SEAFARER

SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

Second Quarter 2023

Andrew Foster
Chief Investment Officer and Portfolio Manager

Paul Espinosa
Portfolio Manager

Lydia So
Portfolio Manager

During the second quarter of 2023, the Seafarer Overseas Growth and Income Fund returned 3.47%.[1,2] The Fund's benchmark index, the Morningstar Emerging Markets Net Return USD Index, returned 1.63%. By way of broader comparison, the S&P 500 Index returned 8.74%.

The Fund began the quarter with a net asset value of $11.79 per share. During the quarter the Fund paid a semi-annual distribution of approximately $0.178 per share. This payment brought the cumulative distribution, as measured from the Fund's inception, to $5.017 per share.[3] The Fund finished the quarter with a value of $12.02 per share.[4]

Performance

In the Growth and Income Fund's preceding portfolio review,[5] I suggested two conditions were chiefly responsible for market fluctuations during the first quarter (namely: vacillating speculation about investment opportunities in China, and perceived shifts in U.S. monetary policy). This quarter was the opposite: no events dominated markets, and stock prices traded sideways, seemingly aimlessly. Speculators and short-term traders eschew such conditions; they disparage them as "directionless" or "listless," as the markets do not exhibit the trending momentum or volatility they prefer to trade. By contrast, this sort of condition is what stock-pickers favor. Without a macro theme or political imbroglio to roil markets, prices move idiosyncratically, and stocks tend to align gradually with the fundamental performance of the companies they track. Stock-pickers appreciate that over the long term, fundamentals tend to win out over the trends that provide short-term momentum – and especially so amid markets that move "sideways."

To be sure, some "big picture" events impacted the emerging markets at the margin. Chief among those was another slump in China's markets. Data published throughout the second quarter revealed that economic conditions in the Middle Kingdom are weak, and corporate performance is struggling. Investors recognized that the "reopening" theme pushed by strategists after the country exited "zero Covid" was only so much hype. Chinese stocks succumbed in response: the Morningstar China Index fell -9.2% during the quarter.[6] Still, even as China equities

This portfolio review addresses the second quarter of 2023 (4/1/23 to 6/30/23). As of 6/30/23 the annualized performance of the Fund's Institutional class was: 1 year 8.09%, 3 year 7.31%, 5 year 5.02%, 7 year 5.05%, 10 year 4.84%, and since inception (2/15/12) 5.39%[1]; the gross expense ratio was 0.87%. The performance data quoted represents past performance and does not guarantee future results. Future returns may be lower or higher. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. View the Fund's most recent month-end performance at www.seafarerfunds.com/performance.

make up the single largest constituency within Fund's benchmark – about 26% weighting at the end of the quarter – the country's malaise was not enough to dampen returns for the index overall, as many other emerging markets pushed into positive territory.[7]

The other major trend to sweep through global markets was an awareness that artificial intelligence (AI) might fundamentally reshape the world – and that some companies might profit handsomely from its propagation. This trend reverberated most productively through U.S. equities. By contrast, it found limited purchase within the developing world. To the extent the trend was manifest, it seems to have boosted stock prices for some semiconductor manufacturers (including **Samsung Electronics**, a holding within the Fund) and the shares of some obscure small companies listed in the A-share market in mainland China. With the possible exception of China, the developing world appears to lag far behind the U.S. in the development of "generative AI" and "large language models;" for better or worse, the associated momentum that pushed U.S. markets higher largely skipped over the emerging markets.

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As stocks traded idiosyncratically and "sideways," the Fund produced gains from disparate underlying sources. The largest contributions came from a Brazilian investment management firm (**XP, Inc.**), a Hungarian pharmaceutical manufacturer (**Richter Gedeon**), a Poland-based video game studio (**CD Projekt**), a Brazilian bank (**Itaú Unibanco**), and a Japan-based maker of specialized integrated circuits used in electric vehicles (**Rohm**). There is no unifying "theme" that spurred all these shares higher, except that each underlying company has produced solid performance against the weight of expectation. Markets might have seemed "adrift," but individual stocks made the difference and drove the Fund's outperformance.

