Matthews Asia™

Matthews Asian Growth and Income Fund

Period ended March 31, 2018

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For the quarter ending March 31, 2018, the Matthews Asian Growth and Income Fund returned -1.83% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned 0.70%.

Market Environment:

Following a fairly strong couple of years of performance for Asian equity markets, the first quarter of 2018 witnessed a marked increase in volatility from historically low levels. This included a market correction, although Asian equities ended the quarter in positive territory. Much of the volatility can be attributed to a combination of interest rate increases in the U.S., political noise out of Washington and a re-emergence of trade tensions between the U.S. and China.

The proposed U.S. tariffs on an initial list of goods worth US$50 billion and a potential further list worth US$100 billion has been met by China with a response of the "same proportion, scale and intensity." Further escalation could be detrimental to broad economic growth. Meanwhile, China's legislature also agreed to end term limits for the president and vice president during the quarter. This enables President Xi Jinping, should he choose, to remain president, general secretary of the Communist Party and chairman of the Central Military Commission for life. This removal of checks and balances may allow a "vision" to be more easily implemented in the short term, but it is also unlikely to be helpful to the rule of law over the medium term.

With much political and policy noise, it was no wonder markets were so choppy. China, Taiwan, and some of Southeast Asia rose while much of the rest of the region declined.

Performance Contributors and Detractors:

The largest detractors to performance in the quarter came from our tobacco company holdings as shares of BAT Malaysia, KT&G and Japan Tobacco were all weak. The threat of alternative reduced-risk products is very real, particularly for Japan Tobacco as its own alternative has missed production targets. For KT&G, its relatively smaller size also puts it at a potential disadvantage in this area. BAT Malaysia was the weakest of these as the rise of illicit trade over the past couple of years has been challenging, and there is concern that the shift to more affordable products will hurt margins. Elsewhere in the consumer sector, shares of South Korean casino Kangwon Land struggled. It has suffered from regulatory pressure on the quantity of tables that it can operate as well as its operating hours.

Some of the Fund's telecom holdings such as China Mobile and Bharti Infratel were also weak despite what we believe to be appealing valuations as investors appeared to shift capital to what they consider to be more exciting growth stocks. The portfolio's lack of exposure to certain areas such as rate-sensitive assets within China also detracted from relative performance.

More positively, the portfolio's health care holdings Resmed, CSL Limited and convertible bond Bangkok Dusit Medical Services were all reasonably strong performers. Shares of sleep apnea device maker Resmed rose on impressive earnings as its connected-care strategy gains more traction. Due to an increasingly expensive valuation, however, we decided to exit the stock. Beyond

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

1-year 9.37%
3-year 4.31%
5-year 2.92%
10-year 5.04%
Inception (9/12/94) 9.37%

Gross Expense Ratio [1]
1.09%

[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.

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* this, the portfolio's top contributor to performance was Taiwan Semiconductor Manufacturing Co. as revenue growth accelerated on artificial intelligence-related demand and potential market share gains for leading-edge technology.

Notable Portfolio Changes:

The portfolio was fairly active this quarter, adding a number of new positions that included Kasikornbank in Thailand, Indian financial conglomerate HDFC Ltd. and Chinese consumer company Zhejiang Supor Cookware.

Kasikornbank has a leading deposit franchise, a strong capital base, a fairly good underwriting pedigree and is the preeminent small and medium-sized enterprises (SME) lender within the country. We believe that the stock was trading at an attractive multiple of only 12x price-to-earnings ratio (P/E) and 1.4x price-to-book ratio (P/B), particularly as we would expect loan growth and some margin expansion to drive solid earnings. HDFC Ltd. is India's leading mortgage financing business and also has stakes in a best-in-class bank, an asset management company and a life insurance business. Again, we were able to take advantage of competition and rate concerns to buy shares of what we believe to be a great company at a reasonable price.

