SEAFARER

SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

First Quarter 2017

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During the first quarter of 2017, the Seafarer Overseas Growth and Income Fund returned 11.22%.[1] The Fund's benchmark, the MSCI Emerging Markets Total Return Index, rose 11.49%. By way of broader comparison, the S&P 500 Index gained 6.07%.

The Fund began the quarter with a net asset value of $11.14 per share. It paid no distributions during the quarter, and finished the period with a value $12.39 per share.[2]

Performance

Between January and March, emerging market equities rose sharply, as reflected by the benchmark's 11.49% increase. In my opinion, three distinct factors were the chief causes of the gain.

First, contrary to widely-held expectation, the U.S. dollar ceased appreciating against most emerging market currencies. As the emerging markets are comprised of more than 25 different currencies, it is pointless to discuss the performance of an "average" emerging currency, as each currency might have widely disparate outcomes when measured versus the dollar. However, using a representative basket of currencies in the developing world can reveal whether the dollar is generally strengthening or weakening over a set period. During the first quarter, the dollar dropped 4.5% relative to the basket.[3]

Indeed, the dollar has been on the decline since December 2015: when measured against the same basket, the dollar has fallen 6.6% through the end of March 2017.[4] This drop occurred even as the U.S. Federal Reserve hiked rates twice in the interim. There is no simple explanation for the dollar's decline. For the moment, it is sufficient to state that the dollar was not gaining in the first quarter, and this condition served as a positive backdrop for the performance of emerging market equities.

Second, during the quarter, companies in the developing world published their results for the calendar year 2016. Those results made it clear that corporate profits expanded about 8% during the year. I believe this should be viewed as a healthy rate of growth, particularly in light of the anemic conditions that prevailed during the preceding five years. Also, such growth happened to match "consensus forecasts" – and this is the first time that reality met expectation in five years. (For more information on this event, please see the Fund's portfolio review for the third quarter of 2016.[5])

Third, at the outset of the quarter, average valuation levels for emerging market equities were considerably lower than equities in developed markets. The relative discount was at least 20%, and as much as 40%, depending on the metrics used to assess valuation. In my opinion, this relative "cheapness" prompted emerging equities to respond positively to the two aforementioned factors. In other words: given that valuations were relatively depressed, it did not take much to nudge prices higher. The dollar's decline, combined with a healthy acceleration in earnings growth, was just enough to spur substantial gains in just three months.

Arguably, a fourth cause was also at work, though personally I place less weight on its relevance. At least temporarily, China's financial liquidity constraints eased, and the country's economic conditions improved marginally. This in turn prompted Chinese equities to lead the gains during the first quarter, to the surprise of many – including me. I acknowledge that imminent threats to China's financial stability seem to have receded. Yet the data also suggest that China is experiencing rising default rates and liquidity mismatches in bond markets. I remain skeptical that conditions are as benign as the recent performance of equities suggests.

Within the benchmark index, Chinese internet stocks again dominated returns for the period. This was to the detriment of the Fund, as it has no holdings in that segment of the market (see the portfolio review for the third quarter of 2016[6] for context). At present, there are 834 constituent securities that comprise the benchmark index. Only 12 of those operate within the Chinese internet sector – less than 1.5% of the total stocks in the benchmark. Yet this niche group enjoys an outsized capitalization: together, they represent a 9% weighting in the index. As a group, these stocks have dominated the performance of the index for many years now, and the stocks' strong performance was again evident between January and March: this small group of Chinese internet stocks accounted for more than 14% of the index's gains during the first quarter.

The Fund's "growth and income" strategy is intended to balance growth objectives with dividend income, with the underlying aim of balancing risk and reward. Ideally, the strategy allows shareholders to participate in some of the growth of the developing world, while also dampening the volatility that routinely disrupts the emerging markets. In abstract, the Chinese internet sector displays some of the growth characteristics that the strategy seeks. Yet the valuation associated with this segment of stocks is speculative. Also, most of these stocks pay no dividends at all; those that do, pay minimal ones. This is a constant challenge for the Fund's strategy: adhering to its discipline means failing to capture the highest heights in the market. So long as emerging market performance is dominated by a narrow group of stocks with speculative valuations and which pay little in the way of dividends, the Fund will likely underperform its benchmark.

Yet, even as the Fund's strategy favors lower valuations and substantial dividend payments, it does not mean that the Fund must forgo nascent industries and higher growth companies altogether. Rather, the strategy seeks to achieve the greatest exposure possible to nascent industries and areas of higher growth; but it aims to do so in niches that are perhaps less obvious, and where valuations are accordingly less speculative. Once found, the Fund aims to retain such holdings for as long as possible, ideally forever.

