Matthews Asia Webcast
Portfolio Manager Roundtable

December 7, 2011

Participants

Jodi Borkowitz, CFA, CFP®, Senior Vice President of Matthews International Capital Management

Robert Horrocks, PhD, Chief Investment Officer and Portfolio Manager, Matthews Asian Growth and Income Strategy

Teresa Kong, CFA, Portfolio Manager, Matthews Asia Strategic Income Strategy

Richard Gao, Portfolio Manager, Pacific Tiger and China Strategies

Jesper Madsen, CFA, Portfolio Manager, Matthews Asia Dividend and China Dividend Strategies

Presentation

Jodi Borkowitz, CFA, CFP®—Moderator
Good afternoon everyone. I would like to thank you all for participating in today's year-end Matthews Portfolio Manager Roundtable. In our quarterly webcasts, we alternate between educational discussions and mid- and year-end portfolio manager roundtables where we hear from a collection of Matthews' Lead Managers who share and update on the strategies that they manage.

I imagine that most of you joined the call today with similar questions. Mainly, what does continued global economic uncertainty mean for Asia and what does it mean for Matthews? What does the more uncertain and lower growth environment mean for the different Matthews investment strategies? And then, finally, what are the risks within Asia, namely the Chinese financial system?

We are going to tackle these three main questions today with four members of the Matthews Investment Team. As many of you know, we have added a number of new members to the team in 2011 and our Investment Team now totals 32 portfolio managers and analysts. All of them are based in San Francisco and our team remains as committed as ever to on-the-ground fundamental research in developed, emerging and even frontier markets of Asia.

Our long-term fundamental research approach is really core to all of Matthews' 13 investment strategies. We are going to highlight several of our strategies, but not all of our strategies today. Joining me are Robert Horrocks, Matthews' Chief Investment Officer and the Co-Lead Manager of the Matthews Asian Growth and Income Strategy. Robert is joined by Teresa Kong, who is the Lead Manager of the Matthews Asia Strategic Income Strategy, which we just formally launched last week. Teresa joined Matthews in 2010 to lead the build-out of our fixed income capabilities. Previously she headed Emerging Market Investments at Barclay's Global Investors and she came to us with over 15 years of fixed income and emerging market experience. Working with Teresa as Co-Managers on this new strategy are Gerald Hwang, CFA, and Robert Horrocks. This strategy is one more example of how at Matthews we always strive to launch new strategies when we identify compelling Asia investment opportunities. We are firm believers in the long-term evolution of Asia's fixed income market and, at this point, we believe the breadth and depth of Asia's bond markets,

Matthews Asia®

coupled with strong fundamentals, makes Asia bonds a bona fide asset class.

Representing our more dividend-oriented strategies today is Jesper Madsen. Jesper is the Lead Manager of the Matthews Asia Dividend Strategy. I would like to congratulate Jesper on the strategy recently celebrating its five year birthday just this past October. Jesper also manages the China Dividend Strategy and shares the Lead Manager role of the Matthews Asia Growth and Income Strategy with Robert.

And finally, representing our growth-oriented strategies is Richard Gao. Richard has been the Lead Manager of Matthews China Strategy since 1999. In addition, along with Sharat Shroff, he shares the Lead Manager role of the Matthews Pacific Tiger Strategy, which is the largest of Matthews' strategies. And Richard is also the Lead Manager on the Matthews China Small Companies Strategy, which we launched earlier in 2011.

Those three questions that I outlined at the onset: What does continued global economic uncertainty mean for Asia and Matthews? What does a more uncertain and lower growth environment mean for different Matthews investment strategies? Finally, what are the risks within Asia, mainly the Chinese financial system? These essentially capture most of the questions that were submitted to us prior to the call and many of the questions that we have had with you one-on-one during the quarter.

So, let's start with our first big question. And I am going to start with Robert and Teresa to tackle the big question, "What does the continued global economic uncertainty mean for Asia and what does it mean for Matthews?"

Robert Horrocks, PhD, Chief Investment Officer
Well, thanks Jodi, and welcome everybody. To answer this question, maybe first we have to look at the context, and for me, context is all about valuations. Looking at the valuations in the market, we can see that we began this year somewhat above the long-term average. We have since fallen down below that long-term average, both in terms of a price-to-earnings ratio—this is a 12-month forward looking, price-to-earnings ratio—and also in terms of price-to-book. We are now at levels in terms of price-to-earnings that are similar to the troughs we experienced after the Asian Financial Crisis, after the TMT (technology, media and telecommunications) bubble in the early-2000s period, and during the SARS crisis, although not quite at the trough valuations we achieved in the recent financial crisis. But, that tells me on a price-to-earnings basis that a lot of slowdown in our economies has been factored in. On price-to-book, we remain 25%-30% above absolute crisis valuations. But again, there is much more of a cushion on the valuation side than there might have been at the beginning of the year.

Why have valuations moved down? It is undeniably true that the slowdown in the U.S. economy would have had some impact. Also, in particular, when you look at the region's performance versus something like the S&P 500 Index, the recent wave of troubles in Europe seems to have opened up a divergence in performance of the two indices. So, there is no doubt that these two external factors have played a big part in the performance of the markets and the valuations recently. But, I suspect that tighter monetary policy in China and India over the course of the past 12 months has played a big part in the performance of the indices. The valuations, to me, now look undeniably cheap relative to long-term history. These are broad, average valuations.

I want to say one more thing about how the markets stand at the moment. Within these averages there has definitely been a divergence. And sectors that are less directly exposed to domestic demand, that is the exporters, some of the more global industries—materials, ship building, shipping—these areas have seen their valuations come down dramatically. In addition, the more cyclical sectors—industrials, banks, property—are also trading much more cheaply. In areas that are more focused on domestic demand and in companies that exhibit reasonable and more certain rates of secular growth, prices and valuations tend to have held up a lot more strongly.

To those of you familiar with the kinds of companies that we like to include in our investment strategies, you will not be surprised to understand that generally the companies that we favor have held up better than a lot of other securities in the market. This is a big part of the performance of the strategies this year. It also brings a little bit of risk into the strategies in the sense that those areas that might be considered more deep value, more cyclical, more distressed, are perhaps those that are likely to respond best to any resolution of the issues in the U.S. and Europe. Nevertheless, we have not done too much to adjust the portfolios. To start investing in some of these securities, we feel we might have to take on an excessive amount of business risk, certainly when viewed as the long-term prospects of these companies. With that context in mind, I think Teresa has some views on how the events in the U.S., and particularly Europe, might be impacting our economies and capital markets.

Teresa Kong, CFA, Portfolio Manager

Thanks, Robert. There are definitely a lot of questions that have come up regarding the impact of Europe on Asia. First, I would like to frame the question by talking about it through two major transmission channels. The first is the capital channel and the second is the trade channel.

I was recently in Asia visiting most of the banks in the ASEAN countries. In general, there is very little direct exposure to the European debt crisis on the part of ASEAN banks and most Asian banks. They don't hold significant amounts of European debt on their books. However, European banks do provide a lot of liquidity to Asia. They provide liquidity through something called the wholesale banking channel. And what I am talking about here is what we refer to as the interbank market, where banks access short-term funding, typically in U.S. dollars. Once banks access this U.S. dollar liquidity, they in turn lend it to companies who need this to fund their inventories and to provide letters of credit to their vendors. This type of liquidity is very important as a lubricant in global trade. Because banks have, in general, pulled back from lending to one another because there have been uncertainties around counter-party risk, we have seen a natural shortage of U.S. dollar liquidity in the bank markets. This means that some companies are finding it harder to get dollar funding. Since global trade is so dependent on dollar financing, this is something that we watch very carefully and might very well lead to a constraint on global trade.

