Bloomberg

May 9, 2012 | bloomberg.com

Personal Finance

A Fund For The Risk-Averse In Emerging Markets

Conservative investors often think of emerging markets as too risky. With much of the world's economic growth coming from Asia and Latin America, ignoring those markets can mean sacrificing significant potential returns. That's why money manager Andrew Foster launched the Seafarer Overseas Growth & Income Fund, a no-load fund with a 1.6 percent expense ratio, this February. In an attempt to dampen the volatile nature of emerging-markets investing, the fund buys high-yielding dividend-paying stocks, convertible bonds and preferred stocks in countries ranging from Brazil to Vietnam.

A former manager of the Matthews Asian Growth & Income Fund, Foster is no stranger to this strategy. Foster now runs Seafarer Capital Partners, with his two-member investment team, in Larkspur, California.

Q: How important is yield in this environment for emerging markets?

A: Yield can provide some defensiveness in emerging markets. By focusing on a company that can produce income consistently, you are by nature a conservative investor because you are looking for a company that can translate more of its earnings into cash. That is a higher hurdle to jump over in my view. That's not saying anything new, but it's surprising how often that's lost in emerging markets. People get excited about a hot, fast-growing company without having a clear understanding how that company makes its money. Because they don't know the cash flow, they don't appreciate where the risks lie.

Q: And why did you want to broaden your focus beyond Asia?

A: I saw some signs in the fall of 2009 that growth in China was going to slow. More important was that I didn't see a counterpart globally to what I saw as an excellent strategy in Asia devised by Paul Matthews. Paul had this vision of launching a classic growth fund — what is today the Matthews Pacific Tiger Fund — which owns growth equities. But he also paired this with a strategy that tries to achieve most of the same growth but maybe leave some growth on the table. In exchange for that, the strategy dampens or mitigates the volatility in the business cycle and the markets and hopefully attracts people to invest for the long-term. In managing that strategy, I became a real fan of it and how unique it was in the context of emerging market investing. As far as I could determine, there weren't counterparts to the strategy in Latin America and Eastern Europe.

Andrew Foster launched the Seafarer Overseas Growth & Income Fund. Courtesy Seafarer

Q: Why do you think China's growth is slowing?

A: If anything, China has a surplus of financial capital. Really, the next stage of its evolution has to derive from human capital. To achieve a higher rate of growth, it has to unlock the services side of the economy. When I look at the Chinese consumer, they have enough physical goods — cars, houses, furniture — given their current level of income. The Chinese under-consume in the service sectors. They don't have proper health care for a large portion of the country. They don't have the education systems that many [in the country] would aspire to. They don't have professional services consumers might utilize — legal, accounting, entertainment and media. The notion that China can continue to grow [gross domestic product] at 10 percent to 12 percent, like it did in the 1980s and '90s, is a mathematical fallacy.

Q: Is there any country that resembles China before its growth spurt?

A: I don't think any country will go through the same evolution. But there are some that are very notable in terms of their growth trajectory. Vietnam is first and foremost. My biggest holding in the fund currently is Van Eck's Market Vectors Vietnam exchange-traded fund. The reason for that is it takes upwards of 125 days to register the fund in Vietnam to trade individual stocks. As soon as I have the ability to trade individual securities, we will shed this ETF and buy direct positions.

Q: What is so promising about Vietnam?

A: Vietnamese companies are trading at five to six times earnings. It's also not too hard to find companies with 5, 6 or 7 percent dividend yields. The securities are fairly inefficiently priced. It's a difficult market to trade, but this caveat is outweighed by the attractiveness of its very vibrant private sector and the growth unfolding there. It reminds me of Bangkok when I first landed in the region 15 years ago.

Q: What about outside of Asia?

A: Brazil reminds me a lot of Indonesia — resource rich, investment poor and it has a large domestic populace with a lot of potential. I see companies there now that are extremely well-run and emerging in the services sector. We have a holding there called OdontoPrev. It runs dental clinics on behalf of corporations and insurance carriers. It's basically a health management organization (HMO) but in the dental industry. I think it has world-class service capabilities. Its earnings are growing about 20 percent a year and it offers a 3 percent dividend yield.

Q: What are some of the holdings you are most excited about?

A: Our biggest equity position is SIA Engineering, an airline-servicing company that does the maintenance for aircraft fleets for Singapore Airlines and other carriers in Asia. It's a mid-cap stock based in Singapore, trades at 16 times earnings, offers a 5 percent dividend yield, has no debt to speak of and has about $400 million of cash on the balance sheet. Its earnings have been growing reliably, at least in the 10 percent range. I think there are a number of reasons it will be growing faster still — expansion into China and the U.S. and overall greater volumes from its existing customers throughout Asia.

Q: What else?

A: I have two preferred stocks in South Korea. The preferred-share market is incredibly discounted at this stage, relative to common stocks. One I have is for Samsung Fire & Marine Insurance. The company has a strong liquid balance sheet and its preferred shares trade at a two-thirds discount to the common stock. That means the yield on the preferred stock is quite a bit more substantial, verging on 6 percent. The common stock has room to grow its dividend and history suggests the company will reward any growth to the common stock dividend to the preferred stock as well.

The other preferred share company is S-Oil, an oil refiner. At 8 percent for the coming year its preferred share yield is even higher than Samsung's and its discount to the common stock price is 42 percent. The refining industry is fairly healthy in Korea. Although the industry is not poised for enormous growth, that 8 percent yield is plenty steady.

By Lewis Braham
(Lewis Braham is a freelance writer based in Pittsburgh.)

ALPS Distributors, Inc. is the distributor for the Seafarer Overseas Growth and Income Fund. ALPS Distributors, Inc. is not the distributor for the Matthews Asia Funds.

Investors should consider the investment objectives, risks, charges and expenses carefully before making an investment decision. This and other information about the Fund is contained in the Prospectus, which may be obtained by calling (855) 732-9220. Please read the Prospectus carefully before you invest or send money.

An investment in the Fund involves risk, including possible loss of principal. International investing involves additional risk. These include risks related to social and political instability, market illiquidity, and currency volatility. Investing in foreign securities may involve certain additional risks, exchange-rate fluctuations, limited liquidity, high levels of volatility, and reduced regulation. Fixed-income investments are subject to additional risks, including but not limited to interest-rate, credit, and inflation risks.

The Seafarer Overseas Growth and Income Fund is new and has limited operating history.

As of 4/30/2012, the Market Vectors Vietnam ETF comprised 4.9% of the Seafarer Overseas Growth and Income Fund; Odontoprev SA comprised 3.9% of the Fund; SIA Engineering Co., Ltd. comprised 4.8% of the Fund; Samsung Fire & Marine Insurance Co., Ltd., Pfd. comprised 4.4% of the Fund; and S-Oil Corp., Pfd. comprised 4.3% of the Fund. Holdings are subject to change.