One such case in point was the Fund's best performing position during the quarter, Pico Far East Holdings. Pico is a small company, with a capitalization of approximately $400 million. It is based in Hong Kong, and it does business in China. The Fund has held a position in the company for two and a half years. Pico is engaged in non-mainstream media-based activities: it produces corporate signage and installs corporate displays for special events, conferences and theme parks. If a company wishes to exhibit or promote its brands in China via means other than advertisement, say at an industry trade show, that company may call upon Pico.

The Fund's "growth and income" strategy has favored Pico because its balance sheet is nearly debt free, and it has extensive holdings in cash (at the time the Fund first acquired shares in Pico, cash holdings accounted for about 40% of the company's equity capitalization).

Typically, smaller companies with such substantial cash holdings are "mature," in that they might lack attractive growth prospects in the future, and their profitability might be on the decline. Not so for Pico: the company normally produces an attractive cash flow yield; and while its growth and financial performance are somewhat cyclical, I believe Pico is capable of sustaining a compound rate of 7% to 9% on average for the foreseeable future. Measured through the end of March 2017, and inclusive of reinvested dividends, the company's stock has returned 99% since its addition to the Fund in August 2014. During this period, Pico has paid dividends such that it offered an annual yield in excess of 4%. Pico is a quintessential example of the "growth and income" strategy at work.

Allocation

Four main events occurred with respect to the Fund's construction during the quarter.

First, the Fund quit all of its holdings in Turkey. In my capacity as Chief Investment Officer, I have determined that Seafarer and the Funds under its management will not, for the present time, invest in Turkey due to concerns about the country's security and stability. This is a rare action: I do not intend to make many "blanket," macro-style judgments that will force Seafarer's clients to vacate a country. However, Turkey's stability and security have deteriorated to the extent that I do not believe client assets are safe there, nor can members of Seafarer's staff reliably travel there. It is with some personal regret I take this decision now. Personally, Istanbul is one of my favorite cities in the entire world. Also, the Growth and Income Fund has prospered due to its investments in the country, even as the currency has been debased versus the dollar. For reference, this decision is not permanent: it might be reversed if our research later indicates that Turkey's stability and security have been restored.

Second, the Fund established its first holding in the China A-share market. The holding will be discussed at a later date, after the portfolio is disclosed as of the end of the first quarter.

The A-share market is denominated in renminbi, and the market has historically been off limits to most foreigners, save for a few of the largest that applied for a special status known as Qualified Foreign Institutional Investor (QFII). Originally, foreign investors were entirely forbidden from investing in A-shares. About 15 years ago, China introduced the QFII designation; but it reserved the designation only for the largest institutions (much larger than the Fund), and it demanded that such investors complete an expensive and uncertain application process – a process that might last years, and which might end in rejection. Once the designation was awarded, QFIIs were awarded fixed "use it or lose it" investment quotas, meaning that investment in A-shares was often very stilted, and the transmission of funds in and out of the program was subject to regulation.

While QFII was technically a step toward greater openness by China, it was tentative and fraught with constraints. However, in late 2014, China developed the Shanghai-Hong Kong Stock Connect, a new means to grant access to the A-share markets. Effectively, it allows foreign investors (i.e., the Fund) to purchase A-shares via the Hong Kong Stock Exchange, and its shares will be held in a special omnibus custody account at the Exchange. The Stock Connect allows investors to access A-shares without lengthy applications, quotas, mandated holding periods, or material asset size-based discrimination. The program is a substantial step towards greater openness, in my view – and Seafarer intends to make use of the Stock Connect for all its eligible clients (which include the Seafarer Funds). However, the program is not without risks or liquidity constraints; because the program is in its infancy, it is also untested amid crisis. Consequently, Seafarer will regulate and restrict its clients' use of the program for the time being. Please see the Funds' prospectus[7] for additional disclosures regarding risks associated with China, renminbi, market access mechanisms such as the Stock Connect program, and A-shares.

Third, the Fund established a new position in Hyundai Mobis (Mobis). Mobis is based in South Korea, and it is engaged in the manufacture of auto parts, components and vehicular systems. Mobis has a capitalization of approximately $20 billion, and is considered part of the Hyundai auto group. Most of its outputs are sold to its sister companies, Hyundai Motor and Kia Motor. Mobis has been added to the Fund because of its relative cheapness, and prospect for steady growth. The company has a low price to earnings ratio of 7; yet it also has substantial financial assets on its balance sheet that mask the company's underlying value. Adjustment for those assets suggests the company can generate a 20% free cash flow yield on its operational assets. The company appears poised to grow such cash flows 5% to 7% per annum. These characteristics are themselves attractive, yet if the financial assets of the company can be redeployed more effectively – and Seafarer has reason to believe that a portion of those assets will be directed toward augmented dividends or stock repurchases over the next five years – then the value afforded by Mobis is stunning.

