Matthews Asia

Matthews India Fund

Period ended 31 March 2019

For the quarter ending 31 March 2019, the Matthews India Fund returned 6.12% while its benchmark, the S&P Bombay Stock Exchange 100 Index, returned 6.62%.

Market Environment:

In February, investor sentiment in India's stock market improved sharply. Despite the losses in state elections faced by the ruling national political party led by Prime Minister Narendra Modi, market participants were optimistic about his return to power. The strong and decisive response by Modi to carry out air strikes inside Pakistan bolstered support for Modi, whose government has turned populist. As part of the interim budget in January, Modi announced an income-support program for small farmers that would pay them 6,000 rupees (approximately US$85) per year.

India's market delivered positive stock returns despite slowing GDP growth, weak industrial production and rising oil prices. Emerging market stocks have seen greater investor appetite globally following the U.S. Federal Reserve's abrupt switch from tighter monetary policy to maintaining the status quo. This has manifested not just in the improved performance of emerging market equities but also in emerging market currencies, which appreciated against the dollar. India's central bank seems to have adopted a more dovish monetary policy and already delivered an unexpected rate cut in February.

Performance Contributors and Detractors:

The portfolio's higher allocation to small-cap stocks versus its benchmark hurt relative performance during the first quarter. By sector, our higher allocation to consumer discretionary, especially auto stocks, posed a drag on relative performance, while our avoidance of the energy sector and stock selection within health care were also performance detractors. The pricing sentiment within the pharmaceuticals industry has not improved materially within export markets and the domestic market is still recovering from the lows seen after the introduction of India's Goods and Services Tax. Within autos, both our holdings—Japan's Suzuki Motor and Eicher Motors—have seen significant increase in costs arising from revised insurance and safety regulations, which affected volume growth as they passed costs on to customers. This should reverse in the medium term once consumer sentiment and affordability improve.

Stock-specific factors within the financials, materials and industrials sectors partially mitigated our relative underperformance. We had been adding to Yes Bank last year when it was undergoing a rough patch, especially in its dealings with the central bank, as we believed that these issues were temporary and not structural in nature. Similarly, we had been adding to our position in chemical maker UPL last year, which makes products for global crop protection, when the market was overly concerned, in our opinion, with its acquisition of a peer firm. Considering our estimation of the synergies and our assessment of the acquisition price, we saw the market as too fearful, and market worries appeared to ease during the quarter.

Notable Portfolio Changes:

During the first quarter, we did not exit any holdings. We did, however, add a few small-capitalization stocks across the financials and information technology sectors, which appear to have significant headroom to grow in the years to come.

Outlook:

We believe volatility in the short term is likely to persist. The outcome of upcoming elections is far from certain given the alliances within regional parties, the distress in rural India and the extent of monetary promises being made by opposition parties. Monetary policy is expected to stay loose as consumer price inflation has remained muted alongside slowing GDP growth and easing pressure from a strong U.S. dollar. Risks for inflation over the medium term, however, continue to build as a fiscal deficit is likely to expand regardless of which political party comes to power given widespread expectations for farm loan waivers and direct-income support to beleaguered farmers.

Since the corporate credit cycle has peaked and most corporate banks are on a path to improving their balance sheets, a revival in India's private capital expenditure is anticipated on the back of lower cost of capital and greater availability of capital for corporate investments. Capacity utilization in the manufacturing sector, however, has remained stagnant at approximately 75%—which implies improvement over the medium term. Valuations across the board are running above long-term averages, with the highest valuations among small-capitalization stocks. Risk of disappointment is fairly high given the historically high earnings growth expectations that are reflected by these valuations.

Rolling 12 Month Returns for the period ended 31 December 2018

Matthews India Fund	**2018**	**2017**	**2016**	**2015**	**2014**
I (Acc) (USD)	-9.78%	37.88%	-3.05%	-2.73%	54.46%
S&P Bombay Stock Exchange 100 Index (USD)	-6.00%	41.88%	2.32%	-6.41%	31.40%
I (Acc) (GBP)	-4.76%	25.78%	16.54%	2.28%	63.93%
S&P Bombay Stock Exchange 100 Index (GBP)	-0.23%	29.51%	22.13%	-1.02%	39.60%

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 currency, 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. Investments in a single-country fund may be subject to a higher degree of market risk than diversified funds because of concentration in a specific country. 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

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Investors should ascertain from their professional advisers the consequences of investing in the Fund 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 the Fund before making an investment decision. The current prospectus, Key Investor Information Document or other offering documents ("Offering Documents") contain this and other information. Applications for shares may only be made on the Fund's most recent Offering Documents which are available from Matthews International Capital Management, LLC. Please read the Offering Documents carefully before investing.

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