SEAFARER®

SEAFARER OVERSEAS GROWTH AND INCOME FUND

Portfolio Review

First Quarter 2023

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During the first quarter of 2023, the Seafarer Overseas Growth and Income Fund returned 3.97%.[1,2] The Fund's benchmark index, the Morningstar Emerging Markets Net Return USD Index, returned 3.55%. By way of broader comparison, the S&P 500 Index returned 7.50%.

The Fund began the quarter with a net asset value of $11.34 per share. It paid no distributions during the quarter and finished the period with a value of $11.79 per share.[3]

Performance

In general, I am reluctant to assign cause to effect when observing the short-term movement of stock prices. Markets are complicated systems with underlying workings that are often counterintuitive. Short-term price movements routinely evade the ready explanations of pundits. Subject to that warning, I will hazard a guess as to what drove the emerging markets between December and March, as price movements during the past quarter seem straightforward in comparison to other periods past.

In my view, two conditions were chiefly responsible for the market movements that occurred during the quarter: vacillating perceptions about investment opportunities in China, and fluctuating speculation about the U.S. Federal Reserve's monetary policy.

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The first weeks of the quarter were dominated by the former condition. After China's government haphazardly exited its disastrous "zero Covid" health policy in November, stock markets in China surged from lows based on the perception that economic conditions in the country would rapidly normalize, perhaps abetted by fiscal and monetary stimulus. China's pronounced policy pivot lifted most of the rest of the emerging markets with it. China is the dominant economy within the developing world, and as such its economic cycles influence those of many other developing countries, especially in East and Southeast Asia and South America.

This portfolio review addresses the first quarter of 2023 (1/1/23 to 3/31/23). As of 3/31/23 the annualized performance of the Fund's Institutional class was: 1 year -5.18%, 3 year 12.57%, 5 year 2.07%, 7 year 4.97%, 10 year 4.02%, and since inception (2/15/12) 5.19%[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.

This strong momentum carried over into the first weeks of January, abetted by brokers and strategists eager to hype a rapid recovery in China. They confidently pushed the notion of "revenge spending," a concept in which deprived Chinese households — having been pent up at home and saving substantial income for the better part of three years — would rush into the world, cash-rich and on a spending bender, consuming anything that was not nailed down. Fueled by easy narratives — and institutional investors suddenly wary they had too little exposure to China in their portfolios – the benchmark index rose nearly 9% between December 31, 2022 and January 26, 2023.[4] Then reality struck, and the "re-opening" hype collapsed.

The benchmark index's momentum peaked during the final week of January, when companies in China began to publish financial results for the fourth quarter of 2022 (and in most cases, also the complete results for the entirety of the preceding calendar year). The results varied across companies and industries, but by and large they were weak, such that 2022 finished on a sour note. Further, when offering prospective comments about 2023, management teams' comments were muted, noting soft demand, the lack of pricing power and increasing competition. In addition, the government's limited monetary and fiscal response failed to impress investors. Meanwhile, private sector investment was flat, and unemployment among youth was at an all-time high in China's modern era. While retail sales have picked up, and some other indicators suggested that a modest recovery in consumption is underway, it was clear that households were not "revenge spending," but rather proceeding cautiously. As the easy story of an economic revival in China unraveled, the market took note, and the benchmark index reversed its gains. By the middle of March, the same index was in the red, down -1.4% year-to-date.[5]

However, before March was over, the benchmark index regained ground, finishing the quarter in the black with a 3.55% return, as noted above. This time, speculation about U.S. monetary policy pushed markets higher. During March, two U.S. banks collapsed swiftly with balance sheets in disarray, ostensibly unprepared for the marked increase in rates undertaken by the Fed over the past year. Speculators interpreted the event as a signal that the Fed would slow the pace and magnitude of future hikes for fear of further distress; they promptly bid up asset prices and currencies in response. The benchmark equity index finished the quarter in positive territory due in part to a surge in the emerging market currencies that underlie equities; indeed, a key currency index rose nearly 2% during the quarter.[6]

