SEAFARER®

SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

First Quarter 2021

Andrew Foster
Chief Investment Officer and Portfolio Manager

Paul Espinosa
Portfolio Manager

During the first quarter of 2021, the Seafarer Overseas Growth and Income Fund returned 3.06%.[1] The Fund's benchmark indices, the MSCI Emerging Markets Total Return USD Index and the Morningstar Emerging Markets Net Return USD Index, returned 2.34% and 2.53%, respectively. By way of broader comparison, the S&P 500 Index returned 6.18%.

The Fund began the quarter with a net asset value of $14.71 per share. It paid no distributions during the quarter and finished the period with a value of $15.16 per share.[2]

Performance

During the first quarter of 2021, the sharp swings in stock prices were some of the most volatile in recent memory, save perhaps for the most extreme moments of the 2008 financial crisis, and perhaps some of the darkest days of March 2020, when financial markets collapsed in a panic over the progression of COVID-19.

Stocks in the developing world rose at a furious pace in the first weeks of January, led by some of the most expensive stocks in the MSCI Emerging Markets Index – comprised mostly of China internet and media stocks, China health care and pharmaceutical stocks, and Taiwan technology companies. By the 25th of January, the index had surged 9.2% year-to-date. The index's two largest holdings – internet giant Tencent, and semiconductor leader Taiwan Semiconductor (TSMC) – jumped 35.9% and 19.9% in U.S. dollar terms, respectively, during the same period.[3]

The gains in these two widely-owned stocks were remarkable when measured in percentage terms, but absolutely breathtaking when viewed in terms of market capitalization: the two companies added an astonishing $435 billion dollars of combined market value during those 25 calendar days.[3] Certainly, both Tencent and TSMC enjoyed strong corporate performance during 2020, so one might intuit that such increases were somehow justified. Yet for the most part, the "news" that drove these stocks to highest-ever prices was already well-known and well-

As of 3/31/21 the annualized performance of the Fund's Institutional class was: 1 year 63.93%, 3 year 8.38%, 5 year 10.05%, and since inception (2/15/12) 7.99%[1]; the gross expense ratio was 0.93%. 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.

circulated prior to the end of 2020, and thus the rapid gains over those 25 days were evidence of wild "momentum," and not reflective of fundamental changes or events.

Not much later, it all came crashing down. First, the index wobbled a bit in late January, but then it climbed to new heights by mid-February: by February 17th, the index climbed 12% year-to-date. But the rapid advance did not persist: heightened regulatory action in China's internet sector, economic uncertainty arising from the pandemic, and somewhat weaker-than-expected profitability during the final quarter of 2020 (but not formally reported until February and March of 2021) all conspired to send the index tumbling. China's stock markets, which had been at the forefront of gains, tumbled sharply, and contributed the most to the index's ensuing decline. The benchmark limped to a gain of just over 2% for the quarter, and investors were left whipsawed.

Amid this extreme volatility, the Growth and Income Fund proved relatively stable.

Amid this extreme volatility, the Growth and Income Fund proved relatively stable: it edged ahead of the index in the first days of January, only to be rapidly eclipsed by the surging benchmark in mid-February; but during the ensuing decline, the Fund held up better than the plummeting index. The Fund finished the quarter with a gain of just over 3%.

As with the benchmark, some of the Fund's biggest contributions came from its holdings in Asian internet and digital media stocks. While the index profited primarily from its position in the behemoth Tencent, the Fund's contributors were **Naver** (a search and e-commerce company based in South Korea) and **China Literature** (a digital publisher and literary content platform, whose largest shareholder is – ironically – Tencent). The Fund's contributions were otherwise more diversified than those of the index, with notable returns from **Richter Gedeon** (a Hungary-based global pharmaceutical company), **Pacific Basin** (a near-shore shipping company focused on the Eastern seaboard of China), and **Jardine Matheson** (a storied holding company with assets that span properties, hotels, grocery and retail, automotives, heavy equipment, mines and palm plantations across East and Southeast Asia).

However, the Fund's exposure to Latin America fared poorly, as Brazil and other nations struggle to manage the pandemic. The Fund saw some of its biggest declines in **Itaú Unibanco** (a Brazil-based diversified financial services company) and **Crédito Real** (a specialized finance company in Mexico). Several Asia-based companies weighed on performance, too: **Accton** (a Taiwan maker of network equipment), **Coway** (a South Korea consumer appliance company) and **Samsung C&T** (a South Korea holding company and construction business).

Allocation

During the quarter, the Fund undertook three allocative changes: one deletion and two new issuers.

