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## Matthews Asia Dividend Fund

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### Period ended 30 June 2018

For the first half of 2018, the Matthews Asia Dividend Fund returned -3.30%, while its benchmark, the MSCI All Country Asia Pacific Index, returned -3.22% over the same period. For the quarter ending 30 June the Fund returned -2.19% compared to the benchmark return of -3.25%.

#### Market Environment:

Asian and global emerging markets suffered during the first half of 2018. Negative investor sentiment resulted from several factors including escalating trade tensions between China and the U.S.; seemingly tighter monetary conditions in China and other emerging markets; and the oscillation of North Korean denuclearization talks.

During the second quarter of the year, the specter of a tit-for-tat trade war between the U.S. and China rose significantly and rattled investor confidence. Recent macroeconomic data from China also started pointing to a potential slowdown in its economic growth induced by China's financial deleveraging policy, another potential warning sign for the region. In addition, a rally in the U.S. dollar, together with a U.S. rate hike cycle and higher oil prices, further constrained the policy options of some Asian central banks, especially for the region's more emerging economies of Southeast Asia as their growth models tend to be more susceptible to external shocks. Facing all these uncertainties, Asia's equity markets struggled during the latter part of the year-to-date period.

#### Performance Contributors and Detractors:

During both the six-month and second-quarter periods, portfolio holdings from South Korea posed a significant drag on Fund returns.

The Fund's holdings in Crystal International Group, a Hong Kong-based textile manufacturer, were among the top performance detractors. As one of the largest original equipment manufacturers of apparel in China, Crystal International supplies products to diversified global apparel brands, including Fast Retailing (Uniqlo), H&M, Levi's and Gap Inc. During the second quarter, the company issued a downward revision of its 2018 earnings outlook for the first half of the year, citing unfavorable foreign currency movements and additional ramp-up costs from its newly expanded manufacturing capacity. This downward revision triggered a negative market reaction, and the stock was sold off aggressively. While we were surprised by this latest guidance, we viewed a significant part of this revision to be short-term and cyclical in nature. We felt the company's long-term, competitive advantages—its manufacturing capability across multiple product categories and its lean supply-chain management—remained intact and believed the firm should support our investment thesis of being well-positioned to grow its business by gaining further market share. We felt the share price was a good value from which to continue adding to our position.

During the second quarter, a top performance contributor to the Fund was Hua Hong Semiconductor, a Chinese semiconductor foundry business. A major player in the mature eight-inch foundry segment, Hua Hong is currently benefiting from an industry-wide supply shortage for foundry capacity, creating an attractive pricing environment for the company. In addition, Hua Hong has consistently improved its product mix over the years, focusing more on higher average selling prices and higher-margin products. The firm's stock price delivered strong returns during the quarter, as the market started to

recognize the favorable industry trend and Hua Hong's ability to deliver additional margin expansion. The company has been paying a modest 30% dividend payout, which we view as a reasonable balance between investing for future growth and returning cash to shareholders.

### Notable Portfolio Changes:

One position we initiated during the quarter was Chongqing Brewery, a Chinese beer company listed on China's domestic A-share market and that is 60%-owned by Carlsberg Group, a leading player in the global beer industry. After a period of significant business restructuring under Carlsberg's ownership, Chongqing Brewery has re-emerged as a more efficiently run business. The company has been adapting well to the latest premiumization trend occurring among Chinese consumers by leveraging Carlsberg's product portfolio and introducing more premium products to Chinese consumers. In addition, following years of consolidation, China's top beer industry players today are shifting strategy from grabbing more market share to growing their profits. We view Chongqing Brewery as well-positioned to deliver on sustainable earnings growth, thanks to its successful product premiumization strategy and a more conducive industry structure. Carlsberg, as Chongqing's controlling shareholder, has been adopting a high dividend payout policy for the Chinese firm, which we believe is likely to be maintained.

During the second quarter, we exited our position in Ping An Insurance because we felt valuations were no longer attractive. We used proceeds from the sale to purchase some new positions.

### Outlook:

Uncertainties surrounding U.S.—China trade war rhetoric and a policy-induced economic slowdown in China, among other things, may continue to dampen investor sentiment toward Asian equities for the remainder of this year. We believe, however, that investors should look beyond the cloudy macro picture and focus instead on individual corporate business fundamentals. As dividend investors, we believe Asian companies are well-positioned to offer attractive dividend yields and sustainable dividend growth.

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There is no guarantee that a company will pay or continue to increase dividends.

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