




Matthews Asia™

Matthews China Small Companies Fund

[Download PDF](#) 

Period ended 31 March 2018

For the quarter ending 31 March 2018, the Matthews China Small Companies Fund returned 4.75%, outperforming its benchmark, the MSCI China Small Cap Index, which returned 2.87%.

Market Environment:

China's equity markets were off to strong start in 2018 until fears of sooner-than-expected interest rate increases and a trade war with the U.S. took over. Fundamentally, we continued to see a broad-based earnings recovery among China's smaller companies, boosted by steadily improving domestic demand growth. Considering the mild global deflation and China's 2018 nominal GDP growth target of approximately 6.5%, the outlook for revenue growth for Chinese corporations appears positive.

We see profit margins recovering, despite a rebound in the producer price index as China has been slowing its loan growth and has cleaned up overcapacity since 2009. From both a top-down and bottom-up perspective, we anticipate a sustainable recovery in the Chinese economy and in corporate earnings. We also believe that, as a result, China's equity markets will see a recovery. The market's concerns over rising interest rates and escalating trade tensions should, in our view, have little impact on China's smaller companies given their domestic focus.

Performance Contributors and Detractors:

During the first quarter of 2018, our strong stock selection in the health care, industrials and information technology sectors contributed to the Fund's outperformance versus the benchmark. The consumer discretionary and energy sectors were the top detractors to relative performance during the period.

Our top individual contributors to Fund performance were Genscript Biotech, a global leader in gene synthesis, and CIFI Holdings Group, an emerging leader in urban property development in China's larger cities. Genscript Biotech grew by diversifying and expanding its product categories and applications while showing impressive, strong execution capabilities versus that of its competition. The firm's breakthrough into biotech oncology treatments was a key to its stock's re-rating over the past year. CIFI Holdings grew because of its focus on buying quality land banks and due to its strong execution of its fast asset turnover strategy.

Among our top detractors to Fund performance during the first quarter of 2018 was Truly International, a diversified technology component manufacturer that has expanded into the automobile electronics industry. China ZhengTong Auto Services, a leading auto dealer with a rapidly expanding auto financing business also did poorly. Both firms were hit hard during the quarter as their A-share IPO spin offs were delayed due to a volatile market environment. We believe both companies will continue to grow in the coming year as Chinese consumers are increasingly seeking cars with more advanced safety and entertainment features. We have not been fazed by the short-term volatility in the share prices for these two holdings.

Notable Portfolio Changes:

During the quarter we shed some "graduates" of our portfolio—stocks that did well during our holding period and saw their market capitalization reach above our small-cap "sweet spot." Consumer discretionary holding Wuxi Little Swan and CIFI holdings are two such examples of stocks that appreciated nicely due to strong earnings growth and valuations re-rating. We continue to selectively add innovative companies to our portfolio, especially in the technology and health care sectors. China's small-cap universe

continues to be a fertile hunting ground for finding cash flow-rich growth stocks at reasonable valuations, and we have been able to easily replace our “graduates” with attractive options.

During the quarter, we initiated a position in Kingdee International Software Group, a leader in small- and medium-size enterprise software. We have followed the company for years and believe it has turned a corner in terms of aligning its products toward more optimal cloud-based structures. It should benefit from this growth trend going forward. We believe work force productivity-enhancing tools such as those developed by Kingdee are addressing China 's dilemma over its shortage of skilled labor.

Outlook:

We are still cautiously optimistic about China's small-cap market despite heightened market volatility as we focus rigorously on the sound fundamentals of our portfolio companies. From a macro perspective, we continue to believe China has the ability to stabilize its economy through fiscal spending, interest rate adjustments and currency management. In addition, steps taken to correct China's structural issues are continuing on the right track, despite the recent changes in presidential term limits. We are focused on seeking innovative and capital-efficient small companies that are relatively insulated from macroeconomic uncertainties. We will continue to seek companies with sustainable, quality earnings streams, strong cash flows and good balance sheets that can weather uncertain economic conditions. We believe sectors such as industrial automation, health care and technology are among the most attractive from a secular growth perspective.

Investing in small- and mid-size companies is more risky than investing in large companies as they may be more volatile and less liquid than larger companies.

Performance figures discussed in any of the Fund Manager Commentaries reflect that of the Institutional Accumulation Class Shares and have been calculated in USD, including ongoing charges and excluding subscription fee and redemption fee investors might have to pay. 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 International Capital Management, LLC (“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 Hong Kong Offering Document for further details of the risk factors.

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

Investment involves risk. Past performance is not a guide to future performance. Investors should not invest in a Fund solely based on the information on this website. The information contained in this website is issued by Matthews Global Investors (Hong Kong) Limited and has not been reviewed by the Hong Kong Securities and Futures Commission. Please read the [Important Disclosures](#) for more details.

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

This website is owned and operated by Matthews International Capital Management, LLC, Matthews Global Investors (Hong Kong) Limited, Matthews Global Investors (U.S.), LLC, Matthews Global Investors (UK) Ltd and Matthews Global Investors S.à.r.l. (collectively referred to herein as "Matthews Group"). Your use of this website confirms that you have read and agree to the Terms and Conditions of this website.

©2018 Matthews International Capital Management, LLC.