



SEAFARER OVERSEAS VALUE FUND

Portfolio Review

Third Quarter 2018

Paul Espinosa
Portfolio Manager

During the third quarter of 2018, the Seafarer Overseas Value Fund returned -2.05%.¹ The Fund's benchmark, the MSCI Emerging Markets Total Return Index, declined -0.95%. By way of broader comparison, the S&P 500 Index gained 7.71%.

The Fund began the quarter with a net asset value of \$11.69 per share. It paid no distributions during the quarter and finished the period with a value of \$11.45 per share.²

Performance

The dominant factor in the Value Fund's third quarter 2018 performance was the extension of price discovery related to the trade dispute between the U.S. and China – from companies directly impacted by tariffs to companies indirectly affected. Melco International Development ([Breakup Value](#) source of value; see Figure 1 for definitions of the seven sources of value referenced in this review), a casino owner and operator; Shangri-La ([Breakup Value](#)), a hotel owner and operator; Xtep International ([Balance Sheet Liquidity](#)), a sportswear designer and manufacturer; and China Resources Beer ([Structural Shift](#)), a brewer, are companies operating in China that have reported incipient signs of earnings growth in recent quarters. In spite of the recent earnings momentum, and the fact that these companies do not have meaningful exports to the U.S. that could be impacted by tariffs, the stock prices of the companies declined during the third quarter, detracting 318 basis points (bp) from the Fund's NAV. In my opinion, the performance of these four stocks is a clear sign that the market has moved beyond price discovery for stocks directly impacted by U.S. tariffs, to downgrading growth expectations for the entire Chinese economy.

Switching from the ebb and flow of markets to the whims of fortune, it is worth noting that WH Group ([Management Change](#)), a Chinese meat processor and owner of U.S.-based Smithfield Foods, has detracted from the Fund's NAV for the third consecutive quarter. While the threat of tariffs during the first quarter of 2018 followed by the reality of said tariffs during the second quarter explain much

As of 9/30/18 the annualized performance of the Fund's Institutional class was: 1 year -3.50% and since inception annualized (5/31/16) 8.11%; the net expense ratio was 1.05% and the gross expense ratio was 1.92%. 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.

Figure 1. A Working Definition of Value

Seafarer has identified seven distinct sources of value in emerging markets that may give rise to viable opportunities for long-term, value-oriented investments.

Opportunity Set	Source of Value
Balance Sheet	Balance Sheet Liquidity Cash or highly liquid assets undervalued by the market
	Breakup Value Assets whose liquidation value exceeds their market capitalization
	Management Change Assets that would become substantially more productive under a new owner / operator
	Deleveraging Shift of cash flow accrual from debt holders to equity holders
	Asset Productivity Cyclical downturn following a period of asset expansion
	Structural Shift Shift to a lower growth regime, but still highly cash generative
Income Statement / Cash Flow	Segregated Market Productive, cash-generative assets trading in an illiquid public market

Source: Seafarer

Sources of value are highlighted in this document using [This Style](#).

Additional information is available in the white paper *On Value in the Emerging Markets* at www.seafarerfunds.com/value-in-em.

of WH Group's share price performance during the first half of the year, the third quarter gave credence to the proverb that when it rains it pours. Reality extracted a pound of flesh from the company by unleashing Hurricane Florence on its hog farms in North Carolina, and bringing African swine flu to several provinces in China, resulting in the quarantine of one of WH Group's farms. The result is a share price that continued to detract from the portfolio's total return during the third quarter.

Following on the idea of stocks that detracted from total return in previous quarters, it is interesting to note that portfolio holdings in the [Deleveraging](#) category of value, which I discussed in [last quarter's portfolio review](#),³ contributed positively to this quarter's total return. Indeed, the stock price of Del Monte Pacific ([Deleveraging](#) and [Management Change](#)), a food producer and owner of the Del Monte brand, and Global Ports ([Deleveraging](#) and [Asset Productivity](#)), a Russian port owner and operator, rose modestly for the former and 16.67% for the latter in U.S. dollars. This performance is both counterintuitive and remarkable in the context of the continued rise of the London Interbank Offered Rate (LIBOR) – the base rate used to price offshore U.S. dollar debt – and the -0.95% decline of the Fund's benchmark during the quarter. While one should avoid extrapolating from a quarter's performance, the stock price behavior of these two companies during a difficult quarter for emerging markets gives credence to one of the core tenets of the Value Fund: that valuation, and not simply earnings growth, determines investment returns.

