, the Russia/Ukraine war and higher-for-longer interest rates take their toll.

Over the past three years, we've seen defaults in Zambia, Belize, Suriname, Sri Lanka and Ghana. That said, there have also been defaults in non-frontier-market countries, such as Ecuador, Argentina and Lebanon. But additional credit events should not deter investors in frontier markets, or EM for that matter. After all, defaults have been part and parcel of the US high-yield bond market forever, yet that has not discouraged investors from allocating to the asset class.

What's important is to find a manager with a successful track record investing in frontier markets. In particular, those that can assess the legal and investment implications of credit events. abrdn is one of only a handful of managers that ticks those boxes.

Chart 4: Frontier bonds provide a meaningful yield pick up
Yield (%)



Source: J.P. Morgan, 30 September 2023. EM Local Currency Sovereign = GBI-EM Global Diversified, EM Hard Currency = EMBI Global Diversified, EM Hard Currency Corporates = CEMBI Broad Diversified, Frontier Markets = NEXGEM, US High Yield = J.P.M.H.Y. A positive yield does not imply a positive return. Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses are reflected. Individuals cannot invest directly in an index. **For illustrative purposes only.**

"Yields of 15% provide investors a generous concession compared to US High Yield."



Q&A with Kevin Daly, lead manager of the abrdn Frontier Bond Fund



Kevin Daly
Investment Director

How did you launch the Fund, who were the initial investors and how have they evolved over time?

We used to manage a global EM debt Fund for a major US financial institution for its offshore clients. This had a high dividend rate, but due to regulatory changes and declining EM debt yields, we had to pay the dividend out of income. We then proposed switching the mandate to frontier markets, which would allow us to maintain a high dividend rate. Most clients agreed to the proposed changes, which provided the seed capital for the FBF in September 2013. Over time, the investor base has evolved, with private banking interest coming mainly from Italy, Switzerland and Miami, along with institutional money from Latin America.

What do you enjoy most about managing the FBF?

I enjoy the challenge of getting information from different sources. I find myself constantly learning something new, which ensures I'm always looking to what lies ahead. I've also greatly enjoyed visiting so many countries, learning about the different cultures and, of course, the people I have met along the way. Over the past three years, I've also had the opportunity to share my views with the official sector on various debt relief measures and restructurings. For my part, I've learned a great deal from discussions with the IMF, the Paris Club, the Institute of International Finance, and the United Nations Economic Commission for Africa

Do you have a most memorable experience from a country trip?

I've been fortunate to visit most of the large frontier countries over the past 20-plus years, but my trip to Nigeria in 2008 was by far the most memorable. I was in Lagos with a handful of investors, along with our hosts at JP Morgan. While driving to lunch, another investor (who will remain anonymous) and I got caught up in a road rage event that lasted for over 30 minutes. Since traffic in Lagos is usually horrible, a half-hour seemed like an eternity. Fortunately, it ended peacefully – although we didn't know that would be the case at the time. It certainly didn't help that the other investor who was with me was outright panicking the entire time. Anyway, we eventually arrived safely at the lunch with a story to share with the other investors and host.

What's the best food you have had from a country trip?

It would have to be the dinner we had at a seaside restaurant in 2018 in Libreville, the capital of Gabon. It was recommended by the IMF resident representative, who joined for the investor dinner. The francophone influence undoubtedly helps explain the delicious food (and wine).

What are the best and worst investments you've made in the Fund?

The best investment was the same, but at two different times. We'd invested in Nigerian open market operations, which were short-dated and high-yielding local currency instruments issued by the central bank. We initiated the position for the first time in 2014 and closed it out before Nigeria imposed capital controls in 2016. We then reinitiated the position in May 2017, shortly after Nigeria reopened the market. We sold the position in late February 2020, as we were concerned about the risk of capital controls amid a worsening investment climate due to Covid-19 risks. Sure enough, Nigeria imposed capital controls again in late March. We were therefore able to avoid getting stuck onshore on both occasions.

The worst investment was holding too large a position in Mozambique. This followed the debt exchange of the so-called 'tuna bonds' for the sovereign Eurobonds offered to investors in the restructuring in early 2016. Alas, their value collapsed in April 2016 after the IMF halted its lending to the country when it discovered US\$1.4 billion in undisclosed loans. No one, including the IMF, saw that coming. In retrospect, however, we should have taken some profits after the restructuring. That would've helped to mitigate the downside risk when the hidden loan scandal unfolded.

How much should clients allocate to a dedicated frontier bond fund?

I would say 20% of their EM risk budget at a minimum, as this is around the average weight of frontier bonds in the mainstream EM benchmark in recent years. But I would recommend up to 50% of the total EM risk budget for investors with a higher risk tolerance.

Important Information

The fund is a Luxembourg-domiciled UCITS fund, incorporated as a Société Anonyme and organized as a Société d'Investissement à Capital Variable (a "SICAV").

The fund has been authorised for public sale in certain jurisdictions and private placement exemptions may be available in others. It is not intended for distribution or use by any person or entity that is a citizen or resident of or located in any jurisdiction where such distribution, publication or use would be prohibited.

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In Switzerland these documents along with the fund's articles of association can be obtained from the fund's Representative and Paying Agent, BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, CH 8002 Zürich, Switzerland (Tel. 058 212 63 77).

In Italy these documents can be obtained from the Paying Agent, State Street Bank S.p.A, 10 Via Ferrante Aporti, 20125 Milano.

In France, these documents can be obtained from the Centralising Correspondent Agent : BNP Paribas Securities Services, 3, rue d'Antin, 75002 Paris, France.

In Spain, these documents can be obtained from Allfunds Bank S.A., c / Estafeta nº6 (La Moraleja), Plaza de la Fuente Complex -Building 3-28109, Alcobendas -Madrid- Spain. For the purposes of distribution in Spain, has been registered with the Comisión Nacional del Mercado de Valores under the number 107. These documents are also available on **eifs.lu/abrdrn**, including; The articles of association; Information on how orders (subscription, repurchase and redemption) can be made and how repurchase and redemption proceeds are paid; Information and access to procedures and arrangements related to investors' rights and complaints handling.

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STA1123798142-001