
Matthews Asia Credit Opportunities Fund

Period ended 30 September 2018

For the quarter ending 30 September 2018, the Matthews Asia Credit Opportunities Fund returned 0.20%, while its benchmark, the J.P. Morgan Asia Credit Index (JACI), returned 1.17% over the same period.

Market Environment:

The third quarter of the year was notable for volatility in emerging markets around the world. U.S. Treasury yields continued to move higher as the U.S. Federal Reserve raised interest rates. Continued solid economic data in the U.S., on the margin, has increased rate hike expectations for the remainder of 2018 and 2019. Meanwhile, concerns around trade wars, the rise in oil prices and slowing growth in China led to a sell-off across Asia.

Asian credit markets performed surprisingly well despite the volatility in the third quarter. After widening significantly in the second quarter, high yield credit spreads tightened 25 basis points (0.25%) from July to August. Chinese and Indonesian issuers performed well as concerns over tight liquidity in onshore China eased and policy actions from the Indonesian central bank lessened the likelihood of an uncontrolled sell-off in the rupiah. By sector, real estate and commodity-linked industries, such as oil and gas and metals and mining, performed well.

Performance Contributors and Detractors:

In the third quarter, among the biggest contributors to portfolio returns were our holdings in the bonds of Lippo Karawaci,¹ Alam Sutera Realty and SoftBank Group. Lippo Karawaci and Alam Sutera are both Indonesian property developers. After selling off as the Indonesian rupiah depreciated in the second quarter, the bonds of both companies rebounded in the third quarter. SoftBank bonds also rebounded as the firm moved closer to the planned IPO of its Japanese wireless business, which may be among the largest IPOs ever.

The largest detractors to Fund performance in the third quarter were our holdings in the bonds of Ctrip.com, Qingdao Haier (issued by Harvest International) and Tsinghua Unigroup. Both Ctrip.com and Qingdao Haier are convertible bonds of Chinese issuers. Ctrip.com is one of the largest online travel agencies in China, and its bonds performed poorly as the value of the underlying equity fell over 20% in the quarter on rising competition and a weak domestic market. Qingdao Haier manufactures household appliances, and its bonds fell as the company faced a challenging environment and battled revenue growth deceleration. Tsinghua Unigroup fell as government policy increased uncertainty around the credit quality of the issuer.

Notable Portfolio Changes:

We made a number of changes to the portfolio in the third quarter, adding short duration corporates while exiting our holdings in a handful of Chinese bonds. We added a number of U.S. dollar-denominated bonds that we believe have attractive yields relative to the risk we are taking. By buying high quality sub-investment grade bonds with maturities from 2019 to 2021, we were able to lock in attractive yields without taking on excessive interest rate or credit risk. For instance, bonds of Aluminum Corporation of China (Chinalco Capital Holdings), Olam and West China Cement have minimal default risk and solid balance sheets. We also added bonds of Krung Thai Bank in Thailand. Krung Thai is a high-quality bank, and because the coupon on the bonds increases significantly late next year, they are likely to be repaid by the company before the higher coupon takes effect.

We sold a number of our holdings in Chinese companies, exiting our renminbi-denominated corporate bonds and the dollar-

denominated bonds of Tsinghua Unigroup after the company announced a plan to divest part of its business, in line with the government's policy to reorganize university assets. . As the yield fell as both interest rates fell and credit spreads tightened, we exited our holdings of renminbi-denominated corporate bonds, including China Southern Power Grid, State Grid Corporation of China and Air China.

Outlook:

In our view, Asian high yield bonds appear attractively valued, while U.S. and European high yield bonds appear overvalued. Credit spreads for Asia high yield bonds are more than 60 basis points (0.60%) higher than historic averages. In contrast, spreads for U.S. and European high yield bonds are about 250 basis points (2.5%) below average. In simple terms, Asian high yield bonds are compensating investors for taking credit risk even with continued volatility.

To be sure, there continue to be risks on the horizon. If a further slowdown in global growth materializes, we expect investor appetite for emerging markets to be diminished. Any escalation in trade shocks or further outflows stemming from policy normalization in the U.S. could also put pressure on Asian fixed income markets. Finally, the demand for Asian credit from Chinese wealth managers might fall as the wealth management channels through which buyers purchase bonds are being more closely regulated.

These risks may increase, but we believe that much of this is already being priced in. We had been expecting volatility to rise in 2018 and it certainly did. Asian credit markets will likely remain volatile for the remainder of 2018. We believe it is imperative, however, that we continue to stay the course and not sell into the volatility. Based on our solvency and liquidity analysis, we do not expect any of the securities in the portfolio to default. As such, the relatively attractive yields in Asia offer a strong base for positive returns. A bond that starts with a 5% to 8% yield and has 25 basis points (0.25%) of credit spread compression, for example, could potentially generate attractive returns for investors over the course of the year.

¹ Lippo Karawaci is listed as Theta Capital Pte, Ltd

Rolling 12 Month Returns for the period ended 30 September 2018

Matthews Asia Credit Opportunities Fund	2018	2017	2016	2015	2014
I (Dist) (USD)	-2.21%	5.88%	14.25%	n.a.	n.a.
J.P. Morgan Asia Credit Index	-1.01%	2.17%	10.55%	n.a.	n.a.
I (Dist) (GBP)	0.39%	2.52%	33.78%	n.a.	n.a.
J.P. Morgan Asia Credit Index (GBP)	1.85%	-1.08%	29.71%	n.a.	n.a.

Risk Considerations

The value of an investment in the Fund can go down as well as up and possible loss of principal is a risk of investing. Investments in international and emerging market securities may involve 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. The Fund may invest in the following: derivatives which can be volatile and affect Fund performance; high yield bonds (junk bonds) which can subject the Fund 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 Fund invests in holdings denominated in foreign currencies, and is exposed to the risk that the value of

the foreign currency will increase or decrease. These and other risks associated with investing in the Fund can be found in the Prospectus.

Performance figures discussed in the Fund Manager Commentary above reflect that of the Institutional Distribution Class Shares and has been calculated in USD. Performance details provided for the Fund are based on a NAV-to-NAV basis, with any dividends reinvested, and are net of management fees and other expenses. Past performance information is not indicative of future performance. Investors may not get back the full amount invested.

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Investors should not invest in the Fund solely based on the information in this material alone. Please refer to the Prospectus for further details of the risk factors.

Sources: Brown Brothers Harriman (Luxembourg) S.C.A, Matthews Asia, FactSet Research Systems, Bloomberg

[Prospectus](#) | [Privacy Statement](#)

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