



Matthews Emerging Markets Equity Fund

Choose a Share Class: Institution: ▾

Period ended September 30, 2020

For the quarter ending Sept. 30, 2020, the Matthews Emerging Markets Equity Fund returned 13.11% (Investor Class) and 13.20% (Institutional Class), while its benchmark, the MSCI Emerging Markets Index, returned 9.70%.

Market Environment:

The macroeconomic environment for most markets—emerging and developed alike—continues to be dominated by the COVID-19 pandemic. Many countries have seen a bounce in economic activity as mobility improved after initial stages of lockdowns, which began earlier in the year. The sustainability of improvements for each country, however, will depend on both incidence and intensity of the virus. The development of a vaccine that is effective, manufactured at scale and successfully distributed remains an open question.

Currently, broad aggregates of economic activity are favoring North Asian markets of China, South Korea and Taiwan, which have implemented highly effective public health responses to the pandemic. The Chinese renminbi appreciated relative to the U.S. dollar, as did the South Korean won and the Taiwan dollar. In contrast, much of the rest of the developing world continues to be more deeply affected by the ongoing public health and economic impacts of COVID-19. The Russian ruble depreciated relative to the U.S. dollar, while the Indonesian rupiah and Brazilian real also lost ground.

We expect the economic recovery may broaden over time. Recoveries have the potential to be accompanied by an expansion of nominal GDP growth rate differentials favoring emerging versus developed economies. This may lead to a recovery in relative earnings growth, a favorable foreign exchange tailwind, tighter emerging market credit spreads (reflecting a lower risk premium), a boost to sentiment and ultimately a recovery in investor inflows across emerging markets in our view.

Contributors and Detractors:

A contributor in the quarter was Polish software services company LiveChat. The company helps their clients, which range from large to small businesses, engage with their end customers via chat functions embedded in websites. LiveChat has seen positive momentum to its growth via new client acquisition and an ability to deepen relationships with current clients. We believe Livechat's business was accelerated by the pandemic and is also likely to thrive in the post COVID-19 world.

A detractor was energy producer Lukoil. The pandemic has suppressed global travel, creating negative sentiment toward the energy sector. At the same time, we see green shoots for energy demand and remain constructive on the company. The company is not particularly geared to the underlying price of oil compared to the sector and has virtually no debt on its balance sheet. The company makes positive cash flow at much lower prevailing energy prices. We expect energy demand to eventually pick up again in the post COVID-19 world.

From a regional standpoint, stock selection in China was a strong contributor to both absolute and relative returns. Amid a V-shaped economic recovery in China, strong performers among the Fund's holdings included Chinese stocks in the consumer discretionary, health care and consumer staples sectors. On the other hand, the Fund's holdings in the Philippines were a mild detractor from both absolute and relative performance. The Philippines, along with much of Southeast Asia, has faced steeper public health and economic challenges associated with the COVID-19 pandemic. From a sector perspective, communication services and financials were contributors to absolute and relative performance. The consumer discretionary sector detracted from relative performance.

Notable Portfolio Changes:

We were active in the quarter, adding several new positions, while exiting a handful of others. Among the new positions initiated was Magazine Luiza, a leading e-commerce player in Brazil. The pandemic has acted like an accelerant for the adoption of online shopping in geographies like Brazil, where e-commerce is less penetrated as a percentage of personal consumption versus many of our Asian markets including China. We also initiated a small position in Fresnillo, a leading producer of gold and silver in Mexico. While the Fund is generally not heavily involved in extractive industries like metals and mining, the extremely accommodative stance of the U.S. Fed may portend U.S. dollar weakness, and thus we thought it prudent to initiate. We exited two positions in consumer staples due to prices that we believe were disconnected from our view of each company's respective prospects.

Outlook:

The world remains highly uncertain, and the U.S. Presidential election is likely to be a key focal point for the remainder of 2020. We expect the effects of the pandemic to persist well into 2021 given that the development of a vaccine requires three steps: 1) acceptable efficacy, 2) scaled production and 3) distribution. None of these steps is insurmountable, but each has challenges. China has had an impressive return of economic activity, but further acceleration likely requires a broadening of recovery from the pandemic.

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

1-year n.a.
3-year n.a.
5-year n.a.
10-year n.a.
Inception (4/30/20[†]) 32.10%

Gross Expense Ratio

2.57%

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%. 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.

At the company level, the effect of the pandemic has been positive for some sectors and negative for others. We believe that some companies who have benefited from the pandemic will start to see that effect wane while others may see sustainable benefit from habitual change that has occurred during this difficult time. Video games might be an example of the former, while the embrace of online shopping is likely to be more durable.

Governments should continue to be as accommodative as possible from a fiscal and monetary perspective. However, many EM geographies may find it hard to do more than they have committed to already. Our focus remains the same as ever—to find great companies at accessible prices that are either domiciled in our geographies or conduct substantial business in emerging markets. We are, paradoxically, quite optimistic in believing that many aggregate indicators will remain challenged while benefiting certain companies or making others more attractive in terms of their share prices.

As of 9/30/20, the securities mentioned comprised the Matthews Emerging Markets Fund in the following percentages: LiveChat Software SA, 1.9%; Lukoil PJSC ADR, 1.8%; Magazine Luiza SA, 0.8%; Fresnillo PLC, 0.7%. Current and future holdings are subject to change and risk.

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

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