Matthews Asia

Matthews China Dividend Fund

I (Acc)

Commentary

Period ended 31 March 2022

For the quarter ending 31 March 2022, the Matthews China Dividend Fund returned -15.53%, while its benchmark, the MSCI China Index, returned -14.19%.

Market Environment:

Chinese equities fell sharply during the first quarter of 2022, as multiple negative impacts created significant market headwinds. The first shock was the Russian invasion of Ukraine, and the severe economic sanctions imposed on Russia by the West which caused the halting of trading of Russian equities. Many emerging markets funds with Russian equities exposure were forced to raise liquidity to cover the resulting losses and redemptions. Since Chinese equities are the most liquid assets in the emerging markets, they suffered a heavy sell off. Additionally, as Russia and China had recently jointly announced that their mutual cooperation "has no limit," market participants worried that China's supportive position toward Russia may result in damaging "secondary sanctions" from the West, dampening global investors' sentiment towards Chinese equities.

The second shock was China's continued implementation of its zero-COVID policy. As COVID cases started to increase in Jilin Province and Shanghai, government officials resorted to locking down the entire city. Locking down Shanghai—a business and financial hub of China—results in not only the loss of economic activity within the city itself but also impacts the production and logistic chain in other parts of China as well, making it look increasingly unlikely that China will be able to achieve the GDP growth target it set earlier this year. An additional shock this quarter stems from an increasingly hawkish U.S. Federal Reserve. Responding to sustained inflation pressures, the Fed has increased the number and magnitude of its forecast rate increases. This has resulted in a stronger U.S. dollar and soaring interest rates during the quarter, a combination that is typically negative for emerging markets equities.

Performance Contributors and Detractors:

On a sector basis, stock selection within the consumer discretionary and energy sectors were the largest detractors from relative Fund performance. Our stock selection within the information technology and communication services sectors were the largest contributors to relative performance.

Turning to individual holdings, E Ink, a global leader of ePaper technology firm based in Taiwan, was the top performance contributor to absolute performance during the quarter. The company continued to forecast strong revenue potential, lifting sentiment for the stock. Postal Savings Bank of China was the second largest performance contributor for the quarter, as the bank reported robust earnings growth for 2021, making it one of the fastest earnings growers among large Chinese banks. Additionally, the bank's operating costs may soon decline, as it seeks to renegotiate the agency fee it is paying to its parent company, China Postal Group.

On the other hand, China Education Group, which operates for-profit colleges, was the largest detractor to absolute performance. During the quarter, there was an unverified "official" document circulating among investors that the Chinese government will target private higher education institutions for tighter regulation, causing some panic selling of the stock. After talking to both company management and other industry sources, we believe the document is forged, and see the potential for operation resilience, especially during the economic down turn. Leading internet platform company Tencent was the second largest absolute performance detractor for the quarter, as investors continued to worry about the industry's substantial regulatory pressures. The recent stall of new online game licenses on its platform also limits the company's earning growth near term.

Notable Portfolio Changes:

During the quarter we added fast- food chain operator Yum China Holdings and reinitiated a position in China Tourism Group Duty Free. We believe these two companies are well positioned for a domestic tourism recovery, and will ultimately gain market share from their ailing competitors. We also took the opportunity of a biotech/health care sector sell-off to add a position in leading pharmaceutical contract manufacturer Asymchem Laboratories Tianjing. Asymchem's strong expertise in its small molecule process has helped it win a large contract with a leading global drug company to make drugs targeting the COVID-19 virus.

We exited e- commerce giant Alibaba Group, as the dual headwinds of slower consumer spending and regulatory uncertainty persist for the company. We also sold Tsingtao Beer to fund other investments, as we are concerned the company's margin improvement may stall this year, with its recent reported strong earnings growth fueled by unsustainable large, one- off government subsidies. Additionally, we exited diesel engine manufacturer Weichai Power Co., as its product cycle looks to have peaked and we are disappointed with the lack of progress of company's corporate governance improvement.

Outlook:

Looking ahead, we are optimistic that the headwinds that precipitated Chinese equities' sell off in 2021 will recede. So far in 2022, we have not seen new internet regulations, and various local municipal governments are relaxing home purchase restrictions. We are also seeing some concrete progress being made on the auditing issue raised by the SEC to Chinese securities regulators. And finally we believe there will be some relaxation of travel restrictions later this year, despite the current strict lock down in Shanghai.

Rolling 12 Month Returns For the period ended 31/03/2022 - I (Acc)

Name	2022	2021	2020	2019	2018	Inception Date
Matthews China Dividend Fund (USD)	-15.91%	43.26%	-13.54%	3.44%	28.18%	31/01/2013
MSCI China Index (USD)	-32.47%	43.81%	-5.66%	-6.08%	39.15%	

Sources: Brown Brothers Harriman (Luxembourg) S.C.A, Matthews Asia, FactSet Research Systems, Bloomberg emerging and frontier securities involves greater risks than investing in securities of developed markets, as issuers in these countries generally disclose less financial and other information publicly or restrict access to certain information from review by non-domestic authorities. Emerging and frontier markets tend to have less stringent and less uniform accounting, auditing and financial reporting standards, limited regulatory or governmental oversight, and limited investor protection or rights to take action against issuers, resulting in potential material risks to investors. Pandemics and other public health emergencies can result in market volatility and disruption.

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