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Matthews Asia

Matthews Asia Perspective

Matthews Asia ex Japan Dividend Fund Reaches a Three-Year Milestone

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Matthews Asia Portfolio Manager Yu Zhang explains why the Fund outperformed in a challenging environment.

Amid rising volatility, increasing U.S. interest rates and escalating China–U.S. trade tensions, the three years following the launch of the Matthews Asia ex Japan Dividend Fund have been anything but plain sailing for Asia investors. Yet since inception, the Matthews Asia ex Japan Dividend Fund delivered an annual performance of 12.08% versus 9.7% from the MSCI Asia ex Japan Index through 30 November 2018.

Prior to the Fund's launch in November 2015, general sentiment toward Asia equities was poor. China A-shares had experienced a dramatic correction and worries were rife that China's financial system was about to collapse. Meanwhile, corporate earnings across Asia delivered negative growth. Given these factors, it is no surprise that the region saw significant investor outflows during that time.

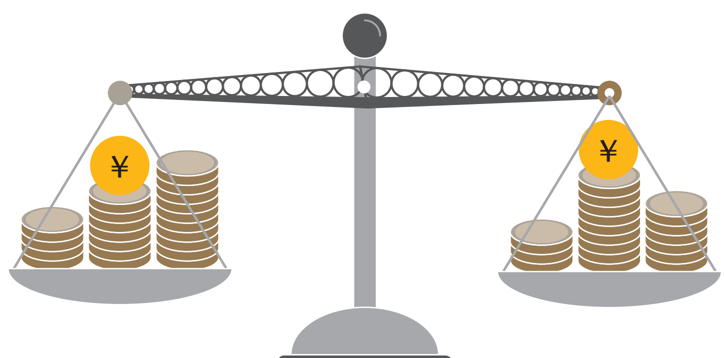
Yet cycles come and go very quickly in Asia. The weakness in 2015 was replaced by a corporate earnings recovery at the end of 2016, and a sustained rally throughout 2017. 2018 has been a more challenging year, yet portfolio construction has allowed us to navigate these volatile periods. The end result is that the Fund is ahead of its benchmark in the three years since it launched.

The Fund seeks to generate returns from an attractive dividend yield as well as capital appreciation. It contains a mix of stable dividend payers and slightly more cyclical, faster-growth dividends stocks, with the balance depending on where the investment team can find value in the market. This flexible investment approach has not only allowed us to capture attractive opportunities, but has also helped us to navigate market volatility

When it comes to portfolio construction, we look for companies with strong growth, a robust business model, plentiful free cash flow and a management team that is willing to pay dividends–and is looking to grow them over time.

We see dividends as an important indicator of company quality. While regular income payments are a nice reward for holding stocks of a particular business, they also are a

Balance stable dividend payers with dividend growers



Dividend payers
Often found in mature industries, such as telecoms, utilities, infrastructure assets and consumer staples.

Dividend growers
Often small- to mid-cap companies that occupy strong market positions in areas that cater to the growing middle class, such as consumption, services and health care.

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.

key component in understanding the quality of cash generation, the strength of the business model, corporate governance practices and overall shareholder engagement.

We favour companies where the management has "skin in the game," especially owner-operator firms. Not only are the founders heavily invested in the success of their firm, with a focus on long-term success over short-term profits, but they are often motivated by more than money. And they want to engage shareholders who can share their success.

Finally, we seek to invest in companies that are reasonably valued and boast sustainable businesses. As a general rule, many of the highest dividend payers are in cyclical sectors, such as oil and mining. This typically means patchy returns–and losses if conditions turn. By contrast, we see more opportunities in the consumer staples and discretionary sectors, which offer a good blend of income and growth, and financials, telecoms and utilities for income and safety.

