Q&A from Matthews Asia Funds

December 2014

Matthews China Dividend Fund: Tapping China's Growth Via Dividends

Q **Why should investors consider this Fund?**

A The Matthews China Dividend Fund offers a distinctive and relevant approach to investing in the Chinese equity market. China's economy continues to transform in a number of ways. These changes will likely put China on a more sustainable growth trajectory over longer periods of time and are generally positive. But current reforms may be accompanied by volatility in the country's economy and capital markets. In this environment, the Matthews China Dividend Fund may provide a more stable means of accessing China's growth than typical growth equity strategies, while also aiming to provide investors with additional income in their portfolios.

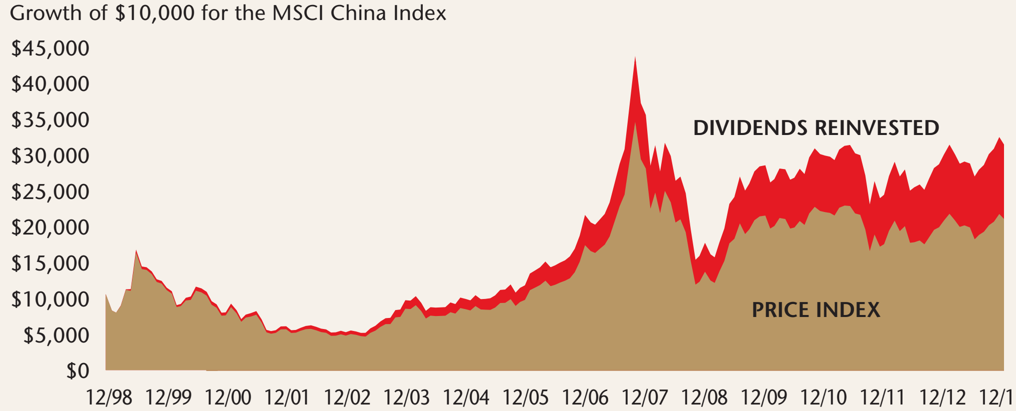
Q **Can the Matthews China Dividend Fund be a lower-risk way of getting China exposure?**

A The Fund seeks to generate attractive levels of total return with an emphasis on current income. The Fund invests in companies that offer meaningful dividend yields, have sustainable business models and that demonstrate the propensity to pay increasing dividends over time. We focus on companies with strong financials that include solid balance sheets, low financial leverage, and improving cash flows and dividend payout ratios. Dividends are, therefore, a lens through which we can identify high-quality, financially healthy companies with prudent capital allocation policies. As a result, the Fund may deliver lower volatility relative to other China strategies. Historically, dividends in China have exhibited lower volatility than earnings.

Q **How does this Fund fit within investors' portfolios?**

A Total return, income generation and the potential for lower volatility are three reasons why investors should consider the Matthews China Dividend Fund for their portfolios. Investors generally turn to China for its growth potential but an emphasis on earnings growth can cause investors to overlook the importance of dividends and dividend growth to long-term returns. The chart below emphasizes the significant role of dividends in total long-term equity returns—even in China. Between January 1, 1999 and December 31, 2013, approximately 49% of the MSCI China Index's total return has been due to the reinvestment of dividends.

WHY DIVIDENDS MATTER
The Impact of Dividends on Long-Term Returns
Growth of $10,000 for the MSCI China Index



For periods 12/31/98–12/31/13. Past performance is not indicative of future results. The MSCI China Index is a free float–adjusted market capitalization–weighted index of Chinese equities that includes China-affiliated corporations and H shares listed on the Hong Kong Exchange, and B shares listed on the Shanghai and Shenzhen exchanges. It is not possible to invest directly in an index.

