SEAFARER®

SEAFARER OVERSEAS VALUE FUND

Portfolio Review

First Quarter 2020

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During the first quarter of 2020, the Seafarer Overseas Value Fund returned -27.10%.[1] The Fund's benchmark, the MSCI Emerging Markets Total Return Index, returned -23.57%. By way of broader comparison, the S&P 500 Index decreased -19.60%.

The Fund began the quarter with a net asset value of $11.92 per share. It paid no distributions during the quarter and finished the period with a value of $8.69 per share.[2]

Performance

I am disappointed with the performance of the Value Fund during the first quarter of 2020, both in absolute terms and relative to the benchmark. I expected a selection of carefully chosen stocks with low valuation and diversified across the sources of investment return, the seven categories of value described in the white paper *On Value in the Emerging Markets*,[3] to perform better during a market drawdown. The soul-searching that inevitably follows every quarter's performance evaluation has failed to yield clarity. There is not a common denominator that explains the Fund's performance during the quarter: cyclical vs. non-cyclical companies, strong balance sheet vs. levered stocks, large capitalization companies vs. small-to-medium capitalization ones, etc. The rise in the price of cash has proven so rapid and strong, that the U.S. dollar price of all assets has declined virtually indiscriminately. The most plausible explanation for the Fund's performance in the quarter, aside from the dramatic shift to a cash preference by the market, is that what is novel about COVID-19 is that it combines a demand and supply shock concurrently and instantly. The Value strategy selects holdings characterized by valuable normalized cash flow and return on equity that trade at a low valuation for reasons the strategy deems surmountable. The virus has arguably put on hold operational progress at most of the Fund's holdings, thus partially explaining the dramatic drawdown in stock prices from a fundamental perspective.

As of 3/31/20 the annualized performance of the Fund's Institutional class was: 1 year -20.27%, 3 year -4.69%, and since inception (5/31/16) -0.81%[1]; the net expense ratio was 1.05% and the gross expense ratio was 1.50%. 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.

One Fund holding shone by virtue of being the exception to the rule. **Tabreed** (Deleveraging and Structural Shift sources of value; see Figure 1 for definitions of the sources of value referenced in this review), an owner and operator of district air-cooling services in the Middle East, was the only holding whose share price appreciated during the quarter. Aside from a series of minor acquisitions during the quarter, there was speculation that the company was close to completing the landmark acquisition of Emaar Properties' district cooling business. Tabreed confirmed the completion of the transaction shortly after the quarter-end. The subsequent positive share price reaction to the news is notable within the context of a corporate sector starved of liquidity as this transaction increases Tabreed's leverage meaningfully.

While business fundamentals prevailed in determining Tabreed's share price evolution during the quarter, the remaining portfolio holdings behaved with little regard to valuation or the operational exposure to the viral nature of this shock. Approximately half of the negative contribution to total return by the top two detractors to performance during the quarter was due to the depreciation of the national currency. Indeed, the 22.7% depreciation of the Brazilian Real accounted for almost half of the 50.7% U.S. dollar share price decline for **Qualicorp** (Structural Shift), a Brazilian life insurance broker. Similarly, the 20.0% depreciation of the Mexican Peso accounted for half of the 40.7% U.S. dollar share price contraction for **Crédito Real** (Asset Productivity), a Mexican consumer finance company focused on payroll lending to government employees. Once again, it is worth noting that neither company suffers from a weak balance sheet that might explain such a severe share price reaction to the virus-induced liquidity crisis. Furthermore, Crédito Real is one of the few financial companies around the world whose assets mature faster than its liabilities.

The strategy holds five stocks directly and negatively impacted by the viral nature of the global health crisis: **Shangri-La Asia** (Breakup Value and Asset Productivity), a hotel owner and operator; **Melco International Development** (Deleveraging and Breakup Value) and **Genting Singapore** (Balance Sheet Liquidity), both casino owners and operators; **Hang Lung Properties** (Breakup Value), an owner and operator of luxury malls and office space, as well as a housing developer; and **Pico Far East** (Segregated Market), an exhibition and conference designer and manager. What is interesting about this group of stocks is their differing relative performance. Melco International Development understandably ranked at the top of negative contributors to the Fund's performance during the quarter; Shangri-La Asia and Hang Lung Properties, whose revenue also depends on the ability of their customers to travel, performed significantly better. The latter two stocks' cheaper valuation suggests that valuation still played a role, albeit a minor one, in stock performance during the quarter.

