Matthews Asia

Matthews Asian Growth and Income Fund

Choose a Share Class: Investor

Period ended September 30, 2020

For the quarter ending September 30, 2020, the Matthews Asian Growth and Income Fund returned 7.91% (Investor Class) and 7.93% (Institutional Class), while its benchmark, the MSCI All Country Asia ex Japan Index returned 10.79%.

Market Environment:

Following the tumult of the first quarter, equity markets across much of the globe have not only reversed such drops but are now approaching, and in some instances are above, all-time highs. While the coronavirus related drop may have been too extreme, we believe the pace and strength of the equity market recovery appears to be pricing in an unlikely rapid return to normalcy. Aggressive loosening of monetary policy by central banks, expansive fiscal stimulus and rampant liquidity exacerbated by increased retail investor participation have amalgamated to seemingly drive market prices, in many instances, away from fundamental value. This is particularly true given a backdrop of high unemployment that may prove stickier than anticipated, elevated geopolitical tension and U.S. election risk.

For Asian markets, these issues seem less relevant. The economic recovery in the region's largest economy, China, has been surprisingly solid with a rebound in the majority of macroeconomic metrics in what is now a predominantly domestic demand driven economy. This could suggest that the rebound in asset prices has more justification than elsewhere. Added to this was a weakening U.S. dollar that likely helped to conspire toward another quarter of double digit returns for Asian markets. This was concentrated predominantly in North Asia with South Korea, Taiwan and China all gaining strongly whereas Southeast Asia struggled given what is likely to be a more sustained downturn due to less fiscal room and weaker health care infrastructure.

Performance Contributors and Detractors:

The largest contributor to performance during the third quarter came from the information technology sector. TSMC, the world's largest semiconductor foundry, gained as competitor Intel announced that it may consider outsourcing its own production. This further confirms TSMC's leading position as it is also likely to gain from increasing content value in Apple's new iPhone as well as potential wins from other customers such as Advanced Micro Devices. Samsung Electronics rose as it is expected that it can gain smartphone market share from Huawei given U.S. restrictions on the latter's access to necessary components. Venture Corporation in Singapore was also a solid performer as the contract manufacturing services business delivered better than expected results. Demand appears to be strong in most verticals including life sciences, medical devices, networking and semiconductors.

The portfolio's Hong Kong holdings were also reasonable performers during the quarter. Power tool leader Techtronic Industries gained as it demonstrated its competitive advantage during the crisis with double digit revenue growth during the first half of the year, taking share from the competition. Auto parts supplier Minth Group rose as it further enters the supply chain for electric vehicles via its battery housing business. Fellow parts supplier Hanon Systems in South Korea also benefited from this as it is a leader in e-compressor technology for climate control systems.

On the other hand, traditional 'defensive' businesses struggled during the quarter, with telecom stocks particularly weak. Japanese telecom KDDI sputtered as new Japanese Prime Minister Suga has long held ambitions of reducing wireless pricing. Singapore's Singtel also fell as lower roaming fees, rising price competition and weaker enterprise revenues all led to weak earnings delivery. Outside of telecoms, China's Jiangsu Expressway fell as a change in truck pricing methodology for the province has hurt traffic flow and is likely to impact revenues in the near term.

Financial stocks again delivered weak performance. China's Ping An Insurance dropped on poor first half earnings that witnessed a decline in value of new business for its life insurance arm and a spike in credit guarantee losses within non-life insurance. Bank of China (Hong Kong) fell as earnings were hit by declining money market rates that weighed on the bank's net interest margins. Similarly, an earnings miss caused Bank of the Philippines Islands to underperform as it aggressively raised credit provisions ahead of asset quality deterioration. We believe this to be prudent management as it seeks to shore up its balance sheet for the long term.

Notable Portfolio Changes:

The portfolio has continued to see significant activity as market price action creates opportunities to upgrade our holdings. We added three new equity holdings and one convertible bond during the quarter with all of these residing in Mainland China.

We established an equity position in Zhongsheng Group—an entity within which we had previously held its

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

1-year 8.46%
3-year 3.44%
5-year 5.90%
10-year 4.34%
Inception (9/12/94) 8.71%

Gross Expense Ratio

1.08%

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: 1.64%

Dividend Yield: 3.05%

The 30-Day Yield represents net investment income earned by the Fund over the 30-day period ended 9/30/20, 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.

