Q&A from Matthews Asia Funds

April 2017

Matthews Pacific Tiger Fund

Q **What does Matthews Pacific Tiger Fund try to achieve for investors?**

A The Matthews Pacific Tiger Fund seeks to generate long-term capital appreciation in an all-cap portfolio that is invested in the Asia ex-Japan region. The Fund aims to achieve its objective by investing in quality, growth companies that can deliver sustainable earnings growth over time, with due regard for valuations and without taking undue risk.

Q **What is the philosophy and approach of the Fund?**

A The investment philosophy of the Fund consists of the following two principles: (i) that an investment horizon of at least three to five years provides long-term value-creation opportunities, and (ii) that the structural growth drivers of Asia continue to support the expansion in domestic demand, including consumption and services activity.

The team utilizes a bottom-up fundamental investment process and seeks companies that have a sustainable competitive advantage in their respective ecosystems. The goal is to invest in companies that are capable of generating durable growth across cycles accompanied by strong profitability and cash flows. Our approach begins with ideas generated from research trips to Asia, idea-sharing with other portfolio managers at Matthews Asia, and screens for fundamental characteristics discussed in more detail below. We evaluate companies based on three criteria—strength of the underlying business, quality of management and valuation.

As an outcome of the investment process, there are certain attributes that are visible across the portfolio holdings: 1) an emphasis on quality over price, 2) all-cap but with a strategic focus on smaller to mid–size businesses, and 3) bias toward sectors like consumer, financials and health care.

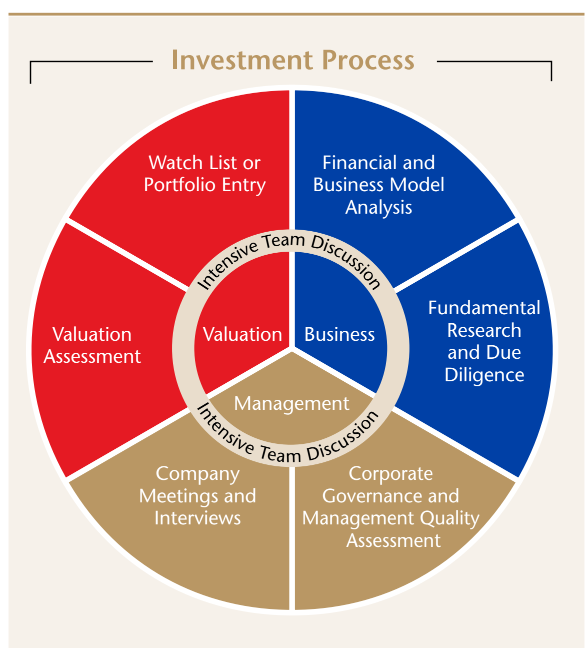
Q **How do you define your focus on quality?**

A In order to evaluate the quality of a business, we identify companies that can sustainably grow earnings and cash flow through various economic and market cycles. We also look for competent management teams with a credible strategy and the ability to execute, and a deep understanding of corporate governance practices. We then value the business as a whole in the context of its expected prospects. Attractive valuations grounded in realistic future expectations are a must.

Assessment of the quality of a company's business team is a process that includes quantitative analysis of its fundamental drivers and a review of the competitive landscape. These drivers include sales and earnings growth, margin trends, return on invested capital, and free cash flow growth. We also assess balance sheet strength, the nature and level of a company's liabilities, and how it finances itself, in order to determine its ability to survive various economic cycles. We prefer companies with high and sustainable returns on invested capital above their cost of capital.

Assessment of the quality of the management is a multivariate process that includes both quantitative and qualitative factors like the incentive structure of the management team, composition of its board, history of capital raising, and shareholder return policies. Given the long-term holding periods, it is vital that we develop a positive view of the governance practices before investing in a company.

Company visits are an essential part of our process and, across the broad Matthews Asia investment team, we conduct more than 2,500 company meetings each year. Company meetings provide us the opportunity to (1) understand a firm's management strategy, track record and long-term business prospects, and (2) assess a company's governance standards. We believe that by investing in quality companies we have the potential to yield impressive returns with a lower risk of permanent loss of capital.



Matthews Asia

Q **What are the benefits of long-term investing?**

A We have learned over the past two decades since the Matthews Pacific Tiger strategy launched that, in Asia there is an excess return to patience. Our emphasis is on the long-term compounding of the economic spread (defined as the return on capital over the cost of capital) as compared to continuously arbitraging valuation multiples.

It is rare to see a business plan being executed in a linear or straightforward manner, and in our experience, it is difficult to time the inflection points accurately, as well as in a repeated manner.

As Matthews Asia is an independent and privately held company, this creates a supportive environment for the long-term investment horizon that we apply to stock selection and portfolio construction. We are aligned with clients when we think about the best long-term interests of our portfolios.

