



Matthews Korea Fund

Choose a Share Class: ▼

Period ended June 30, 2018

For the first half of 2018, the Matthews Korea Fund returned -11.72% (Investor Class), while its benchmark, the Korea Composite Stock Price Index, fell -9.13% over the same period. For the quarter ending June 30, the Fund returned -9.90% (Investor Class), while its benchmark returned -9.37%.

Market Environment:

South Korean equities underperformed other Asian equity markets during the first half of the year due to fears of increased regulatory risk and as investors contemplated how trade talks between the U.S., China and Europe could affect Korean exports. In early June, South Korea held regional elections for congress. The elections gave President Moon Jae-in's left-of-center political party, the Democratic Party of Korea, a clear majority in congress. The party is focused on increasing the minimum wage, improving corporate governance standards and regulating industries that may have monopolies. With control of both the executive and legislative branches, the party now has fairly wide latitude to pursue its legislative agenda. Investor sentiment darkened as fears of higher labor costs and forced break-ups of larger conglomerates clouded the landscape. Improved corporate governance standards will continue to benefit South Korea's markets over the long term, but there could be some market disruptions in the short term as standards continue to be defined and implemented.

In June, U.S. President Donald Trump met with North Korean leader Kim Jong Un in a historic summit. The meeting reduced military tensions on the Korean peninsula, but had little impact on South Korea's equity markets or currency exchange rates. The summit may have impacted South Korea's regional elections, however, by reflecting favorably on President Moon's party and giving him a clear congressional majority. In the meantime, South Korea's domestic economy remains stable despite a rising unemployment rate and exports continue to support overall GDP growth.

Performance Contributors and Detractors:

The Fund underperformed its benchmark during the first half of the year. Against a backdrop of increased business regulation in South Korea, three of our bank holdings generated double-digit losses for the six-month period ending June 30. KB Financial Group, Hana Financial Group and Shinhan Financial Group all suffered from negative investor sentiment. Investors may expect mortgage lending to become subject to new regulations. Property prices have risen significantly in many housing markets and the government may try to enact stricter lending standards to help curb price appreciation and housing costs. Another security that underperformed during the first half of the year was Modetour Network. Tourism and travel outside the country was slow in the first half.

On the positive side, Kiwoom Securities generated double-digit positive returns in the first half. Kiwoom is South Korea's top online brokerage company. The company's innovative business model led to strong stock price gains over the first and second quarters. South Korea's equity markets tend to be primarily driven by domestic investors, creating opportunities for Kiwoom, which has the largest market share of brokerage activities.

Notable Portfolio Changes:

During the second quarter, we exited our position in Innocean, the advertising arm of Hyundai Motor, on concerns of rising regulatory risks that the company may face. We also initiated a position in Cafe24, an innovative e-commerce platform provider. Cafe24 helps small and midsize merchandisers sell their products on major platforms such as Naver, South Korea's top search engine. Cafe24 provides its clients with payment systems and advertising support. With existing operations in Japan and China, Cafe24 can leverage its insights and tools globally and may be well-positioned to capture continued growth in the e-commerce space.

Outlook:

We remain cautious in our outlook for South Korean equities. Rising regulatory risks domestically and escalating trade conflicts globally may continue to weigh on investor sentiment. South Korea is a net exporter, so we will keep an eye on holdings that may be impacted by trade worries. On a positive note, stock price valuations have come down quite a bit in the first half because of regulatory risk. If the regulatory environment turns out to be less restrictive than the market expects, there may be some buying opportunities. In addition, corporate governance and minority shareholder return policies are both areas where we continue to see improvement. Among our portfolio companies, awareness of corporate governance issues tends to be very high within management teams.

As of June 30, 2018, the securities mentioned comprised the Matthews Korea Fund in the following percentages: KB Financial Group, Inc. 3.2%; Hana Financial Group, Inc. 3.3%; Shinhan Financial Group Co., Ltd. 3.0%; Modetour Network, Inc. 3.4%; Kiwoom Securities Co., Ltd. 2.6%; Hyundai Motor Co., Ltd. 4.2%; Cafe24 Corp. 1.1%; Naver Corp. 3.7%. The Fund held no position in Innocean Worldwide, Inc. Current and future portfolio holdings are subject to risk.

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

1-year 0.00%
3-year 5.74%
5-year 10.46%
10-year 7.95%
Inception (1/3/95) 6.39%

Gross Expense Ratio

1.15%

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](#).

KOSPI performance data may be readjusted periodically by the Korea Exchange due to certain factors, including the declaration of dividends.

Visit our [Glossary of Terms](#) page for definitions and additional information.

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