Another observation worth noting is that the drawdown currently underway answers two long-standing questions, at least provisionally. One is whether emerging markets would outperform the S&P 500 index due to a lower valuation, and the other is whether a value style of investing would finally outperform a growth style for the same reason. For the time being, the answer to both questions is no. For the first quarter of 2020, the S&P 500 outperformed the MSCI Emerging Markets Total Return Index by 397 basis points, whereas the MSCI Emerging Markets Total Return Growth Index outperformed the MSCI Emerging Markets Total Return Value Index by 867 basis points.

The foregoing is meant to shed light on the nature of the global sell-off in stock and bond prices. Seafarer does not find solace in the performance of the market. The firm chose the strategies it manages for their potential to generate what investors need: the increase in the future purchasing power of savings. Performance by or relative to a universe or style of investing is irrelevant in the pursuit of what investors actually need. Thus, the Allocation section that follows discusses how the Overseas Value Strategy is using the severe dislocation in stock prices for its future advancement.

Allocation

In light of the discussion in the preceding section, the relevant question to ask is not whether an investor should commit to the emerging markets or a value strategy. It is more useful to ask how a manager is using the opportunities afforded by the market. The reason for anticipating and refocusing the question most likely asked by the reader of this quarterly review is that the categorization of countries as emerging markets has lost some coherence as economies have developed over time. Similarly, style classifications, while useful to some degree, are somewhat arbitrary as well. Ultimately, an investment is always the purchase of future cash flows at a discounted price today, regardless of how one goes about finding said cash flows. Finally, it is imperative not to lose sight of the fact that two years of cash flow constitute a small percentage of the value of a company. If it is generally agreed that health professionals are capable of finding a vaccine against COVID-19 within two years, the majority of the equity value of a company still lies in the outer years of normalized cash flow and return on equity (ROE) convergence from normalized to a terminal rate (the ROE curve in industry jargon). This last point is the most important reason to maintain equanimity at a time when many stock valuations appear to anticipate much more than the impact of the virus.

Thus, how is the Seafarer Overseas Value Fund responding to the sharp movement in the price of stocks within and outside the portfolio?

The strategy has used the drawdown during the first quarter of 2020 to sell lower conviction stocks with a smaller capitalization. While the sale price was below that available pre-COVID-19, the Value strategy deemed it an opportunity to concentrate the portfolio in positions that offered equal or more value, but benefited from higher conviction and trading liquidity, an upgrade to the portfolio. The Fund exited two positions, and sold shares of a third position, faster than it has re-deployed the proceeds, such that it finished the quarter with 16% in cash.

The Fund decided to sell **Xtep International** (Asset Productivity), a Chinese sports apparel manufacturer and retailer, before the onset of the virus. Conversations with management after it issued new equity for acquisitions made clear that the control party had little sensitivity to the cost of equity. While Seafarer was supportive of the brand expansion strategy, it disapproved of the financing method. Anticipating that this issue would likely recur in the future, the strategy decided to sell the position even if the business enjoyed positive growth momentum at the time.

The sale of shares of **Texwinca** (Structural Shift), a Hong Kong-based textile manufacturer and apparel retailer, was the recognition of an investment mistake. Attracted by management's response to previous down-cycles and subsequent dividend growth, I gave this family-controlled company the benefit of the doubt that it would rectify missteps in fabric innovation and its approach to mainland Chinese customers. The past few years of owning this stock has convinced me that even if management restores trading momentum, the company seems to have lost part of its historical competitive advantage, and Fund capital could be better deployed elsewhere.

Lastly, the strategy exited **Philip Morris Czech** (Structural Shift), a producer and distributor of tobacco products based in the Czech Republic. The purpose of this sale was to put into practice the lesson learned from the Texwinca experience, that is, to identify structural change earlier. The company's classification in the Structural Shift category of value already acknowledged tobacco as an industry in long-term decline; the stock's presence in the portfolio recognized the potential to earn an investment return from a highly visible future whose cash flows may be priced in the present, while the holding's positive contribution to the Fund's total return validated the concept. What the exit from the stock captures is the early recognition that the volume decline in tobacco consumption may accelerate from the current rate on a structural basis due to COVID-19's specific targeting of the respiratory system. The strategy deemed it prudent to lock-in investment gains and redeploy them in existing holdings or new ideas with greater trading liquidity and lower structural risk.