Which leads us to the second transmission mechanism that I highlighted—the trade channel. While the capital channel is probably shorter term in nature and is already hitting us, we feel the immediate effects. And while we have been feeling it, they tend to be shorter lived. Whereas in the trade channel, the effects can be very long-lasting and may actually have a much deeper impact in terms of growth. So, by trade channel, what I mean is the effect that a slowdown in European economies could have on the ability of Asian Countries to continue to trade. We think that the most exposed countries will be the small open economies of Singapore and Hong Kong. And we have already seen this. I see them as the "canaries in the coal mine," if you will. For example, in the latest October trade data that came out from Singapore, we have seen a material fall in several categories, including electronic exports, which fell by 31% year-on-year, and even in non-electronic exports, which have been down by about 7% year-on-year.

Away from these smaller open economies, I'm sure all of you are thinking about China. What is the effect of Europe on China? First and foremost, the European Union is China's single largest export market. A slowdown in exports will undoubtedly lead to some slowdown in China. We think that one of the key transmission mechanisms that we want to watch very closely will be through the banks and whether this might lead to even further non-performing loans on the bank's balance sheets.

In the more commodity-rich countries like Indonesia and Australia, we probably expect to see that commodity prices might stabilize and maybe even fall if global growth slows down significantly. This will further have an impact on overall investment in those counties.

Finally, in South Asia, in countries like India, the key issues have typically been fiscal deficit as well as current account deficit. We expect the fiscal account deficits to actually get worse because the revenues coming into these countries will likely fall.

Having painted the backdrop of how the Europe crisis might translate to Asia and the impact through both the capital and the trade channels, I'm sure you are wondering what will be the policy response. We have already seen a monetary response on the part of many governments. Robert hinted that we have had a significant tightening of interest rates across a lot of Asian countries. We have seen that and a very explicit turnaround over the last three months.

Indonesia has gone from tightening very aggressively to lowering interest rates by 75 basis points (0.75%) since October. The Bank of China lowered reserve requirements by 50 basis points (0.50%) last week. One question came up as to whether or not we thought this might be the beginning of a definitive easing cycle. While it coincided with the Fed's coordinated action on the part of several banks, we think that this is very much the beginning, and we expect more easing to come from China over the next several quarters.

I will wrap up by talking briefly about what the implications might be for a bond manager. The key three things that you need to keep in mind is that there are really only three major drivers of returns in bonds. They are currency, credit and interest rates. I call this the holy trinity—credit, currency, and rates.

First, I will talk about interest rates. Falling interest rates tend to be good for bonds since bond prices rise when interest rates fall. However, this would be offset somewhat by the limited appreciation of the currencies. Why do I think that? If global trade falls, most of the Asian countries will try to keep a cap on the amount that they will let their currencies appreciate so that they can be competitive on the international front and keep their exports cheap relative to one another. We think that there is still room for some of these Asian currencies to appreciate. We think that the upside growth might be somewhat capped in the near term. In terms of credit quality, the third leg of the holy trinity, we think that the lack of liquidity, as well as the higher cost of funding, will hurt smaller, more marginal players because their credit costs will go up, and for some it will even dry up. But, for large blue chips, we may not see a major impact as the rise in credit spreads may be somewhat offset by overall falling interest rates. We are positioning our strategy to benefit relatively more from the falling interest rates than the appreciation of the currency, and we are limiting our credit exposure to names that would not be too exposed to potential liquidity issues.

Robert Horrocks
We had one question—do you believe that the European banks cutting their credit to Asia is already reflected in prices, and what is the fundamental implication? I guess the way that I look at this is if you look at the relative performance of Asia versus the S&P 500 since August, it has definitely suffered just as the European crisis has worsened. And so markets are factoring in the U.S. as a safe haven. They are factoring in fundamental hits to Asia. When you look at the valuations across sectors, between domestic demand-driven stocks and externally-driven stocks, they are factoring in a differential, and not an insignificant one. Have they got the magnitude right? I don't know. There are a lot of these macro events that are factored into markets pretty quickly.

Fundamentally, for me, the world is like a balloon. The western part of the balloon is being squeezed in and that is pushing all of the air into the eastern part of the balloon. To me, that means Asia has one thing that the west does not have, and that is demand. There is no fundamental shortage of aggregate demand in Asia. It is, therefore, better able to cope with these issues as they come along through things like monetary and fiscal policy.

Jodi Borkowitz
Thanks, Robert. I want to stay with you and then turn this over to some of the other portfolio managers. In the end you have global growth slowing and you have these macro challenges, but all of you are charged with finding Asian companies with sustainable, long-term growth prospects within all of the strategies that you lead here at Matthews. I would love to get your thoughts on how you are going about that. And give us an update on what this year has meant to you; what has worked, what hasn't worked, what have you done to make changes in your strategies, and what investors should expect going forward.

Robert, why don't we start with you: lead us through the Asian Growth and Income Strategy. Part of its objective is to participate in Asia's growth, but to offer some protection in negative markets such as we have experienced this year. Your perspective?

Robert Horrocks

First of all, I would like to say that we have tried to strengthen the team this year. Joining myself and Jesper at the head of the strategy we now have Kenny Lowe, CFA, who began the year as an analyst. We have promoted him in recognition of his strong work on this strategy to the co-manager level. We have also hired another gentleman by the name of Siddharth Bhargava, who has a background in both credit and equity analysis with a concentration on balance sheet quality analysis. This is really at the heart of the strategy, finding those businesses that, due to the strength of their balance sheets, sustainability of cash flows, fixed nature of the assets that they own, and sometimes to the sort of security that you are selecting, be it a high dividend yield in stock or a convertible bond, offer a degree of protection when times turn bad. They will still give you some participation, although maybe not full participation, in the upside.

And certainly the strategy has performed along these lines this year, offering protection of half of the drawdown that you would have seen in the markets. Now, within that, some things have worked, some things haven't worked. What has not worked for the strategy is financials, banks, property. And some of the worst performers in the strategy have been drawn from the banks in Hong Kong, Australia and the Chinese insurance positions, as well as positions in Hong Kong and Chinese property.

To an extent, we have tried to limit the exposure here in a couple of ways. In property, we exited more residential, more Hong Kong focused positions. And we have focused more on commercial and retail property development. In the banking sector, we have also trimmed some of our positions. And we have also remained zero exposure towards Chinese banks. For property and financials, it was inevitable in a macroeconomic environment like this that it would perform poorly. It still remains, however, a strategic element in the strategy.

Although maybe less significant in terms of impact on the portfolio, what has perhaps been more of a disappointment from the stock selection angle has been the software industry where we try to find businesses. Because we like the general model of the software industry and the general characteristics of these sorts of businesses, we try to find some long-term holdings in China and also in Japan. However, these businesses have run into issues in terms of their product and in terms of breaking open the market in China. And we have, by and large, exited these positions during the year.

On the positive side, what has really helped the strategy has been, in a broad sense, monopolistic businesses with good strong assets, reasonable dividend yields and a reasonable underlying rate of growth. And we have found these across industries, in the semiconductor industry, in the broadcast media sector, in utilities, but most obviously within the telecommunications companies across the region. And this has spanned all sorts of different countries within Asia. These businesses are perfect fodder for this kind of strategy. What we have seen this year, two extra elements. On the one hand, more tactical investors do tend to use these businesses as a way to hide or take a more defensive stance. But also at the operating level, we have seen some of these businesses enjoy better pricing power through more data usage or for the businesses that we own, have seen increased market share as weaker competitors have faltered. And, I think in common with a lot of my colleagues, I focus on consumer staples and health care, which has generally been positive.

