



25 Years of Investing in Asia

This month *Asia Insight* speaks with Robert Horrocks, PhD, and Sharat Shroff, CFA, for their thoughts on 25 years of investing in Asia.

- * Robert Horrocks, PhD, Chief Investment Officer and Portfolio Manager
- * Sharat Shroff, CFA, Portfolio Manager

Asia has developed significantly over the past 25 years. What misconceptions do people still have of Asia?

Robert Horrocks (RH): People underestimate the differences across the region—from Australia, to Japan, to Thailand, China, South Korea and Cambodia. Different levels of wealth, different ethnic backgrounds, different legal systems. People also tend to hold a general suspicion of the region. They often ask: Can we trust the numbers? And yet, many Asian companies do generate cash flows, pay dividends and look after shareholders. This brings us to the notion of Asia as an emerging market. Whilst some Asian markets are not as developed, in general, as the West, many do have a long history and the markets of Hong Kong, Japan, Singapore and Australia are certainly developed. Even those less-developed markets have not stood still, but rather have grown and matured even as the label that describes them has stayed obstinately unmoved.

People also regard Asia as a low-wage growth story. It isn't. Wages have grown far faster than other parts of the world because of rising productivity. It would be better to call Asia a high-wage growth story.

What has been the most unexpected development in Asia?

RH: The widespread adoption of democratic systems. Taiwan and South Korea were both military, authoritarian governments not too long ago. The stable political democracies in Southeast Asia are another new development, as has been the opening up of countries like Myanmar and Cambodia. China, too, has been tinkering with more democratic reforms and will surely follow, gradually, in the footsteps of the rest of Asia.

What have been your biggest lessons learned?

Sharat Shroff (SS): In terms of investing lessons, we have learned to stay fully invested in our portfolios—painful as it may be in times of volatility. For example, during the last quarter of 2008, we were fully invested but suffered significant outflows. Had we taken the wrong step, and gone more to cash, that would have been a mistake.

The importance of identifying transparent and motivated management teams cannot be emphasized enough. We examine the capital allocation decisions they have made in the past. We take a look at the types of incentives that exist. We ask: what is the structure of the business? Where does the founder's wealth reside? Is it with the minority shareholders? Simple as it may seem, there isn't a checklist of items to get to a positive view of governance.

RH: Patience, patience, patience—always. I have made the biggest mistakes through a lack of patience, or excess greed. We have learned not to try to make decisions too quickly in the heat of the moment. It is tremendously important to cool off a little to think about an investment you are making, keeping in mind that you are not trying to shoot the lights out in a one-year period. It is not complicated, it is just emotionally challenging. So, surround yourself with good people—those who can talk you out of dumb or hastily assembled ideas.



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Are there any investment opportunities you feel you may have missed?

RH: The point is that you miss opportunities every day! I guarantee it. But the real question is: “Is your philosophy strong enough that you can consistently find some good opportunities?” You will miss some because the risks were too great or the outcome too opaque. One could make a lot of money through lucky speculation—or lose a lot with the same process. We remunerate the investment team based on the long-term performance of their portfolios versus benchmarks and versus peers. Only by keeping people aligned with what we believe clients want can we help to keep the process pure and give ourselves the best chance of finding enough good opportunities.

SS: There seems to be a mismatch between how fast the economies have been changing and progressing, and inability of the capital markets to keep up with that change. So, we are somewhat constrained by the development of the capital markets and the pace at which they can mirror the changes in the real economy. More recently, there has been a trend toward liberalization of capital markets in Asia, especially in places like China. So that improves the accessibility and “investibility” for minor shareholders like ourselves.

We have previously noted the many contributions of Deng Xiaoping on the region. Who would you say was the next most critically influential force for the region over the last few decades.

SS: Last year, we lost a legendary statesman in Lee Kuan Yew, Singapore’s founding father. Singapore has long been on the forefront of Asia’s sustainable growth, however we interpret that. And Lee’s influence has reached far beyond the borders of his small city-state. As an example, the country has been exporting its “green” public-sector expertise and selling the Singapore Inc. model to such countries as China.

What are your thoughts on countries we tend to hear less about, such as North Korea, or “frontier” nations, such as Vietnam, Sri Lanka and Cambodia?

SS: Appealing in theory, and becoming less difficult in practice. There will have to be significant advancements

for globally competitive companies to emerge from these nations. But the economic cycles in these frontier countries may march to a completely different rhythm than the rest of the Asian region, providing some diversity.

What’s ahead for Asia?

