SEAFARER OVERSEAS VALUE FUND

Portfolio Review

Third Quarter 2020

Paul Espinosa
Portfolio Manager

During the third quarter of 2020, the Seafarer Overseas Value Fund returned 5.59%.[1] The Fund's benchmark indices, the MSCI Emerging Markets Total Return USD Index and the Morningstar Emerging Markets Net Return USD Index, increased 9.70% and 9.01%, respectively. By way of broader comparison, the S&P 500 Index returned 8.93%.

The Fund began the quarter with a net asset value of $9.84 per share. It paid no distributions during the quarter and finished the period with a value of $10.39 per share.[2]

Performance

During the third quarter of 2020, the Seafarer Overseas Value Fund's net asset value (NAV) continued to recover in absolute terms from the market drawdown in the first quarter. Nevertheless, the sequential performance improvement pales in comparison to that of the benchmark indices.

It would be easy to hide behind sweeping statements, such as "value investing is out of favor," to explain the Fund's relative performance. However, I am stating in writing that the underlying dynamic of investment return generation through the recognition of attractive valuation is alive and well even within the current growth-oriented market context.

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The Fund is fortunate to have held **Amvig Holdings** (Structural Shift source of value; see Figure 1 for definitions of the sources of value referenced in this review), a Chinese tobacco packaging manufacturer, during the third quarter to illustrate the point. Presumably driven by the low valuation Hong Kong-listed Amvig shares ascribed to the company's cash flow, a Chinese private

As of 9/30/20 the annualized performance of the Fund's Institutional class was: 1 year -7.95%, 3 year -2.31%, and since inception (5/31/16) 3.46%[1]; the net expense ratio was 1.05% and the gross expense ratio was 1.44%. 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.

equity fund announced a tender offer for the publicly-listed shares of the company at a 51.4% premium to the last traded price prior to the announcement.

Similarly, the share price of **Wilmar International** (Asset Productivity and Breakup Value), an edible oils and consumer company, contributed positively to performance for yet another quarter, as company announcements made clear that the initial public offering (IPO) of its Chinese subsidiary would take place in the near future.

It is important to note that Amvig's business did not experience any shifts during the quarter that the share price needed to adjust to, nor was Wilmar's operation in China a new development. Both businesses had operated for decades, and the market had plenty of opportunity to price each of them.

And yet, only now did these companies realize the value embedded in their balance sheets. So much for the theory of market efficiency...

Still, if market participants recognize the inefficiency that academic textbooks do not, why is the Fund's performance significantly lagging the benchmark indices this year?

Based on the performance of the rest of the portfolio, part of the answer to this question must relate to the idea that share prices tend to overshoot. I make this statement based on the performance this quarter of three stocks that had significantly detracted from the Fund's NAV since the start of the pandemic: **First Pacific** (Breakup Value), a consumer and infrastructure conglomerate operating in South East Asia; **PetroVietnam Fertilizer and Chemical** (Management Change and Asset Productivity), a Vietnamese fertilizer manufacturer; and **Giordano** (Structural Shift), a manufacturer and retailer of casual wear in Asia and the Middle East. These companies rank among the poorest performers during the first quarter of the year when markets were trying to price the impact of the pandemic; yet, they rank among the best performers this quarter after disclosing more information on how operations fared during the first half of the year. The point of citing these examples is that the market, like every other human endeavor, is an imperfect mechanism and prices do overshoot in both directions.

This price overshooting tendency is the only way to explain the 0.3x price to book value of portfolio holding **Georgia Capital** (Breakup Value), a conglomerate operating in the country of Georgia. Despite owning some of the country's prime assets in sectors including banking, healthcare, and utilities, the stock trades at a valuation more appropriate for a company facing solvency risk. This contradiction, however, did not stop the portfolio holding from ranking among the top detractors to performance this quarter.

Similarly, **China Foods** (Asset Productivity), a Coca-Cola bottler with territories covering half of China, also ranked among the worst performers this quarter. The contradiction in this case relates less to valuation, and more to the relationship between operating results and stock price performance. Despite reporting resilient first half results, a trait shared by high-flying technology stocks, China Food's stock price declined significantly in absolute terms during the quarter in spite of an already low valuation.

The only way I can explain the contradictions highlighted in the two examples above is that at this stage the market seems disinterested in Georgia Capital's frontier market risk and China Foods' small capitalization risk. I base this interpretation on the contrast between these two companies and other portfolio holdings that also performed poorly during the quarter but for understandable reasons. Holdings such as **Melco International Development** (Breakup Value and Asset Productivity), a casino owner and operator in Macau, as well as **Shangri-La** (Breakup Value and Asset Productivity), a hotel owner and operator in Asia, represent businesses dependent on their customers' ability to travel. Thus, the poor performance of their stock prices in the quarter despite their low equity valuations is understandable. That is not the case for other portfolio holdings, such as the previously cited examples.