One thing I should say about this strategy going forward is the convertible bond portion. It was an area where, at the beginning of the year, we were somewhat nervous about the valuation. It has proven that, in the liquid convertible bonds this year, they were not a good place for finding downside protection. And so we have been relatively comfortable with the light weighting towards these instruments in the portfolio this year. That constantly remains under review and should we find valuations attractive in the convertible bond space we would look to add, but we will do that on a selective basis going forward.

I think at the margin, areas that look interesting are in some of the higher quality industrial names as we have seen then sold down recently. And they look like potential areas for further investment. Overall, I am comfortable that the strategy has done what it is supposed to have done this year.

Jodi Borkowitz
Thank you, Robert. Jesper, we launched the Matthews Asia Dividend Strategy five years ago and that was seeing a growing pool of dividends coming out of Asia and seen as a compelling investment opportunity. So, how has the Matthews Asia Dividend Strategy fared over the past year and do you think that long-term dividend story still remains compelling today?

Jesper Madsen, CFA, Portfolio Manager
Yes, thanks Jodi. I am obviously happy to say that I think our rationale five years ago for launching the strategy remains the same. The payment of dividends remains important to the companies we have been able to invest in, and that has been important to the risk return profile we have been able to achieve since inception. It has been a strategy that has been yielding less volatility than the overall market. Again, being a yield-focused investor, focusing on strong business models for the most part has definitely, I would say, has set us somewhat apart from the marketplace.

Also, and importantly in terms of what we are going to be talking about or what we have talked about today in terms of the lower growth environment, not having to reach for that much growth because you already have a great deal of your total return in hand by the dividend does make you a very different investor when you look to Asia. Again, you do not have to be necessarily invested with the fastest growing companies; you can scale back some of your expectations and that means you don't have to pay that much for the companies, either. So, all of those combined with yield has resulted in the risk return profile we are seeing here as well.

Dividends have contributed to the strategy's total return. And, again, I just want to remind you that for the strategy that is the objective. [The objective of the strategy is to provide total return with an emphasis on current income.] And over longer periods, while during any given year the dividend in itself might not be that important over longer periods, they can contribute more than a third of the total return since inception, for instance. So, again, it is not an area that you want to overlook and also some of the capital appreciation that we have experienced is not something that is aside from the dividend. It is because we are investing with companies that can grow those dividends and the marketplace does appreciate that over longer periods.

We haven't just grown over the last five years in terms of assets under management; we have also been adding to the team this year. Yu Zhang was promoted from an analyst position to that of Co-Portfolio Manager. We have also added Sherwood Zhang, CFA, to support both our greater China efforts, as well as real estate expertise. And then we also have Vivek Tanneeru, who has joined us recently to help us predominately with India and ASEAN coverage. So, again, we have been building a team throughout the year as well. And I am stressing that because I think that is important for looking into the future.

And, with that, Jodi, to answer your question about what has worked over the last 12 months, I would say the process more than anything else. We have been focusing on yielding companies, on companies that have stable business models, and that definitely helped us with, I would say, more of a shallow drawdown or sell-off than the market in general during some of the more volatile periods this year.

In terms of where we have seen the performance for the strategy, it has predominately been, in terms of country, out of Thailand, out of our Japanese holdings. Japan was particularly helpful during some of the volatile periods, because the yen had a tendency to strengthen during these periods as a safe haven currency. And also some of the more stable business models, such as consumer staples, performed quite well for the strategy as well. Besides consumer staples, we also saw strong performance within health care and utilities. And we continue, I want to stress, to focus on the margin, in terms of the marginal allocation within the strategy on some of these, I would say, larger cap companies with stability in terms of the earnings stream as well as the dividend.

We have had our fair share of challenges, especially within consumer discretionary, and particularly, I want to stress, within our brand apparel retailers. We have somewhat underestimated some of the need for turnaround within these businesses and, as a result, I would say, the ongoing stress to the dividend within these companies. One in particular we have had to exit as a result since we just simply felt that dividend had been impaired on a three-year forward basis. Financials, as Robert mentioned, has also been an area of challenge this year and here particularly within one of our online brokerages, as well as one of our insurance companies.

I also want to mention one area that Teresa touched upon and that has to do with credit, the availability of credit. We did see some weakness, the main weakness in the portfolio, along the lines of small and mid caps. When you have higher risk aversion in the marketplace, when you have chatter and lack of availability within certain segments of credit, small- and mid-size companies tend to sell off more severely. And we did experience that within certain segments of the portfolio.

But, Jodi also asked a question about the future, so I just want to quickly also stress why it is that I believe that Asia will continue to be an attractive place, especially if we are looking at a low-growth environment to be invested for yield and growth.

Asia, by far, still pays out a higher proportion in terms of yield compared to that of the U.S. So, you do get a yield pickup by looking at Asia. Historically, it has been growing faster and I still believe that Asia is better positioned going forward, even with the current stress in the system, on a long-term basis and structurally to deliver higher earnings growth, and therefore higher dividend growth. And, lastly, it is coming from a well-diversified pool of dividends that is spread across both developing and developed, as well as various sectors across Asia. So, you have a very wide range of companies that you can invest in to achieve this kind of growth and yield.

Jodi Borkowitz

Thank you, Jesper, congratulations on a good five years. We will switch gears here and, Richard, take it over to you. You lead our Asia ex-Japan growth-oriented strategy, Matthews Pacific Tiger, and our growth-oriented Matthews China Strategy. So, you can combine your comments here in sharing with us what has worked, what hasn't worked and the changes that you have made in the strategy over the last year.

Richard Gao, Portfolio Manager

Sure, Jodi. First of all, I would like to mention that we have two new analysts working on our Matthews Pacific Tiger and Matthews China Strategies. Sherry Zhang, CFA, joined us in July of this year as a senior analyst on the Pacific Tiger team. And Hardy Zhu just joined us as an analyst in the China team in October of this year. Both of them have great experience in Asia, especially in China, and the addition of these two analysts has greatly strengthened our overall research capability in the strategies.

So, it has been a very volatile year this year for the Asian stock market; for the Matthews Pacific Tiger and the Matthews China Strategies, it was a particularly challenging year to find growth opportunity in a tightening environment in Asia. We continued our long-term, bottom-up approach to focus on fundamentally solid companies with good business models and strong management teams.

So for the Matthews Pacific Tiger Strategy, our overweight position in the ASEAN countries, such as Indonesia, Thailand, Malaysia, has brought us positive contributions to the portfolio. The ASEAN countries are relatively less affected by the global financial crisis outside of Asia and we are seeing strong growth continuing in the domestic consumption area. Inflation in these countries is less severe than other parts of Asia. And companies in the financial and consumer sectors are particularly benefiting from the strong domestic economy.

The Southeast Asian countries learned a very hard lesson from the Asian Financial Crisis in the late 1990s. Companies are now more focused on the efficiency and productivity, as well as healthy balance sheets rather than focusing on the expansion and market share that we saw during the Asian financial crisis in the late 1990s. So, as a result of that, we are finding and also have been investing, over-weighting, in the Southeast Asian countries and have been able to find more solid and more profitable growth companies to invest with a long-term horizon.

And besides ASEAN, our overall investment in the consumer staples, health care and telecom sectors also outperformed this year. Our traditional approach of focusing on the domestic-oriented business with strong cash flows has provided us with some buffer in a harsh macro environment. In the consumer staples companies that we invested in Hong Kong, in China, and Taiwan, for example, have shown their capability of consolidation and taking away market share to become stronger in this tough environment. The health care and the telecom sectors have relatively stable growth and strong cash flows and are more defensive and also contributing well so far this year to the overall performance in the Pacific Tiger Strategy. On the negative side of the portfolio, the financial sector, which includes banks, insurance companies and property companies, did not perform well across the region, especially in countries like China and India, and we are going to talk more about it later.