Chinese stocks also managed a late surge, driven by a single corporate announcement that – at least temporarily – reshaped investors' perceptions about investment opportunity in the whole of the country. On March 28, **Alibaba** (a current holding of the Fund) announced that it intended to pursue a corporate reorganization in which six underlying business divisions would be reconstituted as separate, stand-alone businesses; each would be managed independently, and each would pursue its own public offering and stock market listing.[7]

The stock surged on the news, likely because investors perceived that six underlying businesses would eventually be valued more highly individually than Alibaba as a consolidated whole.[8]

Yet Alibaba's news did more than lift Alibaba's stock: indeed, most Chinese stocks followed suit, rising sharply in the last few days of the month. China watchers speculated that Alibaba's "historic" announcement was de facto evidence the company was on better terms with the Chinese government.[7] Pundits further assumed this news augured well for Chinese technology companies – and other industries besides – which had suffered under a capricious "regulatory cycle" during the preceding two years.[9] Investors told themselves that Alibaba's reform was voluntary and had at least tacit government support, and this in turn meant the government was at last softening its attitude towards Chinese industry. This speculation was abetted by Alibaba founder Jack Ma's reappearance in China after two years in what many believed was a self-imposed exile: the country's original techno-capitalist hero was at last comfortable to return home. This news supercharged Chinese stocks, thereby lifting the entire benchmark index in the final days of the quarter.

Amid these events, the Fund swung generally with that of the broader equity market; however, the diverse allocation of its portfolio (relative to its benchmark index) ultimately drove its modest outperformance. For instance, the Fund carried a substantial underweight to China and Hong Kong securities (roughly half that of the index); yet even as Chinese equities swung into positive territory at the end of the quarter, the Fund managed to deliver larger gains than those of the index, due to the substantial outperformance of its individual holdings (notably **Alibaba** and **Pacific Basin**).

The Fund's significant exposure to Mexico – only 6%, but roughly double that of the index – also helped deliver outperformance. Mexican equities surged during the quarter, seemingly untroubled by events in China. (Indeed, evidence is accumulating that Mexico is benefiting from China's troubled economic environment: some Chinese industries have chosen to build factories in Mexico rather than China, to better serve North American customers, with greater proximity and less geopolitical risk.[10]) Your Fund has been more active in Mexico of late — it has added two new positions in the past year — and this enhanced exposure lifted its performance during the period.

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Perhaps most subtly, the Fund's low exposure to the Indian equity market also worked to its benefit during the quarter. During the past three years of the global pandemic, Indian equities have experienced widespread gains – some seemingly warranted, some seemingly not – such that by the end of 2022 the market generally enjoyed lofty valuations. The Fund had low or no exposure to Indian stocks during this period, admittedly to its detriment. Our team has not necessarily been deterred by elevated valuations in the aggregate: we are not "top-down" investors, but rather evaluate the merits of individual securities rather than whole markets. We do not abandon a market simply because it seems "expensive" in aggregate, and especially not one such as India, which has a diverse and deep set of corporate listings. In such markets, we will use "bottom-up" research techniques to identify opportunities in niches that run contrary to the general grain. Still, the lofty environment has made it difficult to find individual stocks that seemed to balance attractive fundamental characteristics with valuations we deemed reasonable.

Concerted research effort has found such niches over the past year, and accordingly the Fund has added four positions in India in recent quarters. (One of those positions, **UPL**, was added during the first quarter of 2023 and is described under "Allocation" below.) Yet even after those additions, the Fund remains substantially underweight India relative to its benchmark index. This low exposure worked to the Fund's advantage in the period, as Indian equities experienced a mild decline during the quarter, and thereby significantly underperformed most other markets.

Allocation

During the quarter, the Fund added three new holdings and deleted four others. Two of the new holdings will not be disclosed at this time, as the Fund is still building those positions up within the investment portfolio.