Given the seemingly indiscriminate nature of the drawdown, the Fund is predisposed to reinvesting sale proceeds into all remaining holdings, as the strategy thinks of investment return in absolute terms, not relative to the benchmark, and all holdings except Tabreed are now cheaper. As a result, the Fund does not engage in tactical trades based on themes or industries favored or disfavored by the pandemic. Instead, the Fund focuses on deploying marginal capital in once-in-a-cycle valuations. Not only do many holdings trade below book value, several of them trade below 0.5x price to book value. While the reasons for a stock to trade at a truly discounted price to book value ratio vary by company, what is peculiar about this shock is that it has halted economic activity while maintaining existing infrastructure intact. Whereas the policy response to the present crisis is reminiscent of wartime deficit spending and central bank accommodation, as is the equity-based valuation of selected companies, the physical capital said book value captures is not impaired. Therefore, however long it takes for economic activity to normalize, it would be faster than what would have been the case if infrastructure had to be rebuilt, as was the case in previous episodes of a similar halting of the civilian economy.

For asset-light companies whose long-term value hinges on their ability to continue to provide a service, and not on the net value of their assets, the Fund is deploying marginal capital in stocks whose market capitalization implies an abnormally low free cash flow generation uncharacteristic of the business – or put differently, a normalized free cash flow yield in the teens.

It is important to recognize that if the market assigns this level of valuation to several portfolio holdings, it must question the ability of these companies to survive a downturn as deep as the present one appears to be. While not immune to error, Seafarer's research strives to guard against this outcome by always studying how a company navigated previous recessions. And even though the present shock to demand is unprecedented, it is important to remember that portfolio holdings such as Shangri-La Asia and Hang Lung Properties borrow against the value of their assets. Thus, they are unlikely to violate debt covenants with a year or two of a severe EBITDA decline. Similarly, portfolio holdings employing an asset-light business model are likely to survive the pandemic-related shock to demand for their services. Holdings such as the aforementioned Pico Far East, as well as **Innocean Worldwide** (Balance Sheet Liquidity), a South Korea-based marketing and communication services firm that operates worldwide, and **HRnetgroup** (Balance Sheet Liquidity and Segregated Market), a human resources service provider based in Singapore that is expanding to the major city centers in Asia, all benefit from high net cash balances that can finance operating expenses through long periods of abnormally low revenue.

The Fund did not add new holdings during the first quarter of 2020. The team is working on new ideas, and re-prioritizing the research pipeline following severe stock price movements in recent months.

Outlook

Financial commentary these days naturally coalesces around the policy response to COVID-19. What concerns this quarterly review is the consequences of said policy response for prospective investment returns generally, and in the emerging markets specifically, which I suspect will prove long-lasting in contrast to the temporary nature of the pandemic.

Before delving into the outlook for prospective investment returns, it is important to first identify what is actually important in the pandemonium of policy response. Paramount in the ranking of policy responses is the Federal Reserve's transition from providing liquidity to banks to price-insensitive purchaser of assets including investment grade and high-yield corporate debt, municipal debt, and small businesses and consumer credit. The extension of the policy of Quantitative Easing from the Treasury to other economic agents, including the private sector, effectively places a floor on asset prices. While the Federal Reserve's intent may be to facilitate the primary issuance of debt by purchasing said securities in the secondary market, the consequence is to maintain asset prices high and interest rates below their natural level. It is far from a foregone conclusion that the trade-off is sensible.

On the positive side of the ledger, the Federal Reserve's action ameliorates asset price deflation, as opposed to consumer price deflation, which is indeed the greater risk of the two. Asset deflation in a highly levered economy would quickly bankrupt many companies and drive weaker banks into insolvency, since asset values could no longer repay the fixed amount of liabilities outstanding. On the other hand, not only is consumer price deflation innocuous, it's actually salutary for the economy, as it is the ultimate sign that enterprises are producing more at a lower cost per unit, and that the purchasing power and living standard of consumers is rising (productivity), i.e. the entire objective of capitalism. It is important to distinguish between these two types of deflation, as understanding the actual consequence of Federal Reserve action justified on the basis of "liquidity" and "price stability" is critical to understanding prospective investment returns.