And, as Jesper just mentioned, it is true also in the Matthews Pacific Tiger Strategy as well. The small- and mid-cap companies in the industrial sectors are experiencing very severe pressures on the margin side as a result of the rising labor costs and raw material costs. And also some technology holdings in the portfolio, they are affected by the negative global environment.

So, very quickly on the Matthews China Strategy, this is for the most part a year about fighting inflation and controlling the risk of the banks and property market for China. And for the China Strategy our defensive names in the utilities and the telecom sectors did relatively well. And the strategy remained very diversified approach to portfolio construction and we do hold positions in the utilities and telecom sectors and these holdings have served as a good stabilizer in a very volatile market environment. Also, select holdings in health care and information technology also performed quite well relative to the market.

On the negative side on the Matthews China Strategy, not surprisingly it is the financial and property sectors that did poorly this year, and also the small- and mid-cap size companies in the industrial sector that came under margin pressure. This is similar to what we have seen in other Asian countries.

Jodi Borkowitz
Thanks, Richard. I know it has been a tough environment, the market has been really short-term growth focused so if there is one thing that keeps you confident about investing in Asia and China going forward, what would you say it is?

Richard Gao
Yes, Asia's emerging economy has been growing very fast in the past decade. But in China's case, the top line GDP growth has been around 10% over the past two decades. It is true that this growth was in large part driven by exports and huge investments in infrastructures. So, going forward with the exports and fixed asset investments going down, it is unlikely that China will keep the rate of growth that we saw in the past. However, it is very important to know that China and other Asian countries' growth have also been driven by productivity growth over the past years.

This is a chart (see presentation) that measures the total factor productivity growth which is a way of measuring the efficiency with which both labor and capital are used. So you can see that China is leading the Asian countries in the productivity gains with an annual total factor productivity growth of around 4% in the past two decades. And this was mainly due to a massive expansion in the private sector economy as well as a shift into higher technology and innovations. This is true not only in China but also in other Asian countries like India and Thailand and Indonesia, for example.

For the growth strategy, we believe that productivity growth means more sustainable, higher quality growth. And we have been investing in innovative companies in the private sectors that are expected to provide sustainable growth. And among them, the service oriented industries in the areas of health care, education, software, insurance and tourism are becoming a more and more important part of our investment.

Jodi Borkowitz
Thanks, Richard. I think it is worth exploring a little bit more and you alluded that we get back to comments on Chinese banks and perhaps we can explore that as a broad portfolio manager team here. So, with you and Robert, where do Chinese banks fit into that long-term picture for Asia?

Robert Horrocks
I think that too often people look at the Chinese financial system with the assumption that allocation of capital across the economy has been extremely poor, that returns on capital are poor. And that this is all the fault of the banks. There is really relatively little evidence in the data for that. And Richard has pointed to productivity growth rates. If you look at returns on capital in China, they have actually over the years been stable to rising, which is what you would expect from an economy that is going from centrally planned to more market-oriented.

And, so, when we discussed the weaknesses of the financial system, the banking system in China, we are really talking about what are generally healthy rates of growth in the economy, healthy productivity. But a banking system that doesn't act on a very commercial basis, that has not been the best allocator of capital to state-owned enterprises, but I dare say one that has reformed quite a bit over time nevertheless.

So we are able in our strategies at least to take a reasonably sanguine view of the economy and yet remain relatively lightly positioned in the banks themselves.

Richard Gao
Yes, I want to add to that. First of all, I want to point out that at the current stage the overall banking system in China is still quite healthy and solid. I just want to mention that the largest state-owned Chinese bank is by far the most profitable bank in the world. And currently the average non-performing loan ratio for the top four state-owned banks is still at a healthy level of below 2%. But that being said, we are expecting that going forward the loan quality will be deteriorating. This is largely as a result of the loan growth, the huge loan growth after China adopted the US$600 billion stimulus program back in 2008, right after the global financial crisis. Many of these loans were written out in the rush and some of them were done through the so-called local government financing vehicles which have very minimal risk management. So, going forward, the non-performing loans are expected to go up for sure.

However, the scale of the non-performing loans should be controllable in our opinion because the total exposure to this type of high-risk category accounts for roughly 10% of the total loan portfolio of the major state-owned banks.

So, we are currently very alert on the developments and the potential deterioration of the bank loan qualities in China. For the Matthews Pacific Tiger and the China Strategies we have been under-weighting in the Chinese banks and we focused our exposure to banks in the Southeast Asian countries and India where we see healthier prospects.

For the Chinese banks, our focus has been on the regional banks in China with strong wealth management capability and less exposure to the local government debt.

Jesper Madsen
Maybe an expansion of what Richard was talking about. In great part the reason why the dividend-focused strategies, both the Matthews Asia Dividend Strategy and the Matthews China Dividend Strategy do not hold any exposure to any of the Chinese financials, whether it be banks or real estate is really one of lack of transparency; that is where it comes down. Again, lack of transparency as a dividend-focused investor, because there might be some rationales for why you might want to have some exposure as a growth-oriented investor.

But, looking at the banking sector more broadly, it is still—as Robert was hinting at as well—an extension of government policy. It is hugely important for the ongoing economic development, both what we have seen in China, what we will continue to see. And as a result of their role, they also do have a very protective status. Everything is regulated in terms of deposit rates and lending rates. And that does lock in a certain profitability for these banks. But, it comes with some social services as well—there are some strings attached to that kind of protective status. One, that means, as Richard was pointing out, that when push comes to shove that banks will fall in line and will lend when there is need for that.

Now, what has changed over the years and how I would say the banks and the economy have moved forward, all things considered, has been that these banks have been listed. That also means that that has brought an additional amount of scrutiny and a new set of shareholders outside of the government and those would be minority shareholders, often times foreigners.

And the question mark in our mind for the dividend-focused strategies, again, is what does that mean in terms of rising credit costs. Richard was mentioning the high non-performing loans. Again, there is very little transparency around the levels, around the pace, and around how the government will react to these changes in credit quality. Because, whether there is a wholesale bailout, or whether or not some of this will fall on the shoulders of minority shareholders is still unknown.

One easy way or one of the first ways or areas a bank can look to shore up its balance sheet would be the dividend, to just increase the retained earnings, and that is exactly what we have heard some of the higher ranking officials talking about—that maybe some of the banks should start considering retaining more and paying out less. Also, the banks have been very busy raising capital. All of these somewhat dilute the outlook for dividends and that is why we at the end of the day do not have any exposure.

Referring back to the analogy of the "canary and the coal mine," there is only one large bank out there, one large Chinese bank that actually pays a semi-annual dividend. The last move that bank made was total omission of that dividend. I don't want to read too much into that, but it might just also mean that when people look at the headline dividends paid out by Chinese banks, they should probably stop and question whether or not those are indeed as solid yields as reflected there. Again, earnings may come true but I have less, I would say, certainty around that dividend.

Robert Horrocks
I thought we should spend a little bit of time talking about the shadow banking system. I think that it has developed in China over the last couple of years. I think it is one of these areas where you have to take the complete opposite view to what you would take in the U.S., where a lot of the problems in the U.S. built up through a system that was all about securitization of debt and was done outside the normal banking channels and normal regulated markets.

In China, because of the weaknesses in terms of credit pricing and capital allocation in the banking system, you have actually had an informal shadow banking or shadow lending system that is built up that may be actually better at pricing credit, but yet it is less regulated, less controlled by the central authorities. But in that sense maybe more market disciplined. I don't want to overstress that point but I think the rise of this shadow banking system is the market's way of trying to find a better pricing of credit and better allocation of capital.