Q **What role do small and mid-cap stocks play in the portfolio?**

A We see good opportunities for growth in the region's faster-growing services sectors as well as from Asia's frontier and emerging countries. The market capitalization of companies operating in these sectors, however, tends to be smaller than those in the commodities and industrials sectors and they are underrepresented in benchmark indices. We view this as an opportunity as such stocks have long been a fertile area for idea generation. Small and mid-cap stocks play an important role in the portfolio, and we maintain a strategic allocation to these firms as we believe they have the potential for sustainable growth.

Q **How important is the role of the benchmark in portfolio construction?**

A We do not use benchmarks as a basis for portfolio construction or optimization. Our view is that Asia's equity indices can be backward-looking and not representative of the industries and companies that we believe will be successful in the future. With this approach, there is a risk that the Fund may underperform the benchmark in certain market conditions. However, we believe in adopting a benchmark-agnostic mindset as a way to avoid excesses in the market and delivering long-term performance for our shareholders.

Q **How is the portfolio positioned to benefit from the long-term structural growth story in Asia?**

A When we launched the Strategy over two decades ago, we were increasingly cognizant that a virtuous combination of savings and investing was likely to propel Asia to become one of the world's most dynamic growth regions. In the past two decades, rising income levels, continuing productivity gains and increasing urbanization have all led to significant wealth creation for the Asian household.

With this in mind, the Fund has significant exposure to domestically oriented businesses, including consumer staples and consumer discretionary, information technology, financials and health care companies. We tend to have low exposure to businesses, such as commodities and materials companies.

Our emphasis is to identify service-oriented firms that are conservatively managed and can build a quality franchise to satisfy the needs of consumers in the everyday market. Health care, for example, is an underrepresented sector in the Asian region. We believe that as consumers accumulate wealth, there will be greater demand for better health care facilities and access to medical insurance, and we see an opportunity to invest in businesses that are addressing this growing need.

As countries in Asia are at varying stages of their economic development and reform processes, our country allocations are also consistent with our focus on domestic demand. As such, the Fund has meaningful exposure to faster-growing economies including India and the Association of Southeast Asian Nations (ASEAN), while being underweight export-oriented economies like Taiwan. Our country and sector allocations, however, are a result of our bottom-up investment process, and there are no country or sector-weighting constraints.

Q **Some investors hold the impression that consumer stocks and quality stocks are expensive. What is your perspective on valuations for those sectors?**

A Quality businesses with strong market positions typically have a premium associated with them, not just because of superior growth, but also because of greater durability in their operating fundamentals. Given the uncertain economic climate over the past few years, the valuation differentials have widened between companies perceived to have better quality than the rest of the equity markets. However, this trend has not been universal. In particular, concerns over China have dampened the valuation on several companies that meet our quality threshold while other markets in the region may be trading at higher valuation levels. One of the ways that we combat these valuation-driven anomalies without sacrificing quality is to maintain a flexible, unconstrained approach of looking for businesses that have an appropriate combination of long-term prospects and value.

In our experience, unique quality franchises that have a significant potential for growth can compound wealth for very long periods of time. We assess valuations using various frameworks to capture the long-term growth potential of such franchises rather than get overly fixated on near-term multiples.

Q **China plays a significant role in the Matthews Pacific Tiger Fund. How does the team get comfortable with the volatility of Chinese stocks, and what role will A-shares play in the portfolio going forward?**

A China will continue to play a key role in the Matthews Pacific Tiger Fund as we seek consumption and services-related growth in that economy.

2015 marked the Fund's first investment in the Chinese A-share market. While we acknowledge the higher volatility and uneven liquidity in the market, the gradual opening of China's domestic markets expands the subset of companies available, particularly in consumer-related and health care sectors. Over time, we anticipate the portfolio's exposure to A-shares to be modest, and it should be viewed as another means of accessing services-led growth in China. For now, the majority of our China-related investments are made through Hong Kong-listed stocks. It is worth emphasizing the difference in volatility of the share price versus volatility in the operating performance of the companies. It is our belief that the process of building stronger regulatory institutions, and improving corporate governance standards will eventually lead to a better reflection of operating fundamentals on stock price performance.

Q How has the investment landscape in Asia changed since the inception of the Matthews Pacific Tiger Strategy in 1994?

A The investment landscape in Asia has become increasingly dynamic as capital markets have become more entrenched in the financial ecosystem. As capital markets have deepened, Asian companies have better access to capital, and foreign investors have more channels through which they can participate in the region's growth story.

Asia has become more diverse as well in terms of the number of countries and companies that are not only available, but also easily accessible, to foreign investors. Markets now include many investible sectors beyond the commodity, banking and industrial sectors that were more prevalent 20 years ago. Companies are also realizing the benefits of engaging with the capital markets for the growth plans of their underlying businesses. Having been through various economic and market cycles, management teams are more experienced and have a greater acceptance of the minority shareholder, which should also support an improving trend in corporate governance over time.

