Matthews Asia

Matthews Asia Small Companies Fund

Choose a Share Class: Institutional

Period ended September 30, 2020

For the quarter ending September 30, 2020, the Matthews Asia Small Companies Fund returned 6.17% (Investor Class) and 6.23% (Institutional Class), while its benchmark, the MSCI All Country Asia ex Japan Small Cap Index, returned 13.05%.

Market Environment:

Asia ex-Japan equities continued their upward trajectory in the third quarter. Many Asian equity markets and currencies rallied as economic activity slowly resumed, with earlier pandemic-related lockdowns easing. Malaysia, South Korea and India were the best performing markets during the quarter, while South East Asian countries like Indonesia and Thailand were laggards. The Chinese renminbi gained on the U.S. dollar, as did the South Korean won and the Indian rupee, while the Thailand baht and the Indonesian rupiah depreciated.

For the second quarter in a row, small caps outperformed large caps suggesting that investors are anticipating broader improvement in economic activity. With an eye toward mitigating the health care and economic impacts of the pandemic, North Asia countries have generally been more successful, coordinated and effective in their public health response. South and Southeast Asia have had a relatively tougher time combatting the virus with intermittent imposition of localized lockdowns. For global equity investors, exposure to Asia provided meaningful diversification in the quarter through access to more varied return drivers, including positive local interest rates, faster normalization of economic activity and rising domestic consumption.

Performance Contributors and Detractors:

Among individual securities, Flat Glass Group, which manufactures glass for solar panels in China, was a notable contributor in the quarter. The growth in solar energy is reaching an inflection point in China, as it has reached grid parity. Given China's goal of carbon neutrality by 2060, we believe continued growth in solar is a long-term secular trend in China. The company may also benefit from a drive toward increased efficiency in solar module performance due to usage of bifacial panels.

ASMedia, a Taiwanese chip design company that specializes in high speed interface integrated circuits (ICs) was among detractors during the quarter. After a strong performance during the first part of the quarter the stock gave up some of its gains during the second half. The key reason was worries about a competitive threat at its main customer, a U.S.-based CPU company. Our channel checks had suggested otherwise. The company has strong intellectual property (IP) accumulated over a decade in this area and we believe it is poised to benefit as newer, higher speed interface products become more mainstream over the coming years. The company is also very well positioned in our view to benefit from China's focus on diversifying its chip supply chain by winning new Chinese customers. Given our positive outlook we had added to our position during the quarter.

From a country perspective, our under allocation to South Korea and over allocation (and stock selection) to China/Hong Kong detracted from performance. From a sector perspective, stock selection in the health care and information technology sectors were detractors. On the other hand, stock selection in industrials and an underweight in real estate were contributors.

Notable Portfolio Changes:

We were active in the quarter, initiating several new positions and rotating capital to reflect secular growth trends we are following. As South Asia's response to COVID-19 in general has been less effective and lagged North Asia's, we have initiated positions in Indian consumer companies such as Marico that we believe stand to benefit from potentially changed consumption patterns in a post-COVID world. As a well-run consumer staples company in India, Marico has benefited from increased demand for its cooking oil products due to COVID-19 induced work from home situation. Its core hair care products also benefit from customers' renewed focus on value. Marico has also rolled out several new products to address the increased hygiene/sanitation needs as well as more emphasis on health and wellness as India gets through COVID-19.

Another new position is IFB Industries, a leading Indian consumer appliances manufacturer. Consumer durables like washing machines and dishwashers in India are very underpenetrated and we believe the company stands to benefit from increased demand tailwinds as people look to reduce reliance on domestic help as a way to reduce COVID-19 exposure risk. We have also selectively initiated position in cheaply valued consumer services companies (with leading market shares) in the region whose sales have been temporarily but severely depressed due to COVID-19 but that we believe will benefit from very attractive long-term growth opportunities.

Outlook:

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

1-year 21.87%
3-year 6.79%
5-year 8.66%
10-year n.a.
Inception (4/30/13) 5.46%

Gross Expense Ratio

1.46%

After fee waiver and expense reimbursement: 1.20% [1]

[1] Matthews has contractually agreed 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 1.20%. If the operating expenses fall below the expense limitation in a year within three years after Matthews has made a waiver or reimbursement, the Fund may reimburse Matthews up to an amount that does not cause the expenses for that year to exceed the lesser of (i) the expense limitation applicable at the time of that fee waiver and/or expense reimbursement or (ii) the expense limitation in effect at the time of 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.*

Stepping back from some of the near-term issues in the region, we are encouraged by the progress of economic reforms in Asia. Amid the pandemic, many of Asia's policymakers have accelerated efforts toward further opening capital markets to foreign investments, as well as toward reforming labor laws, giving employers greater flexibility in managing their workforces. While the nature of reforms varies among countries in different stages of economic development, the overall trend is unifying and positive for Asia's capital markets. These economic reforms, combined with rising household incomes and growing domestic consumption, make Asia an attractive destination in our view for long-term equity investors.

Considering the outlook for small companies, the broadening of the economic recovery across Asia provides a potential tailwind for Asia's smaller and more entrepreneurial businesses. Small companies remain a vibrant source of innovation and creativity in Asia. As always, we look for companies with strong management teams, healthy balance sheets and compelling growth prospects.

As of 9/30/2020, the securities mentioned comprised the Matthews Asia Small Companies Fund in the following percentages: Flat Glass Group Co., Ltd. H Shares, 3.0%; ASMedia Technology, Inc., 2.1%; Marico, Ltd., 1.5%; IFB Industries, Ltd., 1.2%. Current and future portfolio holdings are subject to change and risk.

Investing in small- and mid-size companies is more risky than investing in large companies as they may be more volatile and less liquid than larger companies.

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.