SEAFARER®

Excerpt from the *Seafarer Funds Annual Report*

Letter to Shareholders

Period Ended April 30, 2018

Andrew Foster
Chief Investment Officer

Dear Fellow Shareholders,

I am pleased to address you again on behalf of the Seafarer Funds. This report covers the Funds' 2017-18 fiscal year (May 1, 2017 to April 30, 2018).

China: At a Crossroads In the World, and In Your Portfolio

The preceding two decades have brought considerable change and progress to the developing world. Economies have expanded, technologies have advanced, incomes have risen, capital has been created, and living standards have improved. Yet throughout such change, one fact has remained constant and essential: within the developing world, China has stood out from all other nations in terms of scale, scope and influence.

There was a time when this fact was not obvious. China's economy was once smaller than some of its peers, and not long ago, its allocation in prevailing equity indices was approximately one fifteenth of the weight accorded Taiwan. Yet thoughtful observers knew even then that China's scale and potential would eclipse all other countries in the developing world. China's subsequent growth and development have made it central to the definition of the "emerging market asset class." Its index allocation eclipses all the rest, and in coming years, its weight will increase further; its rise has re-shaped or influenced the course of events in nearly every other developing country; its success or failure will determine whether the asset class has long-term investment merit. As goes China, so go the emerging markets.

While China's prominence has never been clearer, the country's political and economic development has grown more complicated, and in some respects, opaquer. Last fall, in the Letter to Shareholders as of October 31, 2017,[1] I offered a personal perspective on China's evolution. The view I expressed was personal and anecdotal – not comprehensive or definitive – but my aim was to convey my concern that the Chinese political system had taken a surprising, worrisome turn.

My concern stemmed from a basic idea. I believe that China's profound development over the past four decades was driven by the de-emphasis of central planning in favor of decentralized decision-making, as well as the opening of the economy to competition and private ownership. I believe that highly centralized economic systems induce instability, corruption, and wasted resources. Decentralized systems lack certain efficiencies; however, given the proper incentives (e.g., the incentives that spring from private ownership), they tend to be more flexible and self-correcting, thereby avoiding gross waste. I think China's adoption of a decentralized approach was fundamental to its growth, spurring the economic might readily visible today.

The October 2017 Letter to Shareholders[2] describes my concern that China's political system is returning to its centralized, pre-1978 roots. President Xi Jinping's government has launched a "third era" in China's history, characterized by substantial political and economic re-organization, and emphasizing centralized government control. My colleague Nicholas Borst has recently launched a blog entitled "Prevailing Winds."[3] The first entry[4] highlights some of the key transitions currently underway in China. I believe some aspects of Xi's new era are welcome and warranted, but it also presents myriad challenges to investors. Chief among them: one cannot rely on China's past progress to extrapolate its future. Past performance is no guarantee of future results.

Some investors may view such change and uncertainty with skepticism, shunning China within their portfolios. Though I share such skepticism, I believe that complete withdrawal would be a mistake. China's growing economic scale and global prominence mean that it cannot be ignored. Though it might be an uncomfortable prospect for some, Xi has made it clear that China's ambition is to occupy a status alongside the U.S. as a new global power, a second hegemon. Assuming China attains Xi's goals peacefully, it will be simply too large, too important and too prosperous for investors to ignore.

China's "Belt and Road" initiative is one visible effort where China's global ambitions are evident. For those unfamiliar with the initiative: my colleague Stephanie Gan has recently written a report on Belt and Road[5] that focuses on the initiative's financial underpinnings. Stephanie's report makes clear that Belt and Road is sweeping in scale and scope; but it also suggests that much of the funding behind it is murky or problematic. My own view is that Belt and Road has the potential to establish China's hegemony in the East, but it could also overextend the country's financial resources along the way. China is determined to climb to the top, but it might go broke in the attempt.

So, what should investors make of this? On the one hand, China has embarked on a path intended to secure its status as a hegemon, making it far too big to be ignored. On the other hand, internal change means that its future is opaque, and success less assured.

