Matthews Asia Perspective

Repositioning for Growth During a Window of Opportunity

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Uncertainty over the U.S.–China trade war has been the biggest overhang for Asian equity markets this year. In an environment where capital expenditure had already been weak, it appears to have created headwinds for cyclically exposed business to generate positive earnings growth. Social unrest in Hong Kong, meanwhile, has hurt both the local economy and Hong Kong-listed companies. In addition, local economic activity in China and India is somewhat slow.

It is hardly surprising that Asian markets underperformed in the third quarter this year, with the MSCI All Country Asia ex Japan Index falling by -4.39%.[1] The Matthews Asia ex Japan Dividend Fund, however, fell only -1.28 during this period. Year to date, the Fund has generated 11.44% versus 5.96% for the MSCI All Country Asia ex Japan Index (USD)[1]. Our approach to dividend investing balances stable, high dividend-yielding stocks with slightly more cyclical, but potentially higher dividend, growth stocks. This flexible approach has helped to navigate volatility and capture Asia's growth upside, as well as provide some downside protection.

While the top-down perspective remains somewhat challenging, I am pleased that policymakers across Asia have been quick to react with aggressive interest-rate cuts. In India, the government announced fairly broad-based corporate tax relief. On-the-ground economic activity in India is still not supporting a positive growth trend for the local market, mainly due to the liquidity crunch that started with Non-Banking Financial Companies Crisis (NBFC). We believe the withdrawal of credit supply from these financial firms had a meaningful impact on real estate and consumer discretionary companies, causing a slowdown in the Indian economy and lowering stock valuations. In parts of Southeast Asia, meanwhile, countries such as the Philippines and Indonesia have been pursuing a policy of monetary easing against a backdrop of muted inflation. Policymakers are trying to put a floor under the economic growth.

From a bottom-up perspective, Asian company earnings show signs of improvement. After year-on-year earnings per share (EPS) growth hit -10% for the region in the fourth quarter of 2018, this rose to -7% in Q1 in 2019 and to 0.1% in Q2[2]. Given the region's historical growth profile, such numbers are not impressive in our view. Companies have overcome a deep earnings recession, however, and we may now be on the cusp of a bottoming-out process. We believe there is a good chance this positive trend can be maintained in the coming quarters.

Considering that Asia earnings are likely to stage a positive recovery, the overall portfolio has been tilted toward dividend growth stocks. Having started 2019 with an even balance between dividend payers and growers, moved to a more pro-growth stance with roughly 60% held in dividend growers and 40% in dividend payers by the end of September 2019.

At present we see an interesting window of opportunity in structurally growing businesses with valuations that are aggressively discounted given the challenging earnings environment. During the most recent quarter, for example, we initiated a position in a Chinese auto dealership business that targets the luxury segment. We saw a disconnect between the company's fundamentals and the market's perception.

[1]Data as of 30 September 2019, I-share class. **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. Source: Brown Brothers Harriman (Luxembourg) S.C.A.

[2]As of 30 September 2019. Source: Factset Estimates

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.

Cyclical businesses are still facing difficulty and may struggle to deliver near-term earnings growth. That being said, Asia's growth model has changed and domestic consumption-driven growth is now more resilient. Secular growth for the Asian consumption story remains intact despite the trade uncertainties.

Over both the third quarter and year to date, some of the portfolio's best-performing companies were typical consumer-facing businesses. These companies delivered strong business and earnings growth, and their share prices performed strongly. Particularly in China, the consumer-upgrade demand has been driving growth, from premium white goods to convenience foods.

Our allocation to small-cap companies also significantly contributed to performance, not just this quarter but also year to date. Many small-cap companies have not yet realized their full growth potential and are often overlooked from an income point of view. In some areas of Asia, they also tend to be under-researched and therefore offer potential alpha opportunities.

Overall there were no significant changes to the portfolio during the quarter. We exited one position due to corporate governance concerns, which are an important criteria for our stock selection. The stock also was the biggest detractor to performance this quarter. Its chairman was asked for assistance in investigating a retired government official for suspected corruption. Although we believed there would be no immediate impact on the company's operation, we decided to exit the position as this type of investigation could drag on for years.