XP has grown rapidly in recent years. Its wealth and investment advisory business has reshaped the financial service industry in Brazil, having won share from traditional banks that have struggled to adapt to new consumer preferences. However, XP's rapid growth stalled in 2022, disappointing some analysts and some short-term investors; the shares slumped in the first quarter of 2023. Yet even as pessimism hung over the company, its performance continued to impress. The company's resilience amid tough market conditions has pushed its shares higher once more, abetted by speculation that Brazil will soon cut interest rates.

Richter Gedeon has produced exceptional levels of profits as one of its drugs has become one of the leading antipsychotics in the U.S., used to treat bipolar disorder and certain depressions. In response, the company has undertaken a dramatic increase in its dividend and launched a stock buyback program. The shares marched higher in response.

CD Projekt experienced a major gaffe with one of its premier game titles a few years ago. Though the game was lauded for its expansive vision, the gaffe nonetheless stifled sales of the game. The shares were left in a funk, and stock analysts that had been rabid cheerleaders turned sour. Yet the company soldiered onward. The studio announced an expansion pack for the original game during the second quarter. The expansion has generated so much anticipation among gamers that the dour analysts have been forced to revisit their assumptions about sales for the original title (one must own the original to play the expansion pack). The shares rallied sharply in the quarter against the pessimism.

Itaú has long been one of Brazil's best-managed and most profitable banks. However, Itaú has executed particularly well amid an environment of rapidly increasing interest rates and difficult economic conditions. Brazil's central bank has proactively battled inflation, and as mentioned above, rates may soon drop. The prospect of lower rates and greater demand for credit has fueled renewed expectations for Itaú's growth.

Rohm is a stalwart of Japan's semiconductor industry. It has survived many preceding cycles and honed the excellence of its products. Nonetheless, it had also grown staid and unresponsive to emerging customers overseas, and consequently it lost market share. Yet under new management, the company has begun to reinvent itself. It has regained share in raw materials critical to the production of power-saving semiconductors, and it has gained share in componentry that is essential for electric vehicles. Meanwhile, the company has exhibited a newfound degree of competitiveness, with greater focus on overseas markets in East Asia and the U.S. With its renewed vigor, the company has placed newfound emphasis on shareholder returns, with dividend increases and a substantial stock buyback campaign over the past few years.

Allocation

During the second quarter, the Fund added three new holdings. No positions were exited, and thus the Fund's portfolio now comprises 50 positions. One of the new holdings will not be disclosed at this time, as the Fund is still building the position within the investment portfolio. However: two positions were added to the Fund near the conclusion of the first quarter. I declined to discuss them at the time, as they were likewise under development; as they are now well-established, I will introduce them here.

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Near the end of the first quarter, the Fund entered the Mexico-based **Becle SAB** (also known as "Cuervo," the maker of the eponymous tequila brand "Jose Cuervo"). As Cuervo's products are prevalent in the U.S., I presume most of you are at least passingly familiar with its brand and products. Most of you also know the company has held a leading position in the mass market for tequila for many years. However, what is less well understood is the company's current corporate transformation – a transformation that appears to be driven by a generational change in control. From its dominant (and lucrative) position as a mass-market liquor leader in North America, it is attempting to capitalize on the worldwide interest in tequila, reinventing itself as a premier global brand. The company is making major investments in support of this transition: investments in global distribution, investments in productive capacity, and investments in inventory. With respect to the last, Cuervo is now carrying large stocks of *añejo* tequilas on its balance sheet. *Añejos* are lauded for their smooth and refined characteristics, but they must be aged for extended periods prior to bottling and eventual sale; effectively, Cuervo has invested in valuable stocks of inventory, marketed under new brands at higher prices (chiefly "Reserva de la Familia"). In addition, the company has acquired non-tequila liquors (whiskey) to diversify its portfolio and give it more clout in distribution channels. If executed well, Cuervo's push for a premium, global expansion could unlock new (and currently underappreciated) growth potential.

