Matthews Asia

Matthews Asia ESG Fund

Choose a Share Class: Investor

For the period ending June 30, 2019

For the first half of 2019, the Matthews Asia ESG Fund returned 9.62% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned 10.83%. For the quarter ending June 30, 2019, the Matthews Asia ESG Fund returned -2.15% (Investor Class), while the benchmark returned -0.56%.

Market Environment:

Asia's capital markets rallied at the start of the year, led by Chinese equities. Volatility flared in May, followed by a rebound for equity prices in June. The dominant factors driving Asia capital markets over the short term were political, stemming from rhetoric around trade relations between the U.S. and China and the resultant uncertainty

The Thai baht was Asia's top-performing currency relative to the U.S. dollar (up 6.17%) during the first half, while the Pakistani rupee was the worst (down -13.11%) for the same period. Currencies that appreciated relative to the dollar included the Japanese yen (up 1.83%), the Indonesian rupiah (up 1.79%) and the Indian rupee (up 1.79%). The Chinese renminbi was roughly flat (down -0.04%). Currencies that depreciated included the South Korean won (down -3.36%) and the Taiwan dollar (down -1.04%). Turning to financial markets, China's equity markets, as represented by the MSCI China Index (up 14.02%), were the top performers in the region for the first half, despite trade tensions. Many other Asian equity markets also enjoyed gains in the period, including Taiwan, South Korea, Malaysia and Thailand.

From a sector perspective, real estate, consumer discretionary, information technology and financials were the top-performing sectors in the benchmark in the first half. In contrast, health care was the only sector with negative benchmark returns for the first half.

Performance Contributors and Detractors:

The Fund underperformed its benchmark during the first half of the year, particularly in the second quarter, which negated the Fund's outperformance in the first quarter. This underperformance was largely due to the Fund's higher allocation to small companies relative to the benchmark, and lower allocation to the region's largest companies relative to the benchmark. During the period, Asian markets experienced a rally, disproportionately benefiting larger companies over smaller companies. The outperformance of larger companies may have been driven in part by flows into index funds. Over a full market cycle, having meaningful exposure to smaller companies can offer attractive opportunities for generating alpha, but this same exposure can cause periods of underperformance over the shorter term.

A contributor to performance during the period was New Oriental Education & Technology Group, a tutoring services company serving students in China. We initiated a position in this company in early 2019 after its stock price was beaten down toward the end of 2018 due to negative sentiment around government regulations for private education services providers and a general market sell-off. We believed the company had the scale and resources to comply with regulations, providing the company with a competitive edge over smaller players in the industry. While New Oriental Education & Technology Group is a large company in the sector, we believe it still has considerable room to grow as its current market share is only a small slice of the overall opportunity set for private tutoring services in China's largest, most economically developed cities. Less-developed urban centers in China present further growth opportunities. We believe there also is further upside from its online initiatives that work in conjunction with its offline classroom infrastructure.

A detractor during the period was Indian multinational tractor and automotive manufacturer Mahindra & Mahindra. The tractor side of its business has been a strong performer over the past few years, but that cycle has shifted on concerns over potentially lower rural income growth prospects due to an adverse monsoon season in India. Meanwhile, automotive sales in India have generally been weak, creating negative sentiment toward automakers in general. Mahindra & Mahindra's auto sales have held up better than the large auto market in India, benefiting from the company's introduction of three new passenger vehicles late in 2018. While the company's stock price closed the period near an all-time low, we continue to like the company's long-term prospects and have been opportunistically adding to the position.

Notable Portfolio Changes:

As mentioned in the contributors section, we added a position in New Oriental Education & Technology Group to the portfolio in the second quarter. Offering the potential for attractive growth, the company is a good match for the Fund's objectives across many criteria. Education is a basic building block for economic progress, as well as an essential element for improving quality of life for Asia's growing middle class.

Outlook:

Looking ahead, economic signals appear somewhat mixed. On the positive side, interest rates are widely expected to ease or hold steady, while oil prices seem to remain in check. Both conditions are positives for Asia currencies. While trade tensions have temporarily softened, several issues remain unresolved and U.S. President Donald Trump's negotiation style is unpredictable. Against this backdrop of uncertainty, China's policymakers have signaled a willingness to take a more proactive stance in using fiscal and monetary policy to support growth. Elsewhere in the region, elections in India and Indonesia resulted in wins for the incumbents, adding a sense of political stability in both countries. With elections concluded, reform cycles in both countries could get a boost.

While sentiment had improved considerably by the end of the volatile first half of 2019, macroeconomic risks remain and trade tensions could resurface. The Fund's focus on high-quality companies has historically helped the portfolio weather bouts of volatility by providing an element of downside protection during market drops. In addition, our strong focus on investing in cash flow-generative companies also has created a lower volatility approach to growth investing in Asia. We continue to look for companies that can grow profits and cash flows sustainably, while improving economic, social or environmental outcomes across the region.

As of 6/30/2019, the securities mentioned comprised the Matthews Asia ESG Fund in the following percentages: New Oriental Education & Technology Group, Inc. 2.2%; and Mahindra & Mahindra, Ltd. 2.3%.Current and future portfolio holdings are subject to risk.

INDEX DEFINITIONS

The MSCI China Index is a free float-adjusted market capitalization-weighted index of Chinese equities that includes H shares listed on the Hong Kong exchange, B shares listed on the Shanghai and Shenzhen exchanges, Hong Kong-listed securities known as Red chips (issued by entities owned by national or local governments in China) and P Chips (issued by companies controlled by individuals in China and deriving substantial revenues in China), and foreign listings (e.g. ADRs).

Average Annual Total Returns - Investor Class (6/30/2019)

1-year 1.05%
3-year 9.80%
5-year n.a.
10-year n.a.
Inception (4/30/15) 4.68%

Gross Expense Ratio

2.20%

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 (e.g., 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, 2020 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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