Richard Gao
Yes, I totally agree that this shadow banking issue that is right now happening in China came as a result of a lack of funding channels for many of the small and mid-sized type of companies in China. And I think that has really called for a better funding channel for the small- to mid-size companies in China.

Now for the shadow banking itself, usually they are done through kind of the trust-related companies selling wealth management products to the public. And the interest rate of those shadow banking lending can be as high as 25% to 50% in some cases. So obviously it is not sustainable and right now the shadow banking issues seems to be still quite limited to certain geographical locations like in the eastern part of China, including a city called Wenzhou where more than 90% of the business is from the small-mid-sized companies. A lot of shadow banking related issues are happening in those areas.

Also, one other thing is the non-transparent nature of the banking system in China because we don't know actually what exactly the size of that shadow banking is. And, also, it is very important that going forward the banking system in China and the whole financial system actually needs to be more open and transparent.

Teresa Kong
Yes, this is Teresa. I would like to follow up on Richard's point about increased transparency. It is interesting, from a Western perspective if you actually put a legal structure, due process, around this type of shadow banking we call it angel investing, and we call it venture capital. And I think what is lacking right now in China are developed markets where risk is priced accurately. Some people point to, well, doesn't China have a major bond market? Well, onshore China actually does have a sizable bond market on the order of US$2.5 trillion.

But that market is not pricing in risk because the primary investors in the bond market are still the banks. So, you are not seeing a differentiated group of investors, such as mutual fund managers or insurance companies, who are coming in, doing their own diligence based on a set of very detailed disclosures that disintermediate that market.

What we are, however, seeing is a small but vibrant market that is growing offshore in Hong Kong—what you might know as the dim sum market—that is enabling some Chinese companies to come offshore to tap the international markets. That development is very interesting and it has all the legality and the due process and also the necessary protection for investors as well as creditors in that offshore market.

Jodi Borkowitz
Thanks, Teresa. The one thing I also just want to hit on, too, because we have gotten a number of questions before the call, is the real estate market in China. So, Richard, the property market in China obviously remains a concern. We have seen a lot of sharp declines in prices and an increase in non-performing loans. Can you give us a sense for what this means for investors going forward?

Richard Gao
Yes, Jodi. We have been closely watching for the development in the property market in China and this has become a very policy-driven market now. The government was very concerned about the over-heating in the property market and has issued many tightening measures to try to cool down the property market in China. And they have been doing that for more than a year. And now finally the market is responding in the property side in China. So in the past two to three months we have started to see a sharp decline in the property selling price as well as the transaction volume in the first tier cities in China. So, in some cities like Beijing, like Shanghai and Guangzhou, we are seeing some developers cutting down prices for new projects by 20% to 30%.

This kind of price cut is beyond our expectations. And if this expands to more cities in China then it will definitely increase the burden on the developers, especially the smaller developers in China. So, for the property market to stabilize going forward, I think it needs the positive policy changes from the government side. The government first slowed down the market, but to make the market grow again I think this time around, you still need to see the government on the property investment encouragement side to lift the market again. But right now we are not expecting that to happen soon.

Robert Horrocks
We received one this question nicely pinpointed the way that the strategies that Matthews sit at the moment, basically asking about the Asian consumers theme—is it over-crowded? And are investors paying too much for growth in these businesses at current prices?

I would say that if you are looking for where is the sensitivity in the markets to a rebound in sentiment to a rebound in global growth, the sensitivity is not generally amongst the consumer names. It is going to be amongst the more distressed businesses. It is going to be amongst the low price-to-book stocks, amongst the cyclical companies—the shipping, shipbuilding, the Chinese industrial names, and as you probably gathered from listening to my colleagues here today, the property and the banking sectors.

Is consumer, therefore, an overcrowded theme? To the extent that there are people investing in these businesses for tactical reasons, I welcome it because I look at the current valuations in this sector, and yes they are higher than other listed entities in the markets, but in an absolute sense relative to the opportunity, relative to the growth that we will see in this region, and relative to the kinds of businesses you can buy, where they tend to be higher quality, they tend to be more protected by brand, more consumer facing. They tend to be able to extend their profitable growth for longer periods of time. I am quite relaxed about the valuations, and should some of those tactical investors be shaken out when you take a longer-term view about these businesses and about these markets, that is actually an opportunity to own more.

So, yes, it may be in a tactical sense a crowded trade, but from a strategic point of view I think still a very nice area to be focusing on for the coming years.

Jodi Borkowitz
Great, Robert. I think that is a great point to end with. So, I would like to thank all of you for joining us today. We had some great questions submitted before and during the call, so thank you all for that.

As you know, we try very hard to be your main resource for insights and for investing in Asia so we appreciate your time today.

Disclosures

Investing in international markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation. Fixed income investments are subject to additional risks, including, but not limited to, interest rate, credit and inflation risks. In addition, single-country and sector strategies may be subject to a higher degree of market risk than diversified strategies because of concentration in a specific industry, sector or geographic location. 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 large companies.

The information contained in this transcript does not, in any way, constitute investment advice. The views and information discussed in this report areas of the date of publication, are subject to change and may not reflect the presenters' current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.

WC031

Portfolio Manager Roundtable

Investing in international markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation. Fixed income investments are subject to additional risks, including, but not limited to, interest rate, credit and inflation risks. In addition, single-country and sector strategies may be subject to a higher degree of market risk than diversified strategies because of concentration in a specific industry, sector or geographic location. 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 large companies.

The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation. Matthews International Capital Management, LLC does not accept any liability for losses either direct or consequential caused by the use of this information. Please see important disclosures at the end of this presentation.

The views and information discussed in this report are as of the date of publication, are subject to change and may not reflect the presenters' current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.