Q The Fund provides meaningful exposure to emerging Asian economies. How does corporate governance play a role in your investment process in the region?

A Assessment of corporate governance is a key part of our investment process, as we believe responsible and disciplined ownership can drive shareholder returns over the long term. Some of the factors we consider when evaluating corporate governance include interest alignment, discipline, transparency, independence and sustainability of the business. These elements provide an important overlay toward the quality of businesses in which we invest. Once we invest in a company, we continue to monitor these factors on an ongoing basis in our portfolio. We believe that our rigorous analysis and high hurdle rate for the quality of a franchise and management should also help to manage risk for the entire portfolio.

As capital markets in the emerging Asian economies have deepened, the role of the minority investor has become increasingly institutionalized, leading to an improvement in corporate governance practices although it is still a work in progress. We believe that as these markets continue to grow in size, we will see further advancements in governance standards. The regulators in various jurisdictions remain focused on tightening rules around disclosure of results and corporate code of conduct. There is also a growing awareness of corporate governance among domestic institutions that invest in these markets. The hope is that these factors will drive a culture of positive corporate governance that can translate into shareholder value.

Q What has not changed about the Matthews Pacific Tiger Fund's investment philosophy and process?

A The desire to take a long-term investment horizon view has stayed the same since the strategy's inception in 1994. We have also remained focused on understanding companies through our bottom-up analysis, first and foremost. This remains the hallmark of our investing process, even today. We continue to seek emerging opportunities in the region in a thoughtful, yet risk-controlled manner rather than letting artificial classifications drive the construction of our portfolios.

Q What are the principal risks inherent to the Fund, and how are they mitigated?

A In terms of risk, our first objective is to avoid permanent loss of capital in the securities in which we invest, and at the portfolio level at large. We believe that by investing in high-quality companies with strong and sustainable cash flow growth, tested business models and strong management teams, we lower the overall business risk for the Fund. Separately, because of our benchmark-agnostic approach, there may be certain periods during which the Fund can underperform the benchmark. However, by emphasizing the risk of permanent capital loss, we believe we increase the odds of delivering solid long-term performance for our shareholders.

Q Why should investors consider the Matthews Pacific Tiger Fund?

A The Matthews Pacific Tiger Fund provides investors exposure to the growing segments of Asia's economies through a portfolio of companies capable of navigating volatility over the course of a market cycle. Our firm has 25 years of experience investing in the Asian markets and Matthews Pacific Tiger Strategy has a proven track record built on an investment process that has remained consistent over the past two decades.

FUND FACTS

Inception Date	30 April 2010
Investment Objective	Long-term capital appreciation
Benchmark	MSCI All Country Asia ex Japan Index

Class	ISIN	CUSIP	SEDOL	Bloomberg Ticker
A Acc, USD	LU0491815824	L6263Q199	B3TQ7X1	MATAPTA LX
I Acc, USD	LU0491816475	L6263Q215	B48X6K0	MATAPTI LX
I Dis, USD	LU0491816558	L6263Q264	B3N9WK8	MAPTIIU LX

Portfolio Managers

Sharat Shroff, CFA
Lead Manager

Sharat Shroff is a Portfolio Manager at Matthews Asia and manages the firm's Pacific Tiger Strategy and co-manages the India and Asia Growth Strategies. Prior to joining Matthews Asia in 2005 as a Research Analyst, Sharat worked in the San Francisco and Hong Kong offices of Morgan Stanley as an Equity Research Associate. Sharat received a Bachelor of Technology from the Institute of Technology in Varanasi, India and an M.B.A. from the Indian Institute of Management, in Calcutta, India. He is fluent in Hindi and Bengali.

Rahul Gupta
Co-Manager

Rahul Gupta is a Portfolio Manager at Matthews Asia and co-manages the firm's Pacific Tiger Strategy. Prior to joining the firm in 2014, he spent almost a decade at Oaktree Capital Management as a Senior Vice President on the Emerging Market Long Short Equity Fund. In this role, he managed portfolios in the technology, industrial and health care industries. Rahul began his career in 1994 with Citibank, and as a Vice President was responsible for heading the development of new financial products. Rahul earned his M.B.A. from INSEAD in France and was also an exchange student at The Wharton School of the University of Pennsylvania. He received a Bachelor of Technology in Mechanical Engineering from the Indian Institute of Technology in New Delhi. He is fluent in Hindi.

Contact Matthews Asia

To learn more about Matthews Asia or how the Matthews Asia Funds can complement your globally diversified portfolio, please call +1 (415) 954-4510 or visit matthewsasia.com.

Disclosures and Notes

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