Matthews Asia

Matthews Asia Growth Fund

Choose a Share Class: Investor

Period ended June 30, 2018

For the first half of 2018, the Matthews Asia Growth Fund returned 2.97% (Investor Class), while its benchmark, the MSCI All Country Asia Pacific Index, returned -3.22% over the same period. For the quarter ending June 30, the Fund returned -2.47% (Investor Class), while its benchmark returned -3.25%.

Market Environment:

Asian and global emerging markets suffered during the first half of 2018. Negative investor sentiment arose from the confluence of escalating trade tensions between China and the United States; seemingly tighter monetary conditions in China and other emerging markets; and the oscillation of North Korean denuclearization talks. In addition, the flight to quality, a stronger U.S. dollar and higher energy prices exposed the vulnerabilities of some emerging market economies.

Chinese shares generated negative returns for the six months ending June 30. Trade disputes with the U.S. proved to be too large a risk for investors during the second quarter. However, resilient corporate earnings, a surprisingly stable renminbi and robust exports were positive contributors to China's economic growth. Elsewhere, India's equity market posted negative returns for the first half of the year. India faced macro headwinds during the second quarter as its reliance on energy imports and a deteriorating current account pressured the Indian rupee and raised inflation concerns. On a positive note, economic growth remained robust and corporate earnings momentum improved.

Japanese shares experienced a volatile quarter and generated negative returns during the first half of the year. Stock prices increased in April as overseas risks seemed to stabilize temporarily as tensions between the U.S. and North Korea faded and trade tensions with China appeared calmer. However, geopolitical tension picked up in May, causing volatility in global stocks, especially within sectors exposed to global trade. This pattern of volatility continued through June despite notably high return on equity (ROE) figures from Japanese companies.

Performance Contributors and Detractors:

During the first half of the year, the Fund outperformed its benchmark on both an absolute and relative basis. The top contributor to performance for the six-month period was Baozun, a Chinese e-commerce solutions firm that is becoming an essential partner to global brands conducting business online in China. The rising purchasing power of the Chinese consumer has contributed to the demand for Baozun's services. Shenzhou International Group Holdings, a Chinese apparel manufacturer, was another top performer. In addition to making apparel for several leading global apparel brands, the firm has shrewdly expanded its focus to include the Chinese consumer. We expect the firm's focus on China's sizeable domestic apparel market to drive attractive growth rates.

Detractors from performance included Bank Rakyat Indonesia, a large bank in Indonesia specializing in small-scale lending. Its stock price fell on negative investor sentiment driven in part by rising interest rates in Indonesia as well as a broader decline among Indonesian equities. We believe, however, that the bank's fundamentals remain solid and that its business may offer attractive long-term growth prospects. Another detractor from performance was PC Jeweller, an Indian jewelry manufacturer. Its shares lost close to three quarters of their value over the same period on unsubstantiated rumors that the company manipulated its financial data. We are closely monitoring both positions.

Notable Portfolio Changes:

During the second quarter, we initiated a position in Terumo, a Japanese medical device company. Valuations looked reasonable and we expect the company to have strong growth prospects over the next five years. In particular, we believe the company's neurovascular business has a sharp focus and clear drivers of growth. As part of our fundamental research process, we met with the company's management team during the quarter and were impressed with the quality of the leadership. We exited our position in Habib Bank, a multinational bank in Pakistan. We initiated the position more than three years ago with the aim of diversification and growth. The bank has faced macroeconomic headwinds specific to Pakistan, however, and made a few management missteps. We decided to sell the stock in order to deploy cash from the sale elsewhere.

Outlook:

Going into the third quarter, trade friction could dampen sentiment but there may be positive drivers. In Japan, Prime Minister Shinzo Abe is up for re-election in September and a competitive Japanese yen could support upward earnings revisions. Most importantly, the November midterm elections in the U.S. could incentivize the Trump administration to back off aggressive rhetoric regarding global trade and investment restrictions such that markets can take a breather from volatility.

U.S. and Chinese GDP growth remains robust and supportive of the global economy. Commodity prices are high enough to fund the budgets of cyclical exporters and regional currency valuations support foreign investment. In addition, local interest rates are high enough to compensate investors for risks and corporate earnings remain relatively strong, making current equity valuations attractive in our view. The strongest headwind seems to be uncertainty stemming from escalating trade tensions between the U.S. and China. While investor sentiment is weak, we believe the fundamental reasons for owning Asian equities are still intact. With share prices seeming to diverge from the positive fundamental trends we are seeing at the company level, current volatility may create buying opportunities for long-term investors.

As of 6/30/2018, the securities mentioned comprised the Matthews Asia Growth Fund in the following percentages: Baozun Inc., 3.8%; Shenzhou International Group Holdings Limited, 4.8%; PT Bank Rakyat Indonesia Persero, 2.6%; PC Jeweller, Ltd, 0.6%; and Terumo Corp., 2.4%. The Fund held no positions in Habib Bank, Ltd. Current and future portfolio holdings are subject to risk.

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

1-year 20.61%
3-year 11.48%
5-year 9.55%
10-year 9.34%
Inception (10/31/03) 10.05%

Gross Expense Ratio

1.12%

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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