SEAFARER

SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

Second Quarter 2018

Andrew Foster
Chief Investment Officer

During the second quarter of 2018, the Seafarer Overseas Growth and Income Fund lost -10.27%.[1] The Fund's benchmark, the MSCI Emerging Markets Total Return Index, fell -7.86%. By way of broader comparison, the S&P 500 Index gained 3.43%.

The Fund began the quarter with a net asset value of $13.60 per share. During the quarter, the Fund paid a semi-annual distribution of approximately $0.114 per share. This payment brought the cumulative distribution, as measured from the Fund's inception, to $1.895 per share.[2] The Fund finished the quarter with a value of $12.09 per share.[3]

Performance

As is obvious from the index's performance, emerging markets were weak during the quarter. Why did markets fall so precipitously? Most commentators suggest that "trade wars" and policy uncertainty are to blame; some also cite the U.S. Federal Reserve's intent to increase interest rates. I think both explanations hold truth, but neither is terribly important. Global trade has been stagnant for the better part of the past five years, and while it has recovered in the past year or so, it has not been particularly robust; therefore, it is unlikely to have been instrumental to the resumption in growth throughout the developing world. The Fed's hikes are probably a bit more influential, but frankly the Fed has increased rates seven times during the past thirty months, and it did not deter emerging market currencies or stocks from substantial gains over the past two years. Perhaps the latest hike, combined with data on accelerating inflation, has finally spooked the emerging markets; yet I think the Fed is only a secondary cause of the market's downturn.

Instead, I believe two other factors acted in tandem to spur the markets' decline. The first and primary cause is that growth in earnings is poised to disappoint, as the recovery in corporate profits that began in only mid-2016 is far more fragile than most pundits believed. Contrary to the over-optimistic forecasts of many analysts, corporate profits barely expanded between 2011 and mid-2016. Growth began to recover two years ago, but the recovery was less stable than most observers stipulated: the profit expansion was verifiably real, but not terribly strong. For much

As of 6/30/18, the annualized performance of the Fund's Institutional class was: 1 year -2.18%, 3 year 2.19%, 5 year 4.67%, and since inception (2/15/12) 5.68%.[1]; the gross expense ratio was 0.92%. The performance data quoted represents past performance and does not guarantee future results. Future returns may be lower or higher. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. View the Fund's most recent month-end performance at www.seafarerfunds.com/performance.

of 2017, policy-based stimulus in China masked the underlying weakness; and China's financial strength temporarily lifted many other economies with it. That stimulus appears to have been withdrawn. Fragility has resurfaced, and most companies have produced lackluster growth, failing to meet the exaggerated expectations of many investors.

The second cause has been the gradual resumption of inflation in many economies across the developing world. Between 2011 and 2016, many emerging markets struggled with a lack of demand and growth, and inflation pressures subsided. This allowed central banks in the emerging markets to decrease their domestic interest rates in a bid to stabilize prices and stimulate credit – even as the U.S. Federal Reserve was hiking rates. Contrary to many currency strategists' forecasts, emerging markets began to recover, and their currencies strengthened, even as their monetary policies were set opposite to that of the Fed. However, inflationary pressures have begun to resurface in several countries, and many of those same nations are struggling to reign in fiscal imbalances. Consequently, many central banks in the emerging markets have ceased cutting rates, and some have begun to hike rates again (thereby following the Fed once more). Monetary conditions are tightening even as growth is fragile, and I am convinced that such conditions are responsible for the emerging markets' decline.

The Fund's poor performance relative to the benchmark stemmed from several holdings that produced acceptable financial results, but which disappointed some segment of investors (but not Seafarer). Many of these companies operate in the information technology sector, either in software or manufacturing: Venture of Singapore (a contract manufacturer of high-end electronic devices); TOTVS of Brazil (a commercial software company); and Delta of Taiwan (a diversified manufacturer of electronic systems and components). These three companies saw their share prices slump sharply in response to passable (but apparently disappointing) results. In all three cases, I believe the market's response was grossly over-exaggerated.

Two other companies are of special note: Sanlam, a pan-African insurance company, saw its shares wilt as it completed the accelerated acquisition of Saham, a Morocco-based carrier. Sanlam surprised investors (including Seafarer) by issuing a new block of shares to finance the transaction. This unexpected and discounted issuance may have precipitated the selloff; however, I believe the acquisition was conducted at an acceptable price and will serve Sanlam well over the long term. The second company to slump was Hyundai Mobis of South Korea. It is the Fund's largest holding, and its decline imposed the single largest drag on the Fund's performance. Mobis is presently subject to highly complex economic circumstances, and these circumstances obscure its merit, but suffice to say: I believe it represents one of the most attractively-valued companies in the emerging markets (and thus it is the Fund's largest holding).