The Fund also initiated a position in Singapore Exchange (SGX) late in the first quarter. SGX is the dominant asset exchange in Southeast Asia. Singapore's reputation for strong supervision and financial transparency helped establish SGX as a regional exchange rather than a minor local stock market. As investors enjoy greater protections, companies throughout Asia vie for listings to tap capital at lower cost, with greater attendant liquidity. However, in the past decade, SGX has moved beyond its roots as a stock exchange. It has demonstrated a capacity for innovation, listing critical contracts, futures, exchange-traded funds, and other derivatives. In the process, SGX has transformed itself into a regional financial hub. We expect the company's steady yet incrementally innovative approach will ensure its leadership within Southeast Asia's growing capital markets for some time to come.

In the second quarter, the Fund established a position in Novatek Microelectronics, a veteran competitor within the semiconductor design industry in Taiwan. The company designs chips primarily for consumer electronics and other consumer goods. It has long held a leading position in the design of integrated circuits that drive display technologies (e.g., flat-panel televisions and monitors). In recent years, Novatek has advanced its designs further, miniaturizing them and reducing power consumption; this in turn has allowed it to enter the lucrative market for mobile phone displays. Throughout its history, the company has placed an extraordinary emphasis on the return of capital to its shareholders, primarily through a generous annual dividend. We think the company's growth prospects, steady cash flow and dividend practices make it an excellent fit for the Fund's strategy.

The Fund also built a position in Bank Central Asia (BCA), one of the dominant banks in Indonesia. BCA has carved out an extraordinary position within the Indonesian marketplace, enjoying one of the leading deposit franchises in the country. Equipped with its stable and low-cost funding base, the bank specializes in short- and medium-term loans, primarily to consumers and small and medium businesses (often for working capital with lower credit risks and rapid conversion to cash). Due to its conservative balance sheet, the bank readily survived – and prospered after – the repeated crises that have shaken Indonesia's financial markets over the past two decades. Its stable growth and profitability have been reflected in an extraordinary dividend policy, not unlike that of Novatek.

Outlook

Looking to the latter half of 2023, the year seems to be poised on the edge of expansion and contraction. Officially, the consensus expectation for earnings growth within the emerging markets is moderately negative: earnings are expected to decline -3.8% compared to 2022.[8] I remain firmly optimistic about emerging equities for the long term (i.e., five years and beyond; see the Fund's fourth quarter 2022 portfolio review[9] for my rationale). Yet I admit that 2023 has been a challenging year for corporate profitability, more so than I thought at the outset of this year. I anticipated a modest expansion against a consensus which was even then negative. However, data from the first quarter supports the consensus: results have been mixed. Some companies in the emerging markets are in rude health, but others are producing lackluster results, and some are experiencing a substantial contraction in profits. The holdings within the Fund have experienced much the same as the broader asset class: mixed results, with some in contraction, such that the overall forecast for the Fund calls for a modest decline in earnings relative to 2022.

Why so? In the Fund's preceding portfolio review,[10] I posed two possibilities: first, that inflation was pushing up input costs for labor and materials quickly, faster than companies might adapt, and this pressure was eating into profit margins. In that scenario, the problem was not one of revenues, demand or growth; rather, profits suffered due to spiraling costs. Alternatively, I suggested that weak demand might be to blame. This possibility was rooted in evidence that most developing nations had tamed their inflation pressures through orthodox monetary policies. Meanwhile, companies had adapted to higher input prices by managing their cost structures (e.g. finding new, cheaper sources for materials, or improving labor productivity), and by increasing end prices to their customers. In that scenario, rising input costs did not pose an insurmountable problem, but weak demand might. Faced with the twin prospect of higher interest rates and rising prices for products and services, businesses and households might reign in consumption, leading to lackluster demand and poor revenue growth.

