SEAFARER

SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

Third Quarter 2018

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During the third quarter of 2018, the Seafarer Overseas Growth and Income Fund gained 1.41%.[1] The Fund's benchmark, the MSCI Emerging Markets Total Return Index, fell -0.95%. By way of broader comparison, the S&P 500 Index gained 7.71%.

The Fund began the quarter with a net asset value of $12.09 per share. It paid no distributions during the quarter and finished the period with a value of $12.26 per share.[2]

Performance

After a tumultuous second quarter marked by widespread losses, emerging market stocks generally moved sideways during the third quarter. However, even as stocks exhibited a veneer of stability when measured in aggregate, specific industries and countries experienced a great deal of tumult during the period.

Perhaps most notable was the sharp downturn in China-related equities. When measured at the middle of the year, most emerging markets had suffered a sharp downturn; but Chinese stocks had exhibited remarkable resiliency. However, by the end of the third quarter, only three months later, Chinese stocks took a sharp turn for the worse. Companies in a number of industries in the country produced weak results, or management teams forecast weak outlooks for the remainder of 2018 – and suddenly one of the best-performing markets in the developing world became one of the worst. The correction was led by China's technology sector, in which several internet companies produced lackluster results, and a subset of which produced poor cash flow. Semiconductor firms throughout Asia also slumped, and some companies that produce precision technology components for consumer electronics – and which had previously enjoyed outrageously lofty valuations – saw their shares tumble as their forecasts bred disappointment.

Meanwhile, shares in Mexico and Brazil staged modest recoveries. Both countries had suffered sharp losses in the second quarter due to over-exaggerated fears over political events. As the worst prognostications did not take hold, both markets recovered in the third quarter.

As of 9/30/18 the annualized performance of the Fund's Institutional class was: 1 year -2.71%, 3 year 8.19%, 5 year 4.29%, and since inception (2/15/12) 5.68%[1]; the gross expense ratio was 0.87%. 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.

Against this backdrop, the Fund's performance can be summarized in two events: first, several of the Fund's holdings that declined in the second quarter rebounded; second, the Fund largely sidestepped the aforementioned correction in Chinese technology stocks.

Regarding the first event: a number of the Fund's larger positions corrected dramatically in the second quarter, in knee-jerk fashion, and were most likely "oversold." When those positions reported better-than-feared results midway through the third quarter, they rebounded quickly, generating a substantial portion of the Fund's gains during the third quarter. Notable positions in this regard were Mobis, a Korea-based auto-parts producer; Shandong Weigao, a medical equipment company in China; Delta Electronics, a Taiwan-based firm engaged in industrial automation; Singapore Telecom, the dominant carrier within the island-state; BolsaMex, Mexico's leading stock exchange; and Richter Gedeon, a Hungarian pharmaceutical firm.

Unfortunately, one of the Fund's larger holdings stood starkly against this trend of a recovering share price predicated upon better-than-feared results: Orion Corp of Korea declined approximately -29% during the quarter, measured in U.S. dollar terms. Orion is a maker of snack cakes, confectionaries, and other food-related products; it has a dominant share of the confection markets in Korea and Vietnam, and it is developing a leading position within China, where its products had met with initial success. Unfortunately, the company lost market share during 2017 as China placed pressure on Korean imports for political reasons. The company has undertaken a well-designed turnaround effort to revamp its distribution, renew its product lineup and rebuild its share in China. Due to these efforts, the company's share price surged to new highs during the second quarter, driven by renewed expectations for the Chinese market. Yet when its financial results were disclosed midway through the third quarter, some observers were apparently dissatisfied with the company's progress in China, and they dumped the company's shares. The negative reaction seems grossly exaggerated, and the Fund will hold the position for the foreseeable future, as Orion's turnaround efforts seem well-placed to secure the company's long-term success in China and beyond.

Allocation

As discussed in the recent Message to Shareholders – Portfolio Manager Update[3] and Portfolio Briefing video for third quarter 2018,[4] the Fund has undertaken a shift in its construct, led by two new Portfolio Managers for the Fund, Inbok Song (also Seafarer's Director of Research) and Paul Espinosa (also the Lead Manager of the Seafarer Overseas Value Fund). Inbok and Paul have led a joint effort to ensure overall continuity in the Fund's "growth and income" strategy, and yet at the same time enhance the Fund's exposure to new positions that will emphasize greater growth potential (and typically, less current yield) and positions with greater apparent value (typically higher yield, lower valuation, and less prospective growth).

The Fund's restructuring means that in practical terms, it has quit a substantial number of the positions it held at the end of the second quarter – a bit over half of them – and it has reinvested the proceeds in a number of new positions accordingly. As a result, the Fund will experience higher portfolio turnover than it has in the preceding years. The restructuring exercise was still underway as of September 30th (the date of this report), though it is nearly complete as I write now, in early November.