Mobis makes parts, modules and systems for the automotive industry. It presently sells most of its wares to a narrow set of related companies (Hyundai and Kia, and their global joint venture partners). Hyundai has recently struggled in the Chinese auto market, and this has weighed on Mobis' performance. However, Mobis' equity capitalization is approximately $18 billion. It has cash, net of debts, of roughly $6 billion; it holds non-operating stakes in related companies worth at least $5 billion; and it sits on properties that are conservatively worth $1 billion in liquidation (the carrying value on the balance sheet is about $3 billion). Thus, the company's financial assets account for, conservatively, $12 billion of the company's $18 billion total capitalization.

Mobis currently generates, even under presently depressed circumstances, about $1.7 billion per year in operating cash flow. This implies that even now the market values Mobis' cash flow at roughly 3.5 times its annual pace; yet Mobis has ample room to grow its sales and expand its margins. It could generate quite a bit more revenue if fortunes in China improve, or if it expands its market share beyond the Hyundai / Kia group (which it has attempted to do, with modest but encouraging success). Intriguingly, the company's controlling shareholder has publicly pledged to boost returns to minority shareholders in a bid to improve corporate governance. Yet Korean investors have sold the stock off recently, on vague (and I believe misplaced) fears about the company's future. Despite the poor performance of the shares, the Fund will retain its stake in Mobis for the foreseeable future.

In an otherwise dismal quarter, there were a few bright spots within the portfolio. Infosys, a long-term holding of the Fund, continued to appreciate, ostensibly in recognition of the company's continued growth and improved shareholder return. Infosys is based in India, but it operates globally as a commercial consultant on information technology and related services. Orion, a relatively recent addition to the Fund, is a confectionary company based in Seoul, but with operations across Asia. The company saw its shares rise sharply as a corporate re-structuring and new growth plan re-energized operational performance.

Allocation

The Fund made no major changes to its holdings during the quarter. As stated in the preceding two portfolio reviews (first quarter 2018[4] and fourth quarter 2017[5]), I have been concerned over the past six months that the emerging markets were poised for losses. I thought it best to avoid adding new and less familiar positions during a period of uncertainty. Rather, I preferred to manage exposure among the portfolio's existing positions to mitigate risk. I think the idea was correct; yet as discussed in the Performance section above, the portfolio was nonetheless struck by a sequence of negative outcomes that undermined its defensiveness. Ironically, some of the most speculative shares in the emerging markets, especially those in China, held up best during the downturn; I will return to this topic in the Outlook section below.

During the quarter, the Fund exited one small position, Cyient of India. Cyient offers engineering and design services to industrial and manufacturing companies. Prior to the second quarter, the Fund had nearly exited the position, as Cyient's share price had appreciated richly, even as the company's fundamental performance had proven unsteady. Apart from Cyient, allocations to several positions were reduced, either because the securities had achieved high valuations, or because they presented elevated risks amid the current environment.

Outlook

The Fund's performance during the past six months was disappointing, particularly given my aim to bolster its defensiveness. In my estimation, some of this was due to an exceptional run of "bad luck." As described above, several of the Fund's larger holdings experienced negative events. Share prices swooned precipitously in response. Personally, I believe some of the declines were overwrought, and I intend to hold most of the affected stocks, in the expectation that their prices might recover.

Even so, "bad luck" is an amorphous excuse. Though some portion of the Fund's decline might have been due to a confluence of improbable events, this does not offer sufficient explanation for the Fund's poor results. Indeed, the Fund's performance has been lackluster for the better part of the preceding two years, and the past six months have only brought the matter to a head. Accordingly, I have spent a good deal of time over the past year re-examining the "growth and income" strategy that underpins the Fund's portfolio. I have concluded that its efficacy has declined, and that it must undergo a measure of reform and evolution to improve its performance.

Why has the Fund's strategy become less potent? In two words: China's rise. Under President Xi Jinping's administration, China has moved decidedly to position itself as a new global hegemon, with an enormous and well-educated populace, the world's largest economy, burgeoning international influence, and growing military might. In my estimation, this thrust to become a new hegemon, alongside the U.S., has structurally altered the manifestation of risk and reward in the developing world. Chinese companies have the scope to grow faster and become larger than ever before; Chinese capital markets have the propensity to become deeper and more liquid than previously imagined; and China's currency, the renminbi, has exhibited greater stability at a higher price than most pundits ever thought possible.