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One of the three new holdings is an agrichemical business called **UPL**. UPL is based in Gujarat, India, a state situated just to the north of Mumbai, but the company operates globally: UPL derives nearly 80% of its revenue outside of India, and it claims to operate in over 138 countries around the world (including the U.S.). As it garners revenues around the globe, it does so with profit margins higher than many of its peers despite manufacturing commodified chemical compounds. UPL generates such margins through its diverse and capillary distribution network. This network affords the company information about farmers' particular needs in each geography; it then uses the resulting insight to blend commodity chemicals into custom formulas attuned to the needs of crops in that region – and the resulting products fetch higher prices. The company ranks among the world's top ten crop protection businesses.[11]

The Fund exited its holding in **Wilmar** to make way for UPL. Wilmar is a Singapore-based company with extensive operations in edible oils – processing, crushing, and trading raw materials – with a prominent presence in China. Our Value team, led by Paul Espinosa, determined that UPL's business, characterized by diversified revenue streams and high margins, would constitute an improvement relative to Wilmar's more concentrated business.

The Fund also exited a holding in **Orion**, a South Korea-based snack maker with operations in China and Vietnam. Our Growth team, led by Lydia So, determined that one of the new, as yet undisclosed holdings offered improved growth prospects for the Fund relative to Orion. The Fund also exited small holdings in **Pico Far East**, a Hong Kong-based media and promotion company, and **Sindoh**, a South Korea-based producer of office equipment.

Outlook

Looking forward, I remain optimistic about the long-term merit of the emerging markets, with the supporting arguments described in full detail in the Fund's third quarter 2022 portfolio review.[12] However, while I am positive about the next five to ten years, the remainder of 2023 is murkier. On one hand, I would warn investors to remain wary about the hype that some pundits are still pushing regarding a strong economic recovery in China: as I warned in the Fund's fourth quarter 2022 portfolio review,[13] China is experiencing an economic recovery, albeit only a limited one that is unlikely to lift growth dramatically for most private industries within the country. Such conditions do not augur well for stock returns from the asset class, as China plays a dominant role within the emerging markets. Yet emerging market stocks already seem to have figured this out quite well, as they have retrenched further in April, beyond what is described above in the Performance section of this review.

Meanwhile, the outlook for earnings is also cloudy. As I write this review at the end of April, about one third of the Fund's holdings have reported results for the first quarter of 2023. The results are decidedly mixed: while most companies have generated substantial revenue growth (indicating steady or perhaps rising demand), many companies have produced lackluster growth in profits, or even a decline in profits, primarily due to compression in profit margins. The exact reason for this compression in profitability is unclear at this time, as it seems to vary widely among individual companies and industries: some seem to be competing more on price, perhaps to attract market share; others may have seen margins eroded by higher input prices or escalating labor costs. Only time will tell what the profit picture will look like for the remainder of 2023; indeed, my comments are drawn from only a handful of companies, and only for the first quarter. There is a lot of the year left to unfold. Still, it may be a difficult year ahead, one characterized by consolidation (i.e., where less competitive companies either fail or retreat from markets).

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We aim to build the portfolio for such moments, in that we look for companies whose fundamental performance is more likely to be secure in times of distress, making them more likely to consolidate market share rather than find themselves among the consolidated. In any case, valuations remain reasonably low, and markets do not seem to be expecting much from the year ahead, which suggests that investors might be prepared for a tepid year of profits. Happily, we have seen several of the Fund's holdings boost their dividends over the past few quarters, suggesting that such companies do not foresee much distress ahead.

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

with Paul Espinosa
Portfolio Manager

and Lydia So
Portfolio Manager

April 30, 2023

[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIGIX). The Investor share class (ticker: SFGIX) returned 3.99% during the quarter. All returns are measured inclusive of Fund distributions paid (in relation to Fund performance) or dividends paid (in relation to index performance), reinvested in full (exclusive of any U.S. taxation) on the pertinent ex-date.

