Matthews Asia™

Matthews Asia Focus Fund

Choose a Share Class: Investor ▼

Period ended June 30, 2018

For the first half of 2018, the Matthews Asia Focus Fund fell -7.31% (Investor Class) while its benchmark, the MSCI All Country Asia ex Japan Index, returned -4.65%. For the quarter ending June 30, the Fund returned -4.73% (Investor Class) compared to the benchmark return of -5.31% over the same period.

Market Environment:

Following almost two years of extremely low volatility and strong equity market performance in Asia, the first half of the year was far choppier and markets ended lower. This can be attributed to a number of macroeconomic and policy-related factors. Monetary tightening in the U.S. through interest rate rises and a reduction of the U.S. Federal Reserve's balance sheet has tightened U.S. dollar liquidity, while monetary conditions also tightened in China. Additionally, significant political risks re-emerged within Europe in the first half of the year. But the resumption of President Trump's trade war rhetoric and planned tariffs swung sentiment into negative territory. This has focused on China in particular, with an initial US$34billion of tariffs to be imposed on imports from China in early July. This number will increase over time. China has responded in equal measure, resulting in an escalated trade war that is economically disruptive for all.

These factors have sparked concern that the globally synchronized growth environment of the past couple of years has passed. Asian equities and currencies have dropped significantly from their peaks in January, with the markets of China and Taiwan holding up marginally better than others.

Performance Contributors and Detractors:

During the first six months of 2018, the largest contributors to returns came from the portfolio's holdings in Australia. The best performer, Macquarie Group, has diversified its business beyond investment banking to become a vertically integrated asset manager capable of delivering stable growth among Australian financial institutions through business cycles. The stock rallied as the market started to appreciate this business model transformation.

In addition, our holdings in the consumer staples sector contributed positively. Heineken Malaysia, a leader in Malaysia's premium beer segment, performed strongly as it delivered above-market growth and benefited from the new government's policies. Meanwhile, shares of Singaporean supermarket chain Sheng Siong Group gained as it offered earnings certainty amid market volatility with its store network optimization and defensive operating cash flow.

The largest detractor to relative returns during the first six months of 2018 came from holdings in the China/Hong Kong markets. Shares of NetEase, a Chinese online game company, declined as investors worried about the lack of new hit game titles and the firm's investment in e-commerce. We think NetEase's franchise value—as the second-largest online game platform in China—remains underappreciated. We also like management's disciplined approach in developing a niche e-commerce strategy. More recently our holdings in Indonesia and the Philippines declined amid global emerging market volatility and foreign fund outflow. For instance, shares of Bank of the Philippine Islands declined to 1.9x price to book, their lowest valuation since 2010. We believe this strong franchise is now attractively valued, as its business is holding up well on measures including loan growth, nonperforming loan ratio and capital sufficiency.

Notable Portfolio Changes:

We added three new positions during the second quarter: ING Life Insurance Korea, Johnson Electric Holdings and JNBY Design.

ING Life Insurance Korea is a high-quality life insurance company in South Korea with a strong management team. Its solvency margin is significantly higher than its peers, making it well-positioned to gain market share amid tighter capital rules. The stock is attractively priced at 9x forward price-to-earnings ratio and offers a 6% dividend yield.

Hong Kong-listed Johnson Electric Holdings is a leading micro-motor maker that benefits from demand driven by the global trend of vehicle electrification. Market concerns of trade wars led to broad weakness in automotive parts manufacturers including Johnson Electric, even though the impact to the company is limited. At 5x enterprise value-to-EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) and 8x forward price to earnings, Johnson Electric is undervalued for its long-term growth in our view.

Additionally, we initiated a position in JNBY Design, an emerging leader in the designer fashion industry in China. Through its successful social media marketing and customer analytics, JNBY Design rides on the tide of consumption upgrades in China and has built a large number of loyal customers, whose purchases accounted for 63% of its total retail sales in the fiscal year ending in June 2017.

During the second quarter, we exited our holding in Heineken Malaysia. The company operates in a duopolistic industry and benefits from the newly elected government's plan to remove Malaysia's goods and services tax (GST). However, after the recent rally, we believed its valuation fully reflected its moderate growth opportunities. In addition, we exited our holding in Tata Motors, which had disappointed investors with its sales performance and investment plans.

Outlook:

The reasons for caution in allocating capital have been increasing and are fairly plentiful at this late stage of the global equity market cycle. The reduction in U.S. dollar liquidity alongside rising autocracy, protectionism, trade wars, reasonably high valuations, significant leverage and the dangers of market dislocations perpetuated by the rise of passive investing are all concerning. Although these may not spark major market declines, particularly against a backdrop of seemingly solid economic growth, these are likely to contribute to a sustained rise in volatility.

For the Matthews Asia Focus Fund, this is an appealing backdrop. Not only is there still solid economic and corporate profit growth in Asia over both the short and long term, but this volatility may provide long-term investors with the ability to purchase shares of high-quality companies at attractive price points. We will look to take advantage of any dislocations to add to our stable of emerging and established leading companies, while the Fund was already trading by June 30 at an appealing 15.0x forward P/E after recent declines.

As of 6/30/2018, the securities mentioned comprised the Matthews Asia Focus Fund in the following percentages: Macquarie Group, Ltd. 3.5%; Bank of the Philippine Islands 2.5%; Johnson Electric Holdings, Ltd. 2.2%; JNBY Design, Ltd. 2.3%; ING Life Insurance Korea, Ltd. 2.0%; NetEase, Inc. 2.7%; Sheng Siong Group, Ltd. 3.3% The Fund held no positions in Heineken Malaysia BHD or Tata Motors, Ltd. Current and future portfolio holdings are subject to risk.

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

1-year 5.38%
3-year 5.70%

5-year 4.93%
10-year n.a.
Inception (4/30/13) 3.41%

Gross Expense Ratio

2.45%

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.

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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