A flexible investment approach generated performance

Throughout the three years, the mix of stable dividend payers and fast-growing dividend payers has shifted depending on market conditions. Negative sentiment toward Asia equities allowed us to add heavily discounted dividend growth companies to the portfolio in late 2015. In the second half of 2016, some macroeconomic indicators and policy directions pointed toward a potential inflection point within the Asian economy. As a result, we continued to tilt the portfolio toward dividend growth, adding exposure to the financial and consumer discretionary sector.

We also increased the Fund's exposure to small-cap information technology (IT) stocks. Despite the Fund's underweight to IT (it does not invest in large internet companies as they tend to not pay significant dividends), our allocation to small-cap technology stocks was one of the biggest contributors to performance in 2017.

Heading into 2018, the portfolio was balanced more evenly between dividend growers and payers. This reflected the more cautious stance we adopted since the return of market volatility in early 2018, with uncertainty sparked by the U.S. interest rate cycle and the U.S.-China trade dispute.

Year to date, we have reduced exposure to certain cyclical dividend growers, including China A-share stocks, as they looked too expensive after a strong run in 2017. Similarly, we also trimmed our holdings of some South Korean small-cap companies, which outperformed that year.

Over its three-year history, the Fund has been consistently overweight in consumer-oriented businesses. We like their ability to generate free cash flows, and our focus is on companies that are willing to share their free cash flow in the form of a rising and consistent dividend. These types of companies are often found in the small-cap and mid-cap space.

Despite a volatile environment, many of these consumer businesses maintained their ability to deliver earnings growth, which led to better share prices performance than the overall market. In addition, some large-cap consumer staple and consumer discretionary stocks, which we owned since 2015, and more obviously in 2017 China A-shares became significant drivers of Fund performance.

A weighting to Frontier Asia also added to the portfolio's risk-adjusted returns. Approximately 10% of the portfolio has been invested in Vietnamese companies for some time. This allocation has not only generated performance but also diversified the risk of the portfolio versus the rest of the Asia ex Japan region.

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.

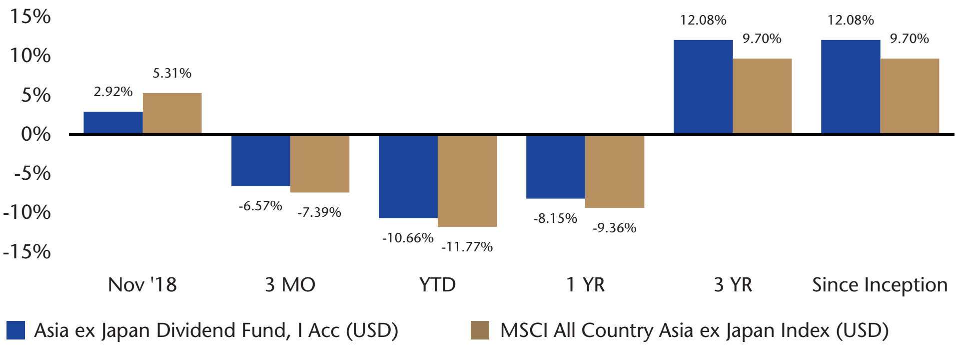
In our view, China's economy will mature over the next three to five years, spelling an end to its high growth phase. As a result, its capital markets could become more rational and less short-term driven as China A-shares become a more meaningful part of international portfolios. In addition, we believe that investors will increasingly look to Asia's emerging and frontier markets for investment opportunities. Economies such as Vietnam and Bangladesh are likely to become more mainstream in Asia portfolios.

One benefit of taking a total return approach to Asia is that it can capture both growth and income. But we believe that dividends offer additional benefits when it comes to investing: a valuation anchor; some comfort that the business is generating cash; and an idea of the corporate governance of the business. As dividend-paying stocks tend to be conservatively run, they generally do not lead the market in bull runs. But that strong management discipline is a defensive protection when markets fall.

This has been the case for the Fund, which experienced less drawdown than the broader market in 2016. In 2017, the situation was reversed with the market performing strongly, yet as a result of individual stock picking the Fund outperformed the benchmark in this environment as well.

