



Matthews China Fund

Choose a Share Class: ▼

Period ended September 30, 2018

For the quarter ending September 30, 2018, the Matthews China Fund returned -10.06% (Investor Class), while its benchmark, the MSCI China Index, fell -7.42% over the same period.

Market Environment:

The third quarter witnessed a significant China market sell-off on worsening trade relations between China and the U.S. Two rounds of trade tariffs covering approximately US\$250 billion worth of Chinese imports into the U.S. went into effect. We believe that the market may have priced in the worst case scenario that additional import tariffs will be imposed in 2019 and remain for an extended period of time. The impact of these tariffs to China, however, may be muted in the short run as China's economy today relies much less on trade. In fact, the dent on China's GDP growth may only be less than 1%, demonstrating that the country's services and consumption industries are now more significant growth drivers. We realize, however, that there could be potential knock-on effects to consumer sentiment given the weak market performance. Businesses could also be impacted as they may have less incentive for further investment. To this end, we monitor domestic income growth and consumption trends closely and have so far not found reason to believe that China is experiencing a significant consumption slowdown. Overall, we remain cautious on near-term political developments but continue to be optimistic about long-term growth prospects, and await the developments of scheduled talks in November between President Donald Trump and President Xi Jinping.

Performance Contributors and Detractors:

During the third quarter, the Fund's holdings in the financials and energy sectors performed well, while our holdings in information technology, consumer discretionary and industrials sectors did poorly. For the period, the Fund underperformed its benchmark due to stock selection, particularly in the industrials sector. Within industrials, environmental services provider China Everbright International declined sharply in August after the firm announced a large rights issue to enlarge its capital base. In information technology, shares of social network and online gaming provider Tencent corrected. The company was our largest detractor to performance after China temporarily halted video game license approvals and issued new regulations to limit the amount of time minors spend playing online games. To move the company forward, Tencent recently undertook a major restructuring to improve the integration of its rich user traffic data and advanced analytics, and strengthen its services to corporate customers. In light of the firm's formidable platform and strong execution, we continue to hold this position and closely monitor its restructuring progress.

Among the top contributors to Fund performance during the quarter were two of our core insurance holdings: Ping An Insurance and AIA Group. These holdings delivered better-than-expected results due to their superior distribution and underwriting capabilities. In energy, shares of China Petroleum & Chemical (Sinopec), a large Chinese integrated energy and chemical producer, outperformed. The company posted strong earnings and cash flow, due to the rising oil price and a favorable pricing environment for refined petroleum and petrochemical products.

Notable Portfolio Changes:

During the quarter, we initiated a position in New China Life Insurance, a large Chinese life insurance provider. The firm has shifted its strategic focus from scale to profitability, and has demonstrated improving new business margins and increasing sales in protection-oriented products. The company's valuations also became attractive as its stock price suffered a sharp pullback earlier in the year. We believe New China Life will continue to be a major beneficiary of the structural growth of the country's life insurance industry as more people join the middle class and affluence rises. We exited our position in Zhejiang Dahua Technology, a major Chinese security and surveillance equipment provider, due to the company's relatively high overseas exposure amid a climate of intensified U.S.-China trade friction.

Outlook:

Market sentiment toward China was quite weak in the third quarter given ongoing political conflicts. At the same time, earnings growth expectations for the market continue to trend in the range of the low teens, largely in line with expectations from the start of the year. Valuations also continue to be attractive at high single-digit price-to-earnings multiples. We find that this is an opportune time for us to prune our portfolio and pick up quality companies at good prices. Looking ahead, we believe that besides dealing with the trade conflicts, China will also continue to further deleverage its economy. We see the fact that China is able to manage both of these challenges without further plans for major stimulus as an indicator that its underlying economy is still on solid footing.

As of 9/30/2018, the securities mentioned comprised the Matthews China Fund in the following percentages: China Everbright International, Ltd. 1.3%; Tencent Holdings, Ltd. 9.0%; Ping An Insurance Group Co. of China, Ltd. 5.3%; AIA Group, Ltd. 4.9% China Petroleum & Chemical Corp. 2.0%; New China Life Insurance Co. 3.0% The Fund held no positions in Zhejiang Dahua Technology Co., Ltd. Current and future portfolio holdings are subject to risk.

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

1-year -1.58%
3-year 14.41%
5-year 6.98%
10-year 8.27%
Inception (2/19/98) 9.69%

Gross Expense Ratio

1.09%

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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