Matthews Asia

Matthews Asia Small Companies Fund

Period ended March 31, 2018

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For the quarter ending March 31, 2018, the Matthews Asia Small Companies Fund returned 1.92% (Investor Class), outperforming its benchmark, the MSCI All Country Asia ex Japan Small Cap Index, which returned -0.44%.

Market Environment:

Asia's markets began the year with strong performance amid optimism over a solid outlook on earnings, encouraging macroeconomic data from China and momentum that had carried over from 2017 among broad equity markets regionally. Sentiment took a sharp turn in February, however, as investors grew nervous that rising wages and inflationary pressure in the U.S. would lead to more interest rate hikes than previously expected. Finally, in March, the U.S. Federal Reserve raised interest rates by 25 basis points (0.25%). Meanwhile, U.S.—China trade tensions created further market volatility as the Trump administration threatened to impose various tariffs on products from China. The trade-war rhetoric continued late into the first quarter, causing significant swings to global markets. Another noteworthy event during the quarter was China's decision to end presidential term limits. This created some uncertainty about long-term political risks relating to a consolidation of power by a “key-man.”

Performance Contributors and Detractors:

Some of our holdings in China, South Korea and Indonesia performed strongly during the quarter, and helped Fund performance. Our enterprise software holdings in South Korea's Duzone Bizon and China's Kingdee International Software were significant performance contributors as their strong business momentum resulted from healthy demand and good user experience from cloud-based products.

Some holdings in Taiwan and Malaysia, however, experienced lackluster performance and posed a drag on absolute returns. Advanced Ceramic X, a Taiwanese radio frequency component maker, suffered some delays with product launches, and this led its share price to correct sharply. Karex, a Malaysian condom manufacturer, was another performance detractor. The company's share price corrected because of its slowing revenue growth and margin compression in recent quarters.

By sector, our exposure to health care helped performance amid a fairly volatile market environment as our holdings showed solid execution of their business strategies on the company level. Some of our financial sector holdings also did well. Long-term holding Bank Tabungan Peniunan Nasional, an Indonesian micro-finance lender, contributed to Fund performance following a bottoming out of the company's fundamentals and news over possible merger and acquisition plans.

During the quarter, the portfolio's industrials sector holdings detracted from performance. Ten Pao, a Chinese power supplier component maker, was among the firms that did not do well. It experienced a severe input cost escalation causing profit margins to contract more steeply than market expectations, and we ultimately exited this position.

Notable Portfolio Changes:

Average Annual Total Returns - Investor Class (3/31/2018)

1-year 20.52%
3-year 5.10%
5-year 6.15%
10-year n.a.
Inception (9/15/08) 12.42%

Gross Expense Ratio [1]
1.49%

After fee waiver and expense reimbursement: 1.47% [2]

[1] Matthews Asia Fund's 12b-1 Plan (the “Plan”) is inactive. Although the Plan currently is not active, it is reviewed by the Board annually in case the Board decides to re-activate the Plan. The Plan would not be re-activated without prior notice to shareholders and any amounts payable under the Plan would be subject to applicable operating expense limitations. If the Plan were reactivated, the fee would be up to 0.25% for each of the Investor Class and Institutional Class, respectively.

[2] 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

During the quarter we made adjustments to the portfolio and exited or trimmed several firms that had performed well in 2017, including two China-based health care holdings: Hutchison China Meditech and Genscript.

Pharmaceutical firm Hutchison China Meditech saw its market capitalization rise to nearly US$5 billion. We exited this holding as we believed most of the positives had already been factored into the share price. Similarly, we trimmed our holdings in Genscript, a life science service company, due to valuation considerations after its share price saw a strong run-up that began in 2017 and carried over into 2018.

We also detected some headwinds facing our portfolio holdings, such as weakness in the mobile handset supply chain; and decided to exit our positions in Unisem, a Malaysia semiconductor packaging company. We were concerned that the company's earning visibility for the short to medium term might be compromised and instead sought more attractive investments candidates elsewhere.

We initiated positions in several new companies that we believed to be poised for reasonably healthy growth trajectories. Chinese enterprise software firm Kingdee Software has done a good job penetrating the small- to medium-enterprise market over the years. In addition, it has shown some growth momentum in its cloud service segment, which should increase user stickiness over the long term. We also initiated a position in Rich Sport in Thailand. The company markets and retails branded athletic footwear products across Thailand and is looking expand its business in neighboring countries. We like the company's capital discipline, as well as its sensible growth strategies.

Outlook:

Despite the fact that markets were off to a roller-coaster beginning in 2018, we believe that the long-term growth trajectory and the fundamentals of most Asian economies remain sound. Over the nearer term, interest rates cycles and ever-evolving geopolitical dynamics will potentially impact firms at the industry or company level. We aim to identify those companies that are poised to benefit from the long-term structural trends we see occurring in Asia, such as productivity improvements, lifestyle upgrades and innovation-driven growth opportunities. We will continue to be vigilant in terms of identifying risks facing our portfolio companies in terms of their impact to profitability trends and competitiveness within their respective industries. The opportunity sets in our small companies universe remain broad and diverse—an ideal hunting ground for long-term investors such as ourselves.

As of 3/31/2018, the securities mentioned comprised the Matthews Asia Small Companies Fund in the following percentages: DuzonBizon Co., Ltd. 1.6%; Kingdee International Software Group Co., Ltd. 1.5%; Advanced Ceramic X Corp. 1.2%; Karex BHD 0.5%; PT Bank Tabungan Pensiunan Nasional 1.5%; Genscript Biotech Corp., 1.3% and Rich Sport Public Co., Ltd. 1.1%

The Fund held no positions in Hutchison China MediTech, Ltd., Unisem M BHD and Ten Pao Group Holdings, Ltd. Current and future portfolio holdings are subject to risk.

Investing in small- and mid-size companies is more risky than investing in large companies as they may be more volatile and less liquid than larger companies.

or reorganization or extraordinary expenses such as litigation) of the Institutional Class 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, 2018 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*

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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.

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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