Matthews Asia

Matthews Asia Credit Opportunities Fund

Choose a Share Class: Investor ▾

Period ended June 30, 2018

For the first half of 2018, the Matthews Asia Credit Opportunities Fund returned -2.77% (Investor Class), while its benchmark, the J.P. Morgan Asia Credit Index (JACI), returned -2.55% over the same period. For the quarter ending June 30, the Fund returned -3.40% (Investor Class) compared to the benchmark return of -1.20%.

Market Environment:

The first half of the year was notable for the volatility in financial markets across the world. U.S. Treasury yields continued to move higher as the U.S. Federal Reserve raised interest rates. Continued solid economic data in the U.S., on the margin, has increased rate hike expectations for the remainder of 2018 and 2019. Meanwhile, concerns around trade wars, the reversal of investor flows and politics in Latin America led to a sell-off across emerging markets.

Asia's credit markets were not immune to this volatility, and in the second quarter, Asian high yield credit spreads widened by 100 basis points (1.0%). Returns were largely negatively correlated to risk, with longest duration and highest spread bonds selling off the most. By country and sector, Chinese issuers came under pressure as policymakers onshore continued to keep credit markets tight, while Indonesian issuers were weak as the Indonesian central bank raised interest rates to combat depreciation in the Indonesian rupiah. The combination of rising interest rates and widening credit spreads created a challenging market environment in the second quarter.

Performance Contributors and Detractors:

Our holdings from China and Thailand were broadly positive performance contributors for the first half of the year. In the second quarter, the biggest contributors to portfolio returns were our holdings in the bonds of Chinese property developers KWG Property Holding and CIFI Holdings Group, as well as the bonds of DFCC Bank in Sri Lanka. The bonds of Chinese property developers have been under pressure this year as spreads have widened and credit conditions continued to be tight in onshore China. Both KWG and CIFI are high quality developers with ample liquidity and solid prospects. DFCC Bank bonds mature in October, and given their short remaining life, we earned attractive carry with little price volatility by owning them.

The largest detractors in the second quarter were sub-investment grade Indonesian corporate bonds issued by Lippo Karawaci and Modernland, and the convertible bonds of CP Foods, a Thai company. Lippo Karawaci and Modernland are both property developers in Indonesia. Bonds performed poorly in the quarter as high yield spreads widened, and the Indonesian central bank raised interest rates to help stabilize the rupiah, potentially dampening property purchases in the country. CP Foods' convertible bonds performed poorly as its subsidiary CP All's shares corrected on softer growth.

Notable Portfolio Changes:

In the second quarter, we started a number of new positions in high yield and convertible bonds. As high yield spreads widened and expectations for rate hikes from the U.S. Federal Reserve increased, we added shorter duration bonds with mid-single digit yields, which we expect will have limited interest rate sensitivity while earning reasonable returns. We opportunistically added bonds of Chinese property issuers such as KWG Property Holding and CIFI Holdings after they fell in price. We also added the convertible bonds of companies, including those of Johnson Electric, one of the largest producers of micro motors in China; Zhongsheng Group, a leading Chinese auto-dealership; and China Overseas Land & Investment, a high-quality Chinese property developer.

We also closed a handful of positions during the second quarter. We exercised our put on the convertible bonds of Saratoga Investama, an Indonesian holding company with stakes in leading Indonesian companies, as we saw limited upside in continuing to hold the bonds. Our bonds of China Hongqiao Group, the largest aluminum producer in the world, matured, while we sold bonds in Bangkok Dusit Medical, a hospital chain in Thailand.

Outlook:

In our view, Asian high yield bonds appear attractively valued, while U.S. and European high yield bonds appear overvalued. Credit spreads for Asia high yield bonds are almost 100 basis points (1.0%) higher than historic averages. In contrast, spreads for U.S. and European high yield bonds are about 200 basis points (2.0%) below average. In simple terms, Asian high yield bonds are compensating investors for taking credit risk, in our view, while U.S. and European high yield bonds are not.

To be sure, risks remain on the horizon. If a further slowdown in global growth materializes, we expect investor appetite for emerging markets to diminish. Any escalation in trade shocks or further outflows stemming from policy normalization in the U.S. also could put pressure on Asian fixed income markets. Finally, the demand for Asian credit from Chinese wealth managers might fall as the wealth management channels through which buyers purchase bonds are being more closely regulated.