Matthews Asia®

Moderator and Speakers

Jodi Borkowitz, CFA, CFP®
Moderator

Robert Horrocks, PhD
CIO and Portfolio Manager
Asian Growth and Income Strategy

Teresa Kong, CFA
Portfolio Manager
Asia Strategic Income Strategy

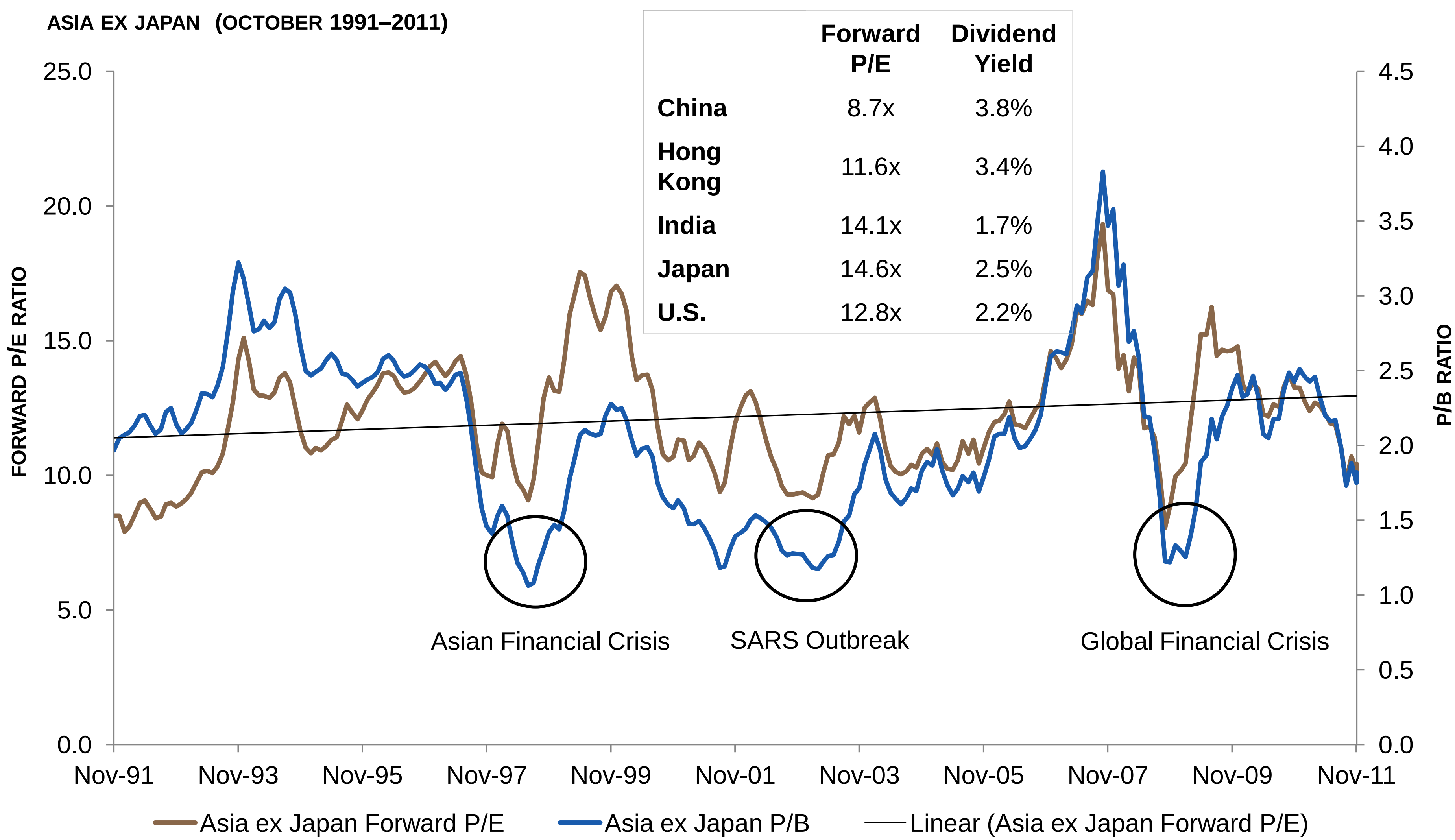
Richard Gao
Portfolio Manager
Pacific Tiger and China Strategies

Jesper Madsen, CFA
Portfolio Manager
Asia Dividend and
China Dividend Strategies

Matthews Asia Investment Strategies

	Asia Strategic Income	Asian Growth and Income	Asia Dividend	Pacific Tiger	China
Lead Portfolio Manager(s)	Teresa Kong 	Robert Horrocks Jesper Madsen 	Jesper Madsen 	Richard Gao Sharat Shroff 	Richard Gao 
Approach	Seeks total return over the long term through credit, currencies, and interest rates via a fundamental, bottom-up investment process	Attempts to offer a more stable means of participating in Asia's growth while providing some downside protection	Invests in income-paying equities; seeks combination of current income and dividend growth	Seeks to identify companies capable of delivering sustainable organic growth	Seeks to identify companies in their earlier growth stages with attractive valuations
Holdings	Primarily bonds of Asian corporate and sovereign issuers in both local and external currencies	Dividend-paying securities and fixed income securities, such as convertible bonds and corporate bonds	Equities of companies with attractive yields relative to the potential for dividend growth	Equities of domestically oriented companies; selectively seeks globally competitive companies	Equities of domestically oriented companies
Geographic Coverage	Asia	Asia	Asia	Asia ex-Japan	China and Taiwan

Asian Valuations



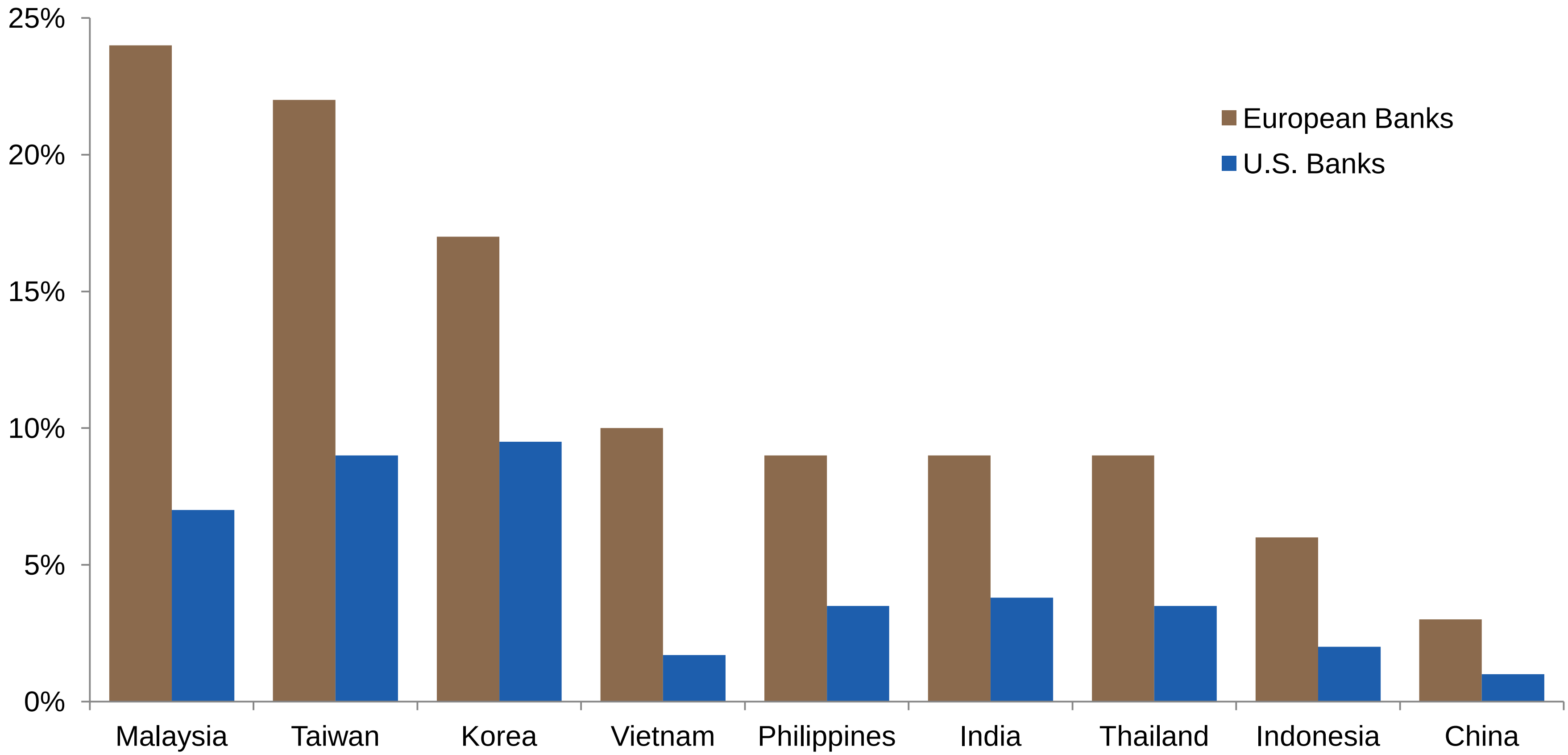
	Forward P/E	Dividend Yield
China	8.7x	3.8%
Hong Kong	11.6x	3.4%
India	14.1x	1.7%
Japan	14.6x	2.5%
U.S.	12.8x	2.2%

Sources: FactSet Research Systems; Data as of 12/01/11. JP Morgan; Data as of 11/25/11

