Matthews Asia Innovators Fund

Choose a Share Class: Investor ▼

Period ended December 31, 2018

For the year ending December 31, 2018, the Matthews Asia Innovators Fund returned -18.62% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned -14.12%. For the fourth quarter of the year, the Fund returned -10.27% (Investor Class) versus -8.60% for the Index.

Market Environment:

Asian markets were volatile throughout 2018. Macro headwinds included tight monetary policy in many parts of Asia, as well as trade conflicts between the U.S. and China and fluctuating oil prices. Monetary tightening by the U.S. Federal Reserve and the People's Bank of China began to take its toll on global liquidity throughout the year, hitting emerging markets the hardest. Fluctuating oil prices injected an additional degree of turbulence into markets, with oil prices rising during much of the year before collapsing by year end.

China underperformed broad emerging markets in 2018 with the majority of its relative weakness occurring from May through October. In the fourth quarter, green shoots finally appeared for Chinese equities as the Chinese government reiterated its willingness to stimulate the economy if needed. Chinese corporate earnings showed resilience and stability amid lowered expectations. South Korea's equities were among the region's weakest in 2018 as investors contemplated how trade talks between the U.S., China and Europe could affect South Korean exports and how prospects of a potential hike in the country's minimum wage could affect corporate earnings.

Meanwhile India and Indonesia were volatile for much of the year, but ended the year on a stronger note. India's equity market experienced wide swings in the first three quarters, but closed out 2018 with two months of strong relative performance. As oil prices eased and other macro headwinds lessened, India equities stabilized. Meanwhile in Southeast Asia, Indonesia equities also ended the year on a stronger note. Lower oil prices benefited Indonesia's currency and economy, easing pressures on its trade balance.

Performance Contributors and Detractors:

Amid negative growth sentiment, growth companies trading at higher price multiples experienced sharper declines than broader markets. Detracting from performance for the full-year 2018 were the Fund's holdings in China and Korea, as well as its holdings in the communications services and consumer discretionary sectors. Contributing to performance for the full-year 2018 were our stock selection and overweight in health care and stock selection in financials. Health care companies generally held up well during the year, although many experienced price corrections in the fourth quarter. We continue to see health care as one of the better growth opportunities in the region, where health care spending per capita is still much lower than in other developed regions.

During the fourth quarter, the top detractors from performance were our holdings in China. Many Chinese equities declined on concerns over trade conflicts. However, we believe the market overreacted. Accordingly, we took advantage of market volatility to add to our holdings in China. Even if China's economic growth slows modestly, we believe China still has the potential to maintain attractive levels of economic growth. The top contributors to performance in the fourth quarter included stock selection in financials and our underweight to the information technology sector. Innovation in the financial sector is a theme we'll continue to follow, as Asian consumers expand their interest in insurance and other financial products.

Notable Portfolio Changes:

During the year, there was a notable pickup in regulatory risk in China, particularly impacting the education, internet and health care sectors. This led to higher than usual changes in the portfolio over the full year. In particular, we shifted away from some holdings that we believe now face higher regulatory risks.

In the fourth quarter, we swapped our preferred shares for common shares in Samsung SDI, a South Korean battery manufacturer. We also initiated a new position in Contemporary Amperex Technology, a Chinese battery manufacturer with the largest market share in China. In addition, we initiated a new position in iQIYI, a Chinese provider of original streaming video content. We believe the environment in China is very favorable to original content producers, benefiting from a trend of improving intellectual property protection in China.

In the fourth quarter, we exited our position in Samsung Electronics, a South Korean semiconductor manufacturer. We believe the overall semiconductor industry has peaked and we are finding more appealing growth opportunities in other sectors. We also exited our position in CSPC Pharmaceutical Group, a Chinese drug manufacturer. Regulatory risk has been rising the Chinese health care sector, including increased government regulation over the pricing of generics, so we decided to exit the position.

Outlook:

As we look ahead, some factors that were headwinds for Asian markets in 2018 may be easing. There is the potential for monetary policy to relax, trade conflicts could ease even if they aren't fully resolved, and oil prices could remain softer. Currencies also started to become a tailwind for some Asian economies, as oil prices have retreated from their 2018 high-water mark and the U.S. dollar has softened.

Notably, there could be additional volatility in the first half of 2019. Risks to global markets include the potential for slower growth in the U.S. and China, as well as general geopolitical risks. If there is a silver lining to be found, a lot of negative sentiment is already priced into Asian markets. Asian ex-Japan markets currently offer much more attractive valuations than developed markets and we are optimistic about the long-term growth prospects of the region.

As always, we seek to invest in innovative companies benefiting from rising consumer income in Asia. As China and other countries in the region transition to economies driven by gains in productivity, we believe the most innovative companies have the potential to outperform the broader markets over a full market cycle. We are excited by the trends of innovation we see across the region and look forward to identifying the next generation of innovation leaders in Asia.

As of 12/31/18, the securities mentioned comprised the Matthews Asia Innovators Fund in the following percentages: Samsung SDI Co., Ltd. 1.9%; Contemporary Amperex Technology Co., Ltd., 0.8%; and iQIYI, Inc., 1.0%. The Fund held no positions in Samsung Electronics or CSPC Pharmaceutical Group. Current and future portfolio holdings are subject to risk.

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

1-year -18.62%

3-year 4.19%
5-year 5.24%
10-year 13.27%
Inception (12/27/99) 2.93%

Gross Expense Ratio

1.24%

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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