Fourth, and last, the Fund established a new mechanism to manage its liquidity on an ongoing basis. First, some context: historically, the Fund has exclusively utilized cash, held at its custody bank, to manage liquidity needs and risks. The Fund's cash was held mostly in U.S. dollars, though occasionally it was held in foreign currencies, usually as the byproduct of a dividend payment, a bond coupon, or arising from the proceeds of an exited holding. Cash is obviously an ideal tool to manage liquidity needs and risks: it is instantly liquid, and it does not suffer obvious price risk – though the latter point is a bit misleading in my view. Cash can incur opportunity-based losses. Personally, I think opportunity losses are every bit as "real" as the losses that occur with an investment that loses value.

While the liquidity associated with cash is valuable to the Fund, it is not costless or riskless, particularly given the Fund's current scale. It is one thing to keep 5% of a fund's net assets in a single bank account if the fund has net assets of $100 million: $5 million is a large sum, but it is rather small in the context of a corporate deposit within the global banking network. However, if a fund has net assets in excess of $2 billion – as the Fund does now – keeping $100 million in the same account at a single bank represents an enormous concentration of risk. This is true in my view even if the banking counterparty is of the highest quality (and I believe Brown Brothers Harriman (BBH), the Fund's custodian, to be a counterparty of high quality and repute).

As the Fund has grown, I have sought to manage the concentration risk the same way I normally manage most risks: via diversification. Last year, I worked with BBH to implement a "sweep program" for the Fund, such that a portion of the Fund's excess cash holdings might temporarily be swept to a network of other banks with which BBH corresponds. This helped reduce the counterparty risk associated with the deposit of a large sum at a single bank.

Yet even as the sweep program reduced risk, it still represented a concentration of liquidity among a small number of global banks. Nor did the program reduce the costs of liquidity in any material way: the swept balances earn a pittance in interest. In response, I have launched a new, complementary liquidity management program for the Fund. The program will invest a portion of the portfolio's liquid assets in sovereign bonds from emerging markets. Those bonds will mostly be dollar-denominated, though the Fund may purchase a small number of foreign currency bonds provided they meet certain criteria. Maturities for the bonds generally will be kept less than 24 months (at the launch of the program, we have selected a few bonds that have maturities up to 30 months).

The aim of the program is to create a crude bond ladder, whereby the Fund will purchase bonds on regular intervals, such that one bond matures every four to twelve weeks. When a bond matures, its proceeds will be rolled into the next bond selected for the ladder (typically one with a term to maturity of 18 to 24 months); or it might be utilized to fund a new portfolio holding; or its proceeds might be used to meet redemptions.

The Fund will attempt to earn a yield to maturity on the sovereign bonds in excess of its expense ratio. Most importantly, these holdings will help the Fund manage its liquidity risks in a manner complementary to its cash holdings. Certainly, the bond prices will fluctuate more than cash; yet they offer greatly enhanced diversification, and lower carrying costs. I do not think of the bonds as "cash equivalent." Yet placed on the same spectrum as the Fund's normal assets – foreign common stock, preferred equities, and corporate bonds – these bonds present substantially higher liquidity and lower price risk. Thus I believe they are "proximate" to cash, even if not "equivalent."

Shareholders can assume that, over time, the size of the sovereign bond program will range between 1% and 5% of the Fund's net assets (it is presently a bit over 2%). Over time, my intention is to make a corresponding reduction in the Fund's cash holdings, to weightings between 0% and 2%. For reference, I have not yet met this objective due to ongoing subscriptions by existing shareholders, though the Fund has made progress (at the end of March, cash was just under 3% of net assets, whereas it was approximately 8% one year before).

Outlook

I believe there are two primary issues to which investors should pay attention over the next twelve months.

First, I acknowledge that imminent risks appear to have receded in China. Yet as you might guess from my comments in the Performance section above, I am not convinced that all is well within the Middle Kingdom. Liquidity gaps in the financial markets have heightened financial distress, and have resulted in rapidly rising corporate defaults (admittedly from a small base). This distress coincides with a recent effort by the government to use regulations and prudential standards to ration liquidity and credit within the financial system, ostensibly to control credit risks. I cannot yet discern whether rising defaults are a welcome byproduct of stricter regulations (i.e., the country is intentionally letting its weakest companies, the "deadwood," intentionally burn); or the liquidity gaps and defaults presage severe conditions yet to come. At present, I believe the risks are not so elevated as to warrant a withdrawal from China. Also, there are companies in the country whose valuations and business models make them worthy of investment, even if a crisis does arrive (therefore the advent of a new A-share holding in the Fund). Nonetheless, investors in China must be on guard.