[2] 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.

[3] The Fund's Investor Share class began the quarter with a net asset value of $11.27 per share; and it finished the quarter with a value of $11.72 per share.

[4] Between 12/31/22 and 1/26/23, the benchmark Morningstar Emerging Markets Index rose 8.85%. Source: Bloomberg.

[5] Between 12/31/22 and 3/16/23, the benchmark Morningstar Emerging Markets Index declined -1.36%. Source: Bloomberg.

[6] Between 12/31/22 and 3/31/23, the Bloomberg Emerging Markets Large, Mid, and Small Cap Currency Implied Yield Index rose 1.4%. Source: Bloomberg.

[7] Zhang, Jane. "Alibaba Shares Soar After Historic Overhaul Heralds IPO Wave." Bloomberg, 28 Mar. 2023. https://www.bloomberg.com/news/articles/2023-03-28/alibaba-splits-into-six-units-that-may-pursue-individual-ipos

[8] Between the close of market on 3/28/23 and 3/31/23, the stock of Alibaba listed in Hong Kong (ticker 9988) rose 19.17% when translated into U.S. dollar terms.

[9] The phrase "regulatory cycle" is the most common one employed by China watchers to describe the deterioration in China's business environment over the past decade. I place it in quotation marks here because I disagree vehemently with its use. Much of the decade's deterioration has not been driven by regulatory action (which occurs when regulators impose new rules in reference to established, public law after careful analysis and consultation); rather, it has been the result of sovereign intervention (where senior government officials – not ordinary regulators – have altered industry rules suddenly, without direct reference to established law, but rather to conform to a new set of opaque policy directives). Nor is there anything "cyclical" about the deterioration: the use of this term subtly implies that the Chinese government's relationship with domestic private industry will "ebb" and "flow" in a somewhat predictable manner over time, and therefore the current "cycle" will eventually reverse. This is a falsity: in the future, China's business environment might improve, but also it might deteriorate further. There is no underlying phenomenon that will necessarily induce a reversal in China's business environment, and investors are positioned best when they assume nothing about the existence of a "regulatory cycle," and rather assess each problematic event for what it is: a capricious intervention in the economy by the state.

[10] Torres, Luis, and Aparna Jayashankar. "Mexico Awaits 'Nearshoring' Shift as China Boosts Its Direct Investment." Federal Reserve Bank of Dallas, 14 Apr. 2023. https://www.dallasfed.org/research/swe/2023/swe2303

[11] UPL Corporate Website. https://www.upl-ltd.com/our-story

[12] www.seafarerfunds.com/funds/ogi/portfolio-review/2022/09/Q3/#outlook

[13] www.seafarerfunds.com/funds/ogi/portfolio-review/2022/12/Q4/#china-recovery

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The Morningstar Emerging Markets Net Return USD Index measures the performance of emerging markets targeting the top 97% of stocks by market capitalization. The index does not incorporate Morningstar's environmental, social, or governance (ESG) criteria. Index code: MEMMN. The Bloomberg Emerging Markets Large, Mid, and Small Cap Currency Implied Yield Index is an index that tracks the performance of a representative basket of emerging market currencies relative to the U.S. dollar. The index aims to reflect the performance of deposits in foreign currency accounts, at interest rates determined using the covered interest rate parity relationship and weighted to each currency following the weights of the Bloomberg Emerging Markets Large, Mid, and Small Cap Price Return Index. Index code: EMLSFX. 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, 2023, Alibaba Group Holdings, Ltd. comprised 3.8% of the Seafarer Overseas Growth and Income Fund, Pacific Basin Shipping, Ltd. comprised 2.0% of the Fund, and UPL, Ltd. comprised 2.0% of the Fund. The Fund did not own shares in Wilmar International, Ltd., Orion Corp., Pico Far East Holdings, Ltd., or Sindoh. 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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