Matthews Asia

Matthews Japan Fund

Effective immediately after market closing on July 29, 2016, the Matthews Japan Fund closed to most new investors. Read more.

Choose a Share Class: Investor ▼

Period ended June 30, 2018

For the first half of 2018, the Matthews Japan Fund returned 0.08% (Investor Class), while its benchmark, the MSCI Japan Index, returned -1.85%. For the quarter ending June 30, the Fund returned -4.89% (Investor Class), underperforming its benchmark, which returned -2.80%.

Market Environment:

Following a somewhat euphoric rise in January and quick correction in February, Japan's equity markets traded in a tight range before retreating toward the end of the second quarter. Tariff measures by the Trump administration signaled an escalation in trade war rhetoric and heightened uncertainty, resulting in a compression of valuations across global markets, including Japan. Foreign investors remained net sellers of Japanese equities, likely related to fund flows out of non-U.S. equities.

Japan's first-quarter GDP figures, meanwhile, showed the economy shrank for the first time in two years on a quarter-on-quarter basis due to weak private residential investment, inventory drawdown and a slight decline in consumer spending. We expected this contraction and believe it is reasonable after the longest spate of growth in almost three decades.

Performance Contributors and Detractors:

For the year-to-date period, the Fund's information technology and health care holdings did well, while our lack of exposure to the utilities and telecommunication services posed a drag on performance. However, during the second quarter, the Fund's underperformance versus its benchmark was largely due to stock selection, particularly in the industrials and health care sectors. Within industrials, shares of human resource solutions provider Persol Holdings corrected after the company announced weaker-than-expected guidance for the March 2019 fiscal year. Shares of automation-related companies such as CKD and Harmonic Drive also weakened as concerns have emerged about a cyclical peak in orders. In health care, shares of biopharmaceutical company PeptiDream declined after particularly strong performance in the previous quarter despite positive business developments for the company.

On the other hand, our positioning in the materials and financials sectors contributed positively to performance. Our lack of exposure to large-cap chemical and steel companies helped as tariff actions and rising oil prices compressed valuations in the materials sector. In financials, our core holding Tokio Marine, Japan's leading non-life insurer, outperformed on the back of an improved earnings outlook combined with higher scope for shareholder returns in the form of dividends and share buybacks.

On an individual basis, fashion e-commerce company Start Today was the top performer as it announced its long-awaited entry into private label apparel. The company aims to deliver custom-made apparel using body size measurement data collected through their proprietary app. Conversely, shares of Ferrotec, a manufacturer of silicon wafers and components for semiconductor production equipment, corrected sharply as production at its Shanghai silicon wafer fab was temporarily halted to comply with environmental regulations.

Notable Portfolio Changes:

During the quarter, we initiated a position in Terumo, a leading Japanese medical equipment company. Terumo saw growth accelerate for its neurovascular and access devices, which carry higher margins relative to corporate averages. The field of neurovascular treatments is an exciting area with new devices and procedures being developed to treat brain aneurysms and strokes. Terumo's U.S. subsidiary Microvention, acquired back in 2006, is a major player in the neurovascular market. We also initiated a position in real estate technology company Tateru. Tateru's main business is to plan and construct apartment buildings in urban areas for individual investors. Most of the sales and servicing is conducted through its app, allowing it to be more cost-efficient than brick-and-mortar competitors. Recently, it has expanded into room share-type properties that could benefit from the influx of foreign tourists.

To fund these positions, we exited our positions in Japan Tobacco, Sumitomo Mitsui Financial Group and Dai-ichi Life Holdings. Japan Tobacco lost market share in the domestic Japanese market as reduced-risk products, also known as heat-not-burn products, from Philip Morris International gained significant market share over the past several years. Japan Tobacco has released its own reduced-risk product but we deemed that it faced a significant hurdle to regain pricing power in the market. Sumitomo Mitsui Financial Group and Dai-ichi Life Holdings are two financials that we expected to benefit from rising interest rates in the U.S. Broader concerns about growth prospects, however, kept a lid on their stock prices and we decided that the funds could be better deployed elsewhere in companies with more attractive growth prospects.

Outlook:

We remain cautious about the outlook for Japanese equities. The biggest risk is with the Trump administration's continued actions on trade. We believe a trade war is bad for all global market participants, including U.S. consumers and Japanese businesses. The most recent Bank of Japan quarterly Tankan survey results showed a downward revision in corporate earnings forecasts compared to the previous quarter, likely reflecting a heightened level of uncertainty among corporate managers. In addition, rising fixed costs and higher fuel costs also are expected to weigh on earnings.

However, the same survey results also showed an upward revision on capital expenditures as the near-term demand environment remains robust. The recent acceleration in wage growth amid record levels of employment gives us some encouragement regarding the outlook for the domestic economy. Wage growth combined with continued strength in business spending may drive an improvement in domestic growth. While we retain a generally cautious tone, we believe valuations in Japan have compressed to levels where equities are modestly attractive and reasonably priced.

As of 6/30/2018, the securities mentioned comprised the Matthews Japan Fund in the following percentages: Persol Holdings Co. Ltd., 1.8%; CKD Corp., 0.8%; Harmonic Drive Systems, Inc., 0.6%; PeptiDream, Inc., 1.2%; Tokio Marine Holdings, Inc., 2.4%; Start Today, Co. Ltd, 2.4%; Ferrotec Holdings Corp., 0.8%; Terumo Corp., 1.8%; TATERU, Inc., 1.0%. The Fund held no positions in Japan Tobacco, Inc., Sumitomo Mitsui Financial Group, Inc., Dai-ichi Life Holdings, Inc. or Philip Morris International, Inc. Current and future portfolio holdings are subject to risk.

Average Annual Total Returns - Investor Class (6/30/2018)

1-year 16.27%
3-year 9.74%
5-year 11.73%
10-year 7.93%
Inception (12/31/98) 6.69%

Gross Expense Ratio

0.95%

After fee waiver and expense reimbursement: 0.94% [1]

[1] Matthews has contractually agreed to waive a portion of its advisory fee and administrative and shareholder services fee if the Fund's average daily net assets are over $3 billion, as follows: for every $2.5 billion average daily net assets of the Fund that are over $3 billion, the advisory fee rate and the administrative and shareholder services fee rate for the Fund with respect to such excess average daily net assets will be each reduced by 0.01%, in each case without reducing such fee rate below 0.00%. Any amount waived by Matthews pursuant to this agreement may not be recouped by Matthews. This agreement will remain in place until April 30, 2019 and may be terminated (i) at any time by the Trust on behalf of the Fund or by the Board of Trustees upon 60 days› prior written notice to Matthews; or (ii) by Matthews at the annual expiration date of the agreement upon 60 days› prior written notice to the Trust, in each case without payment of any penalty.

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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