While we only have one quarter of published results by which to judge, the latter explanation seems the dominant. Demand is weak, especially in East Asia, centered in China. Further, China is such a large consumer of goods from East and Southeast Asia and raw materials from South America that weak consumption patterns there produce ripple effects across many other portions of the developing world. The emerging markets do not have an inflation problem; they have a demand problem.

Is this problem serious? Not terribly so in my view, at least not yet. While China's consumption may be weak, with knock-on effects felt in some industries elsewhere, much of the rest of the emerging markets have resumed growth – we see it in portfolio holdings across a wide range of countries and industries. India's economy looks to be in rude health, even if valuations are terribly steep for most shares. The possibility of recession in China looms, but short of that, growth in the rest of the developing world looks set to persist if not even accelerate a bit.

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Most of the weak demand emanates from China one way or another. Given China's economic scale and integration with other countries' markets, it obviously warrants scrutiny. In my opinion, the country's foreseeable future looks difficult. Investors should not expect a sudden or rapid recovery courtesy of Beijing's largesse. The same strategists that pushed the over-hyped "reopening" narrative will now pivot and pretend that some weakness was to be expected, and that the numbers are not as bad as they look. To the extent there is a demand problem, they will suggest that "pragmatic" Beijing will inevitably act to stimulate the economy.

Not only are such post-fact revisions disingenuous, they are also likely wrong. Beijing does not have the capacity to stimulate the economy as it once did: orthodox monetary policy is unlikely to be effective amid the country's deflationary, balance sheet-driven downturn. Meanwhile, the government's capacity for fiscal stimulus is severely constrained due to preceding cycles of over-expenditure and debt accumulation. Accustomed to the government's past profligacy, strategists have confidently predicted major stimulus packages during each of the preceding three years, based on the assumption that Beijing would act decisively to offset persistently weak growth. Yet each time they have been astonished and disappointed by Beijing's apparent fiscal rectitude. They have failed to discern that the country's coffers were constrained, and that it cannot spend as freely as it once did. China no longer has a simple "out" through fiscal stimulus. (For more on the constraints hampering China's fiscal stimulus, please see the Fund's second quarter 2023 portfolio briefing video,[11] and my colleague Nicholas Borst's excellent series on China's Balance Sheets.[12])

Yet for all this gloom, my counsel is that no investor should dismiss China altogether. The country's growth over the past three decades has been powered almost entirely by individual entrepreneurs and private enterprise – not macro themes, government policies or economic stimulus. My advice is not to bet against such commercial endeavor and entrepreneurial strength. In the meantime, while Beijing's fiscal resources may be crimped, it has a surfeit of sovereign authority. The government's far-reaching control could prove the economy's salvation.

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How does a country extricate itself from a deflationary, balance sheet-driven recession? There are two main approaches, in my view. The first approach is to muddle forward, pretending that bloated and insolvent balance sheets are not a serious problem. The government provides just enough liquidity to keep insolvent banks afloat, but then leans on those banks to roll over financing for "zombie" companies that are unproductive and likely insolvent. The muddling will result in a long period of sub-par growth, as unresolved debts and low productivity constrain balance sheets and dampen new investment. Over time, political pressure will build to inflate away the large stocks of unresolved debt, probably terminating in an unorthodox quantitative easing policy that pushes interest rates near (or even below) zero. This is the approach that Japan took between 1990 and 2010.

The second approach is to tackle the problematic debt directly. Financial restructuring can materially improve credit quality for some debts, saving otherwise marginal credits from default. (China could vastly improve the credit quality of its problematic municipal and provincial debts by consolidating them with the central government, which enjoys a strong balance sheet; for more on this topic, please see the Fund's second quarter portfolio briefing video.[13]) The rest of the bad debt must be written off, liquidated and purged from the system, with recapitalizations to follow thereafter. The merit of this second approach is that will reset the financial system faster, allowing markets to restore their function, improving the investment climate, and prompting the resumption of growth from a new base. However, this approach imposes economic austerity, and as such is politically infeasible in a responsive democracy. Therein lies China's advantage relative to Japan: Beijing may lack for fiscal resources, but it does not want for control, nor for the iron will to enact painful reform.

