



Matthews China Small Companies Fund

I (Acc)

Commentary

Period ended 31 December 2023

For the year ending December 31, 2023, the Matthews China Small Companies Fund returned -15.73%, while its benchmark, the MSCI China Small Cap Index returned -24.82%. For the fourth quarter of the year, the Fund returned -6.44% versus -2.93% for the benchmark.

Market Environment

2023 was a disappointing year for Chinese equities and the Chinese economy overall. It's disappointing, in our view, not just in the sense of the underwhelming recovery of Chinese consumer spending post COVID lockdowns, but also due to the lack of any significant stimulus measures by the government. While the government started to gradually loosen nearly all property purchase restrictions across most cities in China, the expectations of potential home buyers regarding future house prices and their own income levels have changed. As a result, these policy changes have barely helped to arrest the slump in the real estate market. As the year progressed, investors gradually gave up on the idea that the Chinese central government would step in to engineer a stronger consumption rebound.

The challenging real estate market and the soft consumption environment combined create a potential formula for deflation, in our view. From what we can see, many entrepreneurs, whose animal spirits were curbed during the COVID period, are now hesitating to start any new investments in this environment. From a geopolitical standpoint, the highly anticipated Biden-Xi summit in San Francisco in November have not curbed the ongoing concerns of the market.

In terms of markets, quarterly results of leading Chinese companies, especially large cap technology firms seem to be hinting towards upward surprises in terms of top line revenue and earnings. During the last quarter of the year, information technology and utilities were the only positive sectors while real estate was weakest followed by consumer staples and communication services. Chinese small and mid caps ended lower but outperformed weak large and mega caps during the quarter.

Performance Contributors and Detractors

From a sector perspective, our allocation to health care and stock selection within industrials detracted the most from relative performance the year. We have been underweight health care relative to the index given its larger exposure in biotech opportunities and we have been more selective in this area. Industrials have underperformed given our exposure in renewables which is going through a slower growth period amid capacity expansions and increased worries that oversupply might lead to weaker pricing. Turning to individual holdings, Xtep International Holdings, a consumer discretionary company engaged in the development and manufacturing of sportswear was among the top detractors to the portfolio's absolute and relative performance. Xtep has been weak given the weaker-than-expected consumption environment which has led to slower-than-expected growth in the sportswear industry. BOE Varitronix, an auto parts manufacturer, was another detractor. The company has been experiencing some pricing pressures given a slowdown in the growth of both China's traditional ICE (Internal combustion engine) and EV (electric vehicle) auto industry. We believe these two names sold down more than relative to their weaker outlook, and that their current valuations have more than compensated for a lower growth outlook ahead.

On the other hand, stock selection within information technology and real estate sectors contributed the most to the Fund's relative performance. Two Taiwan-listed information technology name including Alchip Technologies contributed the most to the Fund's absolute and relative performance as beneficiaries from the secular trends of AI (artificial intelligence). Alchip designs application-specific integrated circuit (ASIC) and the company continues to see growing penetration and development from customized AI chip designs. Anhui Yingjia Distillery, a mass market white liquor manufacturer, was another top contributor. Anhui Yingjia has done well given the company's positive efforts in distribution and branding restructuring in its hometown of Anhui province.

Notable Portfolio Changes

We streamlined the number of positions in the portfolio from 63 to 43 over the course of the year. Overall exposure in mainland-listed companies has been reduced from around 39% in Dec 2022 to 22% at the end of the year. Many smaller A-shares positions that were more expensive were exited from the portfolio as cheaper valuations given the pull back enabled us to build more into better quality holdings. In the more recent quarters, we have incrementally added to our positions in certain communication services names such as Cloud Music (driven by low valuations as well as increased willing to spend and pay for online services). We've also added to consumer names such as Melco Resorts & Entertainment and Tongcheng Travel Holdings (driven by the pull back of these names leading to attractive valuations for what are still renowned brands in China) and to health care names such as Innovent Biologics.