Zhejiang Supor Cookware is a leading Chinese small kitchen appliance manufacturer. It is 81% owned by parent Groupe SEB of France, and this has helped it with local research and development and export orders, allowing it to stay ahead of the competition and take advantage of rising penetration and consumer upgrades in China. We believe the stock was reasonably priced at 20x P/E given this parentage, a clean balance sheet and midteens earnings growth. It is also the portfolio's first foray into China's A-share market and that allocation is likely to continue as we find more quality companies at attractive prices.

These were funded through the aforementioned sale of ResMed, alongside Vitasoy, USS Co. and our CPFoods convertible bond as all of these had valuations that had become stretched.

Outlook:

We have seen a marked increase in volatility within asset markets globally on the back of significant changes in monetary and trade policies as well as alterations in the political landscape. These alterations are not likely to disappear in the near term. Further, the potential ramifications of a trade war or, at the least, a worsening relationship between the U.S. and China are significant. There would clearly be first order effects that would impact Chinese companies supplying products to the U.S. that are subject to tariffs, but there are also second order impacts of this bleeding through to the rest of the economy through supply chains, confidence levels, retaliation etc.

Additionally, even with a resolution to avoiding a trade war, monetary and fiscal policy errors are still possible at this stage of the economic cycle as the high levels of debt in the U.S. (and across the globe) may struggle to cope with an increase in rates.

From an Asia investor's perspective, we cannot dismiss these risks. Asia's markets are at a different point in the cycle, however, where earnings growth is likely to continue to deliver at an attractive low-teen percentage for the foreseeable future. For that, valuations are also reasonable at around 13x P/E.

This all creates a rather appealing backdrop for the portfolio. Our weak relative performance over the past couple of years has been due to a lack of these more “exciting” growth companies. As a result, the underlying stocks in our strategy are now trading, on a weighted harmonic average, at an appealing 14.5x P/E. In addition, they offer an attractive3.5% dividend yield for a range of what we believe to be high-quality businesses with sustainable growth. And amid any continued volatility, we will look to add to this stable of leading companies if shares of good businesses sell off on short-term concerns.

been waived. Please see the Fund's most recent month-end performance.

Yield as of 3/31/2018
30-day Yield: 2.38%

Dividend Yield: 3.41%

The 30-Day Yield represents net investment income earned by the Fund over the 30-day period ended 12/31/17, expressed as an annual percentage rate based on the Fund’s share price at the end of the 30-day period. The 30-Day Yield should be regarded as an estimate of the Fund’s rate of investment income, and it may not equal the Fund’s actual income distribution rate. Source: BNY Mellon Investment Servicing (US) Inc.

The Dividend Yield (trailing) for the portfolio is the weighted average sum of the dividends paid by each equity security held by the Fund over the last 12 months divided by the current price as of report date. The annualized dividend yield for the Fund is for the equity-only portion of the portfolio. Please note that this is based on gross equity portfolio holdings and does not reflect the actual yield an investor in the Fund would receive. Past yields are no guarantee of future yields. Sources: FactSet Research Systems, Bloomberg, Matthews

As of 03/31/2018, the securities mentioned comprised the Matthews Asian Growth and Income Fund in the following percentages: British American Tobacco Malaysia BHD 0.9%; KT&G Corp. 1.3%; Japan Tobacco, Inc. 1.7%; Kangwon Land, Inc. 1.0%; China Mobile, Ltd. 1.6%; Bharti Infratel, Ltd. 1.7%; CSL, Ltd. 1.5%; Bangkok Dusit Medical Services Public Co., Ltd. 1.6%; Taiwan Semiconductor Manufacturing Co., Ltd. 3.0%; Kasikornbank Public Co., Ltd. 1.5%; Housing Development Finance Corp., Ltd. 1.6%; Zhejiang Supor Cookware Co., Ltd. 1.4%. The Fund held no positions in ResMed, Inc.; Vitasoy International Holdings, Ltd.; USS Co., Ltd.; CPFoods Holdings, Ltd.; Groupe SEB. Current and future portfolio holdings are subject to risk.

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