Matthews Asia™

Matthews Asia ex Japan Dividend Fund

Period Ended 31 December 2018

For the year ending 31 December 2018, the Matthews Asia ex Japan Dividend Fund returned -12.37%, while its benchmark, the MSCI All Country Asia ex Japan Index, returned -14.12%. For the fourth quarter, the Fund returned -8.66% versus -8.60% for the Index.

Market Environment:

2018 was a year of turbulence for Asian equities. Protracted U.S.—China trade tensions and rising U.S. interest rates became significant overhangs for Asia›s equities and its currencies. Within Asia, China's financial deleveraging campaign, which is designed to rein in excessive shadow banking activities and reduce systemic risk, nevertheless caused a near-term economic slowdown. Facing such external and internal headwinds, investors became increasingly concerned about a potential deceleration in global growth. Most major Asian equity markets suffered steep, double-digit losses. Only individual markets that had lower exposure to global trade but were more driven by domestic consumption, such as India, were able to contain equity market losses.

Performance Contributors and Detractors:

Fund performance in 2018 was lackluster, finishing the full year only slightly ahead of its benchmark. Our approach toward dividend investing is anchored by what we call a "total return" approach—one that balances stable, high dividend-yielding stocks with slightly more cyclical, but higher dividend, growth stocks. Following a very strong 2017 for Asian equities, the Fund's outperformance by some of our dividend growth holdings started to make valuations less compelling. This prompted us to re-position the overall portfolio by gradually reducing some cyclical dividend growth stocks while adding exposure to higher dividend-payout stocks with stable cash flow that were trading at more reasonable valuations. While such rebalancing positively contributed to the Fund's relative outperformance, the year's market volatility was more severe than we initially anticipated. Ultimately, the portfolio struggled to provide better downside protection as we had hoped.

Given the overall fragile market sentiment due to U.S.—China trade tensions, Vietnam has been benefiting and taking market share from China in global exports. We have been aware of and positioned accordingly for this trend for some time. Not surprisingly, two of the top performance contributors, Vinh Hoan and Saigon Beer Alcohol Beverage, are Vietnamese. Vinh Hoan, a consumer staples holding that processes fish products, has gained market share in both the U.S. and China. Its stock performed well as its new controlling shareholder began making decisions over management team changes—these previously were made by government appointment.

On a sector basis, the Fund's overweight in the consumer staples sector and specific stock selection within the information technology sector were the top contributors to performance for the full year. Stable cash flows, strong balance sheets and high dividend payouts all contributed to the defensiveness of the share performance of those stocks, especially amid market turmoil. On the other hand, the Fund's overweight in the consumer discretionary sector was detrimental to its overall performance. Specifically, several of the Fund's auto parts holdings, such as Minth Group, Fuyao Glass Industry Group and Hyundai Mobis, suffered significant share price setbacks, partially due to an overall slowdown in the automobile industry and partially due to investor concerns about their exposure to U.S. tariff risks. For Minth and Fuyao Glass, we believe the de-rating of those stocks was driven by a cyclical factor and we expect their long-term competitiveness to remain intact. In addition to industry cyclicality, Hyundai Mobis's share price underperformance followed a delay of the Hyundai Group's restructuring.

On a country basis, our holdings in China/Hong Kong were the top contributors to Fund performance. The Fund's exposure to India was the top detractor to performance. Both our underweight in India, which held up significantly better than the broad Asia market, and poor stock selection, including companies such as Bharti Infratel, detracted from the Fund's relative performance.

Notable Portfolio Changes:

During the fourth quarter, the Fund initiated a new position in WH Group, a China-based, major global pork processing company with significant business presence both in mainland China and the U.S. WH Group's share price declined significantly in 2018 as the company was caught in the crossfire of the U.S.—China trade spat. An outbreak of African swine fever, a viral disease that spread through China in August, also hurt sentiment toward the stock. We saw WH Group an attractive investment opportunity at its valuation late in 2018. The company's main earnings come from its downstream, branded meat product business (sausage, ham, etc.) in mainland China, which is rather stable and quite cash-generative.

Also during the fourth quarter, we reduced our exposure to sectors that tend to be more sensitive to economic cycles, mostly by reducing our holdings in several energy businesses in the region. The capital was partially redeployed into a few newly initiated positions, including WH Group.

Outlook:

Near-term market volatility is likely to remain elevated as investors grapple with a decelerating Chinese economy and a possible slowdown in U.S. GDP growth. Ironically, such reversals in growth trajectories might pave the way for removing two large external overhangs for Asian equities—a full-blown trade war between China and the U.S. and U.S. dollar strength driven by monetary tightening efforts. A dimmer growth outlook in China and the U.S. could add both incentive and a sense of urgency for the two nations to reach a deal. While the struggle between China and the U.S. goes well beyond just trade deficit issues, a trade compromise that averts an all-out trade war could still significantly reduce market uncertainty. Similarly, if the U.S. dollar starts to weaken on the back of less hawkish U.S. Federal Reserve policy, emerging markets, including Asia, could also start to recover. Chinese policymakers have already prioritized the stabilization of the country's economic growth with both fiscal policy support and more accommodating monetary conditions. A combination of the above policy outcome, together with an Asian equity valuation that is already well below its long-term average after the 2018 sell-off, could set the stage for an equity market recovery. However, investors should be mindful that policymakers are walking a tightrope, leaving little room for making policy errors. Therefore, while the current market sell-off is giving us an increasing number of attractive investment opportunities, we believe it is prudent to position the portfolio neutrally between dividend growth and dividend yield at this juncture.

Rolling 12 Month Returns for the period ended 31 December 2018

Matthews Asia ex Japan Dividend Fund	**2018**	**2017**	**2016**	**2015**	**2014**
I (Acc) (USD)	-12.37%	47.29%	6.89%	n.a.	n.a.
MSCI All Country Asia ex Japan Index (USD)	-14.12%	42.08%	5.76%	n.a.	n.a.
I (Acc) (GBP)	-7.38%	34.23%	28.50%	n.a.	n.a.
MSCI All Country Asia ex Japan Index (GBP)	-8.78%	29.78%	26.15%	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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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

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