Matthews Asia™

Matthews Asia Total Return Bond Fund

The Fund's name changed from the Matthews Asia Strategic Income Fund to the Matthews Asia Total Return Bond Fund on 25 May 2020.

Period ended 30 June 2020

For the first half of 2020, the Matthews Asia Total Return Bond Fund returned -2.92% while its benchmark, the 50% Markit iBoxx Asian Local Bond Index/50% J.P. Morgan Asia Credit Index (JACI), returned 1.87%. For the quarter ending June 30, 2020, the Fund returned 10.64% compared to the benchmark return of 5.75%.

Market Environment:

Just as the recovery from Covid-19 has been uneven globally, the recovery in markets has also been uneven. For some asset classes, it's as if the virus never happened, posting positive gains for the year. These are generally the less risky parts of the market, such as developed market government bonds, investment grade corporates and gold. The riskier parts of the market have also rebounded from March lows but given the lingering uncertainty to economic activity and corporate fundamentals due to the coronavirus, these markets still faced losses year to date.

For Asia fixed income, this means that investment-grade corporates and rates performed the best in the first half of the year, followed by high yield. Within credit, issuers from more developed countries such as China have outperformed issuers from emerging countries such as Indonesia and India. Within Asian currencies, the most punished in the first quarter rebounded the most in the second quarter, including the Indonesian rupiah and the Thai baht.

Global central banks continue to provide ample liquidity, which we believe undergirds a lot of the markets' return to normalcy. The U.S. Federal Reserve continues to signal it will do “whatever it takes” to remain accommodative and to support the smooth functioning of financial markets. Meanwhile, the European Central Bank increased the size of its bond buying program by 600 billion euros in June. Many Asian countries are also in the enviable position of having ample fiscal flexibility to boost spending. For instance, Thailand and Singapore have already started disbursing fiscal stimulus packages.

We also see increased experimentation with support from EM central banks. For instance, the Indonesian central bank has announced a program to buy government bonds in both the primary and secondary markets. For now, it looks like the Indonesian central bank's goal is to act as a buyer of last resort and cap government bond yields, rather than monetizing the debt. As such, this alleviates pressure on the government without debasing the currency. However, we are watching carefully as emerging market countries tread the narrow path between fiscal prudence to provide the needed social support for a health crisis and fiscal largess that could lead to a financial crisis.

Performance Contributors and Detractors:

A key driver of positive performance in the second quarter was the Fund's exposure to U.S. dollar high yield issuers, which recouped much of their first quarter losses. In general, lower-rated bonds outperformed higher-rated bonds. The top contributors included our positions in Chinese property developer Dalian Wanda, Tata Steel, a top three global steel producer, and Bharti Airtel, one the three largest wireless companies in India. These large blue chip companies recovered most quickly as their probability of survival, even in a protracted economic downturn, is materially higher than their peers. Top detractors included Modernland Reality, Franshion Brilliant and Sino-Ocean. As a real estate developer in Indonesia, Modernland faced both a revenue shortfall as well as potential liquidity issues due to the economic lockdown in response to Covid-19. Both Franshion Brilliant and Sino-Ocean are fundamentally sound, with their long-dated perpetual bonds slower to recover than their shorter dated ones.

Local currency bond exposures also added to performance as most Asian currencies appreciated relative to the U.S. dollar, and interest rates across Asia fell in the quarter. Relative to our benchmark, overweights to Indonesia, Malaysia and Thailand were the top rate contributors while underweights to the Philippines and Singapore detracted, even though these positions still posted positive total returns. Our exposure to local currency-denominated bonds of Indonesia contributed most in our local currency positions as the rupiah was one of the best performing currencies globally, appreciating 14% in the second quarter.

Notable Portfolio Changes:

During the second quarter, we exited our position in Sri Lanka sovereign bonds. We believe these bonds have limited upside after the pandemic-driven sell-off. We expect developing countries across the world to seek external assistance in the coming quarters and think that will weigh on performance in Sri Lanka. We also exited Chinese auto manufacture Geely perpetual bonds, and Cinda Asset Management, a state owned Chinese financial company. Both of these bonds carry investment-grade level risk and had reached our price targets after the pandemic-induced sell-off. We decided to take profit and re-deploy into bonds with more upside. Finally, we exited the bonds of Modernland Realty as the company seemed less willing and able to refinance its maturities.

In the second quarter, we initiated new positions in a handful of high-quality bonds where we see the potential for upside. These include the bonds of JD.com, a Chinese e-commerce company, and Sygenta, a global chemicals company headquartered in Switzerland and wholly owned by ChemChina, a state owned enterprise.

Outlook:

We expect the Asia credit, currency and interest rate markets to continue to be driven by policy makers' response to the coronavirus in the coming quarters. Countries that have been the most effective in stopping the spread of the coronavirus have also had the fastest economic rebounds. Given this view, we remain most concerned about the spread of coronavirus in the U.S. and emerging market countries. While the U.S. remains behind the curve in terms of curtailing the spread of the coronavirus, it has been ahead of the curve in terms of stimulus, which has been supportive for its asset prices. Emerging markets are in a tough spot since many countries lack the resources to control the virus as well as the monetary and fiscal space to stimulate their markets.

Our strategy is to hold issuers that we believe have the best fundamentals to survive the coronavirus and its related economic challenges. Taken altogether, we believe Asia to be well positioned in this crisis, given their early control of the virus and space for economic stimulus. We continue to be overweight to Asia high yield, especially to credits which have a positive skew in price. In terms of Asia currencies, we have positioned the portfolio to be slightly long U.S. dollar given our expectations of continued volatility which still favors safe haven currencies such as the U.S. dollar. Among rates, we continue to be overweight countries like Thailand, Malaysia and Indonesia where we think rates are stable and provide attractive carry. Our biggest overweight in interest rates remains in the U.S., where the U.S. Fed has effectively signaled structurally lower rates for the coming quarters to buoy the markets. As the market recovers, we expect the credit spread compression to more than compensate for a mild rise and steepening of the U.S. yield curve.

Rolling 12 Month Returns for the period ended 30 June 2020

Matthews Asia Total Return Bond Fund	**2020**	**2019**	**2018**	**2017**	**2016**
I (Acc) (USD)	0.76%	7.03%	0.64%	8.36%	4.41%
50% Markit iBoxx Asian Local Bond Index, 50% J.P. Morgan Asia Credit Index (USD)	5.22%	9.24%	0.11%	2.00%	6.00%

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 Accumulation 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