Matthews Asia

Matthews Pacific Tiger Fund

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Period ended 31 March 2018

For the quarter ending 31 March 2018, the Matthews Pacific Tiger Fund returned -1.91% while its benchmark, the MSCI All Country Asia ex Japan Index, returned 0.70%.

Market Environment:

Asia's markets continued their upward momentum in early January. Broad-based synchronized global growth across most developed countries and major Asian economies set the stage for a strong start to the quarter. Cyclical sectors including financials, energy and materials benefited from prospects of growth, improvement in profitability of many previously stressed sectors in China and a continued rise in exports and purchasing manager indices. Mid-quarter, however, volatility in equity markets picked up. This volatility was fueled in part by U.S. interest rate increases, as well as the reemergence of protectionist rhetoric in the U.S. The resulting correction in the U.S. stock market impacted markets across Asia.

Chinese equities posted the strongest gains in 2017 and started 2018 by leading the pack. The key driver for gains in stock prices was an improvement in earnings across many sectors in China. China's policymakers have shown improved discipline on supply-side consolidation without impacting growth. In addition, the continued structural growth of the Chinese middle class is benefiting many service-oriented sectors, providing a strong backdrop for China's economy.

Our team visited India during the quarter, meeting with a cross section of businesses, including many financial services companies. We learned that risks emanating from various reforms, including demonetization and the Goods and Services Tax (GST), seemed to be receding. Accordingly, we believe earnings for Indian companies have the potential to improve going forward. At the same time, the macroeconomic outlook in India seems to have slipped. The federal budget deficit came in higher than the market expected, while a massive public sector bank scandal also came to light, dampening investor sentiment. The scandal was yet another reminder to us that state-owned banks historically have been poorly managed. As state-owned banks account for the bulk of India's bank deposit assets, they are unfortunately constraining overall growth. In contrast, private sector banks, where we have our capital deployed, continue to do a better job of allocating capital and protecting against leakage.

Performance Contributors and Detractors:

Our portfolio trailed the Index during the quarter. Key performance gaps emerged due to the portfolio's underweight in the information technology (IT) sectors, including the absence of businesses in technology hardware and smaller positions in Chinese internet companies. A few portfolio positions in India and South Korea experienced what we expect to be temporary price declines for reasons specific to each individual company. India's Tata Power has tried to clean up its balance sheet and restore the true value of its utilities franchise. Its stock, however, pulled back due to negative sentiment around one of Tata's legacy projects. Our investment in Chinese Resources Beer Holding was the largest positive contributor to absolute performance during the quarter as the company has benefited from early signs of consolidation and pricing discipline in the sector.

Notable Portfolio Changes:

During the quarter we made some portfolio adjustments, including exiting a few positions. Online publishing firm China Literature was a small IPO allocation that we were not able to build at the right valuations. We may revisit it should we find more appropriate valuations, and after observing its monetization abilities. We also exchanged our position in U.S. fast food company Yum Brands for Yum China Holdings. These two positions were a consequence of the split of the original combined company that we had invested in due to our desire to buy Yum's China business.

By country, we have allocated more capital into Indonesia on an incremental basis. Indonesian businesses have pulled back over the past few years and are now available at more attractive valuations. We also see green shoots of economic growth in Indonesia. Employment levels are improving as commodities-related sectors start to expand following an extended price rally in commodities. Consumer and health care businesses are two areas where we are beginning to deploy capital in Indonesia.

Outlook:

News of trade conflicts picked up again during the quarter. Should trade issues not be well-managed, they could be detrimental to global growth and global equities. To date, however, we have seen measured responses from China. At the Davos World Economic Forum in January, for example, Liu He, China's top economic advisor to President Xi Jinping, made public comments that suggested strong support for global trade. Our investment strategy has a structural bias toward domestic demand-oriented businesses, which may be more insulated against trade issues than companies in export-driven sectors.

Corporate earnings across Asia have been improving over the past 12 to 18 months. Earnings growth, which started with cyclical sectors, such as IT, is now expanding to a broader range of sectors. In addition, elections cycles will pick up over the next two years in many countries, including India, Indonesia, Malaysia, Taiwan and the Philippines. Elections have the potential to create market volatility. At the same time, incumbent governments tend to increase spending during election cycles, which can be supportive of underlying fundamental demand and provide further support to earnings improvement.

Looking ahead, we see a healthy environment for equity markets with reasonably strong growth. We also expect to see reasonable valuations, backed by continued improvements in earnings. In our view, emerging markets may be poised for stronger earnings growth than developed markets. The U.S. Federal Reserve has signaled that it is likely to increase short-term interest rates. However long-term interest rates continue to be stable and should not disrupt Asia's domestic economic cycle, especially given healthy consumer balance sheets. Underlying continued productivity improvements, a positive wage cycle and increasing spending power of the middle-class in most of our markets continue to keep us excited about domestic demand-oriented businesses in Asia.

Rolling 12 Month Returns for the period ended 31 March 2018

Matthews Pacific Tiger Fund	2018	2017	2016	2015	2014
I (Acc) (USD)	21.93%	11.95%	-8.01%	16.33%	3.67%
MSCI All Country Asia ex Japan Index (USD)	26.16%	17.82%	-11.59%	11.02%	3.07%
I (Acc) (GBP)	8.15%	29.09%	-5.52%	31.09%	-5.78%
MSCI All Country Asia ex Japan Index GBP (GBP)	12.45%	35.42%	-8.69%	24.68%	-6.13%

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. 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