Asian Exposure to European Financing

Asian countries have exposure to wholesale financing from Europe

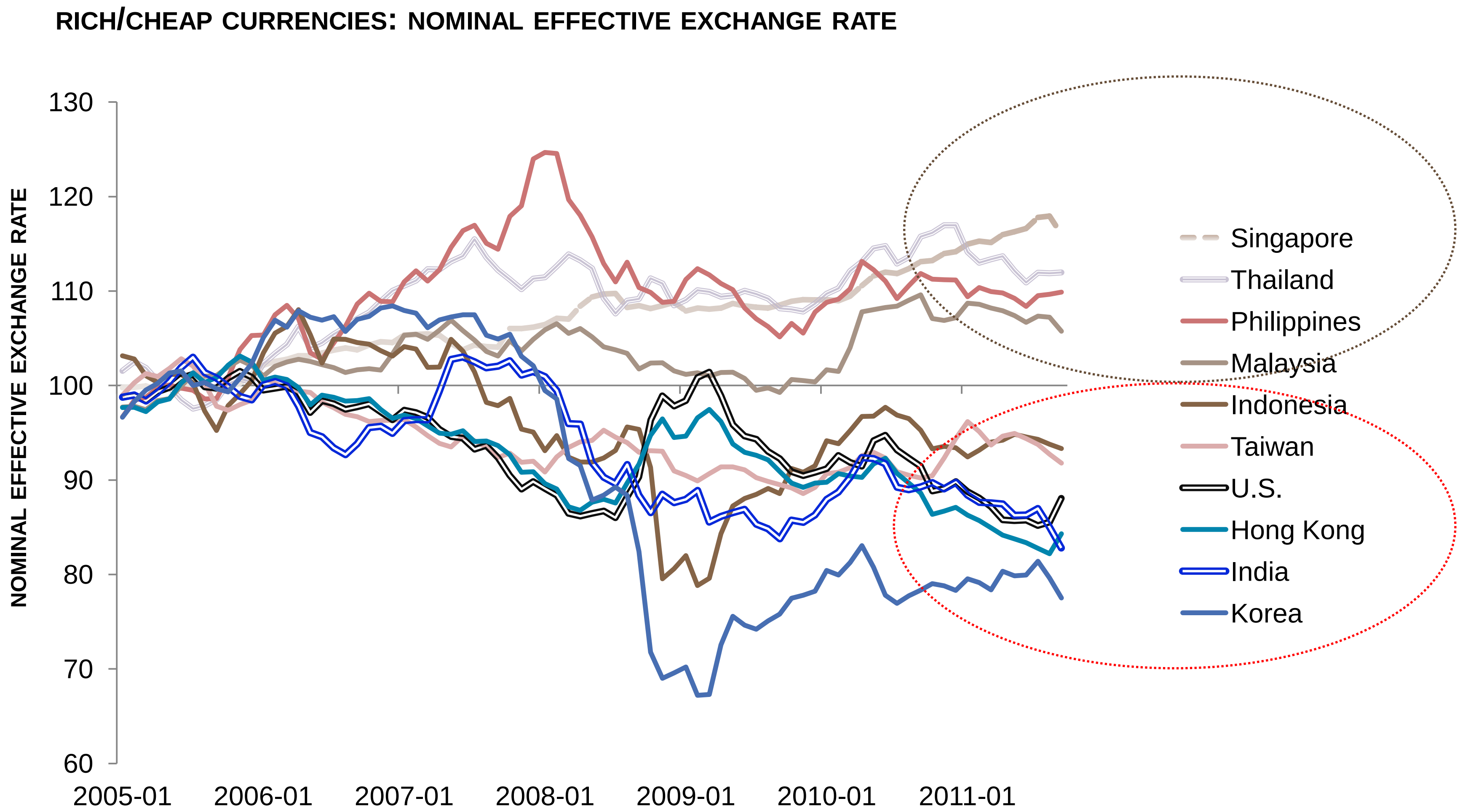
CONSOLIDATED CLAIMS OF EUROPEAN AND U.S. BANKS
(% OF GDP)



Claims are on immediate borrower basis. Uses sum of quarterly GDP in U.S. dollars during Q2 2010 to Q1 2011.
Source: IMF; Data as of Q1 2011