Indeed, another counterintuitive positive contributor to the Value Fund's third quarter performance is Crédito Real ([Asset Productivity](#)), a Mexican non-bank finance company whose stock price has declined since the 2016 U.S. presidential election raised doubts about the future of one of the pillars of the Mexican economy, the North American Free Trade Agreement (NAFTA). The fact that the U.S. target federal funds rate began a consistent upward march starting in December 2016 compounded the issue by raising Crédito

Real's cost of funding. While the successful renegotiation of NAFTA during the third quarter of 2018 probably contributed to the stock's role as the third largest positive contributor to portfolio performance during the period, one must remember that the federal funds rate continues to increase. Again, at the risk of reading too much into one quarter's performance, in my view valuation considerations are reasserting themselves in determining the stock price performance of Crédito Real, as they did in the case of the portfolio's holdings in the [Deleveraging](#) category of value.

I would put forward the same argument for the other top two contributors to portfolio performance this quarter: Samsung SDI ([Breakup Value](#)), a Korean battery manufacturer, and PetroVietnam Technical Services ([Management Change](#)), a Vietnamese service provider to oil exploration and production companies. The former's improving profitability and the latter's revenue leverage to a rising oil price may explain the rising stock prices of both companies. However, I would argue that the magnitude of the stock price increases over the quarter (21.17% for Samsung SDI and 32.00% for PetroVietnam Technical Services, both in U.S. dollars) also relates to the starting point of each company's valuation.

In summary, the Value Fund's -2.05% NAV decline during the third quarter reflected a severe reassessment of Chinese growth prospects that was largely, though not fully, counterbalanced by value considerations reasserting themselves over growth-related ones in portfolio holdings with operations in other parts of the world.

Allocation

By the beginning of the third quarter, the cumulative price markdown from December 31, 2017 to June 30, 2018 of the MSCI Emerging Markets Total Return Index and the Seafarer Overseas Value Fund had reached -6.51% and -3.31%, respectively. These relatively benign figures belie significantly sharper price declines for the benchmark and the Value Fund

from the interim high on January 26, 2018 to June 30, 2018, of -14.96% and -9.17%, respectively.

The Value Fund used this general markdown of emerging market equity prices to make use of its meaningful cash resource to purchase additional shares in portfolio holdings that presented particularly attractive valuations. Tracking the Fund's cash balance quarter-over-quarter illustrates the idea best. The Value Fund ended the first quarter of 2018 with a cash balance of 16.75%. By the end of the second quarter, cash declined to 13.60%. The Fund ended the third quarter of 2018 with a cash balance of 10.08%. These figures understate the magnitude of the switch in preference from cash to equities throughout this year in the deployment of the inflows into the Fund, which also proved significant.

It is important to note that the partial switch from cash to equities in the third quarter was not limited to those securities whose share price had declined the most, but also included the equity of companies that offered counter-balancing fundamental characteristics. Thus, the portfolio balanced its incremental share purchase of Chinese discretionary companies mentioned in the Performance section of this review (namely: Melco International Development, Shangri-La, Xtep International, and China Resources Beer) with the purchase of additional shares in companies with inherently visible cash flows that offer a sustainably high dividend yield: Philip Morris CR ([Structural Shift](#)), a tobacco manufacturer and distributor in the Czech Republic, Asia Satellite ([Deleveraging](#)), an owner and operator of commercial satellites, and Amvig Holdings ([Structural Shift](#)), a manufacturer of tobacco packaging.

During the quarter, in addition to reducing its cash holdings in favor of equities as emerging market equity prices declined, and balancing its overall fundamental exposure, the Value Fund added a new security. HRnetgroup ([Balance Sheet Liquidity](#) and [Segregated Market](#)) is a human resources service provider based in Singapore that is expanding to the major city centers in Asia. The attraction of this company extends beyond the low and increasing penetration of said services, to an operating ethos that focuses on the resiliency of cash flow generation, including during downturns in the business cycle.

Outlook

As the Performance section of this quarterly review makes clear, the trade dispute between the U.S. and China continues to influence the price performance of a large segment of emerging market equities. I already presented my views on the subject in the portfolio reviews for the [first quarter](#)⁴ and [second quarter](#)⁵ of 2018. I don't have anything further to add other than to emphasize again that the disagreement undermines the reserve status of the U.S. dollar, and to point out that it is taking place at the same time as China gradually opens its capital account. This state of affairs presents a strategic opportunity for China to accelerate the use of the renminbi (RMB) in international monetary settlements. Contrary to the concern expressed in financial media that China could use a devaluation of its currency to offset trade tariffs, I see a strong strategic imperative for Beijing to maintain a sound currency.

Within the context of a trade dispute resolution that remains elusive, the Value Fund continues to maintain a meaningful cash reserve to deploy in the event of sustained pressure on the prices of emerging market equities generally, and Fund holdings specifically.

As stated in the [second quarter 2018 portfolio review](#),⁵ I find speculation on the outcome of the trade dispute a fool's game. The most sensible course of action and the one followed by the Value Fund is to continue to focus on companies that create value themselves, not because they operate in emerging markets; and to purchase the cash flow these corporations generate at a discount rate that matches the requirement of an individual's retirement savings, not the market discount rate that references central bank policy-related rates as the risk-free base rate.