Second, I am concerned about the rapid escalation in expectations for earnings growth within the developing world. To provide some context: between 2011 and 2015, earnings expectations were unrealistically high (above 10% every year, sometimes well above); every year the actual results fell drastically short of forecast. By 2016, analysts had suffered enough embarrassment as to finally adopt modest and realistic expectations for growth, at 8%. This figure was achieved – and when combined with modest valuations at the outset of 2016, stock prices rose.

Unfortunately, the investment analysts that guide "consensus expectations" for growth have forgotten their modesty all too quickly. At the outset of 2017, the consensus forecast was for 13% growth, already 5% higher than the prior year. More galling is the fact that by early April, analysts flush with their recent "success" revised the 2017 forecast to 17%, nearly double the 2016 rate. I am concerned that investors will be let down by the widening gap between forecasts and reality.

It is entirely possible that earnings growth will accelerate in 2017, and deliver growth higher than 8%. Apart from China, macro-economic conditions are mostly benign, and could accommodate it. Yet I am concerned that revenues and margins in the developing world are not particularly robust; and the 8% growth in 2016 was due to the modest recovery of several cyclical industries that were under severe stress in the preceding year. It is unlikely that those cyclical companies can make an equivalent contribution to growth this year, and therefore I believe it will be difficult for aggregate earnings to even match the 8% pace of growth in 2016.

To summarize: apart from China, I have a relatively optimistic view on the prospect for profit growth in developing markets; but I am concerned that expectations have been led too far, too fast, and that is usually a recipe for broad-based disappointment.

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
Seafarer Capital Partners, LLC

April 15, 2017

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[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIGIX). The Investor share class (ticker: SFGIX) gained 11.15% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $11.12 per share; it finished the quarter with a value of $12.36 per share.

[3] Source: *Bloomberg*; MSCI Emerging Markets Currency Index (index code: MXEF0XC0).

[4] Source: *Bloomberg*; MSCI Emerging Markets Currency Index (index code: MXEF0XC0).

[5] See www.seafarerfunds.com/funds/ogi/portfolio-review/2016/09/Q3#expectations-gap

[6] See www.seafarerfunds.com/funds/ogi/portfolio-review/2016/09/Q3#chinese-internet-companies

[7] Available at www.seafarerfunds.com/documents/prospectus

Glossary

Cash Flow Yield is cash flow generated by an asset during an accounting period divided by the price of said asset.

Chinese A-Shares are 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.

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

Free Cash Flow is operating cash flow minus capital expenditures.

Free Cash Flow Yield is 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.

Price to Earnings (P/E) Ratio is the market price of a company's common shares divided by the earnings per common share. The Price to Earnings ratio may use the earnings per common share reported for the prior year or forecast for this year or next year (based on consensus earnings estimates). (Source: *Barron's Dictionary of Finance and Investment Terms*, 1995)

Qualified Foreign Institutional Investor (QFII) is a program that permits certain licensed global international investors to participate in China's renminbi-based mainland stock exchanges.

Renminbi (RMB) is 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.

Shanghai-Hong Kong Stock Connect is a trading link launched in 2014 that allows offshore, non-domestic-Chinese investors and entities to invest in certain Chinese-listed stocks (known as "A-shares") that previously were inaccessible to such offshore investors. Investment in A-shares via the Shanghai-Hong Kong Stock Connect occurs through a special mechanism that was designed and implemented by the Hong Kong Stock Exchange.

Yield to Maturity (YTM) is a concept used to determine the rate of return an investor will receive if a long-term, interest-bearing investment, such as a bond, is held to its maturity date. It takes into account purchase price, redemption value, time to maturity, coupon yield, and the time between interest payments. Recognizing time value of money, it is the discount rate at which the present value to all future payments would equal the present price of the bond, also known as internal rate of return. (Source: *Barron's Dictionary of Finance and Investment Terms*, 1995)

For More Information

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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/ogi/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. It is not possible to invest directly in this or any index.

The MSCI Emerging Markets Currency Index tracks the performance of emerging market currencies relative to the U.S. dollar. The Currency Index measures the total returns of the currencies of countries in the corresponding MSCI equity index (i.e. MSCI Emerging Markets Index). Index code: MXEF0CX0. It is not possible to invest directly in this or any index.

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 this or any index.

The views and information discussed in this commentary are as of the date of publication, are subject to change, and may not reflect the writer'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 March 31, 2017, Pico Far East Holdings Ltd. comprised 0.9% of the Seafarer Overseas Growth and Income Fund, and Hyundai Mobis Co., Ltd. comprised 3.8% of the Fund. The Fund had no economic interest in Hyundai Motor Company or Kia Motors. View the Fund's Top 10 Holdings at www.seafarerfunds.com/funds/ogi/composition. Holdings are subject to change.

The liquidation of all holdings in the country of Turkey may create a taxable event for the Fund and shareholders.

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