



Matthews Asia

# Matthews Asia Small Companies Fund

I (Acc)

## Commentary

Period ended 31 December 2023

For the year ending 31 December 2023, the Matthews Asia Small Companies Fund returned 11.27%, while its benchmark, the MSCI All Country Asia ex Japan Small Cap Index returned 22.09%. For the fourth quarter of the year, the Fund returned 3.53% versus 8.73% for the benchmark.

## Market Environment

2023 was a year of opportunities and challenges marked by two distinct narratives: the Federal Reserve's 'higher for longer' interest rate strategy and China's labored and ongoing struggle to recover from the pandemic. Elevated interest rates and a strong U.S. dollar posed headwinds while China's travails impacted the economies of markets like Thailand. But there were also strong performances by markets like India which benefited from national infrastructure programs and strong domestic investor inflows. Smaller companies in emerging markets also thrived in many cases in 2023. And toward the end of the year there was a general consensus that inflation had peaked in the global economy and that the Fed would pivot toward cutting rates in 2024. This provided some tailwinds across markets.

Taiwan was the best-performing market in the benchmark index during 2023, followed by India, South Korea and Malaysia. China/ Hong Kong was the worst-performer followed by Thailand and Indonesia. From a sector perspective, information technology (IT) was the top performer, supported by market exuberance over advancements in commercial artificial intelligence (AI), followed by industrials while consumer discretionary and real estate were the worst performers, impacted in part by China's challenges in these sectors.

From a currency perspective, the Thai baht, Indonesian rupiah and Philippine peso appreciated against the U.S. dollar. The Malaysian ringgit, Chinese renminbi, South Korea won and India rupee depreciated against the greenback.

## Performance Contributors and Detractors

From a country perspective, stock selection in South Korea was the top contributor to total and relative returns in 2023. Underweights in Thailand and Singapore supported relative performance while stock selection in Indonesia was a positive contributor to returns. On the flip side, an overweight and stock selection in China/Hong Kong was by far the biggest detractor to total and relative returns in the period. As the year progressed, markets grew more pessimistic about the prospects of China's economic recovery, for a turnaround in its real estate sector and for an improvement in consumer sentiment. In our view, the MSCI AC Asia ex Japan Small Cap Index has a much smaller allocation to China than is warranted as it doesn't have mainland A-shares representation and this accounts for the bulk of the small-cap investment universe in China. An underweight and stock selection in India also impacted relative performance as did an underweight in Taiwan.

At the sector level, an underweight and stock selection in real estate and consumer staples contributed the most to relative returns in the period. An overweight in financials also contributed. In contrast, stock selection in industrials was the greatest detractor to relative performance in 2023. Stock selection in IT and a slight overweight and stock selection in consumer discretionary also detracted.

From a holdings perspective, Ecopro BM, a South Korean cathode maker, Shriram Finance, an Indian financial services provider, and Elite Material, a Taiwanese maker of base materials for the printed circuit board (PCB) industry, were among the top contributors to total and relative returns in the year. Ecopro BM's share price rallied on the expectations of strong pickup in orders from U.S. battery manufacturing capex spend. Shriram continued to deliver strong results and, given its very attractive valuations, the stock performed well. Elite Material did well as the market assessed positively the company's dominant position in the key raw material involved in making printed circuit boards for high performance chips used for applications such as AI.

On the other hand, China consumption-oriented names such as Hainan Meilan International Airport, Beijing Capital International Airport and Xtep International, a sporting goods company, were among the biggest detractors to total and relative returns. The Chinese airport operators were weak on the back of reduced expectations on the rebound in consumption broadly, and in air travel services, in particular, as 2023 progressed. We remain positive on the longer-term outlook for international travel in the case of Beijing Capital International Airport and for domestic tourist arrivals in the case of Hainan Meilan, despite near-term headwinds as people tilt their travel budgets internationally.

## Notable Portfolio Changes

In 2023, we participated in the initial public offering (IPO) of Wuxi XDC. The company is an affiliate of Wuxi Biologics, a leading Chinese contract, development and manufacturing entity. XDC specializes in bioconjugates, including antibody drug conjugates, a promising area of growth within the biotech industry globally. Among our exits, we sold Lemon Tree, an Indian mid-market hotel chain operator, to take profits, and sold our position in Bank Tabungan Negara in Indonesia to deploy capital elsewhere.

## Outlook

Today, we believe the Asia ex Japan region contains many companies with solid business models and quality management. In addition, U.S. interest rates are looking downward which should create some macro tailwinds for the coming year. As well as the macro landscape and global trade, our focus in 2024 will be on key emerging markets that are generating robust growth, like India, and those that are challenged, like China.

Longer term, we expect the emerging markets gross domestic product (GDP) growth-differential with developed markets to improve from a 23-year low reached in 2022. This, alongside relatively attractive valuations, should potentially lend support to better equity performance against developed markets compared with the last decade.

We believe small companies in Asia offer long-term growth opportunities given their innovation and domestic consumption orientation while also being less exposed to regulatory and geo-political risks. We continue to find quality businesses at attractive valuations in this asset class.

### Rolling 12 Month Returns For the period ended 31/12/2023 - I (Acc)

Name	2023	2022	2021	2020	2019	Inception Date
Matthews Asia Small Companies Fund (USD)	11.27%	-14.49%	22.19%	46.12%	17.53%	30/04/2013
MSCI All Country Asia ex Japan Small Cap Index (USD)	22.09%	-19.93%	21.23%	26.60%	7.58%	
Matthews Asia Small Companies Fund (GBP)	5.26%	-4.17%	23.80%	41.22%	14.03%	30/04/2014
MSCI All Country Asia ex Japan Small Cap Index (GBP)	15.20%	-9.84%	22.35%	22.69%	3.43%	
Matthews Asia Small Companies Fund (EUR)	7.48%	-9.25%	32.41%	N.A.	N.A.	30/12/2020
MSCI All Country Asia ex Japan Small Cap Index (EUR)	17.96%	-14.68%	30.44%	N.A.	N.A.	

Sources: Brown Brothers Harriman (Luxembourg) S.C.A, Matthews Asia, FactSet Research Systems, Bloomberg

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