On the negative side of the ledger, the blanket, price-insensitive purchase of private assets by the Federal Reserve prevents better-managed companies from taking market share from weaker actors who survive due to the low cost of debt alone. It perpetuates malinvestment and fosters more of it by distorting the most important price signal of all: the price of money.

Thus, the Faustian bargain consists of avoiding asset price deflation that results in a depression at the expense of future potential economic growth and its sustainability.

The implications for future investment returns are manifold. First and foremost is the idea that an investment return is the inverse of the price paid for a security. Purchasing the right to receive $100 a year from now for $91 today, equates to a 10% return. Paying more than $91 lowers the rate of return and vice versa. Central bank intervention in the market for private securities interferes with the process of price discovery, and to the extent that asset prices are not only determined (instead of being discovered), but are also kept at an elevated level commensurate with the quantity of debt outstanding, this type of intervention effectively lowers future investment returns.

Furthermore, as explained above, the malinvestment that results from distorting the natural rate of interest lowers the potential growth rate of the economy, as does the high leverage that accompanies an unnaturally low borrowing rate. Finally, a low cost of capital necessarily leads to low investment returns as what drives investment profit is the spread between the cost of capital and a project's nominal return.

While market participants are well aware of the above dynamic, which has been in effect in every economic cycle since the creation of the Federal Reserve, it "feels" different this time, which is why it is worth revisiting the issue. Historically, the Federal Reserve has limited its intervention to the realm of the incentive structure in the form of the expected reaction by market participants to changes in the risk-free rate. Upon facing the 2008 crisis, the Federal Reserve transitioned from managing the incentive structure to indirectly monetizing Treasury debt, thereby manipulating Treasury prices outright along the interest rate curve. The Federal Reserve responded to COVID-19 by going further down the same road of asset price determination through the indirect purchase of private securities.

The reader may already see the problem in the foregoing. The fundamental difficulty investors face going forward is that the consequence of the policy response to COVID-19 is to elevate asset prices while simultaneously lowering the rate of potential economic growth. On both counts, prospective investment returns are lower than they would have been without policy intervention, and my guess is that they are structurally below actuarial assumptions for public and private pension funds.

The long-term consequences of COVID-19 that I expect will impact prospective investment returns stem from the policy response, but extend to corporate and individual behavior as well. The experience of surviving an extended period of low demand for corporates, and no income for individuals, may change behavior on a long-term basis. It is probable that corporates may return to an era when they used to constrain their growth to what their internal cash flow would afford, with only a conservative supplement of debt. Individuals may return to the previous generation's pattern of saving for the future and consuming less. To the extent COVID-19 changes preferences in this manner, the Federal Reserve's influence on corporate and individual behavior through the incentive structure may lose power.

The point is that even with the federal funds rate at virtually zero, it is questionable whether new demand for credit will materialize. This limit to the Federal Reserve's power is a critical point, in that it highlights the natural limitations of monetary policy, in contrast to recent pronouncements by policy makers to the contrary. Note that aside from the point that as long as individuals maintain autonomy, the economy is not a machine that can be manipulated by pulling levers, the other natural limit of monetary policy is high inflation. It is untrue that the Federal Reserve can monetize Treasury debt to infinity, or put differently, that sovereign debt is riskless. The loss of purchasing power through currency debasement is the natural limit to the power of monetary policy, and history is littered with examples of this natural law at work. It is important to keep in mind these two limitations to monetary policy during the present pandemic where policy makers are using the monetary lever without restraint and precedent as a panacea. As it relates to investment returns, it is sensible to expect lower structural growth going forward not just from the burden of debt outstanding, but from lower demand for credit. Recall that high rates of debt growth are associated with the expansion phase of the most recent economic cycles.

In summary, I am concerned that the policy response in developed markets to COVID-19 accelerates the decline in structural economic growth, while simultaneously elevating valuations for bonds and stocks. Both of these forces suggest low prospective investment returns for savers, that I suspect will fail to meet actuarial assumptions.

