Matthews Asia

Matthews China Fund

I (Acc)

Commentary

Period ended 31 March 2022

For the quarter ending 31 March 2022, the Matthews China Fund returned -18.52%, while its benchmark, the MSCI China Index, returned -14.19% over the same period.

Market Environment:

The first quarter of the year was broadly negative and choppy for emerging and Asian equity markets for the third consecutive quarter. Chinese equities were weak led down by the confluence of COVID-19 case spikes resulting in policy-enforced lockdowns in tier one cities, ADR delisting pricing pressures and investor worries that Russia-like sanctions could be implemented upon select Chinese companies. Although macro data in January and February contained upside surprises, the Chinese government's zero-COVID policy continued to weigh heavily on certain sectors.

The Chinese government announced during the quarter that they favor a 2022 GDP growth rate of "around 5.5%." In our opinion, this was an important "stake in the ground" announcement. Because of the significant lockdown pressure on consumption, GDP growth will need to be created elsewhere in the economy in order to reach the 5.5% growth target. We envision a battle between temporary lockdowns and stimulus to unfold. Regardless, we think the government will largely succeed in supporting the Chinese economy and that corporate earnings will remain some of the highest globally in 2022-23.

Performance Contributors and Detractors:

The portfolio's overweight to A-shares detracted from performance in the first quarter. The A-share markets experienced pull back on weak consumer sentiment given the Chinese government's zero-COVID policy, and a general property market weakness. The A-share market has also performed well over the past two years, and growth sectors, which have become expensive, are undergoing a healthy correction. Around half of the portfolio exposure is currently to A-shares. Despite the recent pull back in the A-share market, we intend to maintain rather similar levels of exposures and believe that there are still many secularly growing opportunities.

From a sector perspective, financials detracted the most from overall relative performance largely due to the portfolio's overweight in securities companies, including China Merchants Securities Co. and China International Capital Corp. Securities companies tend to be sensitive to market and trading sentiment and therefore underperformed during this period of market volatility. Longer term, we still view these companies as attractively priced businesses that would benefit from China's deepening capital markets.

On the other hand, the portfolio's underweight to U.S. ADRs was beneficial given continued pressure on this space with rising risks of ADR listings, including the onset of the Russia and Ukraine war which weakened sentiment on emerging markets. From a sector perspective, our underweight to U.S. ADRs helped consumer discretionary contribute the most to relative performance while real estate was also a big contributor, aided by our stock selection. Our real estate exposure benefited from our holding in China Overseas Land and Development, which is a state-owned enterprise (SOE) property developer. SOE developers have stronger balance sheets and portfolio managers believe they will benefit from the ability to buy attractively priced assets as the consolidation of real estate continues.

Notable Portfolio Changes:

The portfolio's A-shares exposure continued to trend up over the quarter to around 50%. Given the selloff in platform companies, we think there is lot of value emerging and added a few names including Pinduoduo, one of China's largest e-commerce shopping platforms with a focus on lower tier city residents. Platform companies in China continue to be dominant businesses and they are still largely unmonetized at the moment. While there will be a moderation of growth, we do not think that regulations derail these businesses from growth entirely. The focus going forward will be on quality growth is a promising sign.

We also increased exposure to the IT sector, driven by more A-share companies, including semiconductor equipment company Beijing Huafeng Test & Control Technology and semiconductor component company Hangzhou Silan Microelectronics Co. Given the continued geo-political tensions, the self-sufficiency drive in China continues to be a definite path for the country in its next stage of development. We believe Huafeng and Silan Micro stand to benefit from market share gains in this industry where foreign firms are still very dominant in China. To fund some of these new positions, we reduced our exposure to financials. We also reduced some exposure from holdings in communication services, including Tencent Holdings as it had held up relatively well compared to other platform companies, and redeployed capital towards other more attractively valued opportunities.

Outlook:

Looking ahead, we expect that China's Zero COVID-19 policy will likely linger, especially over the next quarter, and we will be watching the overhang closely as it puts pressure on consumer sentiment. At the same time, the property market continues to be weak, although there are signs that the government is increasingly in the camp of loosening the very tight conditions of the property market. Given these two pressures, we believe there is more support for monetary easing in the second half of 2022 as China's key goal is still both economic and political stability.

The larger unknown is how U.S. – China relations will pan out. While we see China becoming more willing to make concessions, we have not quite seen the same level of openness from the U.S. This lack of ability to ascertain U.S. – China politics will be a risk that will unfortunately be hard to manage for. Elsewhere, results remain largely in-line with expectations and continued healthy pace of growth is seen with some signs of margin erosion but managed relatively well. We remain more hopeful of an improvement in sentiment given still resilient earnings growth and an increased likelihood of policy easing ahead.

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

Name	2022	2021	2020	2019	2018	Inception Date
Matthews China Fund (USD)	-29.94%	61.17%	-2.29%	-5.73%	43.53%	26/02/2010
MSCI China Index (USD)	-32.47%	43.81%	-5.66%	-6.08%	39.15%	
Matthews China Fund (GBP)	-26.51%	44.59%	3.51%	1.39%	27.27%	28/02/2011
MSCI China Index (GBP)	-29.24%	29.24%	-0.86%	1.11%	24.04%	

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

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