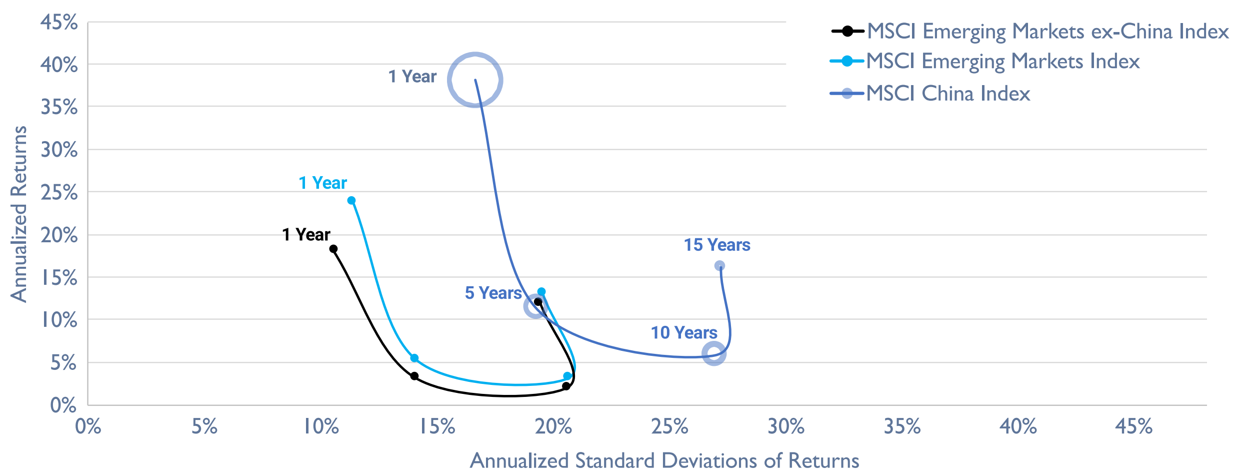
In my estimation, this change has shifted the ground below the Fund's feet. Whereas previously emerging markets were known for their elevated rewards, they were also known for their elevated risks; even if they produced attractive returns from time to time, they were often shocked into deep submission by a financial crisis or credit crunch. These shocks meant that companies' progress was episodically interrupted, and they could not compound their growth to the same extent. Companies rarely realized their full potential (and many failed) due to such conditions.

These conditions favored the Fund's "growth and income" strategy, as its construct was intended to favor steady companies that might have a better-than-average chance of withstanding such shocks (and thereby compounding growth despite economic and financial volatility). Yet as China comes to dominate the developing world, and as its rise fundamentally re-shapes the sheer scale of its economic potential, the steadiness that characterized the Fund's strategy has become an impediment to its success. This was visible during the quarter's decline: Chinese shares weathered the downturn far better than securities in other markets, even as I believe many Chinese stocks are priced with elevated valuations and exhibit poor underlying corporate performance. Put bluntly: speculative stocks in China held up better than the supposedly defensive holdings of the Fund.

In my estimation, investors and markets have begun to recognize that China's potential is somehow different and exceptional. Investors ostensibly anticipate that China might, over the long term, offer ever greater potential for reward, with lower propensity for risk; and thus, contrary to history and expectation, they have not sold off positions in haste amid a sharp downturn – even as Chinese stocks might presently suffer from shoddy fundamentals or elevated valuations.

My argument might seem abstract; yet empirical data seems to bear it out. Figure 1 plots return (measured by annualized returns in U.S. dollar terms) against a widely accepted measure of risk (annualized standard deviation in those returns, measured over the same time horizons).[6] The chart represents the performance of three indices from index provider MSCI:

Figure 1. Annualized Risk and Return – Measured over Trailing 1, 5, 10 & 15 Year Horizons (3/31/2003 – 3/31/2018)



Past performance does not guarantee future results. It is not possible to invest directly in an index. Sources: Bloomberg, MSCI, Seafarer.

the emerging markets index (the Fund's benchmark), the same emerging markets index excluding China, and the China index. The chart plots data over four different time periods: the preceding 1, 5, 10 and 15 years, ending March 2018; a line connects the four data points for each index to indicate how the relationship between risk and reward has changed over time. The size of the bubbles representing China's data points offers an indicative scale of the expansion in the country's total market capitalization over the past 15 years (i.e., total capitalization in 2018 is 17 times larger than it was in 2003).

As you examine the data, please note two underlying trends: first, over the past 15 years, China's allocation within the emerging markets index has grown markedly, such that from an initially small weighting, it is now the dominant constituent within the emerging markets index. The country's larger scale accounts for the increasing separation over time between the standard emerging market index and the index which omits Chinese shares. The second trend is that China's performance has moved distinctly upwards and to the left. China has begun to offer higher rewards, with much lower risk. Volatility in China has declined markedly, and it appears to have spurred a structural shift in the relationship between risk and reward across the emerging markets (mainly because China is now the dominant constituent). China's rise is fundamentally reshaping expectations for risk and return, and it is doing so on a much larger scale than ever before.

