SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

First Quarter 2018

Andrew Foster
Chief Investment Officer

During the first quarter of 2018, the Seafarer Overseas Growth and Income Fund returned -0.22%.[1] The Fund's benchmark, the MSCI Emerging Markets Total Return Index, rose 1.47%. By way of broader comparison, the S&P 500 Index lost -0.76%.

The Fund began the quarter with a net asset value of $13.63 per share. It paid no distributions during the quarter and finished the period with a value of $13.60 per share.[2]

Performance

A brief glance at the performance of the Fund (-0.22%) and its index (1.47%) for the quarter might suggest the quarter was a relatively subdued one. Reality was quite different: pronounced volatility characterized the entire period. By January 26th, the index surged upward 9.94%, only to collapse to a negative return of -1.27% by February 9th. The index then surged forward again, rising 5.91% year-to-date by March 13th, only to fall backward a second time, finishing the quarter up 1.47%. Amid this uncertain environment, the Fund experienced modestly less volatility, but it ultimately finished lower than the index, and failed to cover itself in any sort of glory.

From my perspective, the performance of the Fund was unsatisfactory. I want to stipulate that three months is far too short a period to meaningfully assess the performance of an investment strategy (indeed, I believe the minimum period is three years, and longer horizons are even better). Still, the Fund's performance was exasperating, especially because we correctly guessed that market conditions were far more precarious than was widely believed. At the outset of the year, most prognosticators espoused glowing views on stocks, especially those of the emerging markets. The pronounced volatility that followed laid bare the glib nature of those rosy forecasts. Still, despite my attempt to position the Fund defensively, it failed to dampen the volatility that reverberated through the quarter. I had the right idea, but the wrong execution.

What happened? At the risk of over-analyzing a very short period, the Fund's performance hung on individual stocks rather than the market's broader gyrations. During the quarter, six of the Fund's holdings declined by more than 10%. Four of those six holdings had allocations above 2% – in other words, a portfolio weight large enough to ensure that each had an acute impact on the Fund's performance. Two of those stocks declined from prices at year-end that were near all-time highs (Sun Pharma Advanced, a pharmaceutical company, and Balkrishna, a maker of tires for commercial vehicles, both based in India), and thus perhaps their pronounced declines signify only a short-term correction in valuation (indeed, Balkrishna has already recovered its losses as of April 2018).

However, the other four stocks (Richter Gedeon of Hungary, Ser Education of Brazil, Hengan of China, and Astra International of Indonesia) experienced stock-specific events that dragged their shares sharply lower during the quarter. Three of the four (Ser, Hengan and Astra) simply presented financial results that were meaningfully below the apparent expectation of most investors; for this, the three saw their share prices drop dramatically. This sort of event – revenues or profits falling below "consensus expectations" (a nebulous term) – can cause stock prices to jerk lower in the short-run.

What seems to be different about the present climate is that expectations for all stocks, everywhere, are so high; the consequence is that, even if a company produces acceptable results, indicative of profitability and growth, the stock price can still suffer because reality fails to meet hyperbolic expectation. I think the wide gap between expectation (rapid, widespread, dramatically-accelerating growth) and reality (steady, decent but not explosive growth, with plenty of short-term hiccups) is problematic – and I will return to this idea in the Outlook section below. For the time being, though, Ser, Hengan and Astra remain in the portfolio because we expect the present difficulties to resolve over the next year or so, and because we believe the stock prices have over-reacted to transitory problems.

The situation at Richter Gedeon (a global pharmaceutical company based in Hungary) is somewhat different. For background, the company is a relatively recent addition to the Fund, as it was added during the second quarter of 2017. I added the position to the portfolio for many reasons, but chief among them was the company's impressive operating history and global reach, combined with an attractive and broad-based portfolio of pharmaceutical therapies. In my view, the company was conservatively but astutely managed, and while the price of the shares was higher than is common for the Fund's growth and income strategy, it was still within an acceptable range, given the company's potential for growth.