Outlook

Looking ahead, we cautiously look for a stabilization of deterioration in the property markets. While we do not expect significant warming of geo-relations, the current status quo of a more constructive post APEC posturing would be welcomed by the market. Valuations continued to trend down in 2023, and the broader China market hovers around similar levels as 2009 despite better quality businesses and earnings profile. We continue to believe that patience is needed in these market environments and that it would ultimately pay off once the market turns. We continue to stick to our knitting and deliver a consistent growth at a reasonable price strategy for our clients.

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

Name	2023	2022	2021	2020	2019	Inception Date
Matthews China Small Companies Fund (USD)	-15.73%	-30.72%	-2.88%	77.70%	31.36%	29/02/2012
MSCI China Small Cap Index (USD)	-24.82%	-24.77%	-6.26%	27.21%	6.63%	
Matthews China Small Companies Fund (GBP)	-20.32%	-22.34%	-1.58%	N.A.	N.A.	30/01/2020
MSCI China Small Cap Index - GBP (GBP)	-29.06%	-15.29%	-5.39%	N.A.	N.A.	

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

Performance figures discussed in the Fund Manager Commentary above reflect that of the Institutional Accumulation Class Shares and has been calculated in USD. Performance details provided for the Fund are based on a NAV-to-NAV basis, with any dividends reinvested, and are net of management fees and other expenses. Past performance information is not indicative of future performance. Investors may not get back the full amount invested.

The information contained herein has been derived from sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Matthews Asia and its affiliates do not accept any liability for losses either direct or consequential caused by the use of this information.

Information contained herein is sourced from Matthews Asia unless otherwise stated. The views and opinions in this commentary were as of the report date, subject to change and may not reflect the writer's current views. They are not guarantees of performance or investment results and should not be taken as investment advice. Investment decisions reflect a variety of factors, and the managers reserve the right to change their views about individual stocks, sectors, and the markets at any time. As a result, the views expressed should not be relied upon as a forecast of the Fund's future investment intent. It should not be assumed that any investment will be profitable or will equal the performance of any securities or any sectors mentioned herein. The information does not constitute a recommendation to buy or sell any securities mentioned.

Investors should not invest in the Fund solely based on the information in this material alone. Please refer to the Prospectus for further details of the risk factors.

An investment in Matthews Asia Funds may be subject to risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation. Additionally, investing in 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.

Fund holdings are subject to change and risk. For current holdings, please visit each Fund's individual overview page.

Matthews Asia is the brand for Matthews International Capital Management, LLC and its direct and indirect subsidiaries.

Your use of this website confirms that you have read and agree to the [Terms and Conditions of Use](#) of this website.

The information on this website is for informational purposes only and does not constitute an offer to sell or a solicitation of an offer to buy any security that may be referenced on or through this website. Unless otherwise specified, it is not intended to be directed to any person(s) in particular. Information from this website must not be used in any jurisdiction where prohibited by law and must not be used in a way that would be contrary to local law or legislation. No investment advice, tax advice, or legal advice is provided through this website, and you agree that this website will not be used by you for these purposes. No representation is given that shares, products, or services identified on, or accessible through, this website are suitable for any particular investor. An investment in the Matthews Asia Funds is not available to investors in all jurisdictions; it is not available to U.S. Persons.

Investors should ascertain from their professional advisers the consequences of investing in the Fund under the relevant laws of the jurisdictions to which they are subject, including the tax consequences and any exchange control requirement. Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund before making an investment decision. The current [prospectus](#), [Key Information Document](#), [Key Investor Information Document](#), or [other offering documents](#) ("Offering Documents") contain this and other information. Applications for shares may only be made on the Fund's most recent [Offering Documents](#) which are available from Matthews International Capital Management, LLC. Please read the [Offering Documents](#) carefully before investing.

In Singapore, this website is available to, and intended for Institutional Investors under Section 304 of the Securities and Futures Act. It should not be circulated or distributed to the retail public in Singapore.

In the UK, this website is only made available to professional clients and eligible counterparties as defined by the Financial Conduct Authority ("FCA"). Under no circumstances should this document be forwarded to anyone in the UK who is not a professional client or eligible counterparty as defined by the FCA. Issued in the UK by Matthews Global Investors (UK) Limited ("Matthews Asia (UK)"), which is authorised and regulated by the FCA, FRN 667893.

If you are a resident of any other country, please go to matthewsasia.com

©2024 Matthews International Capital Management, LLC