Matthews Asia™

Matthews Asia Growth Fund

Choose a Share Class: Investor ▼

Period ended September 30, 2018

For the quarter ending September 30, 2018, the Matthews Asia Growth Fund returned -4.35% (Investor class) while its benchmark, the MSCI All Country Asia Pacific Index returned 0.62%.

Market Environment:

Many Asian markets suffered during the third quarter amid a confluence of challenging macroeconomic headlines. Escalating trade tensions between the U.S. and China, seemingly tighter monetary conditions across many parts of the world and higher energy prices exposed the vulnerabilities of certain emerging market economies. Market volatility and weakness were significant at times during the quarter.

Japanese equities were among the best regional performers. Although trade tensions increased between U.S. and China, the focus on Japanese trade seemed to fade slightly during the quarter, helping to boost sentiment and share prices. In addition, the yen softened slightly against the U.S. dollar, supporting exporters and helping the MSCI Japan Index reach its highest levels since January 2018. Prime Minister Shinzo Abe was elected for the third time on September 20, which should provide for continuity of policy.

Indonesian equities also generated positive returns during the quarter, despite struggling earlier in the year. Indonesia's macro environment has improved steadily this year, with GDP growth rising as private domestic demand rebounded. Key risks for Indonesia include the potential for higher oil prices leading to greater trade imbalances and a volatile parliamentary/presidential campaign that may raise risk premiums on Indonesian assets.

Chinese shares suffered in the third quarter, following a weak second quarter. Significant headwinds surrounding trade and tariffs proved to be too large a risk for investors. Many market participants are pricing in expectations that trade issues will impede markets and contribute to uncertainty for months to come. However, there are potential green shoots in China. Resilient corporate earnings; a reasonably stable renminbi (RMB); a government willing to re-stimulate the economy as needed; and a market that has already priced in significant fallout from trade all contributed to potential stability in Chinese equities.

Performance Contributors and Detractors:

The Fund underperformed its benchmark during the quarter. Detracting from performance was the Fund's significant overweight in the health care sector relative to the benchmark. Many of our Chinese health care holdings, which experienced major gains over the past several quarters, pulled back during the third quarter on negative sentiment toward China's equity markets. In particular, China's domestic A-share market, where many health care stocks trade, experienced major volatility. Stocks for two our A-share-listed holdings, Jiangsu Hengrui Medicine and Yunnan Hongxian Yixintang Pharmaceutical fell on negative sentiment. Notably, both securities have still generated positive year-to-date returns on the strength of earlier price gains, even considering recent volatility. We see the health care sector as a major source of innovation and growth in Asia, with attractive long-term prospects, and hence we believe market weakness could present buying opportunities.

Meanwhile, the telecommunication services sector was a positive contributor to Fund performance during the quarter. SoftBank Group, a global multinational telecom and internet provider domiciled in Japan, experienced significant gains in stock price. During the quarter, the stock had one of its most significant price gains in the past decade, although it is hard to pinpoint a specific reason among many positive trends working in the company's favor. The company's reach is substantially more global today than 10 years ago with acquisitions of global household companies like U.S.-based Sprint and British-based Arm Holdings. Ongoing discussions of a spin-off of the Japanese telecommunication company may have also contributed to its stock price appreciation. Another reason for its price gain may simply have been the rally of Japanese large-cap stocks in September, as SoftBank is one of the largest components of the Nikkei 225 Index.

Notable Portfolio Changes:

During the quarter, we initiated a new position in Sony, a diversified conglomerate headquartered in Tokyo. Over the past two years, the company has transformed its business model from one-time sales to recurring revenue streams. Sony's operating profit reached a record high last year and the majority of its profits are now from recurring sources, including financial services, games and music. We were able to initiate the position at attractive valuations and free cash flow yields.

We also initiated a new position in Keyence, a global leader in factory automation headquartered in Osaka. We have followed the company with interest for a long time, waiting for more attractive valuations before buying. After witnessing a solid quarterly result, strong topline growth and robust operating margin, we took advantage of lower stock prices to purchase the stock.

During the quarter, we exited our position in Komatsu, a Japanese manufacturer of construction equipment. The company was a long-time holding in the portfolio, initially purchased in 2009 after the Global Financial Crisis. While the company remains a global leader in construction equipment, we sold the stock because we believe the earnings recovery process is almost done, with less growth left in the cycle. Valuations for the company are decent, but we would rather deploy cash into more secular growth companies.

Outlook:

Having received positive inflows of cash from new and existing shareholders during the quarter, the Fund has a healthy cash position for making new purchases in the fourth quarter. As long-term investors, we are excited to be buying when others are selling, as high-quality names often experience price declines on poor sentiment. Looking ahead, we will keep an eye on trade concerns and how they may impact economies across Asia, as there is potential for additional market volatility to come.

We also see reasons to be optimistic. Across the region, economies are growing, consumers are spending and wages are rising. Market volatility in China may present buying opportunities, as valuations are looking increasingly attractive following market declines in many parts of the market. Health care remains one of the most dynamic sectors in the region, where we will seek out opportunities using a bottom-up, company-by-company approach. We remain sanguine about opportunities for growth investing in Asia, with domestic consumption and growing consumer purchasing power serving as key drivers for innovation throughout the region.

As of 09/30/2018, the securities mentioned comprised the Matthews Asia Growth Fund in the following percentages: Jiangsu Hengrui Medicine Co., Ltd. 2.1%; Yunnan Hongxiang Yixintang Pharmaceutical Co., Ltd. 1.1%; SoftBank Group Corp. 2.7%, Sony Corp. 2.6%; and Keyence Corp. 1.8%. The Fund held no positions in Sprint Corp. or Komatsu Ltd. ARM Holdings is a wholly owned subsidiary of SoftBank. Current and future portfolio holdings are subject to risk.

Average Annual Total Returns - Investor Class (9/30/2018)

1-year 7.99%

3-year 15.55%
5-year 7.42%

10-year 10.64%
Inception (10/31/03) 9.55%

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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