My view is that investors must seriously consider a substantial, structural increase in their exposure to China. To enact that increase, I think investors must seek dedicated exposure to a broad array of asset classes.

U.S. investors pursue a multitude of strategies, so it is foolish to generalize. However, I suspect that most investors' portfolios have single-digit exposure to China; for many, the effective exposure will be under 5%. I also suspect that most investors have exposure only to equities via regional funds that invest primarily on the Hong Kong stock exchange. There are many important Chinese companies listed in Hong Kong; but to invest only in Hong Kong is to omit a vast multitude of companies listed exclusively on China's onshore, domestic markets – the "A-Shares." Lastly, I suspect very few investors have exposure to asset types beyond equities – fixed income, real estate, private equity, venture capital, etc. I believe that portfolios that have limited exposure to China (below 5%), and only via Hong Kong stocks (omitting A-Shares, fixed income, real estate, etc.), are not well-positioned for China's future rise.

I imagine that many investors will find it alien to consider a portfolio with dedicated exposure to China across an array of asset types. However, as a brief thought exercise, I encourage you to reverse your frame of reference for a moment. Imagine you reside outside the U.S., a citizen of some other country. How then would you seek to invest in the U.S.? Would you only use one fund, whether active or passive? Would you only seek exposure to equities, or would you consider bonds too? If your capital, risk tolerances and time horizons allowed, would you want exposure to U.S. real estate, U.S. private equity and U.S. venture capital? Surely you would not invest in the U.S. only via a "North America Region Equity Fund," which by design sought to offer a blended exposure to the U.S., Canada, Mexico, and the Caribbean in one package. A regional fund would never give you sufficient exposure to the primary market, the country that you really wanted to feature in your portfolio – the U.S.

I expect that most investors would favor dedicated exposure to the U.S., and they would not rely solely on a fund built around a stylized, regionally-driven asset class. Most investors would also seek exposure across an array of assets (stocks, bonds, etc.), and use a mix of funds, highlighting strategies (active, passive) across a range of styles (growth, value, large cap, small cap, etc.) according to their preferences. They would do so because the U.S. economy is broad, deep and dynamic; its financial markets are vast and liquid; and because the U.S. as a hegemon is too big to underweight or ignore.

You might feel that China is innately different from the U.S. case, and therefore my argument is invalid. Certainly, China is not *yet* a global hegemon, and it does not *yet* enjoy all the structural characteristics that situate the U.S. economy above all others. Still, I would urge you to consider whether China's ambitions might give it similar status over the next two decades. If so, I would argue that you should treat China no differently than the U.S. within your portfolio.

I imagine that some shareholders of the Funds expect that Seafarer will or should offer sufficient exposure to ensure that their portfolios do not "miss out" on the best aspects of China's rise. While I hope that the Funds offer intriguing exposure to Chinese stocks, I do not think their mandates are designed to offer sufficient, dedicated, well-rounded exposure to China's rise. At Seafarer, we are "stock pickers," and eclectic ones at that. We are certainly aware of the changes taking place in and around China – perhaps more so than some others – but our aim is not to build structural, well-diversified exposure to the Chinese market. Rather, the Funds have focused strategies which place emphasis on balancing risk versus reward. For reasons stemming from either risk or valuation, the Funds are unlikely to own all the stocks critical to China's emergence. Also, while the Funds enjoy a great deal of geographical freedom (and therefore could, in theory, offer elevated exposure to a single country), we tend to view our strategies as best implemented across an array of countries. Put bluntly: the Seafarer Funds are unlikely to ever offer sufficient exposure to the full breadth of Chinese equities, let alone other Chinese asset types.

