Matthews Asia

Matthews Asia Perspective

Asia ex Japan: There Could Be a Turnaround on the Horizon

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After a turbulent year for Asian equities in 2018, which saw the MSCI All Country Asia ex Japan Index fall 14.12%, the first quarter of 2019 has been much more rewarding for investors as the backdrop for Asian equities improved thanks to easing fears concerning trade tensions, a pause in the U.S. rate hikes and new monetary and fiscal policy measures coming out of China.

Year to date, the MSCI AC Asia ex Japan Index is up 11.45%, while over the same time period the Matthews Asia ex Japan Dividend Fund returned 10.86%.[1] However, despite macro improvements and a strong rebound in Fund performance, we made few changes to the portfolio in the first quarter of the year.

Asia is beginning to enter a late stage earnings cycles, with consensus expecting either flat or slightly negative earnings per share growth (EPS) for equities in 2019. This uncertainty regarding earnings sustainability, combined with the need for fundamentals in the region to improve further, means we are reluctant at this stage to position the portfolio more aggressively.

Our approach to dividend investing balances stable, high dividend-yielding stocks with slightly more cyclical, but higher dividend growth stocks. This flexible approach not only allows us to capture attractive opportunities, but has also helped to navigate market volatility, such as we saw in 2018.

Over three years to 31 March 2019, the Fund displayed lower volatility than the benchmark, with standard deviation of just 11.95% versus 13.09% for the MSCI Asia ex Japan Index. However over the same time period the Fund has outperformed, with an annual return of 14.57% versus 12.21% for the index.

Since we launched the Fund in November 2015, the balance between stable dividend payers and fast-growing dividend payers has shifted depending on market conditions. Last year the portfolio was repositioned to have a roughly even split between the two, a stance we maintained throughout the first quarter. Our view is that if we reach a trade war resolution, which is by no means certain, more than half of this has already been priced into valuations. As a result we need to be slightly more cautious on what today represents an attractive opportunity.

We could adjust our positioning slightly as different sectors and different companies provide alternative earnings profiles at the early stage of the earnings cycle versus the latter stages, but if people are already pricing in an earnings recovery our stance will be less aggressive.

Spikes of volatility do not change my view that relatively speaking conditions in Asia are beginning to recover and improve. We will likely use these shots of volatility to increase our exposure to dividend growth names that were previously quite expensive. If volatility brings down the valuation of these good structural names, I will happily deploy additional capital.

Two of the stocks added to the portfolio in the first quarter fit into this category. One sits in the consumer business sector, the other is a consumer discretionary. In both cases it was volatility that brought down their valuations.

While year-to-date the portfolio has not changed hugely, we did increase our exposure to Chinese A-shares. We think China's recovery looks more sustainable compared with 2015, when it underwent a quick boom and bust cycle owing to leveraged liquidity going into the stock market. This time the recovery is mainly the result of the market opening up to foreign investors and the MSCI's increased weighting to Chinese A-shares, while leveraged liquidity is being better controlled by regulation. As a result some of the A-Shares are beginning to look more reasonably priced after last year's correction.

1 As of 31 March 2019, in U.S. dollar

Geographically, while we do consider macro factors when making long-term investment decisions, the Fund is very much a bottom-up driven strategy. The portfolio's large overweight in some of Asia's frontier markets, such as Vietnam and Bangladesh, is where we have been able to find a number of companies that in our view have strong business models, are well-run by competent management teams and are offering an attractive combination of high dividend yields and fast growth in the underlying dividends. From a country perspective Vietnam remains the Fund's largest overweight position. While the market has lagged year-to-date, especially compared with China, the Fund's Vietnamese holdings continue to operate steadily from both a macro and bottom-up level.

Annual returns for the 12 month period ended 31 March	2019	2018	2017	2016	2015
Matthews Asia ex Japan Dividend Fund (I Acc, USD)	-4.31%	32.01%	19.06%	n.a.	n.a.
MSCI All Country Asia ex Japan Index (USD)	-4.95%	26.16%	17.82%	n.a.	n.a.

All performance quoted represents past performance and is no guarantee of future results. Investment return and principal value will fluctuate with market conditions so that when redeemed, shares may be worth more or less than the original cost. Current performance may be lower or higher than performance shown. Investors investing in funds denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal. Performance details provided are based on a NAV to NAV basis with any dividends reinvested, and are net of management fees and other expenses. Volatility is the standard deviation of returns.

Source for 12 month period returns: Brown Brothers Harriman (Luxembourg) S.C.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.

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