Matthews Asia

Matthews Asia Credit Opportunities Fund

Choose a Share Class: Institutional

Period ended September 30, 2020

For the quarter ending September 30, 2020, the Matthews Asia Credit Opportunities Fund returned 3.14% (Investor Class) and 3.20% (Institutional Class) while its benchmark, the JP Morgan Asia Credit Index (JACI) returned 2.12%.

Market Environment:

The third quarter was characterized initially by optimism and improvement in market sentiment before market conditions deteriorated near the end of the quarter. The average spread of JACI was 18 basis points (0.18%) tighter on the quarter. The average spread of the high yield portion of JACI was 34 basis points (0.34%) tighter in the quarter.

A number of factors whip-sawed risk sentiment. Throughout the quarter, news flow pointed to progress in the race to manufacture an effective COVID-19 vaccine. Beyond the potential sale of TikTok's U.S. operations, there was no significant deterioration in U.S. — China relations or either country's commitment to the Phase One Trade Deal. Toward the end of the quarter, sentiment shifted, with daily confirmed COVID cases rising in the U.S. and Europe and a lack of progress on a second round of stimulus in the U.S. With the U.S. election quickly approaching, markets focused on the uncertainty, in particular regarding the accuracy of final vote count as well as a potential messy transfer of power.

Within Asian credit, China was the single largest contributor to positive performance, given its large index weight and also positive performance. During the third quarter, one of the most significant negative news for Chinese companies came from the large property developer Evergrande. A letter circulated suggesting the company was seeking government support and considering a restructuring. Even though the company denied the authenticity of the letter, it was enough to drive credit spreads wider across Asia. We believe Evergrande's issues to be idiosyncratic and not an indication of the overall health of Chinese developers. We have avoided companies such as Evergrande on credit concerns and generally prefer higher quality Chinese property names.

Performance Contributors and Detractors:

Long-duration investment-grade names, such as Asahan Aluminum Persero (InAlum), Syngenta, and China Jinmao perpetual bonds contributed to performance during the quarter as investors reached for yield without straying too far from credit quality. Across the board, high yield companies generally did well and had positive performance in the quarter. The top returning sector continued to be Chinese property developers, with China Jinmao and Dalian Wanda as the two biggest contributors to outperformance.

The top detractors were perpetual bonds of Philippines fast-food conglomerate Jollibee, convertible bonds of Baozun, a Chinese e-commerce solutions company, and PB International, an Indonesian textile manufacturer. Jollibee, as a restaurant business, has had an uneven recovery from COVID. However, we like the long-term operating track record of the company and therefore believes it has long-term upside potential. Pan Brothers faces market scrutiny due to its upcoming bank loan refinancing needs, but we feel comfortable holding the bond due to the continued strength in operations, which have been buoyed by a shift towards manufacturing of personal protective equipment.

Notable Portfolio Changes:

During the third quarter, we exited Indonesia InAlum and Cikarang Listrindo, both Indonesia companies. These bonds had recovered quite well, and we felt there was limited remaining upside. We also exited the contingent convertible securities of HSBC and Standard Chartered.

We added bonds issued by Tata Motors after the company committed to significantly reducing its outstanding debt in the next few years. We also added bonds of Poseidon Finance, a financing vehicle of China Shipbuilding Investment Corporation that are exchangeable into shares of Postal Savings Bank in China. While Postal Savings Bank equity will continue to come under pressure, the credit quality of China Shipbuilding Investment Corporation, as a wholly owned central government enterprise, is that of a quasi-sovereign. The yield on the bonds reflected the challenging outlook for the underlying equity, but compensates well for the minimal default risk.

Outlook:

Looking ahead, there are numerous uncertainties on the horizon in the coming quarters. With voting already underway in the United States, the November election will give markets a direction after a rollercoaster year. Even with the election settled, the true extent of the coronavirus spread in U.S. and emerging markets remains uncertain, with an imminent vaccine more of a hope than a foregone conclusion at this point.

Average Annual Total Returns - Institutional Class (9/30/2020)

1-year 0.58%
3-year 3.11%
5-year n.a.
10-year n.a.
Inception (4/29/16) 4.86%

Gross Expense Ratio

1.07%

After fee waiver and expense reimbursement: 0.90% [1]

[1] Matthews has contractually agreed (i) to waive fees and reimburse expenses to the extent needed to limit Total Annual Fund Operating Expenses (excluding Rule 12b-1 fees, taxes, interest, brokerage commissions, short sale dividend expenses, expenses incurred in connection with any merger or reorganization or extraordinary expenses such as litigation) of the Institutional Class to 0.90% first by waiving class specific expenses (e.g., shareholder service fees specific to a particular class) of the Institutional Class and then, to the extent necessary, by waiving non-class specific expenses (e.g., custody fees) of the Institutional Class, and (ii) if any Fund-wide expenses (i.e., expenses that apply to both the Institutional Class and the Investor Class) are waived for the Institutional Class to maintain the 0.90% expense limitation, to waive an equal amount (in annual percentage terms) of those same expenses for the Investor Class. The Total Annual Fund Operating Expenses After Fee Waiver and Expense Reimbursement for the Investor Class may vary from year to year and will in some years exceed 0.90%. Any amount waived with respect to the Fund pursuant to this agreement is not subject to recoupment. This agreement will remain in place until April 30, 2021 and may be terminated at any time by the Board of Trustees on behalf of the Fund on 60 days' written notice to Matthews. Matthews may decline to renew this agreement by written notice to the Trust at least 30 days before its annual expiration date.