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

Paul Espinosa
Portfolio Manager
Seafarer Capital Partners, LLC

October 2, 2018

¹ References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIVLX). The Investor share class (ticker: SFVLX) returned -2.14% during the quarter.

² The Fund's Investor share class began the quarter with a net asset value of \$11.68 per share; it finished the quarter with a value of \$11.43 per share.

³ <http://www.seafarerfunds.com/funds/ovl/portfolio-review/2018/06/Q2/#performance-holdings>

⁴ <http://www.seafarerfunds.com/funds/ovl/portfolio-review/2018/03/Q1#outlook>

⁵ <http://www.seafarerfunds.com/funds/ovl/portfolio-review/2018/06/Q2#outlook>

Glossary

Capital Account: the net change in physical or financial asset ownership for a nation. The capital account, together with the current account, constitutes a nation's balance of payments. The capital account includes foreign direct investment (FDI), portfolio and other investments, plus changes in the reserve account.

Current Account: the difference between a nation's savings and its investment. The current account is an important indicator of an economy's health. It is defined as the sum of the balance of trade (goods and services exports less imports), net income from abroad, and net current transfers. A positive current account balance indicates that the nation is a net lender to the rest of the world, while a negative current account balance indicates that it is a net borrower from the rest of the world. A current account surplus increases a nation's net foreign assets by the amount of the surplus, and a current account deficit decreases it by that amount.

Current Account Surplus: a positive difference between a nation's savings and investment. A current account surplus indicates that a nation is a net lender to the rest of the world, in contrast to a current account deficit, which indicates that it is a net borrower.

Dividend Yield (Trailing 12-Mo): a measure of the sum of the dividends paid per share during the trailing 12 months divided by the current share price.

Federal Funds Rate: the interest rate at which U.S. depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight, on an uncollateralized basis.

Foreign Direct Investment (FDI): investment in domestic businesses by foreign citizens.

London Interbank Offered Rate (LIBOR): the interest rate at which banks offer to lend funds (wholesale money) to one another in the international interbank market.

Net Asset Value (NAV): a fund's net asset value per share; for an open-end mutual fund, the net asset value is equivalent to the fund's price per share. A fund's net asset value per share is calculated by summing the fund's assets (including portfolio securities and cash), netting off the fund's liabilities, and then dividing the residual balance by the number of fund shares outstanding.

North American Free Trade Agreement (NAFTA): a comprehensive trade agreement established among the North American countries of Canada, Mexico, and the United States in 1994.

Renminbi (RMB): the official currency of the People's Republic of China. The name literally means "people's currency." The yuan (sign: ¥) is the basic unit of the renminbi, but is also used to refer to the Chinese currency generally, especially in international contexts.



For More Information

Individual Investors

☎ (855) 732-9220
✉ seafarerfunds@alpsinc.com

Investment Professionals

☎ (415) 578-4636
✉ clientservices@seafarerfunds.com

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/ovl/performance.

The MSCI Emerging Markets Total Return Index, Standard (Large+Mid Cap) Core, Gross (dividends reinvested), USD is a free float-adjusted market capitalization index designed to measure equity market performance of emerging markets. Index code: GDUEEGF.

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 September 30, 2018, Melco International Development, Ltd. comprised 2.9% of the Seafarer Overseas Value Fund, Shangri-La Asia, Ltd. comprised 3.2% of the Fund, Xtep International Holdings, Ltd. comprised 3.9% of the Fund, China Resources Beer Holdings Co., Ltd. comprised 3.1% of the Fund, WH Group, Ltd. comprised 3.7% of the Fund, Del Monte Pacific, Ltd. comprised 3.0% of the Fund, Global Ports Investments PLC comprised 1.7% of the Fund, Crédito Real SAB de CV SOFOM ER comprised 3.3% of the Fund, Samsung SDI Co., Ltd. comprised 4.7% of the Fund, PetroVietnam Technical Services Corp. comprised 3.0% of the Fund, Philip Morris CR AS comprised 1.9% of the Fund, Asia Satellite Telecommunications Holdings, Ltd. comprised 4.2% of the Fund, AMVIG Holdings, Ltd. comprised 3.2% of the Fund, and HRnetgroup, Ltd. comprised 3.0% of the Fund. The Fund did not own shares in Smithfield Foods, Inc. View the Fund's Top 10 Holdings at www.seafarerfunds.com/funds/ovl/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.

Important Risks: *An investment in the Funds involves risk, including possible loss of principal. International investing involves additional risks, including social and political instability, market and currency volatility, market illiquidity, and reduced regulation. Emerging markets are often more volatile than developed markets, and investing in emerging markets involves greater risks. Fixed income investments are subject to additional risks, including but not limited to interest rate, credit, and inflation risks. Value investments are subject to the risk that their intrinsic value may not be recognized by the broad market. An investment in the Funds should be considered a long-term investment.*