The Fund exited **Taiwan Semiconductor Manufacturing Company** early in the quarter. The company is the world's largest and most profitable "semiconductor foundry," which means that it makes semiconductors on behalf of global "design firms" – clients that only design and market chips, but which do not manufacture them. Prior to its sale, TSMC was the longest-held position within the Fund, and consistently one of the largest over the past decade. It is an exceptionally well-managed company, with strong cash flow and a favorable dividend policy. Our decision to exit the stock was driven by the company's outsized growth in capital expenditures – capital expenditures that at the margin seem to be driven as much by political forces as actual, legitimate customer demand. We are concerned those rising capital expenditures might consume most all of the company's free cash flow, rendering it unable to pay its historic dividend, or possibly forcing it to incur debt (which it has avoided in the past). As China races to install quasi-nationalized "foundry" capacity of its own, and as TSMC still faces rivalry from other competitors such as **Samsung Electronics** (a Fund holding), the risk that the industry might suffer a glut of oversupply is rising, even as demand seems insatiable at present. TSMC's valuation has never been higher and in our view does not seem to account for such risks.

Prior to its sale, TSMC was the longest-held position within the Fund, and consistently one of the largest over the past decade.

The Fund purchased stakes in two new issuers in South Korea: **Samsung C&T**, a holding company of the Samsung Group, with substantial interests in Samsung Electronics, and other group assets; and a healthcare company that will be discussed in next quarter's portfolio review.

Outlook

The outlook for the developing world is a complicated one. The emerging market asset class is bifurcated along geographical lines: exactly three countries – China, South Korea and Taiwan – have, for all practical purposes, exited the pandemic due to strong protocols and risk controls. Their economies have been functioning normally for the past several quarters. These three nations have seen their stock markets soar from such success, with valuations that have priced in recovery, and possibly more (as noted in the Fund's fourth quarter 2020 portfolio review,[4] portions of China's markets are experiencing a financial bubble).

Meanwhile, most all of the remaining emerging markets are mired in the pandemic – some deeply so – with human and economic tolls that continue to grow. For most developing nations, "normalization" is nowhere on the horizon in 2021. Sadly, highly-populated countries such as India and Brazil appear to have mismanaged protocols worst of all, and both are struggling to administer the vaccine in sufficient numbers, and as a consequence, COVID-19 now runs amok. It may be years yet before those two nations and some others control the virus within their borders. We watch these nations' struggles and losses of life with sadness, and we hope for a miracle, but the situation appears grim.

For most developing nations, "normalization" is nowhere on the horizon in 2021.

The forecast for corporate performance is also bifurcated along geographical lines. The aforementioned "normalized" countries (China, South Korea, Taiwan) are forecast to see corporate profits grow 23%, 64% and 20%, respectively, in 2021. Such rates of growth are quite high, but they reflect a warranted recovery from lower levels seen in 2020. Yet it might surprise you to learn that these rates are pedestrian when compared to the rates forecast for many other nations within the emerging market asset class, such as Brazil (137%), Mexico (126%), Russia (114%), India (32%), and even Peru (705%).[5]

These elevated forecasts from the latter group have one element in common: they are predicated on a reflexive assumption of "normalization" in economic and corporate performance for most countries during 2021. Together, these forecasts undergird an astonishing expectation for growth of 45% from the constituents of the MSCI Emerging Markets Index this year.[5] Yet as noted above, "normalization" will not occur during 2021 for the majority of the developing world. Thus the 45% forecast appears rooted in wildly misplaced expectations – yes, China, South Korea and Taiwan have normalized, but the rest have not, and will not anytime soon. Unsurprisingly, but as usual, professional analysts are over-optimistic; and this time, their forecasts appear wildly out of touch with a terrible reality.

We do think the emerging markets will see profit growth this year, given the pandemic-induced nadir of 2020. It is possible that the benchmark's constituents will collectively produce profit growth between 20% and 27.5%, and at this time we expect the Fund's holdings will perform within a similar range. Still, we would encourage investors to approach the asset class with a strong degree of caution, and to disbelieve the hype over recovery and normalization. As usual, the truth is far more complicated – in this case, the asset class is bifurcated between nations mired in pandemic, and those that have moved beyond.

We would encourage investors to approach the asset class with a strong degree of caution, and to disbelieve the hype over recovery and normalization.

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 and Portfolio Manager

Paul Espinosa
Portfolio Manager

April 26, 2021

[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIGIX). The Investor share class (ticker: SFGIX) returned 3.07% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $14.64 per share; and it finished the quarter with a value of $15.09 per share.

[3] Source: Bloomberg.

[4] www.seafarerfunds.com/funds/ogi/portfolio-review/2020/12/Q4#outlook-china

[5] Source: J.P. Morgan, "Emerging Markets Equity Strategy Steering Board," 1 April 2021.

Glossary

Free Cash Flow: operating cash flow minus capital expenditures.

Market Capitalization: the value of a corporation as determined by the market price of its issued and outstanding common stock. It is calculated by multiplying the number of outstanding shares by the current market price of a share. (Source: *Barron's Dictionary of Finance and Investment Terms*, 1995)

Seafarer
seafarerfunds.com

For More Information

Individual Investors
(855) 732-9220
seafarerfunds@alpsinc.com

Investment Professionals
(415) 578-5809
clientservices@seafarerfunds.com