Sources: MICM, MSCI

Matthews Asia

Q **How can recurring income streams augment returns?**

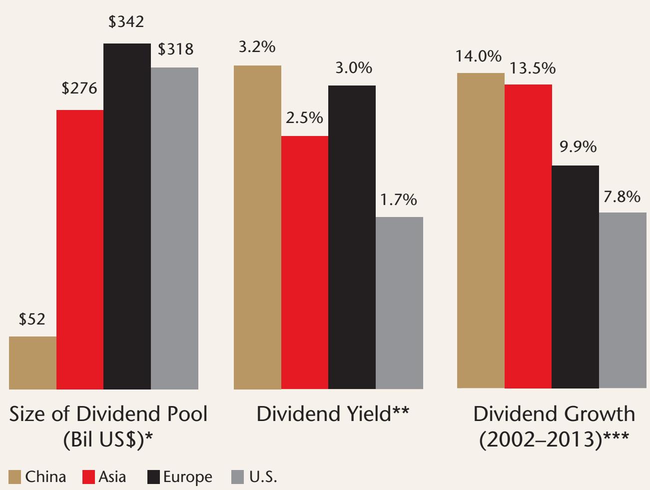
A The previous chart demonstrates that recurring income streams can significantly impact long-term total return. At times, they can also impact short-term returns and can even turn price depreciation into appreciation. To illustrate, we point to the timeframe between January 1, 2011 and December 31, 2013 when the MSCI China Index experienced a total cumulative return of 4.63%. During that time, if the contribution made by reinvesting dividends was excluded, that cumulative return would have actually been -4.84%. In other words, dividend payments provided a return of approximately 9.47%, during this three year period, and turned overall negative returns into positive returns.

Q **From a yield and dividend growth perspective, how do Chinese equities compare with equities in other regions?**

A What may surprise many investors is that Chinese companies offer not only higher yields but also faster dividend growth than companies in many other parts of the world. The graph below is illustrative of this point. In recent periods, Chinese equities have provided higher yield and dividend growth than equities in broader Asia, the U.S. or European equities; China's dividend growth rate has been 14%, far higher than that in the U.S. or Europe.

In this respect, an allocation to Chinese dividend paying equities provides investors not only with potential yield enhancement, but also with the opportunity to participate in the dividend growth of high-quality Chinese companies.

DIVIDENDS—HOW ASIA COMPARES TO EUROPE, CHINA AND THE U.S.



*2013 dividends by index members as of December 2012; Europe (Bloomberg European 500 Index), China (MSCI China Index), Asia Pacific (MSCI AC Asia Pacific Index), U.S. (S&P 500 Index).

**Trailing Dividend yield estimates for 2014 as of 7/7/14 based on FactSet aggregates.

*** Compound annual growth rate based on index constituents of Europe (Bloomberg European 500 Index), Asia Pacific (MSCI AC Asia Pacific Index), U.S. (S&P 500 Index) as of 12/31/02, excluding those that are no longer in existence as of fiscal year 2013. Dividend growth for MSCI China is derived using index members as of 12/31/05 for improved index representation; for reference S&P 500, MSCI AC Asia Pacific Index and Bloomberg European 500 Index members grew dividends at 5.7% CAGR, 8.4% CAGR, and 3.1% CAGR, respectively, from 2005-2013.

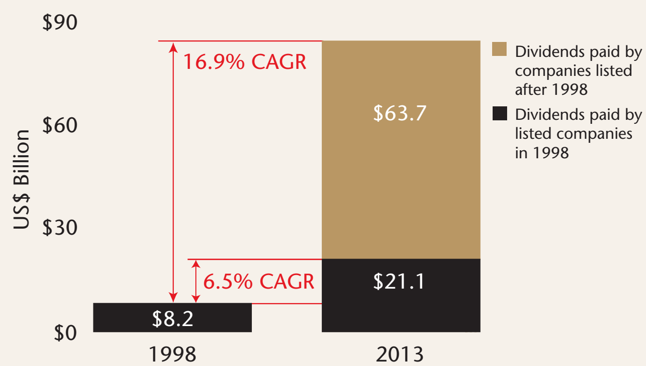
Sources: FactSet, MSCI, S&P, Bloomberg

Q **How has the universe of dividend-paying equities in China evolved over time?**

A Even as Asia remains the region of the global economy with the strongest long-term growth fundamentals, companies across the region are paying increased attention to shareholder return policies, and China is no exception. During the past 15 years, China's equity markets have expanded significantly in breadth and depth; and along with this, the universe of dividend-paying companies has grown dramatically, with aggregate dividend payments increasing from just US$8 billion in 1998 to almost US$85 billion in 2013. As shown in the chart below, the bulk of dividend growth has come from Chinese companies listed after 1998. Unlike most initial public offerings (IPOs) in the West, many of China's IPOs are due to the privatization of large stakes in State-Owned Enterprises (SOEs) or the listing of family-run businesses, which means that these are typically established companies that pay dividends from the time of their public listing. This explains why China has become one of the largest and fastest-growing dividend markets in Asia.