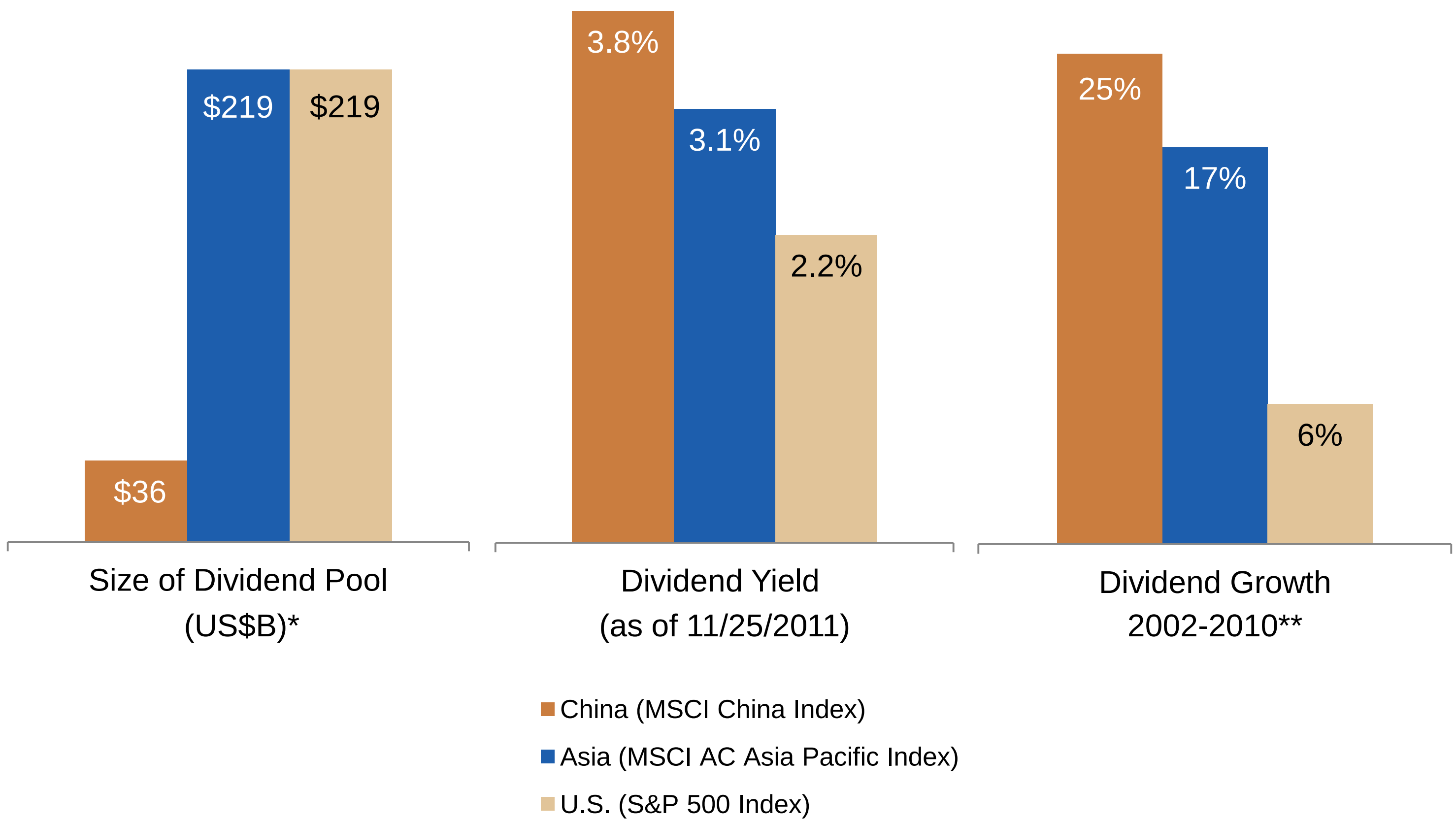
Currencies

Lower export growth may lead to slower appreciation of Asian currencies



Source: Bank of International Settlements (BIS) November 2011

Growth and Returns in a Low-Growth Environment



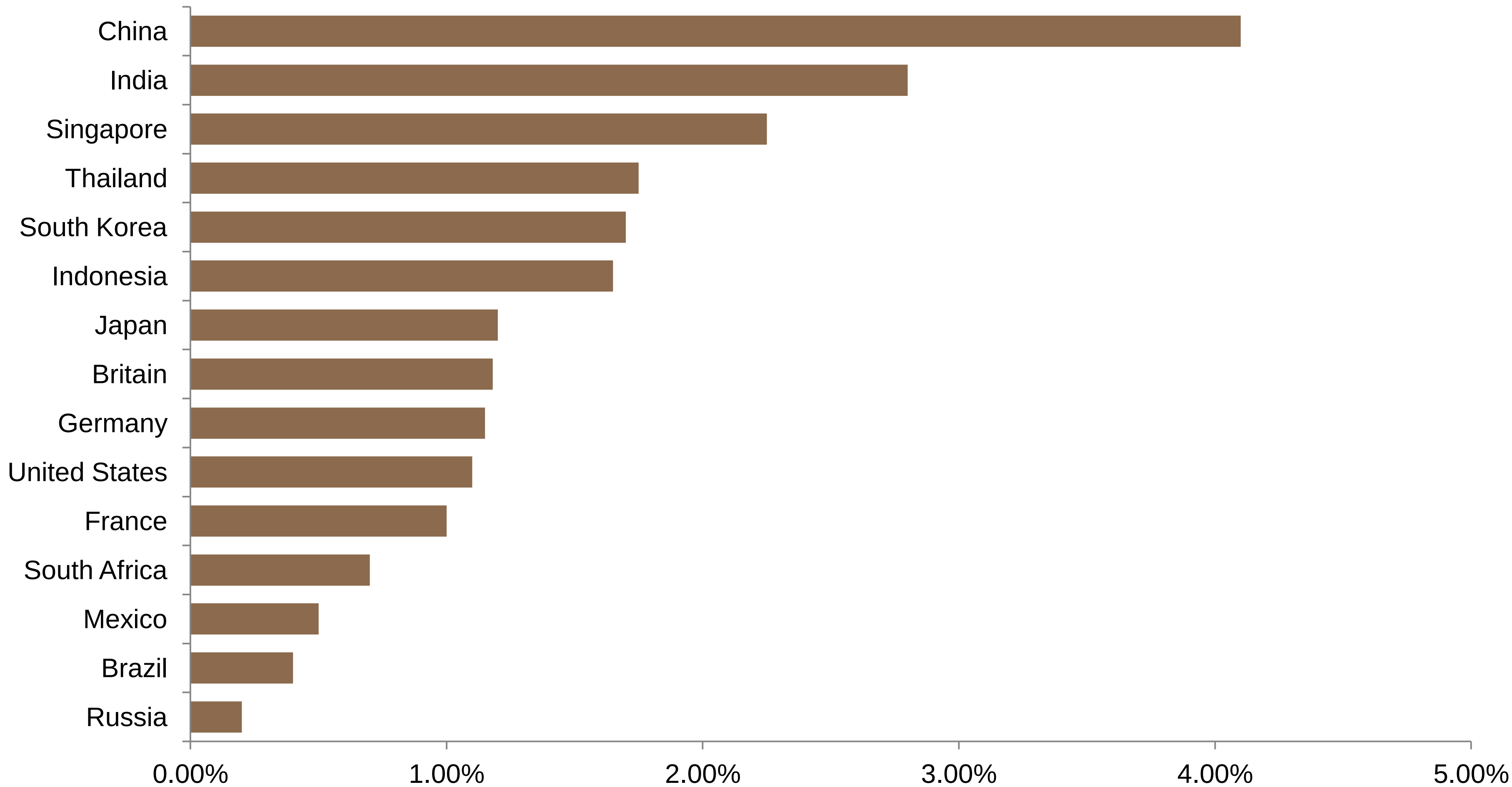
*Index members as of 2009.

Dividend growth for MSCI China is derived using index members as of 12/31/05 for improved index representation; for reference S&P 500 and MSCI Asia Pacific Index members grew dividends at 0.2% CAGR and 11.7% CAGR, respectively, during the same period. ***All performance quoted represents past performance and is no guarantee of future results.* It is not possible to invest directly in an index.

Sources: Factset, MSCI, I/B/E/S, JPMorgan, S&P

Innovation Drives Sustainable Growth

TOTAL FACTOR PRODUCTIVITY
AVERAGE ANNUAL GROWTH (1990-2008*)



* Or closest years available
Sources: UBS, OECD

Important Disclosures

This document does not constitute investment advice or an offer to provide investment advisory or investment management services, or the solicitation of an offer to provide investment advisory or investment management services, in any jurisdiction in which an offer or solicitation would be unlawful under the securities law of that jurisdiction. This document is directed at and intended for institutional investors (as such term is defined in the various jurisdictions). This document is provided on a confidential basis for informational purposes only and may not be reproduced in any form or transmitted to any person without authorization from Matthews International Capital Management, LLC.

Investors should ascertain from their professional advisers the consequences of investing with Matthews under the relevant laws of the jurisdictions to which they are subject including the tax consequences and any exchange control requirement. Investors should carefully consider the investment objectives, risks, charges and expenses of any strategy before making an investment decision.

Past performance is not indicative of future results. As with any investment there is always potential for gains as well as the possibility of losses.

These materials are provided solely for use in a private meeting and are intended for informational and discussion purposes only. To the extent that these materials are circulated, it is intended that they be circulated only to persons to whom they may lawfully be distributed and any recipient of these materials should inform themselves about and observe any applicable legal requirements. Persons who do not fall within such descriptions may not act upon the information contained in these materials.

The information presented in these materials is believed to be materially correct 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. Nothing set out in these materials is or shall be relied as a promise or representation as to the future.

The manager referred to in these materials means a U.S.-based investment adviser registered with the U.S. Securities and Exchange Commission who has not represented and will not represent that it is otherwise registered with any other regulator or regulatory body.

An investment in certain of the strategies is subject to interest rate risk, which is the possibility that a strategy's yield will decline due to falling interest rates and the potential for bond prices to fall as interest rates rise. The value of debt securities may be affected by the ability of issuers to make principal and interest payments. The strategies may invest in the following: derivatives which can be volatile and affect performance; high yield bonds (junk bonds) which can subject a strategy to substantial risk of loss; and structured investments which can change the risk or return, or replicate the risk or return of an underlying asset.

The MSCI All Country Asia Pacific Index is a free float-adjusted market capitalization–weighted index of the stock markets of Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, Philippines, Singapore, South Korea, Taiwan and Thailand. The Matthews Asia Dividend Strategy may invest in countries that are not included in the MSCI All Country Asia Pacific Index. It is not possible to invest directly in an index.

The MSCI China Index is a free float–adjusted market capitalization–weighted index of Chinese equities that includes China-affiliated corporations and H shares listed on the Hong Kong exchange, and B shares listed on the Shanghai and Shenzhen exchanges. It is not possible to invest directly in an index.

The S&P 500 Index is a broad market-weighted index dominated by blue-chip stocks in the U.S. It is not possible to invest directly in an index.