China has a second advantage relative to Japan: whereas in Japan bad debts were distributed throughout the private sector – making them difficult to identify and consolidate – most of the dubious and bad debts in China's system stem from government-linked entities (state-owned enterprises and local government financing vehicles ("LGFVs," which are quasi-public/private entities that borrow on behalf

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of provincial and municipal governments to advance state-driven fiscal projects)). While China's financial problems are largely of the government's own making, Beijing has all the control it needs over balance sheets and politics to clean up the problem – perhaps in two to three years – if it chooses. I suspect that if Beijing acts swiftly and concertedly, Chinese stocks could respond favorably. Indeed, an initiative launched last quarter to formally recognize and refinance certain LGFV debts may be a precursor to a larger restructuring effort.[14] Do not bet on easy narratives about pragmatism, or facile calls for stimulus – but likewise do not give up on China, stay tuned.

Thank you for entrusting us with your capital. We are honored to serve as your investment adviser in the emerging markets.

Andrew Foster
Chief Investment Officer and Portfolio Manager

with

Paul Espinosa
Portfolio Manager

and

Lydia So
Portfolio Manager

July 17, 2023

[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIGIX). The Investor share class (ticker: SFGIX) returned 3.47% during the quarter. All returns are measured inclusive of Fund distributions paid (in relation to Fund performance) or dividends paid (in relation to index performance), reinvested in full (exclusive of any U.S. taxation) on the pertinent ex-date.

[2] The performance data quoted represents past performance and does not guarantee future results. Future returns may be lower or higher. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. View the Fund's most recent month-end performance at www.seafarerfunds.com/funds/ogi/performance.

[3] The Fund's inception date is February 15, 2012.

[4] The Fund's Investor Share class began the quarter with a net asset value of $11.72 per share; it paid a semi-annual distribution of approximately $0.176 per share during the quarter; and it finished the quarter with a value of $11.95 per share.

[5] www.seafarerfunds.com/funds/ogi/portfolio-review/2023/03/Q1/#performance

[6] Morningstar China Net Return USD Index, measured in U.S. Dollars between 3/31/23 and 6/30/23. Source: Bloomberg.

[7] Based on the Morningstar Emerging Markets Net Return USD Index, as measured on 6/30/23. Source: Bloomberg.

[8] This statistic is based on the consensus expectation for emerging markets earnings growth as calculated by J.P. Morgan. Source: J.P. Morgan, "Emerging Markets Equity Strategy Steering Board," June 29, 2023.

[9] www.seafarerfunds.com/funds/ogi/portfolio-review/2022/12/Q4/#outlook

[10] www.seafarerfunds.com/funds/ogi/portfolio-review/2023/03/Q1/#outlook

[11] www.seafarerfunds.com/video/2023/06/ogi-portfolio-briefing/#weak-demand

[12] www.seafarerfunds.com/commentary/a-balance-sheet-approach-to-china

[13] www.seafarerfunds.com/video/2023/06/ogi-portfolio-briefing/#government-debt

[14] "LGFV Evolution Requires New Rules," *Bloomberg Intelligence*, June 12, 2023.

Glossary

A-Shares: a class of securitized common stock in Chinese companies, traded exclusively on Chinese stock exchanges (i.e., Shanghai and Shenzhen), and denominated in renminbi, China's currency. Historically, the renminbi was subject to strict controls, such that foreign (i.e., non-Chinese) investors were not able to obtain or use the currency for financial purposes (i.e. savings or investment). Because of this constraint on the currency, A-shares were historically inaccessible to foreign investors, de facto: foreigners could not legally obtain renminbi for portfolio investment purposes, and therefore they could not fund any purchase of A-shares. Beginning in 2002, China liberalized the use of the renminbi for investment purposes, allowing selected, large foreign institutions to apply for Qualified Foreign Institutional Investor (QFII) status. Foreign institutions granted QFII status can legally purchase renminbi under a quota scheme, and that renminbi can be used to fund the purchase of A-shares and other financial assets within China. Beginning in 2014, China launched a second program known as the Stock Connect; this program allows foreign investors to purchase selected A-shares on the Shanghai or Shenzhen exchanges. A-shares are not to be confused with H-shares (Chinese companies incorporated in China, but listed in Hong Kong) and ordinary Hong Kong-listed companies of Chinese origin (Hong Kong incorporated, and Hong Kong-listed, but with substantial economic ties to mainland China).

