Matthews Asia

Matthews Asia ESG Fund

Choose a Share Class: Investor ▼

For the period ending September 30, 2018

For the quarter ending September 30, 2018, the Matthews Asia ESG Fund returned -1.33% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned -1.45%.

Market Environment:

The benchmark return of -1.45% for the quarter masked the severe turbulence experienced by the Asia ex-Japan markets. The benchmark saw four moves of about 5% (moves of -4.9%, +5%, -6.3% and +4.6% respectively between the second week of August and quarter end) as the market struggled to comprehend the timing, magnitude, sustainability and end game of the trade friction between the U.S. and China. Additional sources of volatility were the run-up in the U.S. long-term bond yields, the strength of U.S. dollar alongside higher oil prices, and the implications it carried for the currencies of current account deficit countries in the region such as India (rupee -5.5%), Indonesia (rupiah -3.8%) and the Philippines (peso -1.3%).

Thailand and Taiwan were the best-performing markets during the quarter, while China/Hong Kong was the worst performer. Strong currency performance of the Thai baht and the stable Taiwanese dollar helped to deliver good U.S. dollar returns. From a sector standpoint, energy (+13.3%) was the best performer, aided by higher oil prices, while consumer discretionary (-10.6%) was the worst performer due to worries of slowing China auto sales.

Performance Contributors and Detractors:

Stock selection in South Korea and country allocation in China/Hong Kong were the biggest contributors to relative performance, while stock selection in India was the biggest detractor to performance. At the sector level, stock selection in the information technology and consumer discretionary sectors contributed positively, while stock selection in the industrials and financials sectors detracted.

Total Access Communication (DTAC), a Thai telecom company, contributed positively during the quarter. The Thai telecommunications regulatory environment showed signs of marginal improvement recently as the regulator was somewhat receptive to feedback from the operators, who have suffered from the regulator's unrealistic spectrum auction pricing expectations and terms. During the quarter, DTAC won a bid for a small amount of spectrum at 1800 MHz and is seeking a remedy period for 850MHz, which would enable it to continue service to its existing customers, while it awaits other opportunities to increase its spectrum allocation at the right price.

Shriram City Union Finance, an Indian non-banking financial company (NBFC) that focuses on micro and small enterprise lending, two-wheeler financing and gold loans, detracted the most from performance during the quarter. In September IL&FS, a large Indian NBFC, defaulted on its borrowings and that led to a panic sell-off in Indian financials, especially in the NBFC space. This was billed as India's "mini-Lehman" moment by some commentators. NBFCs accounted for a meaningful share of loan growth in India over the past three years, as public-sector banks, which were saddled with non-performing loans and capital constrained, had not been actively lending. NBFCs stepped in to fill that gap by partly relying on wholesale funding. The market worried about potentially slower growth, drying up liquidity and also about asset-liability mismatches at these entities and sold off NBFCs aggressively. We believe Shriram is among the best operators in this space and it has a well-diversified funding base including retail term deposits, along with well-matched assets and liabilities. It is also among the most well-capitalized financial institutions in the country. We continue to believe that Shriram will do well over the long term and added to our position during the sell-off as valuations touched multiyear lows.

Notable Portfolio Changes:

During the quarter we initiated a new position in Jaya Real Property, a greater Jakarta-focused property company that provides affordable housing to the low- and middle-income population. The company develops townships and has a large land bank. The greater Jakarta property market has been soft over the past few years as income growth in Jakarta has slowed down alongside the uncertainty induced by the government's recent tax amnesty program. But household formation in Indonesia continues to be strong and we believe continued urban infrastructure buildout in Jakarta will have a positive impact on the company operations over the coming years. Jaya has a solid balance sheet and a net cash position, which is unusual for an Indonesian property company. It was very attractively valued with a strong dividend yield on offer. The company has a 50% independent board and also has a female board representative.

During the quarter we exited our position in Kasikornbank to fund new initiations.

Outlook:

As trade friction between the U.S. and China has escalated sharply in recent months, we will continue to be watchful and cautious. We believe China has the ability to at least partially the address the shorter-term drag on growth by way of stimulus. What exact shape or form it takes remains to be seen. In addition, we continue to watch out for current account deficits and higher exchange-rate volatility, especially in South and South East Asia, due to factors such as high oil prices and weak local currencies, which might cause central banks to raise interest rates to defend currencies and therefore act as a drag on economic growth.

The recent sell-off has selectively provided attractive entry opportunities in Asia and we continue to employ a fundamental, bottom-up investment process and use any further market dislocation in Asia as an opportunity to buy shares of what we consider to be high-quality companies with best-in-class ESG attributes at reasonable prices.

We are confident in Asia's ability to effectively address global ESG challenges through its leadership position in areas including electric vehicles, access to affordable health care and financial inclusion, among others. This leadership provides an encouraging backdrop for pursuing ESG-focused investing in Asia. We also find that investing in companies that are improving the quality of life in Asia is a way to address the aspirations of the newly emergent and increasingly sophisticated middle class.

As of 9/30/2018, the securities mentioned comprised the Matthews Asia ESG Fund in the following percentages: Total Access Communication Public Co., Ltd. 2.7%; Shriram City Union Finance, Ltd. 2.5%; PT Jaya Real Property 0.8%. The Fund held no position in Kasikornbank Public Co., Ltd. Current and future portfolio holdings are subject to risk.

Average Annual Total Returns - Investor Class (9/30/2018)

1-year 3.54%
3-year 10.07%
5-year n.a.
10-year n.a.
Inception (4/30/15) 5.00%

Gross Expense Ratio

2.65%

After fee waiver and expense reimbursement: 1.50% [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 (which is offered through a separate prospectus to eligible investors) to 1.25%, 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 1.25% 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 1.25%. 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.*

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

The views and opinions in this commentary were as of the report date, subject to change and may not reflect current views. They are not guarantees of performance or investment results and should not be taken as investment advice. Investment decisions reflect a variety of factors, and the managers reserve the right to change their views about individual stocks, sectors, and the markets at any time. As a result, the views expressed should not be relied upon as a forecast of the Fund's future investment intent. It should not be assumed that any investment will be profitable or will equal the performance of any securities or any sectors mentioned herein. The information does not constitute a recommendation to buy or sell any securities mentioned.

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You should consider the investment objectives, risks, charges and expenses of the Matthews Asia Funds carefully before making an investment decision. This and other information about the Funds is contained in the prospectus or summary prospectus, which may also be obtained by calling 800-789-ASIA (2742). Please read the prospectus carefully before you invest or send money as it explains the risks associated with investing in international and emerging markets. These include risks related to social and political instability, market illiquidity and currency volatility. Investing in foreign securities may involve certain additional risks, exchange rate fluctuations, less liquidity, greater volatility and less regulation. Fixed income investments are subject to additional risks, including, but not limited to, interest rate, credit and inflation risks. Single-country *and sector funds may be subject to a higher degree of market risk than diversified funds because of a concentration in a specific sector or geographic region. Investing in small companies is more risky and more volatile than investing in large companies.*

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