The Dividend Yield (trailing) is the weighted average sum of the dividends paid by each equity security held by the Fund over the last 12 months divided by the current price as of report date. The annualised dividend yield is for the equity-only portion of the Fund and does not reflect the actual yield an investor in the Fund would receive. There can be no guarantee that companies that the Fund invests in, and which have historically paid dividends, will continue to pay them or to pay them at the current rates in the future. A positive distribution yield does not imply positive return, and past yields are no guarantee of future yields. Sources: FactSet Research Systems, Bloomberg, Matthews convertible bonds. The company is a leading auto dealership in China with over 300 branches offering brands such as Mercedes-Benz, Lexus, Honda and Toyota. Management has done an impressive job in scaling the company and it now has over 50% of its gross profit coming from the less cyclical after-sales services. We believe that it will have continued growth through a rising number of dealerships, car volume growth and ramping up its after-sales services further. The stock trades at a relatively attractive valuations.

Elsewhere in China we added Ping An Insurance. Trading at attractive valuations, we believe the leading financial conglomerate in the country is well placed. Its renewed focus on improving life insurance agent productivity as well as its impressive technology suite stand the company in good stead in our view to take advantage of the vast opportunity in providing social infrastructure for the country. We also added property developer China Resources Land as we believe it has delivered well in diversifying into more recurring revenue streams including its 42 shopping malls. A top 10 developer, it is well positioned to grow through this and its newer businesses such as rentals and senior housing.

We also added convertible bonds issued by e-commerce service provider Baozun. The firm offers store operations, logistics and marketing to brand partners and will likely grow along with e-commerce trends and new customer acquisition.

These ideas were funded through the sale of lower conviction holdings including Prudential, Shanghai Airport, CK Asset, China Mobile and Jardine Matheson.

Outlook:

Despite a challenging backdrop, the third quarter of the year surprised us with the strength of global equity markets. We believe that this march upward is unlikely to be as smooth going forward as continued wrangling over the next somewhat unaffordable fiscal stimulus bill, a potentially contested U.S. election, rising geopolitical tensions, broad based unemployment challenges and high valuations are all prospective volatility generators.

However, Asia seems to look relatively better positioned than many. China appears to be the most 'normal' major economy, with levels of activity in certain areas already returning to those seen in 2019. And much of North Asia has a similarly solid outlook.

At a fundamental level, Asian markets have priced in a return to expansion with expectations for 23% earnings growth in 2021, and the MSCI Asia ex Japan Index trading at a relatively high 14.7x those estimates. It should also be noted that certain sectors such as technology and health care, in our view, appear to be the most extreme in disconnects between company fundamentals, valuations and the economic outlook. This leads us to remain broadly cautious in these areas.

For the Matthews Asian Growth and Income Fund, we remain constructive. Asia's relative economic standing is solid and, in our estimation, volatility in asset prices may return to elevated levels. Backdrops such as this are typically environments where the Fund's focus on quality companies that we believe are built to last bears fruit. In choppy waters, our aim to mitigate volatility and produce reasonable total returns through the steadier means of balancing growth and income should be well placed to deliver for clients.

As of September 30, 2020, the securities mentioned comprised the Matthews Asian Growth and Income Fund in the following percentages: Taiwan Semiconductor Manufacturing Co., Ltd., 6.5%; Samsung Electronics Co., Ltd., 3.2%;. Venture Corp., Ltd., 1.6%; Techtronic Industries Co., Ltd., 2.6%; Minth Group, Ltd., 1.7%; Hanon Systems, 1.2%; KDDI Corp., 1.2%; Singapore Telecommunications, Ltd., 1.2%; Jiangsu Expressway Co., Ltd. H Shares, 1.3%; Ping An Insurance Group Co. of China, Ltd. H Shares, 1.2% Bank of the Philippines Islands, 1.2%; Zhongsheng Group Holdings, Ltd., 1.4%; China Resources Land Ltd., 1.5%; Baozun, Inc., Cnv., 1.625%, 05/01/2024, 1.4%.

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

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