Matthews Asia™

Matthews Asia Focus Fund

Choose a Share Class: Investor ▼

Period ended December 31, 2018

For the year ending December 31, 2018, the Matthews Asia Focus Fund returned -17.24% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned -14.12%. For the fourth quarter, the Fund returned -7.44% (Investor and Institutional Class) versus -8.60% for the Index.

Market Environment:

2018 closed with yet another increase in volatility for global asset prices as the prior years of globally synchronized growth with limited tail risks seemed a distant memory. The combination of tightening U.S. dollar liquidity as G-3 central banks began exiting the decade-long experiment of quantitative easing, alongside rising geopolitical tension and slowing growth in China, were major factors in driving a risk-off environment. We are unquestionably long in this economic cycle and it is understandable that slowing growth accompanied by high valuations and egregious levels of outstanding debt led many market participants to take pause and reduce risk.

With this backdrop, all Asian markets struggled in U.S. dollar terms, particularly as many currencies depreciated against the greenback. The weakest of these were the export-heavy North Asian markets of China and South Korea, whilst the more domestic demand-oriented countries of Southeast Asia held up relatively better.

Performance Contributors and Detractors:

The largest contributors to portfolio returns for the full year came from the consumer staples and health care sectors. Heineken Malaysia gained during the first half as the brewer returned to attractive top-line growth through strong marketing campaigns and new branch launches. This, however, failed to translate into equivalent growth in earnings and we exited the position earlier in the year. Singaporean supermarket chain Sheng Siong Group also rose, with solid earnings growth driven by new store openings and improving margins as the company increased its mix of fresh food and improved efficiencies from its distribution centers. Within health care, sleep apnea device maker ResMed delivered strong performance on sustained mask and device growth, driven by its impressive connected care strategy.

During the fourth quarter, the portfolio's holdings in India and Indonesia were the strongest contributors. Both countries benefited from the drop in oil prices as that helped fiscal and current account deficits. Financial stocks Bank Rakyat Indonesia and HDFC (Housing Development Finance Corp.) gained in this environment of looser liquidity, easing asset quality and growth concerns.

For the full year, the largest detractors to returns came from some stock-specific challenges within Southeast Asia. Malaysia casino operator Genting Malaysia fell as the government raised its casino license fee and gaming taxes more than anticipated to increase fiscal revenues. Further, the company suffered as previous theme park partner Twenty-First Century Fox pulled out of its memorandum of agreement after much of the project had already been built but prior to opening. Genting has launched a lawsuit in an attempt to reclaim these expenses and punitive damages. Indonesian department store Matahari fell as rising competition from online and specialty retail, alongside some corporate governance concerns, weighed on the stock. We exited our position in response to this. Beyond this, Chinese social networking and games operator Tencent Holdings dropped significantly after previously strong performance and concerns over the Chinese government freezing game approvals.

Notable Portfolio Changes:

We added one new position to the portfolio during the quarter, Taiwanese specialty store Poya International. The company's stores focus on lower priced beauty products as well as clothing, accessories and food primarily for female customers. We believe that its vast product offering and price point is a solid moat that helps the business generate healthy margins and a return on equity over 40%. Further, management pays out most of the company's cash generation through dividends and the stock is yielding more than 4.5% and trades at around 18x P/E. There are also additional growth opportunities for the company through a return to positive same-store sales growth, an increase in store count, weakening competition and improved labor productivity.

Outlook:

The reasons for elevated volatility to persist throughout 2019 appear fairly lengthy in nature. Although tariff negotiations are ongoing in the U.S.—China trade war, the rise of geopolitical tension between the two nations is likely here to stay given differing economic and political ideologies. Additionally, there continues to be risk of policy errors as the U.S. Federal Reserve attempts to find a balance of discovering the elusive neutral rate as well as reduce the existing scale of its balance sheet. Further, global growth rates are slowing with China and parts of Europe particularly weak, albeit China has both the willingness and firepower to stimulate if growth rates become uncomfortably low. Beyond this, it is a heavy election year in Asia as countries from Thailand to India go to the polls and this always provides scope for increased volatility.

The macroeconomic backdrop suggests significant tail risks. However, the microeconomic backdrop appears more constructive. Valuations for the MSCI All Country Asia ex Japan Index are approximately 11.4x P/E and growth is still forecasted to be positive and likely to be in the high single-digit range. Despite the negativity, that provides us with an exciting environment where active management becomes important once again. Growth is still available but selectivity is key as volatility is likely to create opportunities for us to enter into quality businesses at attractive price points.

As of 12/31/2018, the securities mentioned comprised the Matthews Asia Focus Fund in the following percentages: Housing Development Finance Corp., Ltd. 3.5%; Sheng Siong Group, Ltd. 2.6%; Poya International Co., Ltd. 2.2%; PT Bank Rakyat Indonesia Persero 3.6%; Genting Malaysia BHD 1.8%; and Tencent Holdings, Ltd. 5.2%. The Fund held no positions in Heineken Malaysia BHD; ResMed, Inc.; PT Matahari Department Store; or Twenty-First Century Fox. Current and future portfolio holdings are subject to risk.

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

1-year -17.24%
3-year 5.92%
5-year 1.75%
10-year n.a.
Inception (4/30/13) 1.07%

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.

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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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