Derivative: a contract whose value is based on the performance of an underlying financial asset, index, or other investment.

Exchange-traded Fund (ETF): a basket of securities that tracks an underlying index. An exchange-traded fund (ETF) is listed on an exchange. An ETF's share price changes throughout the trading day as shares are bought and sold on the market.

Liquidity: the ability to buy or sell an asset readily and with reasonable volumes without affecting the asset's price. (Sources: Seafarer and *Barron's Dictionary of Finance and Investment Terms*, 1995)

Local Government Financing Vehicles (LGFVs): special purpose vehicles that borrow funds on behalf of local governments to finance projects ranging from infrastructure to real estate development.

Quantitative Easing: the attempt by a central bank to inject more money into the economy and to keep long-term interest rates low through the purchase of large amounts of assets, often held by financial institutions. (Source: MITnews, "Explained: Quantitative Easing," August 17, 2010)

State-owned Enterprise (SOE): a legal entity that is created by the government in order to participate in commercial activities on the government's behalf. A state-owned enterprise can be either wholly or partially owned by a government.

SEAFARER
seafarerfunds.com

For More Information

Individual Investors
(855) 732-9220
seafarerfunds@alpsinc.com

Investment Professionals
(415) 578-5809
clientservices@seafarerfunds.com

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The Morningstar Emerging Markets Net Return USD Index measures the performance of emerging markets targeting the top 97% of stocks by market capitalization. The index does not incorporate Morningstar's environmental, social, or governance (ESG) criteria. Index code: MEMMN. The Morningstar China Net Return USD Index is an index that measures the performance of China's equity markets targeting the top 97% of stocks by market capitalization. The index does not incorporate Morningstar's environmental, social, or governance (ESG) criteria. Index code: MSCNUSDN. The S&P 500 Total Return Index is a stock market index based on the market capitalizations of 500 large companies with common stock listed on the NYSE or NASDAQ. It is not possible to invest directly in an index.

The views and information discussed in this commentary are as of the date of publication, are subject to change, and may not reflect Seafarer's current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles. It should not be assumed that any investment will be profitable or will equal the performance of the portfolios or any securities or any sectors mentioned herein. The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation. Seafarer does not accept any liability for losses either direct or consequential caused by the use of this information.

As of June 30, 2023, Samsung Electronics Co., Ltd., Pfd. comprised 3.5% of the Seafarer Overseas Growth and Income Fund, Samsung Electronics Co., Ltd. comprised 1.4% of the Fund, XP, Inc. comprised 3.1% of the Fund, Richter Gedeon Nyrt comprised 3.7% of the Fund, CD Projekt SA comprised 2.1% of the Fund, Itaú Unibanco Holding SA comprised 2.3% of the Fund, Rohn Co., Ltd. comprised 3.7% of the Fund, Becle SAB de CV (Cuervo) comprised 1.7% of the Fund, Singapore Exchange, Ltd. comprised 2.2% of the Fund, Novatek Microelectronics Corp. comprised 1.4% of the Fund, and Bank Central Asia Tbk. PT comprised 1.2% of the Fund. View the Fund's Top 10 Holdings at www.seafarerfunds.com/funds/ogi/composition. Holdings are subject to change.

ALPS Distributors, Inc. is the distributor for the Seafarer Funds.

Investors should consider the investment objectives, risks, charges and expenses carefully before making an investment decision. This and other information about the Funds are contained in the Prospectus, which is available at www.seafarerfunds.com/prospectus or by calling (855) 732-9220. Please read the Prospectus carefully before you invest or send money.

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