In summary, while the overall performance of the Value Fund relative to the benchmarks so far this year is disappointing, I would not conclude that either the strategy itself, or value investing more generally, is "dead." Rather, I see the underlying dynamic that enables value realization to be alive and well. I observe, however, that public equity markets seem disinterested in virtually any risk unrelated to the largest companies in the benchmark.

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Allocation

During the third quarter of 2020, the Fund added two new holdings that fit the general description of what Seafarer refers to as a "gem." These are companies that have historically distinguished themselves by a return on equity significantly higher than the cost of equity almost regardless of the macroeconomic context they operate in, combined with good treatment of minority shareholders.

It should not surprise the reader that Brazil's woes, as reflected in the approximately 45.2% devaluation of the currency since early 2017, have provided unusually low valuations for gems that have historically traded at a premium valuation. Taking advantage of this opportunity, the Fund established a new position in **Ambev** (Structural Shift and Asset Productivity), a Brazil-based Latin American brewer that also operates in Canada. The market is currently trading Ambev stock at the level it traded in 2009, presumably because of poor operating conditions and a newfound competitive threat from Heineken that is perceived as structural. Whereas I am more sanguine about the competitive threat, though I fully acknowledge I may be wrong, I am reasonably confident that Ambev will recover its historical level of profitability in U.S. dollars. A brewer with Ambev's caliber of management, brand equity, and distribution strength has an underappreciated capacity to recover margins and U.S. dollar-based profit after a currency devaluation. That is ultimately what the Fund is buying with this new holding.

The second addition to the Fund this quarter is **Itaú Unibanco** (Asset Productivity and Breakup Value), the largest privately-owned bank in Brazil. Concerned about the seemingly fatal combination of higher prospective loan losses and low interest rates with which to fund said losses, the market is also trading Itaú stock at the same level as it did in 2009. What the Fund is buying with this new holding is an unusually low price for the bank's extraordinary ability to generate a return on equity in the mid-teens even under stressed operating conditions, management's ability to generate a return on equity hovering around 20% under less-stressed conditions, and the underappreciated value of the bank's stake in XP Inc, best described as Brazil's version of Charles Schwab.

The Fund exited three positions during the quarter. The sale of **China Resources Beer** (Structural Shift), a Chinese brewer, and **Qualicorp** (Structural Shift), a Brazilian life insurance broker, both relate to valuation. The former represents a textbook case of a share price that in my estimation already anticipates that China Resources Beer will generate profit in-line with what other global brewers earn, which significantly exceeds the Chinese brewer's abnormally low profitability. While the latter was not as richly valued as China Resources Beer, Qualicorp had already realized much of its value after competitor Rede D'Or took a strategic stake in the insurer. The Fund decided to book profits and reinvest these in Ambev and Itaú.

Finally, the Fund exited **Del Monte Pacific** (Deleveraging and Management Change), a food producer and owner of the Del Monte brand. The Fund realized a meaningful loss with this sale. I deemed this realization in the Fund's interest after it became clear that management is running out of time to turn around the U.S. subsidiary. While the company has made significant progress on this front, its refinancing agreements to extend the maturity of its considerable leverage include terms that I consider too onerous. Furthermore, even if management ultimately succeeds in making the U.S. operation profitable, it is doubtful that it can earn its new cost of debt. The Fund exited Del Monte Pacific because the investment's risk rose beyond a level I felt comfortable with.

Outlook

In last quarter's portfolio review[3] I discussed how monetary and fiscal policy in developed economies increasingly mimics the worst practices of emerging markets in their earlier history. Predicting low investment returns for U.S. equity markets following the combination of said policies and generally acknowledged high valuations for U.S. equity market indexes, I also discussed structural points of differentiation for prospective investment returns between developed and emerging markets.

Given the underperformance of emerging market benchmarks relative to the S&P 500 index over the past decade, I felt compelled to address a few points a U.S. dollar investor should consider when contemplating an allocation to emerging markets.

Given the Fund's performance relative to the benchmarks year-to-date, I feel similarly compelled to address the question of whether a value strategy remains useful for investors. Arguably, I already made the case for the Seafarer Overseas Value Fund in the white paper *On Value in the Emerging Markets*.[4] Please refer to it for quantitative and qualitative arguments.

I will use the opportunity in this portfolio review to instead share my personal view, at a more conceptual level, of why a value discipline remains as relevant as it has always been. As explained earlier in this review, I see the process of value realization still at work in individual cases, though not at a strategy or index level. As I pointed out in the case of Amvig Holdings and Wilmar International, low valuation can persist for extended periods of time, and the timing of it leading to substantial investment returns is unpredictable. Thus, a value strategy requires the wherewithal and patience to exploit this market "inefficiency." This is ultimately the trade-off a value-oriented investor engages in.

