Matthews Asia

Matthews India Fund

Period ended 30 September 2018

For the quarter ending 30 September 2018, the Matthews India Fund returned -8.34% while its benchmark, the S&P Bombay Stock Exchange 100 Index, returned -3.89%.

Market Environment:

India, which continues to be heavily dependent on imports for its energy needs, has seen market turmoil this year amid a weak currency, rising oil prices and a liquidity squeeze in the third quarter. The rupee depreciated by nearly -12% against the U.S. dollar from January through the end of September as oil prices increased by over 23% amid global supply shocks. India's central bank attempted to intervene to stem a sharp fall in the rupee but that led to a liquidity shortage, which was exacerbated by a leading infrastructure finance company defaulting on its bond payment. That, in turn, elevated funding and refinancing risks for many of India's other non-banking financial companies.

Despite rising oil prices, inflation and economic growth data were generally positive in India for the quarter. Inflation eased to an 11-month low in August, which may have been the reason India's central bank held interest rates unchanged during the first week of October, after raising benchmark rates during its previous two policy meetings. India's GDP accelerated to 8.2% in the second quarter of the year versus 7.7% in the previous quarter.

Performance Contributors and Detractors:

The portfolio's higher allocation to small and mid-cap stocks hurt the Fund's relative performance against its benchmark. The underperformance was partially mitigated by stock-specific factors. In recent years, we have trimmed expensive small and mid-cap stocks as their valuations ran ahead of fundamentals. We continue to hold significant exposure to smaller companies, however, as we appreciate their long-term prospects. Even at a fundamental level, however, India's smaller firms have had a harder time adjusting to the shocks of demonetization and the Goods and Services Tax (GST), compared to their larger peers.

By sector, the portfolio's higher allocation to the consumer discretionary sector and lower allocation to the energy sector, compared to its benchmark, were also detractors during the third quarter. The benchmark's energy sector performance was driven by Reliance Industries, an Indian conglomerate engaged in petrochemicals, textiles, natural resources, and telecommunications. Reliance has benefited recently from its foray into India's telecom segment, where it has been able to win significant market share. This increased competition in telecom has eroded what little profitability the sector had, and the portfolio's avoidance of the telecom sector helped mitigate the Fund's underperformance. Some auto firms suffered from recent changes to regulations, the weakening rupee and rising commodity prices. This culminated in higher costs for the industry, however, our stock selection in the consumer discretionary sector helped our relative performance. During the quarter, India's credit markets took a hit after Infrastructure Leasing and Financial Services (IL&FS), a major financier of infrastructure and power plants, announced a default. The portfolio's higher allocation to non-banking financials became a detractor to performance given the liquidity concerns that resulted.

For the year-to-date period, our lack of allocation to utilities and metals, and higher allocation to consumer staples were performance contributors amid a volatile market. For the third quarter of the year, our zero allocation to utilities was a detractor.

Notable Portfolio Changes:

During the quarter, we initiated a position in Wipro, an information technology services corporation. We feel optimistic about changes under its new management team, which we believe will bring greater accountability, spur business growth and, over time, improve margins.

We exited out of Taro Pharmaceutical Industries during the quarter, as we anticipate pricing pressure to continue on the back of customer consolidation and increased competition in dermatology.

Outlook:

Looking ahead, on the positive side, India's economic and earnings growth should continue to recover from the shocks of the GST and demonetization across industries, with the exception of financials, where state-owned banks may continue to see losses amid credit costs. At the same time, the uncertainty surrounding elections at the state and national level; currency weakness; high oil prices; and rising interest rates amid valuations that are still ahead of their historical averages could weigh on short-term market movements.

We feel that the market has been overly concerned with liquidity issues pertaining to non-banking financials, which may increase the cost of funding for most players but may not disrupt their business models. We have seen past instances of liquidity squeezes occur fleetingly, and believe that well-run companies should be able to recover quickly from such shocks. If anything, the volatility creates opportunities to hold shares of good companies at lower valuations in an otherwise expensive market.

Rolling 12 Month Returns for the period ended 30 September 2018

Matthews India Fund	**2018**	**2017**	**2016**	**2015**	**2014**
I (Acc) (USD)	-4.64%	15.36%	3.97%	4.22%	62.58%
S&P Bombay Stock Exchange 100 Index	-0.09%	18.59%	9.45%	-3.57%	43.97%
I (Acc) (GBP)	-2.05%	11.55%	21.91%	11.04%	62.28%
S&P Bombay Stock Exchange 100 Index (GBP)	2.63%	14.83%	27.71%	3.37%	43.54%

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.

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

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