RH: Stability, comfort, consumerism, leisure, media and entertainment. All parts of the middle-class lifestyle. For Asia, we foresee a bigger role on the world stage in global political institutions. Don’t forget, the region makes up over half the world’s population. At some point, the world will be an Asian world, and not so focused on Europe and the U.S.

SS: In our interactions with companies and Asian households, we detect a culture of opportunity and a belief that anyone could become successful. These belief systems can be important assets particularly during times of heightened volatility.

We are now at a point where the Asian economic system has the potential to be self-sustaining in its own right. The home market is large and still growing, capital is much more easily available than in the past, and there is a growing pool of talent—all necessary preconditions for building firm domestic foundations to the Asian economies.

What differentiates Matthews Asia?

RH: We have a singular focus on Asia. We do this with a team of portfolio managers in San Francisco. We are somewhat physically removed from Asia in order to have a place for reasoned dispassionate analysis of the long term. We have a long-term, bottom-up investment philosophy. And while this is not unique, I would say that much of the investment in Asia is of a higher-turnover, more short-term horizon. That is not our skillset; not our mission. Corporate ownership differentiates us from many firms. All portfolio managers hold equity in Matthews International Capital Management, LLC, the advisor to the Funds. I think this helps to align them with the business and with clients because the business survives only to the extent that the client experience is good. And I think, finally, accessibility is part of our identity. This doesn’t just mean reasonable portfolio fees and the ability to buy our products on platforms, but it also means that

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we try to give honest views on what we see happening in the region. Views across the team may differ, but we want to make these opinions accessible to both retail and institutional investors on our website and through webcasts, written materials, conferences, and, when we can, during face-to-face meetings.

Matthews Asia has come a long way. What have been the biggest challenges in the firm’s evolution?

RH: In any investment management firm, the biggest challenge is probably the passing of the baton from one generation of investors to the next. How do you do this while keeping the culture intact? It requires both generations to work together to achieve this—the willingness of the preceding generation to take a step back as well as the ability of the successors to understand the philosophy, morality and personality of the people who built the firm and nurtured its track record. This goes beyond investing to an atmosphere of compliance in the way we communicate with clients, and the way we build the portfolios. I am proud of the job we have done, grateful to our founder Paul Matthews and Chairman of the Board of Directors Mark Headley in the roles they have played. They took the task up to the mid- to late-2000s under trying market circumstances and did a terrific job.

SS: There has also been incredible skepticism, among those outside of the region, over Asia as an investment destination. Asia has often been seen as a place to trade frequently, and make money quickly, but not as a region for long-term growth. So we’ve always faced headwinds in this regard.

Since our founding in 1991, there have been at least two significant points of stress for Asian capital markets. First, there was the Asian Financial Crisis of 1997, and then the more recent Global Financial Crisis that began in 2007. Both formed times of substantial challenges during which we were tested.

We’ve learned lessons as a firm and then, separately, there have been investing lessons. As a firm, we’ve always managed things conservatively. There were probably times in which we felt we were underinvested for growth, and debating whether we were holding too much cash. We tend to be patient investors. Matthews Asia maintains a conservative balance sheet.

Looking back, what are you most proud to say that Matthews Asia has created?

RH: A sense of Matthews Asia’s culture—whether it is a brand image, a style of communicating, a way of behaving or, perhaps most importantly, the sense of a “Matthews Asia type of investment.” Why am I most proud of this? Because it embodies the wisdom of 25+ years of investment experience and carries that through to new generations. Always malleable, always open to refinement and change—but always cherishing the core strands of DNA that give it life: long-term and bottom-up investing.

It’s powerful because it has been shown to be effective; it is not easily replicated, not subject to a simple algorithm or a rulebook. But rather, like the best institutions, has grown organically over time.

Hopefully, we will not fall foul of the sin of hubris. One of the key elements is the idea that we must “question everything.” To maintain an atmosphere of open debate and discussion about how the region, the industry, the clients and our company are changing is essential to our stability.

SS: In a modest way, I also think we have helped establish Asia in some client portfolios, and created greater awareness among even more investors by identifying the risks and the opportunities, and offering perspectives on the headlines of the day. Asia has evolved from being an “interesting but obscure” part of the world to a frontline asset class for global equity investment. We would like to think that we had a small part to play in bringing that change to investor portfolios, and delivering a positive client experience.

We are also proud of our collection of talent, particularly within our investment team. In 2005, when I joined our San Francisco-based firm, we had fewer than 30 employees, of which 12 were investment team members. Today, we also have offices in London and Hong Kong, and more than three dozen investment team members who collaborate actively to generate portfolio decisions in the San Francisco office.



Matthews Asia

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