The company's progress came to an abrupt halt in early January, when Richter disclosed that prescriptions of one of its key reproductive health therapies, marketed variously as "Fibristal" and "Esmya," would be restricted until the European Medicines Agency (Europe's chief pharmaceutical regulator) could complete a review. The drug is suspected to cause or contribute to liver damage in some patients. Four instances of liver damage have been reported; the drug has been in wide use since 2012, and the company estimates that it has been prescribed to 670,000 patients since that time.[3] Between the end of December and the end of March, Richter declined about 20% in U.S. dollar terms, largely in response to the news of the restriction, and because Richter's management chose to write off most of the capitalized research and development expenditures associated with the drug. The stock's price decline constituted the most substantial drag on the Fund's performance during the quarter.

There is no doubt that the suspension of Esmya from the market constitutes a substantial setback for Richter. Without offering a formal opinion, the drug was probably responsible for 20% to 25% of Richter's capitalization prior to the regulatory action. Certainly, we thought that Esmya was a key part of Richter's portfolio, as it and other reproductive health therapies could unlock the company's potential to expand across the globe, especially in the U.S. and China (these two countries together account for a relatively small, but growing portion of the company's sales). The market's response has been to swiftly wipe out most of the value that might have been attributed to the drug.

My current intent is for the Fund to retain Richter while we learn whether Esmya will be permanently discontinued, or whether the drug's value can be salvaged after the regulator's review. At this stage, I think the stock's price largely ignores most positive outcomes, whereas the drug's long use and historical efficacy suggests that there is some reasonable basis to wait. Wisely, the company's management has adopted a conservative accounting treatment, writing off most of the drug, even as the company continues to represent the drug's efficacy within the review. Even in the absence of Esmya, Richter has proven itself a very capable, well-managed company; its fate has been swung lower by this event, but it is by no means determined by it, as the company has a well-diversified and economically attractive portfolio. We will watch events at the company carefully, but the combination of its operational strength and depressed valuation demand patience.

Allocation

During the quarter, the Fund did not add or delete any investment holdings, though a number of positions were re-sized.[4] In particular: the Fund substantially reduced its holdings in both Infosys (a global software company based in India) and Sanlam (an insurance company based in South Africa). These two positions have long been among the Fund's largest; my intention was to harvest some of the gains associated with the two investments, which have been quite successful for the Fund. Both positions had appreciated such that they occupied outsized weightings, each representing well over 6% of the Fund at their peak weightings. Given the current environment, I thought it prudent to reduce the capital invested in each. Infosys has been held since nearly the Fund's inception, and Sanlam since the middle of 2014. I intend to continue to hold both positions for the foreseeable future, retaining meaningful but reduced allocations (both are now below 5% of the Fund).

Two notable positions that grew across the quarter are both domiciled within South Korea: Hyundai Mobis and Orion Corporation. The former saw its shares initially dip, based on the anticipation of disappointing results for the fourth quarter of 2017; but its shares then rallied sharply, as the controlling shareholder (the Chung family) announced a group restructuring. The Chung's plan has since been publicly countered by a global activist investor, Elliott Management. Mobis currently constitutes the single largest position within the Fund. Orion's weighting grew from circa 2.5% at the outset of the quarter to approximately 3.5% due to a combination of additional capital and appreciation.

Near the end of 2017, and in anticipation of another bout of volatility in the emerging markets, I attempted to steer the Fund towards a more "defensive" allocation at the margin. Though the Fund's performance was disappointing in this regard, I do not intend to make any major changes in the Fund's course, at least for the moment. Throughout my career, I have been constantly reminded that the shrewdest, cheapest and best course of action is to do nothing, except adopt a very watchful and aware sort of patience.

Outlook

As discussed above, I believe there is a substantial gap between the expectation for earnings growth and the underlying reality. Personally, I think this gap is the primary cause of the pronounced volatility that the emerging markets have experienced in 2018. Other factors have contributed to be sure, though: the prospect of global "trade wars" and uncertain international economic policy; global security concerns stemming from North Korea, Iran and Syria; and unstable liquidity conditions in China.

