

MATTHEWS PACIFIC TIGER FUND

MATTHEWS ASIAN GROWTH AND INCOME FUND

MATTHEWS KOREA FUND

MATTHEWS CHINA FUND

MATTHEWS JAPAN FUND

MATTHEWS ASIAN TECHNOLOGY FUND



August 2001

Why Micro Trumps Macro in Asian Investing

Most international investing has historically been driven from a macro or top-down perspective with regional, country and sector analysis preceding company analysis. Both principals of this company began our careers in this camp. We abandoned it long ago to focus on individual companies in Asia.

For us, Asia is a pool of several thousand listed companies that is analogous to the U.S. market. While the current groupthink is to scoff at regional investing, a regional portfolio manager is able to do exactly what the average U.S. portfolio manager does - take a broad and deep pool of regionally related companies and build a sensible portfolio.

There are obviously more diverse economic and social conditions to deal with in Asia than in a U.S. single

country fund. Still, the reality for bottom-up driven portfolio management is very much the same. From our experience, the rationale for that bottom-up approach is even more compelling in an environment of rapid change.

Asia's less reliable corporate disclosure and the regular lapses of corporate governance force investors to rely more heavily on the integrity of company management. The most important task in our process is the on-site company visit. Nothing replaces direct discussion with management and direct exposure to a company's working environment. The value of such meetings is not easily won and many years of Asian company visits are required to develop real skill as with any profession.

The more turbulent the economic and financial environment, the more

you rely on a coherent business plan and a sound industry outlook for long-term success. Quarterly earnings are a dubious tool for any serious equity investor, and in developing markets one should measure corporate progress in years, not weeks.

Valuation analysis must be flexible enough to apply to a wide variety of situations rather than a simple matrix. Growth potential should be judged against an understanding of local, regional and global forces. If you think a bottom-up driven global fund gets the job done, this is their real Achilles Heel. To understand the domestic trends in a region's economy is achievable. To do it globally is, in our experience, fanciful.

The more profound structural change is in an industry, country or region, the more you rely on the

Continued on Page 3

CHINA

The People's Bank of China stated that it will keep the Yuan stable against the U.S. Dollar. China's tax revenue rose 27% in 1H01 to US\$91 BL. China collected 15.1 BL more Yuan from trade tariffs YoY in 1H01. China's economy expanded 7.8% YoY in 2Q01, almost four times the rate forecast for the world this year. Asia's second largest economy is now on target to reach or exceed the 7.0% growth rate targeted for the next five years. Chinese equities continued their correction in July, pushing the benchmark Shenzhen B Share Index down 25.51% for the month. However, it is still up 100.71% year-to-date ending July 31.

HONG KONG

Hong Kong exports fell for a fourth month in June as slowing global economic growth cut orders for China-made goods shipped through Hong Kong. Exports fell 8.4% YoY to US\$14.8 BL. Hong Kong Financial Secretary Antony Leung hinted that the government might lower its GDP growth forecast for 2001 because of sluggish exports. The benchmark HSI Index fell 5.55% in July.

INDIA

India's annualized inflation rate slowed to 5.1% in July. India's foreign exchange reserves rose US\$45 MM to US\$43.6 BL in July. The trade deficit widened 34% YoY to US\$720.2 MM, the biggest drop in almost three years. Exports fell 4.6% to US\$3.3 BL and imports rose 0.6% to US\$4.1 BL. Former Unit Trust of India Chief P.S. Subramanyam and two other officials of the country's largest mutual fund were ordered to remain in judicial custody. The benchmark SENSEX Index was down 3.59% in July.

INDONESIA

Indonesia's net foreign reserves rose 0.56% to US\$28.9 BL in July. The trade surplus narrowed by 30% YoY to US\$2.1 BL in June as global demand slowed. A weaker Rupiah and higher prices for electricity drove annual inflation up to 13% in July, the highest in nearly two years. Indonesian equities performed very well in July, pushing the benchmark JCI Index up 22.65% for the month.