No one should interpret my view as an urgent call to portfolio re-construction. Instead, I encourage investors to first consider several critical questions: do you believe China's rise will be peaceful, or mired in martial conflict? (I think the probability of direct conflict is small but cannot be ruled out.) Do you believe China has the political, diplomatic, economic, technological and financial skills to emerge as a hegemon? (For the most part, I think it does, though it might overextend itself financially in pursuit of the Belt and Road initiative.) Do you think that China's economic rise will go unmarred by a major economic or financial crisis? (I think the country's extreme indebtedness will eventually hamper economic growth, and it might yet induce a crisis.) Most importantly: do you have the risk tolerance and long-term time horizon to sustain investment in China's transition? (I think anyone with an investment horizon less than two decades should forgo a dramatic shift toward China.) You must have confidence in your answers before undertaking a major overhaul of your portfolio. Given the complexity that surrounds China's future, I do not believe any intermediary – including Seafarer – can answer these questions definitively on your behalf.[6]

However, if you determine that your exposure to China should increase, I encourage you to develop a long-term plan to re-build your portfolio. In my view, it should emphasize diversification across asset types and strategies, and it should be suited to your risk tolerances and applicable time horizons. When you are ready to implement the plan, I would suggest you act gradually: right now, I harbor concerns that China might still experience a major economic shock or financial crisis, one that might rival historical events in other nations. Rapidly building outsized exposure to risky asset classes will almost assuredly destroy capital. Yet I do not know whether a shock will occur; postponing indefinitely may prove sub-optimal. Rather, I would suggest a measured pace of implementation – and if a crisis strikes midway, I would consider whether it afforded an opportune time to accelerate implementation, rather than abandon your plan in frustration.

China recently passed over a crossroads as a country. President Xi has changed direction, and China has embarked on a new and unfamiliar course. The country's stated destination is clear, even if the road ahead is not. I believe your portfolio is passing over the same crossroads. Make certain that it does not miss the turn, and that you are well prepared for the next leg of the journey.

Expense Ratio Reduction and Economies of Scale

As described in the Letter to Shareholders as of April 30, 2017,[7] Seafarer has committed to reduce expenses for the Funds, particularly as time and scale afford greater efficiency.

I am pleased to announce that, consistent with that commitment, the Overseas Growth and Income Fund experienced a reduction in its operating expense ratios during the fiscal year ended April 30, 2018. The ratios declined to 0.87% and 0.97% for the Institutional and Investor classes, respectively. For reference, the expense ratios were 0.92% and 1.02% for the respective classes during the preceding fiscal year.[8] The expense improvement can be traced to two underlying causes: Seafarer's ongoing efforts to control costs, and the Growth and Income Fund's substantial scale.

For the past six years, Seafarer Capital Partners (adviser to the Seafarer Funds) has worked with the Funds' various service providers (chiefly: ALPS Fund Services, the Funds' administrator, and Brown Brothers Harriman, the Funds' custodian bank) to keep a careful watch over operating expenses. Seafarer sought to ensure that, if either Fund attained scale, it would realize meaningful efficiencies.

During the fiscal year ended April 30, 2018, shareholders of the Growth and Income Fund entrusted it with substantially more capital than the prior year (net assets were $3.0 billion at April 30, 2018, versus $2.4 billion at the end of the prior fiscal year). The increase in assets under management brought new economies of scale, and the Fund's expense ratio declined in accordance with Seafarer's long-term goals.

As for the Overseas Value Fund: its smaller scale does not yield an equivalent degree of efficiency. However, Seafarer has established the same underlying expense structure for the Value Fund. Should the Fund's assets grow over time, it is expected to achieve similar economies of scale. In the meantime, Seafarer Capital Partners continues to "cap" the Fund's operating expenses via a contractual commitment, such that its net expense ratios remain 1.05% and 1.15% for the Institutional and Investor classes, respectively.[9]

Expansion of Seafarer's Team

Seafarer continues to invest in its research and operational capacities, particularly through additions to the team. In the past six months, three individuals have joined Seafarer.

Nicholas Borst[10] joined the firm as Vice President and Director of China Research. As Vice President, Nicholas is a leader in the management of the firm, with a focus on fund administration, firm-wide technology, and human resources. As Director of China Research, he analyzes financial and economic developments in Greater China. Previously, Nicholas conducted research on China's economic development at the Federal Reserve Bank of San Francisco, the Peterson Institute for International Economics, and the World Bank.