CHINA'S DIVIDEND GROWTH

Aggregate Dividend Payments by Chinese Companies*



*Excluding A-share market; CAGR = Compound Annual Growth Rate
Dividend payments in chart do not reflect dividends paid by shares held in Matthews China Dividend Fund.

Sources: FactSet, MICM

There is no guarantee that companies will maintain or grow their dividend pay-out ratio, or pay dividends.

Q **What may a dividend reveal about the quality of a company and its management?**

A Dividends align management, or majority shareholders, with the interests of minority shareholders.

Compared to developed markets, Chinese companies tend to have more concentrated company ownership, either in the form of a founding family or a government-affiliated entity.

For private founders who have taken their company public, dividends may become their primary source of income. For government-affiliated shareholders of SOEs, dividends are often an important source of funding for government spending. In such cases, dividends are meaningful because they assure that minority shareholders have as equal a claim to earnings as large shareholders; and they are also paid in accordance with their percentage of ownership. In this regard, dividends often signal positive corporate governance.

Discipline around dividends can help to identify healthy companies and provide signals that may not be readily apparent by looking at a firm's financials. Because cash is less prone to accounting manipulation, dividend growth is a better indicator of business performance than reported accounting earnings growth. Moreover, by reducing cash on the balance sheet, dividends force company management to become more disciplined in their decisions around capital utilization. Dividends thereby may indicate that managements are acting as good stewards of the capital with which they have been entrusted and may lower corporate governance risk.

The Matthews China Dividend Fund aims to focus on companies that can grow dividends in a predictable fashion over time. Companies that pay stable and/or growing dividends often exhibit:

- stable earnings that allow for the ongoing funding of the dividend
- strong balance sheets to provide shareholders higher claims to cash flows
- proven track records of dividend payments
- a commitment to continue dividend payments—and to grow them over time

Q Please describe the composition of dividend payments within China by sector.

A China's expanding universe of dividend-paying companies has made it possible to pursue a scalable dividend investment strategy across a diversified portfolio. Chinese companies paid out approximately US$85 billion in dividends during 2013. Of that, companies in the financial services sector (banks, insurance and real estate) paid the most, approximately US$41 billion (49% of the total). Telecommunication services stocks paid out a combined total of about US$10 billion (12% of the total).

CHINA'S DIVERSE POOL OF DIVIDENDS
Aggregate Dividend Payments of Chinese Companies (US$BN) (excluding A-share market)

Sectors	1998	2013	1998	2013
Consumer Discretionary	0.7	10.2	8%	12%
Consumer Staples	0.2	2.4	2%	3%
Energy	0.0	6.7	0%	8%
Financials	3.8	41.5	46%	49%
Health Care	0.0	0.6	0%	1%
Industrials	1.9	6.4	23%	7%
Information Technology	0.1	1.6	1%	2%
Materials	0.1	1.8	1%	2%
Telecommunication Services	0.1	9.9	1%	12%
Utilities	1.4	3.8	18%	4%
Total	**8.2**	**84.8**	**100%**	**100%**

Sources: MICM, FactSet

There is no guarantee that companies will maintain or grow their dividend pay-out ratio, or pay dividends.

Q How do State-Owned Enterprises factor into this strategy?

A Many of the largest dividend-paying Chinese companies are former SOEs with a continued high degree of government ownership. Therefore, the Chinese government does still influence both earnings and dividends. Dividend policies have been improving, and we are encouraged by explicit government support for companies to return a greater share of earnings to shareholders via dividends.

Q What is the focus of your investment process?

A The Matthews China Dividend Fund team utilizes a bottom-up investment process that evaluates companies for their ability to pay dividends, as well as their willingness to pay and increase dividends over time.