In contrast, I see a culture of "something for nothing" pervading public policy and investment culture alike. Governments in developed economies appear to believe that more debt (ever-expanding fiscal deficits) will somehow reverse a debt-induced, structural economic slowdown. The U.S. Federal Reserve officially announced in August of this year that it will likely abandon the best practice of raising rates in anticipation of inflation, and instead raise them once inflation has already been running above 2% for some time. The Fed seems to believe that somehow inflation creates employment, thus enabling it to fulfill its dual mandate of full employment and an inflation target of 2%. If deficits and inflation led to prosperity, developing economies would have graduated to developed status long ago.

> Rather than a comeback of value versus growth, I do expect a return to profit and valuation as the drivers of sustainable returns, as they have always been.

Similarly, with regard to investment culture: the ever-expanding popularity of passive investment strategies and their outperformance of most actively-managed funds appears to have cemented a blind belief in the efficiency of markets. In effect, investors seem to believe that they can generate a lasting investment return by simply buying the largest companies whose prices have appreciated the most. Somehow, size and past price performance constitute the basis of future investment returns. Work in the form of research, contemplation, patience, process, and diligence are not requisites for earning attractive future investment returns. These simply appear without any work involved, the same way that governments seem to rely on deficit spending at the expense of entrepreneurial work to drive economic growth, and the Fed relies on currency debasement instead of hard money as the foundation for full employment.

This mentality appears to have spread to the value vs. growth dilemma as well. I see it on a bottom-up basis in the numerous companies Seafarer researches as well as in Fund holdings, as explained in the Performance section of this review. At an index level, I see this mentality in the long-running outperformance of indexes focused on large, tech-oriented constituents. More generally, size and revenue growth seem to trump profit considerations in predicting individual stock price appreciation. Prominent examples of this dynamic include Tesla and Uber. Again, the underlying assumption seems to be that somehow revenue growth has value without the hard work of figuring out how to earn a profit first.

This detour into sharing my personal views on the current investment climate is not meant to justify the Fund's underperformance versus the benchmarks, but rather its intent is to make self-evident the flimsy ground on which index returns to date are based. I do expect a change in the investment regime as a result; and rather than a comeback of value versus growth, I do expect a return to profit and valuation as the drivers of sustainable returns, as they have always been.

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

Paul Espinosa
Portfolio Manager
Seafarer Capital Partners, LLC

October 16, 2020

[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIVLX). The Investor share class (ticker: SFVLX) returned 5.60% during the quarter.

[2] The Fund's Investor share class began the quarter with a net asset value of $9.82 per share; it finished the quarter with a value of $10.37 per share.

[3] www.seafarerfunds.com/funds/ovl/portfolio-review/2020/06/Q2#outlook

[4] www.seafarerfunds.com/value-in-em

Glossary

Initial Public Offering (IPO): the process of offering shares of a private company to the public in a new stock issuance. Public share issuance allows a company to raise capital from public investors.

Price to Book Value (P/BV) Ratio: the market price of a company's common shares, divided by the company's book value per share.

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.

SEAFARER
seafarerfunds.com

For More Information

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

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

All performance is measured in U.S. dollar terms. For the MSCI Emerging Markets Total Return USD Index, performance is calculated to reflect the reinvestment of dividends, capital gains, and other corporate actions gross of foreign jurisdiction withholding taxes (i.e., such taxes are ignored). For the Morningstar Emerging Markets Net Return USD Index, performance is calculated to reflect the reinvestment of dividends, capital gains, and other corporate actions net of foreign jurisdiction withholding taxes. 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/ovl/performance.

The MSCI Emerging Markets Total Return USD 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 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 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 September 30, 2020, Amvig Holdings, Ltd. comprised 2.9% of the Seafarer Overseas Value Fund, Wilmar International, Ltd. comprised 5.3% of the Fund, First Pacific Co., Ltd. comprised 5.4% of the Fund, Petrovietnam Fertilizer & Chemicals JSC comprised 3.4% of the Fund, Giordano International, Ltd. comprised 2.2% of the Fund, Georgia Capital PLC comprised 2.9% of the Fund, China Foods, Ltd. comprised 4.3% of the Fund, Melco International Development, Ltd. comprised 3.7% of the Fund, Shangri-La Asia, Ltd. comprised 4.5% of the Fund, Ambev SA comprised 2.6% of the Fund, and Itaú Unibanco Holding SA comprised 2.4% of the Fund. The Fund did not own shares in The Coca-Cola Co., Heineken N.V., XP Inc., Charles Schwab Corporation, China Resources Beer Holdings Co., Ltd., Qualicorp Consultoria e Corretora de Seguros SA, Rede D'Or Sao Luiz SA, Del Monte Pacific, Ltd., Tesla, Inc., or Uber Technologies, Inc. View the Fund's Top 10 Holdings at www.seafarerfunds.com/funds/ovl/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.

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