



Matthews Asia

Matthews China Small Companies Fund

I (Acc)

Commentary

Period ended 31 March 2022

For the first quarter of the year, the Fund returned -18.94%, while its benchmark, the MSCI China Small Cap Index, returned -16.33% 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. However, the worsening COVID-19 lockdown environment in China may increasingly make it difficult for China to reach these goals. We continue to 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 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. In addition, our A-shares holdings are in the growthier part of the A-share markets such as information technology and industrials. These sectors have performed well over 2020 and 2021, and growth sectors, which have become expensive, are undergoing a healthy correction. However, longer term, these are still secularly growing areas in our view. They are also very aligned with the China's intent to become more self-reliant in areas such as semiconductors and automation.

From a sector perspective, materials and industrials detracted the most from relative performance. The industrials holding underperformance was led by battery equipment-manufacturer Zhejiang Hangke Technology and building material-testing agency China Testing & Certification International Group. Materials sector underperformance was led by fiber glass and wind turbine manufacturer Sinoma Science & Technology and building materials-manufacturer Keshun Waterproof Technologies. A common thread among these holdings is that they are all A-shares and are either in the renewables sector where there has been profit taking or in building materials which is linked to property weakness.

On the other hand, allocation and stock section within utilities and the portfolio's underweight in consumer discretionary and communications services contributed to relative performance. Among individual holdings, China Overseas Property, a property management company affiliated to large state-owned enterprise (SOE) developer China Overseas Land and Development, contributed to performance. SOE developers have stronger balance sheets and we believe they will benefit from the ability to buy attractively priced assets as the consolidation of real estate continues. We also believe the property market will likely recover this year given the already very weak conditions and more monetary easing that is happening, including the lowering of mortgage rates, and the faster approvals of mortgages, etc.

Notable Portfolio Changes:

Over the quarter, we made a few changes as part of our efforts to position the portfolio for exposure to the most innovatively growing parts of China driven by domestic demand. We initiated a new position in frozen food manufacturer Anjoy Food. The company has strong business-to-business (B2B) and growing business-to-consumer (B2C) lines of business. Anjoy continues to roll out new product categories that include that of frozen convenience meals, but its stock suffered a sizable correction given market conditions. We took the opportunity to add this name given the longer-term growth opportunity of convenience foods in both the B2B and B2C markets. We also exited a few holdings including camera module manufacturer Q Tech. The company disappointed in its delivery of margins amid a weak smartphone sales environment.

Outlook:

Looking ahead, we expect that China's Zero COVID-19 policy will likely linger, and especially over the next quarter, and we will watch 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 a 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 Small Companies Fund (USD)	-21.84%	62.23%	25.87%	-10.72%	42.20%	29/02/2012
MSCI China Small Cap Index (USD)	-30.18%	64.63%	-19.51%	-10.05%	16.63%	
Matthews China Small Companies Fund (GBP)	-18.03%	45.57%	N.A.	N.A.	N.A.	30/01/2020
MSCI China Small Cap Index - GBP (GBP)	-26.84%	47.95%	N.A.	N.A.	N.A.	

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

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