To ascertain the "ability" to pay growing dividends, we assess the fundamentals of each company, including stability of sales and earnings growth, sustainability of margins and high returns on invested capital. We look for firms with moderate dividend payout ratios that allow the company strong dividend coverage, and the potential for further dividend growth through expansion of the payout ratio. We prefer conservative balance sheets, which lower the risk of cash flow being diverted to debt servicing. We also focus on cash flow rather than accounting earnings, and look for companies that generate cash earnings.

Following the business assessment, we evaluate the strength of the management team, its approach to capital allocation, and the thinking behind a dividend policy. Meetings with company management are a mandatory part of our investment process, through which we aim to build a comprehensive understanding of a company, the environment in which it operates its capital allocation policy and its commitment to dividend payments.

Once we are comfortable with a company's ability and willingness to pay and grow dividends, we consider valuation in terms of a stock's current yield and the company's potential for dividend growth over the coming three to five years.

The Matthews China Dividend Fund's bottom-up investment process results in an all-cap portfolio that typically consists of 30-60 stocks. The portfolio includes a combination of stable dividend-paying companies with modest expected growth rates together with modest-yielding companies that offer the potential for attractive dividend growth over the next three to five years.

Q Tell us about the portfolio management team's experience investing in China.

A Matthews Asia has over 20 years of investing in China and eight years of experience in managing dividend funds in Asia. Our China Dividend team is supported by several China-focused analysts and draws on the expertise of a 35+ member investment team focused on wider Asia.

Yu Zhang, CFA, is a Lead Manager of both the Matthews Asia Dividend and Matthews China Dividend Funds. Prior to joining Matthews in 2007 as a Research Associate, Yu was an Analyst researching Japanese companies at Aperta Asset Management from 2005 to 2007. Before receiving a graduate degree in the U.S., he was an Associate in the Ningbo, China office of Mitsui & Co., a Japanese general trading firm. Yu received a B.A. in English Language from the Beijing Foreign Studies University, an M.B.A. from Suffolk University and an M.S. in Finance from Boston College. He is fluent in Mandarin.

Sherwood Zhang, CFA, is Co-Manager of the Matthews China Dividend Fund. Prior to joining the firm in 2011, Sherwood was an analyst at Passport Capital from 2007 to 2010, where he focused on such industries as property and basic materials in China as well as consumer-related sectors. Before earning his M.B.A. in 2007, Sherwood served as a Senior Treasury Officer for Hang Seng Bank in Shanghai and Hong Kong, and worked as a Foreign Exchange Trader at Shanghai Pudong Development Bank in Shanghai. He received his M.B.A. from the University of Maryland and his Bachelor of Economics in Finance from Shanghai University. Sherwood is fluent in Mandarin and speaks conversational Cantonese.

The team is complemented by prominent China analyst, Andy Rothman, an Investment Strategist for Matthews Asia, focusing on China's ongoing economic and political developments. Prior to joining Matthews, Andy spent 14 years as CLSA's China macroeconomic strategist. He also spent 17 years in the U.S. Foreign Service, with a diplomatic career focused on China, including as head of the macroeconomics and domestic policy office of the U.S. embassy in Beijing. In total, Andy lived and worked in China for over 20 years. His in-depth knowledge and unique insights support the Matthews China Dividend Fund team.

Q **What are the risks associated with this Fund's strategy?**

A We believe China has solid long-term growth prospects but we still expect volatility in this market. The lack of geographical diversification is one of the main risks of the Matthews China Dividend Fund. China's restricted capital account means there is less currency diversification. Because the government plays a dominant role in the Chinese economy, there are also greater political and regulatory risks. Central regulatory directives can significantly impact dividend payments. Nevertheless, China's regulatory changes have generally been positive for dividend payments.

Dividend-paying equities can offer downside protection against share price depreciation but they may not fully participate during periods of broad market appreciation.

There is no guarantee that the Matthews China Dividend Fund or the companies in its portfolio will pay or continue to pay dividends.

Contact Matthews Asia

To learn more about Matthews Asia or how the Matthews Asia Funds can complement your globally diversified portfolio, please call 800.789.ASIA or visit matthewsasia.com.

Disclosures

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All performance quoted represents past performance and is no guarantee of future results. It is not possible to invest directly in an index.

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