Consensus estimates for the current year call for over 15% growth from the MSCI Emerging Markets Index constituents.[5] While this outcome might be possible, it certainly does not fit with the reality that I have observed thus far in 2018, which is littered with companies that have grown at a basic rate, but which have fallen short of lofty expectations. Certain sectors (e.g. Chinese internet stocks) continue to produce much faster growth; yet even there, the growth appears to be decelerating rather than accelerating, and the underlying quality of the earnings is suspect. Ultimately, I will be very pleased if the companies in the portfolio produce 9% growth collectively, and I imagine that it will be difficult (though not impossible) for the overall market to produce much better. I still believe stock markets are on precarious footing, and much like last quarter, I would counsel prudence and caution. My advice is to harbor low expectations for growth, to avoid overpayment based on bloated assumptions, and to de-emphasize markets that could suffer from an acute deterioration in liquidity.

However, there is one "silver lining" for the emerging markets, one that has taken on even greater relevance than in past quarters: the prospect that the financial markets and economies of the developing world might exhibit "decoupled" characteristics from that of the developed world, for better or worse. I will not belabor the point much here, as I have discussed the topic in several preceding commentaries (including the third quarter 2017 portfolio review[6]), and I will do so again in a forthcoming video that will be published on the Seafarer website. However, I would note that China's leadership and policy-making seems predicated upon this very idea: I have not before observed such willingness from China's authorities to embark on an independent economic path, assuming that the U.S. no longer wishes to engage in open trade and commerce. This new but unsurprising turn in the direction of China's policy bespeaks a confidence in the future and a resolution to achieve much greater economic independence.

Only time will tell whether the country will be successful, but China's determination is unmistakable. If so, the prospect of "decoupling" will rise, and the potential diversification benefit from the emerging markets could become meaningful.

Thank you for your interest in Seafarer, and for entrusting us with your capital.

Andrew Foster
Chief Investment Officer
Seafarer Capital Partners, LLC

April 30, 2018

[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIGIX). The Investor share class (ticker: SFGIX) returned -0.22% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $13.59 per share; it finished the quarter with a value of $13.56 per share.

[3] "Hungary's Richter Says No Link Seen Between Esmya Drug and Liver Damage, Reuters, 4 December 2017. www.reuters.com/article/us-richter-gedeon-esmya-probe/hungarys-richter-says-no-link-seen-between-esmya-drug-and-liver-damage-idUSKBN1DY15R

[4] The statement that "the Fund did not add or delete any investment holdings" intentionally omits bonds that matured or were added to the Fund's "sovereign bond program." Since late 2016, the Fund has invested a portion of its liquidity in a series of short-term emerging markets government or government agency bonds, most of which are denominated in U.S. dollars, and which are intended to function as a basic "bond ladder." This sleeve of the Fund's portfolio is known within Seafarer as the "sovereign bond program," and it was first introduced in the Fund's portfolio review for the first quarter of 2017. www.seafarerfunds.com/funds/ogi/portfolio-review/2017/03/Q1#new-liquidity-management

[5] Pedro Martins, "Emerging Markets Equity Strategy," JP Morgan, 26 April 2018.

[6] www.seafarerfunds.com/funds/ogi/portfolio-review/2017/09/Q3#decoupling

SEAFARER
seafarerfunds.com

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/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.

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.

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As of March 31, 2018, Sun Pharma Advanced Research Co., Ltd. comprised 1.6% of the Seafarer Overseas Growth and Income Fund, Balkrishna Industries, Ltd. comprised 0.5% of the Fund, Richter Gedeon Nyrt comprised 3.8% of the Fund, Ser Educacional comprised 1.1% of the Fund, Hengan International Group Co., Ltd. comprised 2.8% of the Fund, Astra International Tbk PT comprised 3.6% of the Fund, Infosys Ltd. ADR comprised 4.2% of the Fund, Infosys, Ltd. comprised 0.6% of the Fund, Sanlam Ltd. comprised 3.9% of the Fund, Hyundai Mobis Co., Ltd. comprised 6.9% of the Fund, and Orion Corporation comprised 3.5% of the Fund. The Fund had no economic interest in Elliott Management. View the Fund's Top 10 Holdings at www.seafarerfunds.com/funds/ogi/composition. Holdings are subject to change.

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

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

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.

