Matthews Asia™

Matthews Asia ESG Fund

Choose a Share Class: Investor ▼

For the period ending December 31, 2018

For the year ending December 31, 2018, the Matthews Asia ESG Fund returned -9.73% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned -14.12%. For the fourth quarter, the Fund returned -6.58% (Investor Class) versus -8.60% for the Index.

Market Environment:

The full range of market emotions was on display in Asia in 2018—from expectations of a “melt-up” in early 2018 and midyear worries about a meltdown due to U.S.-China trade tensions, to fewer worries amid signs of a thaw in trade tensions toward year end. 2018 was also the year of a strong U.S. dollar. All major Asian currencies except the Japanese yen (up 2.7%) and Thai baht (up 0.1%) depreciated against it, with the worst-performing currencies being in South and Southeast Asia (Indian rupee down 8.5%; Indonesian rupiah down 5.7%).

Pakistan and South Korea were the worst-performing markets during the year, while Thailand and Malaysia held up reasonably well in a difficult year for Asia. Utilities was the best-performing sector, while consumer discretionary was the worst-performing sector.

Performance Contributors and Detractors:

Most of the outperformance in 2018 was generated from stock selection. At the country level, China/Hong Kong were the biggest contributors to relative performance, while Vietnam and the Philippines slightly detracted from performance. From a sector standpoint, consumer discretionary and information technology were the biggest positive contributors, while financials detracted the most from performance.

At the stock level, Wuxi Biologics was the biggest contributor to performance. The company is a vertically integrated Chinese contract development and manufacturing organization (CDMO) that enables cost- and time-efficient drug discovery, development and manufacturing of biologics. Wuxi Biologics plays an important role in speeding up the innovation cycle in the global biotech industry in general and the Chinese biotech industry in particular by helping both global majors as well as Chinese biotech startups through its scaled-up CDMO model. The company continued to execute well on its strategic plan and experienced faster migration of contracts into the higher value clinical trial stage from the pre-clinical trial stage.

On the other hand, Inner Mongolia Yili was the biggest detractor from performance. Yili's performance was in line with that of the weak China A-share market performance as investors worried about the impact of the U.S.-China trade friction, alongside the impacts of the deleveraging campaign and the property-market cooling efforts by the Chinese government on China's economy. From a fundamental standpoint, the company executed well, with the impact of higher raw material prices somewhat offset by an improving product mix. We continue to like Yili's long-term business prospects and added further to our position during 2018.

Notable Portfolio Changes:

During the fourth quarter, the Fund initiated a position in Unicharm, a Japanese personal care company that focuses on baby diapers, feminine care products and adult incontinence products. Unicharm is Asia's largest and the world's third-largest company in the disposable hygiene category. The company has a dominant position in Japan's adult diaper market and is poised to benefit from aging populations and rising life expectancy in other parts of Asia. Unicharm also has market-leading positions in baby diapers and feminine hygiene products across several Asian markets. The company has strong environmental programs to reduce its footprint and has a plan to achieve 100% third-party certification of paper and pulp, a key raw material, by 2020. The company is also in the process of commercializing a diaper recycling system that should materially reduce the raw material intensity of the business over time. Unicharm is focused on shareholder returns and has a 50% total return (dividends and buybacks) policy.

Outlook:

U.S.-China trade friction, which escalated sharply up until the G20 summit meeting in Argentina in November, seems to be de-escalating but we continue to monitor progress very closely. We believe China has the ability to at least partially address the shorter-term drag on growth by way of stimulus. And the broad contours of such stimulus are slowly taking shape in the form of targeted infrastructure investments, reduced banking reserve requirement ratios and tax relief. Also, we are watching for sharp oil price movements that could impact the current account balances of South and Southeast Asian countries, with implications for their currencies.

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 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 12/31/2018, the securities mentioned comprised the Matthews Asia ESG Fund in the following percentages: Wuxi Biologics Cayman, Inc. 1.5%; Inner Mongolia Yili Industrial Group Co., Ltd. 4.2%; Unicharm Corp. 3.0%. Current and future portfolio holdings are subject to risk.

Average Annual Total Returns - Investor Class (12/31/2018)

1-year -9.73%
3-year 5.99%
5-year n.a.
10-year n.a.
Inception (4/30/15) 2.73%

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

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.

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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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