As it relates to emerging markets, I would suggest that even though their policy response rhymes with that of developed markets, the tune driving emerging economies is closer to an Allegro than a Requiem. The "setup" for prospective investment returns in emerging markets differs from that in developed economies in that it enjoys a lower starting point for valuation, and higher structural economic growth. Remember that there are only two determinants of an economy's long-term growth rate: population and productivity growth. Most of the world, including the larger emerging economies, suffer from aging populations. As a result, a focus on productivity is essential to sustaining a meaningful long-term rate of growth. It is on this point that the long-standing policy in developed markets of avoiding recessions with ever-higher levels of debt is a disservice to their economies. Recessions are healthy because they correct past misallocations of capital and increase productivity. For reasons explained earlier in this review, the developed market policy response to COVID-19 further impairs future productivity.

Emerging economies, on the other hand, are emerging precisely because they suffer from a historical political economy that stunted their productivity growth. The process of gradually allowing market forces to determine capital allocation in these economies has partially closed the gap with developed markets on this front. This process of productivity convergence is in reality what actually defines Seafarer's emerging market specialization, more so than somewhat arbitrary country classifications. Similarly, Seafarer's active research process searches for companies that don't simply cater to an underserved market, but that also distinguish themselves by improving productivity at every cycle downturn. In my experience, successful investing is less about predicting the future, and more about positioning.

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

Paul Espinosa
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Seafarer Capital Partners, LLC

April 20, 2020

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[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIVLX). The Investor share class (ticker: SFVLX) returned -27.06% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $11.90 per share; it finished the quarter with a value of $8.68 per share.

[3] www.seafarerfunds.com/value-in-em

Glossary

EBITDA: an acronym that refers to "Earnings Before Interest, Taxes, Depreciation and Amortization." EBITDA is used as a very rough proxy for a company's ability to produce gross cash flow (cash flow itself being a proxy for a company's profitability). Analysts often utilize EBITDA because it is easy to calculate, and because it is fairly comparable from one company to another. EBITDA is a very superficial, basic measure, and consequently it might not always serve as an accurate guide to a company's long-term profitability; however, one of its chief benefits is that it precludes many of the accounting and financial decisions that a company's management might utilize to influence (or even distort) ordinary operating profits.

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.

Free Cash Flow Yield: a basic evaluation measure for a stock that examines the ratio of free cash flow per share to the share price. Some investors regard free cash flow (which takes into account capital expenditures and other ongoing costs a business incurs to keep itself running) as a more accurate representation of the returns shareholders receive from owning a business, and thus prefer free cash flow yield as a valuation metric over earnings yield.

Market Capitalization: the value of a corporation as determined by the market price of its issued and outstanding common stock. It is calculated by multiplying the number of outstanding shares by the current market price of a share.

Price to Book Value (P/BV) Ratio: the market price of a company's common shares, divided by the company's book value per share.

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.

Return on Equity (ROE): the amount of net income returned as a percentage of shareholders equity. Return on equity measures a company's profitability by revealing how much profit the company generates with the money shareholders have invested.

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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.

The MSCI Emerging Markets Total Return Growth Index captures large- and mid-cap securities exhibiting overall growth characteristics across emerging market countries. Index code: M1EF000G.

The MSCI Emerging Markets Total Return Value Index captures large- and mid-cap securities exhibiting overall value characteristics across emerging market countries. Index code: M1EF000V.

It is not possible to invest directly in an index.

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As of March 31, 2020, Tabreed (National Central Cooling Co. PJSC) comprised 5.2% of the Seafarer Overseas Value Fund, Qualicorp Consultoria e Corretora de Seguros SA comprised 2.9% of the Fund, Crédito Real SAB de CV SOFOM ER comprised 1.8% of the Fund, Shangri-La Asia, Ltd. comprised 4.1% of the Fund, Melco International Development, Ltd. comprised 2.6% of the Fund, Genting Singapore, Ltd comprised 2.4% of the Fund, Hang Lung Properties, Ltd. comprised 2.4% of the Fund, Pico Far East Holdings, Ltd. comprised 0.3% of the Fund, Texwinca Holdings, Ltd. comprised 0.1% of the Fund, Innocean Worldwide, Inc. comprised 3.1% of the Fund, and HRnetgroup, Ltd. comprised 3.1% of the Fund. The Fund did not own shares in Emaar Properties, Xtep International, or Philip Morris Czech. 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.