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.*

Yield as of 9/30/2020

30-day Yield: 5.83%

30-day Yield Excluding Expense Waiver: 5.71%

The 30-Day Yield represents net investment income earned by the Fund over the 30-day period ended 6/30/20, 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.

As markets continue to assess the uncertainties mentioned above, we expect idiosyncratic risks and company specific risks to be the dominant concern. We believe the market will focus on determining the degree to which a sector and company is impacted by the pandemic. As a result, dispersion between geographical regions and between different credit qualities will in our view increase going forward. Given the high macro risks, we continue to favor companies with good credit quality and low liquidity risks, which should give them the best buffers to withstand macro uncertainties.

Looking still further ahead, we note that the importance of geopolitics will not wane once the U.S. election is decided, particularly between the U.S. and China, where trade and intellectual property disputes can be expected to continue for years to come. In addition to U.S. — China relations, we are increasingly worried about uncertainties in U.S. election vote counting as well as implications of a potential disruptive power transfer in U.S. Although this is a small probability tail risk, we believe it deserves further attention.

As of September 30, 2020, the securities mentioned comprised the Matthews Asia Credit Opportunities Fund in the following percentages: Syngenta Finance N.V., 5.676%, 04/24/2048, 2.0%: Syngenta Finance N.V., 5.182%, 04/24/2028, 1.7%; Syngenta Finance N.V., 4.892%, 04/24/2025, 0.2%; Franshion Brilliant, Ltd., 5.750%, 07/17/2067, 4.9%; Wanda Group Overseas, Ltd., 7.500%, 07/24/2022, 2.7%; Wanda Properties International Co., Ltd., 7.250%, 01/29/2024, 2.6%; Jollibee Worldwide Pte, Ltd., 3.900%, 07/23/2068, 1.5%; Baozun, Inc., Cnv., 1.625%, 05/01/2024, 2.8%; PB International BV, 7.625%, 01/26/2022, 4.9% (Pan Brothers); Tata Motors, Ltd., 5.875%, 05/20/2025, 3.3%; Poseidon Finance 1, Ltd., Cnv., 0.000%, 02/01/2025, 4.0%. The Fund held no positions in Evergrande; PT Indonesia Asahan Aluminium Perser; Listrindo Capital BV; HSBC Holdings PLC; Standard Chartered PLC. Current and future portfolio holdings are subject to change and risk.

Fixed income investments are subject to risks, including, but not limited to, interest rate, credit and inflation risks. Investing in emerging markets involves different and greater risks, as these countries are substantially smaller, less liquid and more volatile than securities markets in more developed markets.

Visit our Glossary of Terms page for definitions and additional information.

The views and opinions in this commentary were as of the report date, subject to change and may not reflect current views. They are not guarantees of performance or investment results and should not be taken as investment advice. Investment decisions reflect a variety of factors, and the managers reserve the right to change their views about individual stocks, sectors, and the markets at any time. As a result, the views expressed should not be relied upon as a forecast of the Fund's future investment intent. It should not be assumed that any investment will be profitable or will equal the performance of any securities or any sectors mentioned herein. The information does not constitute a recommendation to buy or sell any securities mentioned.

The information contained herein has been derived from sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Neither the funds nor the Investment Advisor accept any liability for losses either direct or consequential caused by the use of this information.

You should consider the investment objectives, risks, charges and expenses of the Matthews Asia Funds carefully before making an investment decision. This and other information about the Funds is contained in the prospectus or summary prospectus, which may also be obtained by calling 800-789-ASIA (2742). Please read the prospectus carefully before you invest or send money as it explains the risks associated with investing in international and emerging markets. These include risks related to social and political instability, market illiquidity and currency volatility. Investing in foreign securities may involve certain additional risks, exchange rate fluctuations, less liquidity, greater volatility and less regulation. Fixed income investments are subject to additional risks, including, but not limited to, interest rate, credit and inflation risks. Single-country and sector funds may be subject to a higher degree of market risk than diversified funds because of a concentration in a specific sector or geographic region. Investing in small companies is more risky and more volatile than investing in large companies.

Matthews Asia is the brand for Matthews International Capital Management, LLC and its direct and indirect subsidiaries.

Matthews Asia Funds are distributed in the United States by Foreside Funds Distributors LLC, Berwyn, PA
Matthews Asia Funds are distributed in Latin America by HMC Partners