JAPAN

Japanese industrial production fell twice as much as expected in June, increasing pressure on companies to shed workers and cut costs as the world's second-largest economy sinks into

recession. Japan's most watched measure of money supply, M2 and certificates of deposit, rose approximately 1.8% YoY in July. Japanese Prime Minister Junichiro Koizumi ordered Nobuteru Ishihara, state minister in charge of administrative and regulatory reforms, to cut spending on government-run corporations by 20% by the next fiscal year that begins April 1. The benchmark TOPIX Index fell 8.67% in July.

KOREA

Korean industrial production had its biggest drop in nine months in June. The unexpected decline may lead the central bank to consider cutting interest rates for the third time this year to combat slowing growth. The OECD lowered Korea's GDP growth rate to 4.0% from an earlier 4.2% forecast. Korea's economic growth is slowing as overseas orders for semiconductors and computers decline. Exports fell 20% YoY in July, and industrial production fell 1.9% MoM in June. The benchmark KOSPI Index fell 8.97% in July.

MALAYSIA

Malaysia's trade surplus narrowed 31% YoY to US\$868 MM. Slumps in U.S. and Japanese demand, Malaysia's biggest markets, have eroded demand for exports. The Malaysian Institute of Economic Research cut 2001 GDP growth forecast to 2.2%. Malaysian equities performed very well during July, pushing the benchmark KLCI Index up 11.29%.

PHILIPPINES

Philippine central bank Governor Rafael Buenaventura said the bank might require banks to boost their cash reserves to boost the Peso, which has lost 6.6% of its value against the U.S. Dollar this year. Philippine exports had their biggest decline in at least 20 years in June as electronics shipments fell. Exports fell 24.7% YoY to US\$2.6 BL. The benchmark PCOMP Index was down 4.96% in July.

SINGAPORE

Singapore said it would accelerate spending and cut taxes to fight a recession. This package was aimed more at protecting workers than cutting company costs. Singapore-made exports dropped 16.9% YoY in June. Non-oil domestic exports fell for a fourth month to US\$4.2 BL. The benchmark STI Index was down 2.34% in July.

TAIWAN

Taiwanese investments in China rose by 25% YoY in the first half of the year as the island's companies sought to take advantage of the Mainland's lower costs and faster economic growth. Taiwanese companies invested US\$1.4 BL in China. Taiwan's economy grew 1.0% in 2Q01, the slowest rate in 26 years. The government predicts the economy will grow 4.0% this year. The benchmark TWSE Index was down 11.14% in July.

THAILAND

Thailand's Prime Minister Thaksin Shinawatra was acquitted of fraud charges that could have barred him from office for five years. The verdict will allow Shinawatra, who took office in February after a landslide election victory, to push ahead with policies to lift the economy. The benchmark SET Index was down 8.53% in July.

Why Micro Trumps Macro in Asian Investing

Continued from front page

inherent fundamental strengths of a company. If you are analyzing a large company in Asia, it must be able to withstand the rapid arrival of full-blown global competition. Smaller companies must either have a very strong niche or they must be positioned to be profitably acquired by a larger regional or global competitor. M&A activity is increasing in Asia and will be a primary determinant of any company's success in coming years.

Micro analysis, whether the objective analysis of valuation or the subjective analysis of management, is most effective in an environment where key issues such as market regulation, corporate disclosure and M&A are progressing. This is especially true when the level of analysis provided by the broad investment industry continues to be pathetic. Independent analysis of company fundamentals and industry direction are clear competitive advantages in markets that remain highly inefficient yet are trending towards greater efficiency. This is Asia today.

In the final analysis, markets are affected by far too many factors to allow measures such as interest rates and GDP growth, presuming one could ever accurately predict them, to define portfolio structures. While top-down factors do form a small part of our approach, we find economic analysis too backward looking and that consistent predictions of currencies and interest rates are a fantasy.

We know that Asia's better companies will muddle through whatever the global economy throws at them. Right about when that top-analysis tell you to jump in the bomb shelter, it is historically a great time to buy!