Brent Clayton[11] joined Seafarer as a research analyst on the investment team. Brent assists Paul Espinosa in the management of the Value strategy. Brent's experience spans a wide number of overseas markets, with a particular emphasis on investment in "frontier" countries.

Meredith Sellers[12] joined the firm as Director of Communications. At Seafarer we are committed to delivering insights to clients directly from the individuals who manage the Funds, and Meredith plays a key role in facilitating this communication. Her career has focused on marketing and client services in the financial services industry.

I am pleased to welcome these individuals to Seafarer. I am excited by the depth and breadth of talent they bring to our organization.

We appreciate the trust and patience that you have extended to our firm, and we are honored to serve as your investment adviser in the emerging markets.

Andrew Foster
Chief Investment Officer
Seafarer Capital Partners, LLC

May 12, 2018

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1 www.seafarerfunds.com/letters-to-shareholders/2017/10/semi-annual#dream-for-china

2 www.seafarerfunds.com/letters-to-shareholders/2017/10/semi-annual#a-different-path

3 www.seafarerfunds.com/prevailing-winds/

4 www.seafarerfunds.com/prevailing-winds/2018/04/forty-years-later-china-in-a-new-era/

5 www.seafarerfunds.com/commentary/one-belt-one-road-many-motives

6 For shareholders interested in reading another perspective on China, please refer to: Martin Wolf, "How the West Should Judge a Rising China," Financial Times, 15 May 2018. https://www.ft.com/content/e30e9ed4-5754-11e8-bdb7-f6677d2e1ce8 (Subscription may be required.)

7 www.seafarerfunds.com/letters-to-shareholders/2017/04/annual#cost-reduction

8 The Growth and Income Fund's Prospectus (dated August 31, 2017) states that the Fund expenses are 0.92% and 1.02% for the Institutional and Investor classes, respectively.

9 Seafarer Capital Partners, LLC has agreed contractually to waive and/or reimburse fees or expenses in order to limit Total Annual Fund Operating Expenses After Fee Waiver/Expense Reimbursements (excluding brokerage expenses, interest expenses, taxes and extraordinary expenses) to 1.15% and 1.05% of each Fund's average daily net assets for the Investor and Institutional share classes, respectively. This agreement is in effect through August 31, 2018.

10 www.seafarerfunds.com/team/?nicholas-borst

11 www.seafarerfunds.com/team/?brent-clayton

12 www.seafarerfunds.com/team/?meredith-sellers

Glossary

Belt and Road Initiative is an international program to spur investment and trade links between China, central Asia, and Europe. The initiative was announced by China's President Xi Jinping in 2013. The official name for the initiative is the "Silk Road Economic Belt and the 21st Century Maritime Silk Road."

Chinese A-Shares is 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 has been 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 have historically been inaccessible to foreign investors, de facto: foreigners could not legally obtain renminbi for investment purposes, and therefore they could not fund any purchase of A-shares. Over the past decade, China has 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. More recently, China has launched a program known as the "Stock Connect," or colloquially, the "through train;" this program allows foreign investors to purchase selected A-shares on the Shanghai or Shenzhen exchanges, regardless of their QFII status.

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). H-shares and Hong Kong-listed companies are available for investment by foreign (non-mainland China) investors; ironically, H-shares are not necessarily available to domestic Chinese parties, who can only invest in Hong Kong via a regulated scheme called "Qualified Domestic Institutional Investor" (QDII).

If a Seafarer Fund is invested in Chinese A-Shares, please note the following: 1) any reduction or elimination of access to A-Shares could have a material adverse effect on the ability of the Fund to achieve its investment objective; and 2) uncertainties regarding China's laws governing taxation of income and gains from investments in A-Shares could result in unexpected tax liabilities for the Fund, which could adversely impact Fund returns.

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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.