You may note that the Fund's count of "unique corporate issuers" (one means by which to measure the number of companies we must follow to track the Fund's existing holdings) swelled from 43 at June 30th to 60 at September 30th (view the Fund's Composition[5]). This level (60) represents the higher end of the range that the Fund might typically hold; I anticipate this figure will decline in the fourth quarter, to likely less than 55, as the Fund completes the exercise at hand.

At present, the restructuring has meant that the Fund has nearly exited its holdings in medium-and long-term bonds – both government and corporate issuers – but it has retained its holdings in short-term sovereign bonds, utilized for liquidity management purposes. Its allocation to East and Central Asia has risen marginally, and its allocation to Latin America has declined in an offsetting fashion. Holdings of cash are a bit higher than might normally be expected, but this is because as of the end of the quarter, the Fund was still mid-transition; I expect that most of the surplus cash will be utilized in the final stage of the Fund's restructuring.

With respect to sector exposures, the restructuring has wrought more pronounced changes, though I caution that any effect you might observe has been exacerbated by the fact that the official classification standards for certain technology and communication industries changed mid-quarter. You can view the Fund's sector composition[5] on the Seafarer website; you can also download the Fund's historical composition in an Excel worksheet,[6] if you wish to study trends over time. I anticipate the Fund's restructuring will be complete midway through the fourth quarter, and thus my colleagues and I will offer a more fulsome description of the new portfolio construction in the next portfolio review, scheduled to be published in January of next year.

Outlook

Thus far in 2018, emerging market stocks have experienced a difficult year, and the Fund no better. Yet, I believe that conditions are now materially better than they might appear.

Measured from the beginning of the year, through September 30th, the benchmark index declined -7.39%. Why were returns so poor? Emerging market currencies and stocks fell in tandem, as they usually do. Currencies accounted for about two-thirds of the loss, and stock price movements made up the rest.

The financial media adopted a narrative: emerging market currencies have declined due to repeated rate increases by the U.S. Federal Reserve. This narrative might hold a bit of truth, but I think the media has overstated the case – in my assessment, there is plenty of evidence that emerging market currencies do not seem to follow the Fed's cues the way they once did. Rather, emerging market currencies and stocks have declined primarily because earnings growth has slowed for reasons unrelated to the Fed, and is likely to fall marginally below "consensus" expectations. At the same time, and after a long period of quiescence, inflation has returned to most all developing economies. This in turn has forced the hand of most local central banks in the developing world – the rate-easing cycle has ended, and most banks are raising local interest rates once more. The combination of decelerating earnings growth against the backdrop of rising local interest rates has cast a pall over emerging market equities and currencies.

So, the principal "bad news" for emerging market equities can be summarized in two ideas: first, that earnings growth has fallen below forecasts, and second, that local rate hikes are happening at the same time. From my perspective, the former issue was a foregone conclusion: as I indicated in the Fund's fourth quarter 2017 portfolio review[7] (published in January of this year), emerging market stocks were in the full swoon of hype and excessive expectations. The consensus estimate for profit growth was officially forecast at 13%, but frankly many analysts were hoping for much faster growth, particularly from technology and internet stocks. Growth surged in the first quarter but has been decelerating since. In the end, I think growth for 2018 will most likely settle around 11% or 12%, below forecast. This may disappoint some speculative, short-term investors; but frankly, such performance is not that bad at all – particularly when compared to the anemic growth that characterized the developing world between 2011 and 2015.

Meanwhile, inflation is picking up modestly, and this may induce more local rate increases. If such hikes occur, they will likely pose headwinds to equities, but frankly this is to be expected – it is all consistent with a healthy level of recovery in consumption and demand within the developing world. Between 2011 and 2015, demand was so weak that deflation and price deterioration were rife. Though rate increases are no picnic, I happily prefer an environment characterized by mild (or moderate) inflation due to a recovery in consumer demand.

Most importantly, I believe stock valuations are, in aggregate, generally reasonable. Though there are notable exceptions, this is the first time in many years that valuation conditions appear favorable.

There is at least one notable challenge ahead. The financial media has focused on the U.S. decision to impose tariffs on Chinese exports – and rightly so. Some pundits have suggested that China's growth is not terribly dependent on trade. This might be true in aggregate, but it is not true for bilateral trade with the U.S. – China is highly dependent on U.S.-bound trade.

Why so? Contrary to prevailing narratives, China is on the cusp of becoming a large and permanent trade-deficit nation. It is no longer the export-driven nation it once was. China's consuming classes have developed a taste for imports, and China is now one of the largest importers of products from the rest of the developing world. China's currency is not yet accepted as a global reserve currency, and thus China cannot finance its rapidly-expanding trade deficits with issuance of renminbi-denominated bonds (as the U.S. can do with its bonds). The only way that China can afford such consumption – and raise the dollars to finance those imports – is by generating a large and sustained trade surplus with the U.S. If that surplus deteriorates, China will be under financial strain to afford its imports. The strain will be most evident in the exchange rate of the renminbi – such strain is already evident and might worsen – and in the country's capital account.