We use dividends as a lens through which we seek to identify high-quality, financially healthy companies with prudent capital-allocation policies. We look for companies that offer meaningful yields, have sustainable business models and that demonstrate the propensity to pay increasing dividends over time. Companies with strong financials that include solid balance sheets, low financial leverage and improving cash flows and dividend pay-out ratios comprise the core universe for the Fund.

From a regional perspective, we continue to find opportunities in China and Hong Kong, where valuations were brought down by the recent unrest. We also see an increasing number of domestic A-share companies that have upgraded the quality of their businesses. Some of them are not only becoming leaders in their own market, but also are globally competitive. There is further room to increase the portfolio's A-share exposure at the right valuation.

We also added to our weightings in Taiwan and Singapore. While our exposure to frontier markets remains our largest overweight, the absolute percentage fell during the quarter partially as a result of weak performance. This was mostly in Vietnam, where some stocks have not done well so far this year.

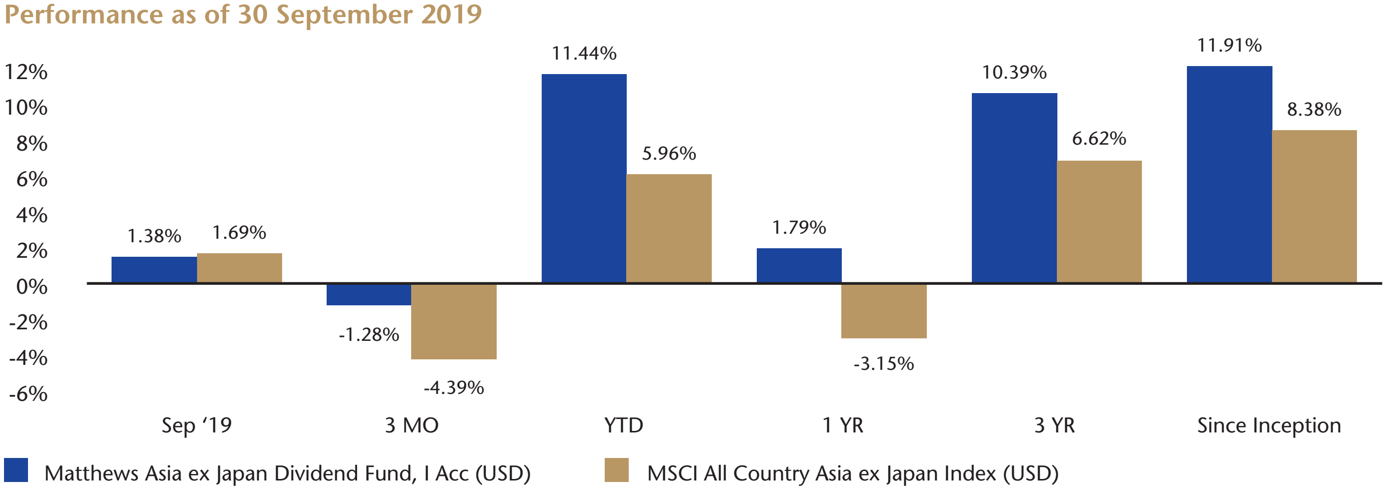
India remains the Fund's largest underweight relative to the MSCI All Country Asia ex Japan Index. While we believe in the country's long-term structural growth potential, many of the quality growth businesses are available only at a fairly meaningful valuation premium. Given the recent slowdown, however, the valuations for these consumer-facing areas have come down to more interesting levels, to the extent that they could offer potential opportunities for the portfolio.

So where do we go from here? For China, we may see a temporary truce on the trade war as attention in the U.S. focuses on the possible impeachment of President Trump. We may see a partial agreement that could drive the market in certain ways.

If the current trade-related uncertainty persists, there are also companies that may continue to benefit from this situation. In Southeast Asian countries such as Vietnam and Thailand, for example, some companies have seen the positive impact of diverted manufacturing orders. Taiwan also has benefited from a reshoring of manufacturing capabilities.