Against this shifting backdrop, the Fund's strategy has aimed for a steady trade-off between risk and reward. It has often sacrificed some reward to reduce perceived risk, nearly always favoring companies that grow at slower but steadier rates. In the past, such companies have better survived shocks, and this has underpinned the strategy's performance. But as China's rise has lifted the ceiling on prospective return – and as shocks have become milder and less frequent – the strategy's opportunity cost has come to the fore.

How will I respond? My goal is to ensure that the Fund is well-equipped to deal with and, where feasible, profit from China's rise. One obvious possibility is to increase the exposure to Chinese equities. While this might seem like a simple and satisfactory response, I do not plan to do so in the short run, for three reasons. First, Seafarer's skill set is in making individual stock selections, not country-driven allocations based on "macro" analysis. Second, I harbor serious doubts that China will achieve hegemonic status in a smooth and uninterrupted manner. Even though China has exhibited vastly reduced risk characteristics, my observation of the country leaves me concerned that it is still plagued by elevated risks, and that pent-up shocks might still lie ahead. Thus, I am not keen to rush into an outsized exposure to China. I will certainly continue to hold Chinese stocks, and I will undoubtedly hold more over time; but I will only do so "stock by stock," based on the individual merits of each new position, and with full recognition of persistent risks. Third, even as China becomes the dominant country within the emerging markets, I am intent that the Fund still offer a balanced representation of the developing world; I think the Fund can prosper by balancing its exposure over the globe.

I believe the Fund's long-standing "growth and income" strategy is versatile enough to cope with the change, but to do so, it must alter its balance between risk and reward. The strategy has historically sought a broad balance between prospective growth and current cash flow, the latter manifest to shareholders in a current dividend yield. Such yield often signaled an attractive valuation, and historically it also meant reduced volatility amid market shocks. In striking this tradeoff, the strategy sought a wide range of stocks, such that their distribution was not unlike a classic bell curve: at one end, stocks with higher prospective growth, and low yields; at the other, stocks with lower prospective growth, and generous yields; and in the middle, stocks with moderately underappreciated growth, and moderately elevated yields.

In my estimation, it was this third group – the "bulky middle" of the curve – that has been responsible for much of the Fund's steadiness in the past, even as the two tails of the curve sought stocks with higher prospective return. I think the middle has failed to keep pace with China's rise: the reduced risk that such stocks offer is simply not as valuable as it once was, and they do not offer enough potential return to keep pace with China's rise. To re-position the Fund, my aim is to bring out a bit more of the tails – stocks that Seafarer believes offer better return potential, even as they might represent a bit more risk. We have always sought such stocks, and our investment team has been built to pursue them. By prospectus, the Fund will continue to seek growing stocks that offer dividends, as it has always done. In the future, we will place greater emphasis on the two tail ends of the curve over the middle – favoring positions with more growth potential (and less current yield) and positions with greater apparent value (higher yield, lower valuation, and less prospective growth).

Thank you for your interest, your trust and your patience. We are honored to have the opportunity to serve as your investment adviser in the emerging markets.

Andrew Foster
Chief Investment Officer
Seafarer Capital Partners, LLC

July 14, 2018

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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) lost -10.32% during the quarter.

[2] The Fund's inception date is February 15, 2012.

[3] The Fund's Investor share class began the quarter with a net asset value of $13.56 per share; it paid a semi-annual distribution of approximately $0.112 per share during the quarter; and it finished the quarter with a value of $12.05 per share.

[4] www.seafarerfunds.com/ogi/portfolio-review/2018/03/Q1#outlook

[5] www.seafarerfunds.com/ogi/portfolio-review/2017/12/Q4#outlook

[6] Figure 1 was assembled by Seafarer with data from Bloomberg and MSCI. However, the chart was inspired by and based on the work of Ben Johnson of Morningstar, in his piece "The Evolution of the Chinese Market," 11 July 2018.

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.

The MSCI China Index is a free float-adjusted market capitalization index designed to measure equity market performance of China. Index code: GDUETCF.

The MSCI Emerging Markets ex-China Index is a free float-adjusted market capitalization weighted index designed to measure equity market performance of emerging markets excluding China. Index code: M1CXBRV.

It is not possible to invest directly in an index.

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.

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As of June 30, 2018, Venture Corp., Ltd. comprised 2.6% of the Seafarer Overseas Growth and Income Fund, TOTVS SA comprised 2.2% of the Fund, Delta Electronics, Inc. comprised 3.4% of the Fund, Sanlam, Ltd. comprised 3.4% of the Fund, Hyundai Mobis Co., Ltd. comprised 6.5% of the Fund, Infosys, Ltd. ADR comprised 4.3% of the Fund, Infosys Ltd. comprised 0.9% of the Fund, and Orion Corp. comprised 4.1% of the Fund. The Fund had no economic interest in Saham Finances, Hyundai Motor Co., Ltd., Kia Motors Corp., or Cyient. 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.

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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.