Matthews Asia

Matthews Asia ex Japan Dividend Fund

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Period Ended 31 March 2018

For the quarter ending 31 March 2018, the Matthews Asia ex Japan Dividend Fund returned 1.52%, while its benchmark, the MSCI All Country Asia ex Japan Index, returned 0.70%.

Market Environment:

Asia's equity markets were significantly more volatile during the first quarter of 2018, breaking the upward trend of the strong bull market rally we saw in 2017. Uncertainties surrounding the U.S. interest rate hike cycle and the specter of a full-blown trade war between the U.S. and China became the two main sources of the sharp market volatility. Both factors negatively impacted the share performance of Asia equities, despite their improving fundamentals and strong earnings delivery. Equity markets in Southeast Asia were less volatile compared with their North Asia counterparts. Vietnam's equity market notably reached an all-time high during the quarter.

Performance Contributors and Detractors:

During the quarter, Chinese insurance brokerage firm Fanhua was among the top contributors to Fund performance. Over the last two years, Fanhua's management successfully restructured its insurance distribution business mix, and moved away from low-margin auto insurance to focus more on growing its life insurance distribution business. It has especially concentrated on protection-type products, which carry higher margins and for which the underlying commission income is more frequently recurring. With these changes Fanhua's profitability began improving significantly. Since the insurance distribution business is capital-light and does not bear underwriting risk, Fanhua's ability to pay higher dividends is also enhanced with improving profitability. The company recently announced a new dividend policy that raised its minimum dividend payout from 30% to 50%, and instituted a quarterly dividend payment schedule.

Conversely, Chinese auto parts manufacturer Minth Group was among the top Fund performance detractors during the quarter. After demonstrating strong share performance in 2017, market expectations were high for the firm to deliver further earnings upside surprises. While Minth did deliver—showing 21% revenue growth and 18% net profit growth—it actually missed the market consensus and the stock was sold off. While the near-term sentiment over the stock could remain weak, we still favor Minth's long-term growth potential, anchored by its successful product range expansion and its deepening penetration into global auto original equipment manufacturer (OEM) customers. We view the current valuation on the stock as attractive.

Notable Portfolio Changes:

During the quarter, we initiated a position in the Postal Savings Bank of China, originally part of China's vast postal service network. This affiliation gave the bank the widest retail branch network among Chinese commercial banks and thus a very strong retail deposit base. Due to the lack of professional management in the past, the bank's asset mix was not optimized, as reflected in its relative loan-to-deposit ratio compared to peers. We believe that in a tightening monetary environment, its funding advantage would allow it to raise net interest margins. We also initiated a position in a leading real estate broker in Singapore, APAC Realty. We believe its experienced management team can lead its well-trained broker forces to ride the strong rebound cycle of Singapore's residential property market, and deliver strong earnings growth.

During the quarter, we exited a few positions, including two Chinese domestic A-share firms, namely Kweichow Moutai and Midea Group. While we continue to like the business fundamentals of both, which saw strong share performance in 2017, current valuation multiples no longer offer as attractive a risk/reward profile as before. We decided to redeploy capital elsewhere.

Outlook:

Currently, the strong fundamentals and attractive valuations for companies in Asia are being overshadowed by market concerns over a potential trade war between the U.S. and China. If not averted, this trade tussle could have broader economic and geopolitical implications. In terms of our strategy, we think it is prudent to increase the portfolio's defensiveness by introducing additional high dividend-yield stocks with stable underlying cash flow, to balance the portfolio's exposure to dividend growth names. While near-term market conditions could remain volatile, from a dividend perspective the sustained earnings growth and improved cash flow profile of many firms in the region have provided a solid foundation for underlying dividends to help accelerate growth.

Rolling 12 Month Returns for the period ended 31 March 2018

Matthews Asia ex Japan Dividend Fund	**2018**	**2017**	**2016**	**2015**	**2014**
I (Acc) (USD)	32.01%	19.06%	n.a.	n.a.	n.a.
MSCI All Country Asia ex Japan Index (USD)	26.16%	17.82%	n.a.	n.a.	n.a.
I (Acc) (GBP)	17.09%	37.32%	n.a.	n.a.	n.a.
MSCI All Country Asia ex Japan Index GBP (GBP)	12.45%	35.42%	n.a.	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. 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. The Fund invests primarily in equity securities, which may result in increased volatility. There is no guarantee that the Fund or the companies in its portfolio will pay or continue to pay dividends. These and other risks associated with investing in the Fund can be found in the Prospectus.

There is no guarantee that a company will pay or continue to increase dividends.

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

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