SEAFARER®

SEAFARER OVERSEAS VALUE FUND

Portfolio Review

Second Quarter 2020

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During the second quarter of 2020, the Seafarer Overseas Value Fund returned 13.23%.[1] The Fund's benchmark, the MSCI Emerging Markets Total Return Index, returned 18.18%. By way of broader comparison, the S&P 500 Index increased 20.54%.

The Fund began the quarter with a net asset value of $8.69 per share. It paid no distributions during the quarter and finished the period with a value of $9.84 per share.[2]

Performance

During the second quarter of 2020, the Seafarer Overseas Value Fund's net asset value partially reversed the decline suffered during the market drawdown in the first quarter of the year. As gratifying as this quarter's 13.23% net asset value appreciation may be in absolute terms, the Fund continues to underperform the benchmark year to date. Following up on the soul-searching in last quarter's portfolio review,[3] growth-oriented companies continued to outperform value-oriented ones, as measured and defined by MSCI-based indexes.

In the case of the Value Fund, small capitalization stocks accounted for the majority of the performance differential versus the benchmark during the quarter. In my view, for the last few quarters the market has expressed a clear preference for highly liquid stocks. The Value Fund's small capitalization holdings performed the worst during the quarter, regardless of industry, country, or fundamentals.

Similarly, the Fund's larger capitalization holdings outperformed regardless of industry or valuation. Indeed, the top contributors to performance included last quarter's top detractors, such as **Shangri-La** (Breakup Value and Asset Productivity sources of value; see **Figure 1** for definitions of the sources of value referenced in this review) and **Melco International Development** (Deleveraging and Breakup Value). The former is a Hong Kong-based regional hotel owner and operator, and the latter is a Macau-based casino owner and operator. Both

As of 6/30/20 the annualized performance of the Fund's Institutional class was: 1 year -14.22%, 3 year -2.84%, and since inception (5/31/16) 2.30%[1]; the net expense ratio was 1.05% and the gross expense ratio was 1.50%. 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.

Figure 1. A Working Definition of Value

Seafarer has identified seven distinct sources of value in emerging markets that may give rise to viable opportunities for long-term, value-oriented investments.

Opportunity Set	Source of Value	
Balance Sheet	Balance Sheet Liquidity	Cash or highly liquid assets undervalued by the market
	Breakup Value	Assets whose liquidation value exceeds their market capitalization
	Management Change	Assets that would become substantially more productive under a new owner / operator
	Deleveraging	Shift of cash flow accrual from debt holders to equity holders
	Asset Productivity	Cyclical downturn following a period of asset expansion
	Structural Shift	Shift to a lower growth regime, but still highly cash generative
Income Statement / Cash Flow	Segregated Market	Productive, cash-generative assets trading in an illiquid public market

Source: Seafarer Sources of value are highlighted in this document using This Style.

Additional information is available in the white paper *On Value in the Emerging Markets* at www.seafarerfunds.com/value-in-em.

companies' revenues hinge on their customers' ability to travel and are thus directly impacted by the pandemic. One could explain both companies' strong stock performance this quarter by suggesting that the market recognized the very low valuations it attached to companies operating in industries directly impacted by the novel coronavirus. Yet, the Fund's top performers also included companies operating in more resilient industries that had outperformed in previous quarters and enjoy relatively higher valuations. Holdings in this category include **Samsung SDI** (Breakup Value), a South Korean battery manufacturer, and **Wilmar International** (Asset Productivity and Breakup Value), an edible oils processor and consumer company. What all these stocks have in common is that they are highly liquid.

Allocation

The Fund added one new holding during the second quarter: **Mondi PLC** (Structural Shift), a global paper and packaging company. I am attracted to this company's unique asset base: difficult to replicate, vertically integrated paper and pulp milling assets strategically located near low-cost fiber sources in geographies including South Africa, Eastern Europe, and Russia. Decades of investment and finetuning of its production facilities and commercial network have made the company one of the lowest cost producers globally. Management shines by its ability to consistently produce high rates of return on invested capital, which enabled the company to consolidate the industry.

The Fund exited **Cherkizovo Group** (Segregated Market), a Russian integrated meat producer. The stock contributed a large and positive total return to the Fund. I decided to harvest returns in this small capitalization company to reinvest in Mondi, a significantly more liquid stock, with a more consistent return on capital through the economic cycle, and global scale.

The Fund also exited **Hang Lung Properties** (Breakup Value), a Hong Kong-based developer and manager of retail, office, and residential properties. Hang Lung's stock price recovered strongly since March 2020 despite the pandemic directly impacting the company's operations. I used this sale to fund the purchase of Mondi, as well as upcoming purchases in the third quarter of 2020.

Going forward, I expect the Fund will continue to add large capitalization stocks with similarly capable management as Mondi, at the expense of its smaller capitalization holdings. This shift in the Fund began a few quarters ago and is motivated by my desire to capture newfound attractive valuations in stocks that have historically traded at a premium in recognition of their consistently above-average rates of return on capital and high caliber management. The Fund has historically found few value-oriented opportunities in this segment of the investment universe not because it did not appreciate the value these companies have traditionally generated, but because they traded at a premium and therefore prospective returns failed to meet Seafarer's requirement. The present pandemic and associated economic slowdown afford the Fund the opportunity to upgrade the liquidity and quality of its holdings without sacrificing prospective return expectations.