Ordinarily, moderate weakness in the renminbi would not bother me much. Yet now, it gives cause for serious concern – and demands your attention. Why so? China has become a relatively large borrower of U.S. dollars via bank loans and bond issuance, with over $2 trillion in total dollar borrowings arising from China's government and Chinese corporations. (For reference, the government's holdings in foreign financial reserves are just over $3 trillion.) The bulk of this borrowing is unlikely to present serious financial risk, as it most likely supports legitimate, currency-matched activities ordinarily denominated in U.S. dollars (e.g. trade finance and working capital). However, there is one acute source of stress: constituent within the $2 trillion is approximately $275 billion in borrowing taken on by China's residential property development sector. In my estimation, that sector's dollar-denominated borrowings represent a massive, unmatched currency risk of the worst kind. The sector generates almost no foreign currency revenues; nearly all sales and the majority of costs are denominated in renminbi. (For more detail on this topic, please see a recent market commentary[8] by my colleague Kate Jaquet.)

Why does this matter? The sector's dollar-denominated debt burden is whopping in scale, and much of it is coming due in the next 24 months. Property companies were already under financial strain, apart from their dollar exposures: they are grossly over-indebted, with renminbi borrowings much larger than their dollar borrowings. However, the sector's dollar borrowings present the most critical risk, because the sector doesn't generate dollars naturally, and because the renminbi exchange rate is now weakening, increasing the effective cost of repayment. As this financial strain accelerates, it may force the property developers to liquidate real estate inventories at a rate faster than the market can bear, and thereby instigate price weakness in physical property markets. Such weakness could, under the wrong circumstances, instigate a broader correction in real estate, thereby undermining Chinese consumption, as households reel from the "wealth effect." (Wealthy and consumptive Chinese households are, in general, far more exposed to residential real estate markets than are their American counterparts – and thus any substantial weakness in this market is likely to depress Chinese households' sense of wealth, and their proclivity to consume.) China's government might be forced to bail out the sector, or risk severe economic stress.

So, in a very roundabout way, I am concerned that U.S. import tariffs on Chinese goods could cause a correction in Chinese real estate; and if this happens – a big "if" – the effects would be severe, and they would be felt across all of the emerging markets (not least because of China's vast imports from the rest of the developing world).

This is a critical risk, and it demands ongoing attention. However, apart from it, I think nearly everything else regarding the emerging markets looks fairly good. Valuations are reasonable; growth will fall short of (exaggerated) expectations, but profits will still expand at a healthy rate; inflation is moderate, and reflective of a healthy expansion in underlying demand. In summary, and apart from my concerns regarding the Chinese real estate market, things are better than they might presently seem.

In closing: I am acutely aware that the Fund's performance has been disappointing this year, and unsatisfying in the year prior. While I can make no promises about the future, I am doing my utmost to rectify this condition. I thank you for your ongoing interest, for your patience, and for your evident commitment to a long-term investment horizon. We are, as always, honored to have the opportunity to serve as your investment adviser in the developing world.

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Seafarer Capital Partners, LLC

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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) returned 1.41% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $12.05 per share; it finished the quarter with a value of $12.22 per share.

[3] http://www.seafarerfunds.com/message-to-shareholders/2018/08/31/

[4] http://www.seafarerfunds.com/video/2018/09/ogi-portfolio-briefing/

[5] http://www.seafarerfunds.com/funds/ogi/composition

[6] http://www.seafarerfunds.com/historical-data/

[7] http://www.seafarerfunds.com/ogi/portfolio-review/2017/12/Q4#pr-performance

[8] http://www.seafarerfunds.com/commentary/china-residential-property-development-sector

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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.

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.

Capital Account is the net change in physical or financial asset ownership for a nation. The capital account, together with the current account, constitutes a nation's balance of payments. The capital account includes foreign direct investment (FDI), portfolio and other investments, plus changes in the reserve account.

Portfolio Turnover is a measure of how frequently assets within a portfolio are bought and sold. Measured as the lesser of long-term purchase costs or sales proceeds divided by the average monthly market value of long-term securities.

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.

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As of September 30, 2018, Hyundai Mobis Co., Ltd. comprised 6.0% of the Seafarer Overseas Growth and Income Fund, Shandong Weigao Group Medical Polymer Co., Ltd. comprised 0.3% of the Fund, Delta Electronics, Inc. comprised 0.6% of the Fund, Singapore Telecommunications, Ltd. comprised 0.4% of the Fund, Bolsa Mexicana de Valores SAB de CV comprised 2.2% of the Fund, Richter Gedeon Nyrt comprised 4.3% of the Fund, and Orion Corp. comprised 4.0% of the Fund. 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.