Matthews Asia™

Matthews Japan Fund

Choose a Share Class: Institutional

Period ended September 30, 2020

For the quarter ending September 30, 2020, the Matthews Japan Fund returned 11.99% (Investor Class) and 12.01% (Institutional Class), while its benchmark, the MSCI Japan Index, returned 7.08%.

Market Environment:

Japanese equity markets slowly climbed a wall of worry in the third quarter amid occasional spikes in COVID-19 cases and weak macro economy numbers. Monetary policies around the world remains extremely accommodative, resulting in risk-taking among investors, especially in growth stocks. Japan is no exception. Japan's central bank announced this year its plans to double exchange-traded funds (ETF) purchases. Japanese government has also passed a stimulus package that is one of the largest in terms of percentage of GDP, both headline numbers and direct spending. On the political front, long-standing Prime Minister Shinzo Abe recently stepped down to undergo treatment for ulcerative colitis. Chief Cabinet Secretary Yoshigide Suga was named as Abe's successor. We do not expect meaningful changes to economic policy as a result of Abe's resignation.

Performance Contributors and Detractors:

Strong stock selection during the quarter contributed to the Fund's relative performance. From a market cap and sector perspective, stocks across all size categories contributed positively to performance. Turning to individual securities, medical platform provider M3 was a contributor to the overall performance for the quarter. Their Japan platform now covers 90% of all doctors in Japan, and the company is using the platform to expand and disrupt in areas such as CRO (contract research organization) and career development, employee recruiting and networking. Overseas markets are a meaningful part of the company's overall revenue, with China being the largest growth driver. On the other hand, telecom carrier Nippon Telegraph and Telephone was a detractor for the quarter. Its defensive characteristics was a negative factor in an environment where investors favored riskier assets. Additionally, Yoshihide Suga, who has long been an advocate for a lower mobile phone fees, was elected Japan's new prime minister, putting additional pressure on the share price. We exited the position in the quarter.

Notable Portfolio Changes:

We initiated a new position in department store and credit card publisher Marui. While ongoing risks linger for retailers, majority of Mauri's earnings come from credit card operations, where card usage grew amid the COVID-19 pandemic. We think these businesses are likely to regain its momentum as consumer traffic recovers. We have also re-initiated a position in medical equipment manufacturer Sysmex, which we believe has the potential to generate attractive earnings growth and gross margin improvement driven by new product launches. We also initiated a handful of other positions geared to improvements in broader macroeconomic conditions. To fund these positions, we exited several stocks, including Lasertec, Asahi Intecc, Infomart, Kao, and Nippon Telegraph and Telephone Corp. Among the positions we exited were stocks that we believed were trading at premium valuations, while their growth rates were starting to slow.

Outlook:

On a relative view, we continue to believe Japan equities are well positioned compared to other developed and emerging market peers. Japanese corporates still have record level of cash on balance sheet, which is a needed cushion to weather the current recessionary environment. On the other hand, if COVID-19 case growth subside and we see faster recovery globally, Japanese corporate profits, geared to global manufacturing activity, may benefit as well.

From a structural point of view, we continue to believe the earnings capability of Japanese companies has improved meaningfully over the past economic cycle, driven by better corporate governance and a higher focus on capital efficiency. Multi-year trends such as productivity growth, health care, technology and material science innovation—where Japanese corporations excel versus global peers—remain intact. Moreover, we expect these trends will accelerate amid the ongoing COVID-19 pandemic. The pandemic has provided stress test on Japan's health care system and costs, as well as labor productivity issues among white-collar jobs as more people work remotely.

Additionally, the orderly transition of power after the abrupt resignation of Prime Minister Shinzo Abe to the election of Yoshihide Suga is a positive for the market in our view, as it reinforced the political stability that Japan has now, which is a stark contrast to a decade ago where the country had a new prime minister almost every year. Against this backdrop, we are optimistic about the long-term growth opportunities within Japanese equities.

As of 9/30/2020, the securities mentioned comprised the Matthews Japan Fund in the following percentages: M3,

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

1-year 21.71%
3-year 6.91%
5-year 10.81%
10-year n.a.
Inception (10/29/10) 10.39%

Gross Expense Ratio

0.88%

After fee waiver and expense reimbursement:

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.*

Inc., 2.9%; Marui Group Co., Ltd., 1.0%; and Sysmex Corp., 1.5%. The Fund held no positions in Nippon Telegraph and Telephone Corp., Lasertec Corp., Asahi Intecc Co., Ltd., Infomart Corp. and Kao Corp. Current and future portfolio holdings are subject to change and risk.

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.

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