



Matthews India Fund

I (Acc)

Commentary

Period ended 31 March 2022

For the first quarter of the year, the Fund returned -6.72%, while its benchmark, the S&P Bombay Stock Exchange 100 Index, returned -1.10% over the same period.

Market Environment:

India is enduring an acceleration of headwinds most notably related to rising global inflation and the U.S. Federal Reserve's monetary tightening in response to it. So far India's central bank has maintained its accommodative policy but we anticipate that will have to change. With China's COVID lockdowns continuing to impact supply chains, inflation for now seems to be on the front foot. More directly for a major energy importer like India, the surge in oil prices resulting from Russia's invasion of Ukraine, is a material negative. Higher energy prices feed into higher inflation which in turn creates a drag on consumption and growth.

While the environment is challenging, India has two positives in its favor. One is the recovery in its banking sector, which is now well capitalized to deal with any adverse credit issues. The other is the fast growth of high-value items like engineering goods within India's exports. This is helping India to diversify away from services and commodities exports and counter current account-deficit pressures from the high oil-price environment.

Performance Contributors and Detractors:

The portfolio's lack of exposure to utilities and underweight in energy and materials sectors were among the biggest detractors to relative performance. We have historically not focused on these sectors given our growth-orientated strategy and all three areas benefited from the upswing in commodity prices.

Our allocation and stock selection within health care also detracted from performance. More specifically, Neuland Laboratories Limited, a small-cap active pharmaceutical ingredient (API) manufacturer, declined the most, leading to a drag experienced in the sector. The company's customers are generally small biotech firms. Neuland's clients destocked inventory last year, leading to slower-than-expected growth for the company. Further, high inflation in certain chemicals has meant pressure on gross margins for Neuland. We expect both of these headwinds to be transitory and still view Neuland as a fundamentally sound business.

On the other hand, the financials sector contributed the most to the portfolio's relative performance and our stock selection within financials partly offset the negative attribution from other sectors. Consumer discretionary was also a significant contributor, helped by our stock selection. Among individual holdings, Shankara Building Products and Lemon Tree Hotels were among the top performers, aided by recovering consumer demand. In financials, Bandhan Bank delivered strong gains.

Notable Portfolio Changes:

During the quarter, we reduced our holdings in information technology. Companies in the IT sector were generally insulated from supply chain challenges faced by other sectors. Revenue growth has been robust in the sector amid mass adoption of digital services and valuations have substantially moved past long-term averages, particularly among mid-caps. We believe accelerated monetary policy tightening is going to have a negative impact on technology spend globally and this in turn makes risk-reward less enticing in IT. Positions we closed in the quarter included Mindtree Ltd., an IT and consulting company, and IndiaMART InterMESH Ltd., an e-commerce platform.

After spending the past couple of years replenishing provisions to withstand credit quality issues emanating from COVID-related disruption to businesses and retail borrowers, we think the underlying profitability of the financial

services sector is set to emerge. Given current valuations, we think risk-reward is highly favorable in the sector. Consequently, we added to our holdings in Bandhan Bank and Axis Bank. We also initiated a new position in Cholamandalam Investment and . Cholamandalam is part of Murugappa Group which has a reputation for strong corporate governance. Earlier this year, the Group disclosed a strategy to diversify Cholamandalam's lending business into newer verticals and Cholamandalam also announced it was acquiring a payments player. Both of these strategic initiatives position the firm well for sustained growth in coming years.

Outlook:

Higher oil prices will mean inflation is going to edge up in India and this could lead to a worse than anticipated current account shortfall. Historically, such an environment has led to heightened rupee volatility. We don't expect that to happen this time as India has adequate foreign reserves to meet external payments and inflation is more of a global issue compared to being more India specific in the past. However, the Reserve Bank of India is behind the monetary policy-normalization policies of other major emerging markets, including Brazil and Mexico, and we expect the central bank to begin to tighten. As a result, we think cost of capital in India is going to move higher in the coming 12 months which doesn't bode well for equity valuations.

Amid macro headwinds, we remain confident in the opportunities that exist among Indian corporates. We think capital goods and the industrials sector will see a significant uptick in activity in the coming 12 months, driven by a recovery in government infrastructure spending and private capital expenditure. We also see an improving outlook for manufactured exports from India.

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

Name	2022	2021	2020	2019	2018	Inception Date
Matthews India Fund (USD)	10.35%	86.27%	-35.65%	-0.99%	12.18%	30/06/2011
S&P Bombay Stock Exchange 100 Index (USD)	16.28%	78.72%	-31.53%	7.00%	11.64%	
Matthews India Fund (GBP)	15.77%	67.12%	-31.83%	6.49%	-0.49%	30/06/2011
S&P Bombay Stock Exchange 100 Index (GBP)	22.14%	60.56%	-28.25%	16.20%	-0.74%	

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.

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