While these risks could increase, we believe that much of this is already being priced in. We have been expecting volatility to rise over the course of 2018, and that was certainly the case in the second quarter. Asian credit markets will likely remain volatile in the second half of 2018, but we believe it is imperative that we continue to stay the course and not sell into the volatility. Based on our solvency and liquidity analysis, we do not expect any of the securities in the portfolio will default. As such, the relatively attractive yields in Asia offer a strong base for positive returns. A bond that starts with a 5% to 8% yield and has 25 basis points (0.25%) of credit spread compression, for example, could generate attractive returns for investors over the course of the year.

As of 6/30/2018, the securities mentioned comprised the Matthews Asia Credit Opportunities Fund in the following percentages: KWG Property Holding, Ltd., 6.000%, 09/15/2022, 3.2%; CIFI Holdings Group Co., Ltd., 6.875%, 04/23/2021, 2.3%; DFCC Bank PLC, 9.625%, 10/31/2018, 2.8%; Theta Capital Pte, Ltd., 6.750%, 10/31/2026 (Lippo Karawaci) 2.0%; Modernland Overseas Pte, Ltd., 6.950%, 04/13/2024, 2.8%; CP Foods Holdings, Ltd., Cnv., 0.500%, 09/22/2021, 1.9%; Johnson Electric Holdings, Ltd., Cnv., 1.000%, 04/02/2021, 1.9%; Zhongsheng Group Holdings, Ltd., Cnv., 0.000%, 05/23/2023, 1.2%; and China Overseas Finance Investment Cayman V, Ltd., Cnv., 0.000%, 01/05/2023, 3.9%. The Fund held no positions in (Saratoga Investama) Delta Investment Horizon International, Ltd., China Hongqiao Group, Ltd. or Bangkok Dusit Medical Services Public Co., Ltd. Current and future portfolio holdings are subject to risk.

Average Annual Total Returns - Investor Class (6/30/2018)

1-year -0.45%
3-year n.a.
5-year n.a.
10-year n.a.
Inception (4/29/16) 4.39%

Gross Expense Ratio

1.86%

After fee waiver and expense reimbursement: 1.15% [1]

[1] Matthews has contractually agreed (i) to waive fees and reimburse expenses to the extent needed to limit Total Annual Fund Operating Expenses (excluding Rule 12b-1 fees, taxes, interest, brokerage commissions, short sale dividend expenses, expenses incurred in connection with any merger or reorganization or extraordinary expenses such as litigation) of the Institutional Class to 0.90% first by waiving class specific expenses (i.e., shareholder service fees specific to a particular class) of the Institutional Class and then, to the extent necessary, by waiving non-class specific expenses of the Institutional Class, and (ii) if any Fund-wide expenses (i.e., expenses that apply to both the Institutional Class and the Investor Class) are waived for the Institutional Class to maintain the 0.90% expense limitation, to waive an equal amount (in annual percentage terms) of those same expenses for the Investor Class. The Total Annual Fund Operating Expenses After Fee Waiver and Expense Reimbursement for the Investor Class may vary from year to year and will in some years exceed 0.90%. If the operating expenses fall below the expense limitation in a year within three years after Matthews has made a waiver or reimbursement, the Fund may reimburse Matthews up to an amount that does not cause the expenses for that year to exceed the lesser of (i) the expense limitation applicable at the time of that fee waiver and/or expense reimbursement or (ii) the expense limitation in effect at the time of recoupment. This agreement will remain in place until April 30, 2019 and may be terminated at any time by the Board of Trustees on behalf of the Fund on 60 days' written notice to Matthews. Matthews may decline to renew this agreement by written notice to the Trust at least 30 days before its annual expiration date.

All performance quoted is past performance and is no guarantee of future results. *Investment return and principal value will fluctuate with changing market conditions so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the return figures quoted. Returns would have been lower if certain of the Fund's fees and expenses had not been waived. Please see the Fund's most recent month-end performance.*

Yield as of 6/30/2018

30-day Yield: 4.07%

30-day Yield Excluding Expense Waiver: 3.83%

The 30-Day Yield represents net investment income earned by the Fund over the 30-day period ended 9/30/17, expressed as an annual percentage rate based on the Fund’s share price at the end of the 30-day period. The 30-Day Yield should be regarded as an estimate of the Fund’s rate of investment income, and it may not equal the Fund’s actual income distribution rate. Source: BNY Mellon Investment Servicing (US) Inc.

Fixed income investments are subject to risks, including, but not limited to, interest rate, credit and inflation risks. Investing in emerging markets involves different and greater risks, as these countries are substantially smaller, less liquid and more volatile than securities markets in more developed markets.

Visit our Glossary of Terms page for definitions and additional information.

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