In our view, what we have ultimately proved with the strategy since launch is that growth and income do not have to be mutually exclusive in Asia. Asia's dividend pool is now slowly but surely approaching the size of Western markets, and as Asia's capital markets broaden and deepen, the opportunity set should only increase.

Performance as of 30 November 2018



	Inception Date	Nov '18	3 MO	YTD	1 YR	Average Annual Total Returns 3 YR	5 YR	10 YR	Since Inception
Matthews Asia ex Japan Dividend Fund (USD)	30/11/15	2.92%	-6.57%%	-10.66%	-8.15%	12.08%	n.a.	n.a.	12.08%
MSCI All Country Asia ex Japan Index (USD)	n.a.	5.31%	-7.39%	-11.77%	-9.36%	9.70%	n.a.	n.a.	9.70%
Matthews Asia ex Japan Dividend Fund (GBP)	30/11/15	2.86%	-4.88%	-5.26%	-2.99%	18.33%	n.a.	n.a.	18.33%
MSCI All Country Asia ex Japan Index (GBP)	n.a.	5.47%	-5.66%	-6.46%	-3.83%	15.92%	n.a.	n.a.	15.92%

ROLLING 12 MONTH RETURNS (for the period ended 30 September 2018)

	2018	2017	2016	2015	2014
Matthews Asia ex Japan Dividend Fund I (Acc) (USD)	11.01%	19.06%	n.a.	n.a.	n.a.
MSCI All Country Asia ex Japan Index (USD)	1.74%	23.02%	n.a.	n.a.	n.a.
Matthews Asia ex Japan Dividend Fund I (Acc) (GBP)	13.95%	15.25%	n.a.	n.a.	n.a.
MSCI All Country Asia ex Japan Index (GBP)	4.67%	19.11%	n.a.	n.a.	n.a.

Source: Brown Brothers Harriman (Luxembourg) S.C.A.

PORTFOLIO BREAKDOWN (%) as of 30 November 2018)

Sector Allocation(%)	Fund	Benchmark	Difference
Consumer Discretionary.	18.7	12.2	6.5
Consumer Staples	17.8	4.9	12.9
Industrials	16.5	7.0	9.5
Information Technology	10.8	16.9	-6.1
Communication Services	9.8	12.9	-3.1
Real Estate	5.9	6.1	-0.2
Financials	4.6	24.0	-19.4
Energy	3.6	4.9	-1.3
Materials	3.5	4.7	-1.2
Utilities	3.2	3.3	-0.1
Health Care	2.8	3.0	-0.2
Cash and Other Assets, Less Liabilities	2.8	0.0	2.8

Sector data based on MSCI's revised Global Industry Classification Standards. For more details, visit www.msci.com.
Source: FactSet Research Systems

Country Allocation (%)	Fund	Benchmark	Difference
China/Hong Kong	47.4	47.1	0.3
Vietnam	11.3	0.0	11.3
Taiwan	11.2	13.0	-1.8
South Korea	8.8	16.0	-7.2
Singapore	5.3	4.0	1.3
Thailand	5.3	2.8	2.5
India	3.2	10.6	-7.4
Philippines	1.8	1.2	0.6
Bangladesh	1.6	0.0	1.6
Indonesia	1.3	2.6	-1.3
Malaysia	0.0	2.7	-2.7
Pakistan	0.0	0.1	-0.1
Cash and Other Assets, Less Liabilities	2.8	0.0	2.8

Source: FactSet Research Systems

Market Cap Exposure (%)	Fund	Benchmark	Difference
Mega Cap (over $25B)	13.0	52.7	-39.7
Large Cap ($10B-$25B)	12.7	24.0	-11.3
Mid Cap ($3B-$10B	16.4	19.6	-3.2
Small Cap (under $3B)	55.1	3.8	51.3
Cash and Other Assets, Less Liabilities	2.8	0.0	2.8

Source: FactSet Research Systems

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.

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