Outlook

Last quarter's portfolio review[4] discussed how the government and central bank response to the pandemic, and associated virtual halt to economic activity, in the form of public and private debt monetization, as well as unprecedented fiscal spending, would depress rates of investment return going forward. This lower expected rate of return may potentially expand the gap between pension fund actuarial assumptions and realistic future investment returns, compounding the underfunding problem of many retirement plans.

My intent is not to promote the emerging market investment universe as a panacea for the existential problem of retirement savings in developed economies, including the

U.S. Indeed, many emerging economies also suffer from similar distortions promoted by their own central banks and governments. Instead, I will highlight a few differentiating factors in emerging economies and the companies that operate there that will hopefully inform a U.S., or developed market, saver in the allocation decision to preserve and grow the purchasing power of his or her savings.

From the perspective of economic distortion, it is important to realize that emerging and developed markets are converging. The term "emerging market" itself implies an original absence of markets and their subsequent emergence. The emerging market investment universe has grown over decades as the centrally planned economies of socialist states have gradually substituted the market pricing mechanism for government targets in the allocation of finite resources. Central banks in developed markets, on the other hand, have used each successive economic slowdown to expand their control from the key price in the entire economy, the price of money, to the prices of other assets. Similarly, developed market governments have used each successive economic slowdown to increase budget deficits with ever diminishing restraint. The misguided objective of avoiding recessions at all costs has resulted in developed economy policymaking mimicking that of emerging markets in their earlier history. Directionally, and at the risk of overgeneralizing, many emerging economies' policymaking in recent history has moved in the direction of enabling healthier growth and investment returns, whereas developed market policymaking has moved in the opposite direction.

Another structural point of differentiation is that generally, but not in every instance, the underpinnings of long-term growth are healthier in emerging economies. These economies tend to have higher rates of working population growth, and greater potential for productivity improvement.

Painting with a broad brush, one could argue that emerging economies enjoy a more attractive long-term growth potential with moderating intervention in the economy to impede the realization of said potential. Developed economies compare poorly on both counts.

The problem with these sweeping arguments extends beyond their inaccuracy in specific cases to the practical problem that they actually fail to inform the investment decision. Seafarer invests in companies, not countries. One of the few general arguments I would venture in the realm of emerging market corporates compared to U.S. companies is that the former have built their book value per share for over a decade, since the 2008 crisis, whereas U.S. corporates have typically paid it out in the form of dividends and buybacks. Emerging market corporates have generally financed growth with a combination of internal cash flow and debt, whereas U.S. corporates have, in the aggregate, relied almost exclusively on debt to finance capital expenditures and buybacks.

This point of corporate differentiation is crucial in the current context. Arguably, the pandemic has served to expose pre-existing tepid and slowing economic activity globally, as well as corporate financial weakness. The generally more robust evolution of book values and internally financed growth of emerging market corporates since 2008 provides an attractive hunting ground for investment opportunities when compared to the aggregate development of book values and balance sheets in the U.S. Book values that have grown over the years, concurrent with dividend growth, should prove more valuable to survive an economic crisis and grow with internal capital when the time comes, than book values that have stagnated due to years of hollowing out corporate capital.

While the foregoing observations will hopefully help U.S. investors in the allocation decision between developed and emerging markets during this turbulent time, they do not guarantee successful stock picking. Time and facts will judge the performance of Seafarer's bottom-up strategies. What I will say at this stage is that the Value Fund's evolution over the past few quarters is in accord with the observed investment context. The substitution of mid-to-large capitalization holdings for smaller capitalization ones in the portfolio is designed to improve the liquidity and scalability of the Fund. What the current investment context provides is the opportunity to add to the Fund what Seafarer refers to as "gems." Gems are large companies that have historically generated a return on equity significantly ahead of the cost of equity throughout most of the economic cycle, with demonstrably capable management and regard for minority shareholders. Since its inception in 2016, when emerging markets entered a bull market, the Value Fund chose to avoid investing in many of these companies due to their premium valuation, judging that attractive future investment returns would not follow a high stock entry price. What current valuations in emerging markets provide is the opportunity for the Value Fund to kill two birds with one stone by upgrading the liquidity of the portfolio, while simultaneously adding high quality companies at a valuation befitting the minimum returns Seafarer and its Value strategy pursue.

Thank you for entrusting us with your capital. We are honored to serve as your investment adviser in the emerging markets.

Paul Espinosa
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[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIVLX). The Investor share class (ticker: SFVLX) returned 13.13% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $8.68 per share; it finished the quarter with a value of $9.82 per share.

[3] www.seafarerfunds.com/funds/ovl/portfolio-review/2020/03/Q1#performance-overview

[4] www.seafarerfunds.com/funds/ovl/portfolio-review/2020/03/Q1#outlook

Glossary

Book Value: the value of an asset as represented in the accounts of a balance sheet. An asset's book value is typically determined by the original cost of the asset, less any depreciation, amortization or impairment costs applied against the asset. The book value of a firm is typically determined by the value of the firm's assets, less its liabilities. In theory, shareholders would be entitled to the firm's book value if the company's balance sheet was liquidated.

Liquidity: the ability to buy or sell an asset readily and with reasonable volumes without affecting the asset's price. (Sources: Seafarer and Barron's Dictionary of Finance and Investment Terms, 1995)

Return on Equity (ROE): the amount of net income returned as a percentage of shareholders equity. Return on equity measures a company's profitability by revealing how much profit the company generates with the money shareholders have invested.

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