Finally, even though the trade dispute continues to overshadow sentiment toward the region, we remain optimistic given the actions of policymakers and improving corporate earnings. As fundamental, bottom-up investors, we pay close attention to whether risks have been priced in correctly. At the moment we see many attractive investment opportunities.

Performance as of 30 September 2019



	Inception Date	Sep'19	3 MO	YTD	1 YR	3 YR	5 YR	10 YR	Since Inception*
					Average Annual Total Returns				
Matthews Asia ex Japan Dividend Fund I (Acc) (USD)	30/11/15	1.38%	-1.28%	11.44%	1.79%	10.39%	n.a.	n.a.	11.91%
MSCI All Country Asia ex Japan Index (USD)	n.a.	1.69%	-4.39%	5.96%	-3.15%	6.62%	n.a.	n.a.	8.38%
Matthews Asia ex Japan Dividend Fund I (Acc) (GBP)	30/11/15	0.32%	1.74%	15.80%	7.82%	12.29%	n.a.	n.a.	17.84%
MSCI All Country Asia ex Japan Index (GBP)	n.a.	0.50%	-1.25%	9.51%	2.49%	8.51%	n.a.	n.a.	14.20%

*Index calculated from 30 November 2015

CALENDAR YEAR PERFORMANCE (for years ended 31 December)

	2018	2017	2016	2015
Matthews Asia ex Japan Dividend Fund I (Acc) (USD)	-12.37%	47.29%	6.89%	n.a.
Matthews Asia ex Japan Dividend Fund I (Acc) (GBP)	-7.38%	34.23%	28.50%	n.a.
MSCI All Country Asia ex Japan Index (USD)	-14.12%	42.08%	5.76%	n.a.

ROLLING 12 MONTH RETURNS (for the period ended 30 September 2019)

	2019	2018	2017	2016	2015
Matthews Asia ex Japan Dividend Fund I (Acc) (USD)	1.79%	11.01%	19.06%	n.a.	n.a.
MSCI All Country Asia ex Japan Index (USD)	-3.15%	1.74%	23.02%	n.a.	n.a.
Matthews Asia ex Japan Dividend Fund I (Acc) (GBP)	7.82%	13.95%	15.25%	n.a.	n.a.
MSCI All Country Asia ex Japan Index (GBP)	2.49%	4.67%	19.11%	n.a.	n.a.

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

PORTFOLIO BREAKDOWN (%) as of 30 September 2019)

Sector Allocation	Fund	Benchmark	Difference
Consumer Discretionary	21.7	13.6	8.1
Consumer Staples	16.0	5.4	10.6
Information Technology	12.2	17.8	-5.6
Communication Services	10.0	12.0	-2.0
Industrials	9.9	6.9	3.0
Real Estate	8.9	5.9	3.0
Financials	7.8	23.4	-15.6
Health Care	2.8	2.8	0.0
Utilities	1.5	3.3	-1.8
Materials	1.0	4.4	-3.4
Energy	0.9	4.4	-3.5
Cash and Other Assets, Less Liabilities	7.3	0.0	7.3

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	45.3	48.3	-3.0
Taiwan	11.5	13.5	-2.0
South Korea	10.6	14.3	-3.7
Singapore	7.3	3.8	3.5
Vietnam	5.6	0.0	5.6
Thailand	3.0	3.4	-0.4
Philippines	3.0	1.3	1.7
Indonesia	2.6	2.4	0.2
India	2.2	10.4	-8.2
Bangladesh	1.6	0.0	1.6
Malaysia	0.0	2.4	-2.4
Cash and Other Assets, Less Liabilities	7.3	0.0	7.3

Source: FactSet Research Systems

Market Cap Exposure (%)	Fund	Benchmark	Difference
Mega Cap (over $25B)	17.7	54.4	-36.7
Large Cap ($10B-$25B)	11.4	22.2	-10.8
Mid Cap ($3B-$10B)	16.9	19.3	-2.4
Small Cap (under $3B)	46.7	4.1	42.6
Cash and Other Assets, Less Liabilities	7.3	0.0	7.3

Source: FactSet Research Systems

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