



## SEAFARER OVERSEAS VALUE FUND

# Portfolio Review

Second Quarter 2021

**Paul Espinosa**  
Portfolio Manager

During the second quarter of 2021, the Seafarer Overseas Value Fund returned 6.07%.<sup>1</sup> The Fund's benchmark indices, the MSCI Emerging Markets Total Return USD Index and the Morningstar Emerging Markets Net Return USD Index, increased 5.12% and 5.65%, respectively. By way of broader comparison, the S&P 500 Index returned 8.55%.

The Fund began the quarter with a net asset value of \$13.02 per share. It paid no distributions during the quarter and finished the period with a value of \$13.81 per share.<sup>2</sup>

### Performance

The most useful question one can ask in examining the Value Fund's second quarter performance, pleasing as it is in absolute and relative terms, is whether one can tease out confirmation of the market chatter concerning a presumed rotation into value stocks. I would argue that, in the case of the Seafarer Overseas Value Fund, other factors are more important.

Ironically, the easiest way to debunk the value-rotation theory is by looking at two of the worst performing holdings during the quarter, which exhibit classic value attributes. **Shangri-La** ([Breakup Value](#) and [Asset Productivity](#) sources of value; the "source of value" for a Fund holding is hereafter referenced in parentheses), a hotel owner and operator in Asia, ceded much of last quarter's share price gain after a sporadically resurgent pandemic delayed the anticipated recovery in hotel occupancy. Similarly, **Melco International** ([Breakup Value](#) and [Asset Productivity](#)), a casino owner and operator in Macau whose revenue growth also depends on its customers' ability to travel, detracted from performance after an incipient recovery appeared to stall. Effectively, these two holdings performed as one would expect, according to short-term earnings-related considerations, despite offering value relative to the balance sheet and normalized earnings.

---

As of 6/30/21 the annualized performance of the Fund's Institutional class was: 1 year 42.32%, 3 year 8.44%, 5 year 9.48%, and since inception (5/31/16) 9.17%; 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](http://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	<b>Balance Sheet Liquidity</b> Cash or highly liquid assets undervalued by the market
	<b>Breakup Value</b> Assets whose liquidation value exceeds their market capitalization
	<b>Management Change</b> Assets that would become substantially more productive under a new owner / operator
	<b>Deleveraging</b> Shift of cash flow accrual from debt holders to equity holders
	<b>Asset Productivity</b> Cyclical downturn following a period of asset expansion
	<b>Structural Shift</b> Shift to a lower growth regime, but still highly cash generative
Income Statement / Cash Flow	<b>Segregated Market</b> 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](http://www.seafarerfunds.com/value-in-em).

Following this line of reasoning, one could argue that anticipated earnings momentum also drove the performance of the Fund's top performing holding this quarter. **Pacific Basin** ([Asset Productivity](#)), a dry bulk shipping company headquartered in Hong Kong, performed very strongly for a second consecutive quarter in anticipation of extraordinary earnings momentum driven by constrained shipping capacity growth coupled with resurgent demand for the transportation of goods.

The case of the Fund's two Brazilian holdings, which also ranked among the top contributors to performance during the quarter, is interesting in that their quarter-to-quarter price volatility appears to be a tug of war between earnings momentum and valuation. **Itaú Unibanco** ([Asset Productivity](#) and [Breakup Value](#)), the largest privately-owned bank in Brazil, and **Ambev** ([Structural Shift](#) and [Asset Productivity](#)), a Brazil-based brewer in the Americas, are both reporting resilient operating performance while macroeconomic considerations impinge on investor sentiment. This dynamic, combined with a valuation that shifts with the stock price from clearly undervalued to requiring deeper work to see through the haze of nominal multiples, explains why these two stocks rank among the top or bottom contributors to performance depending on the quarter. It is important to note, however, that the cumulative performance contribution of these holdings since the Fund's original purchases has been positive as of the date of this portfolio review.

One could argue that anticipated earnings momentum drove the performance of the Fund's top performing holding this quarter.

## Allocation

During the second quarter, the Fund added **Coca-Cola Femsá**, a.k.a. KOF ([Asset Productivity](#)), the largest Coca-Cola

franchise bottler in the world by volume, operating throughout Latin America. Despite the name, the Fund did not purchase KOF stock to participate in the growth of Coke consumption in the region. This Fund addition is designed to capitalize on an operating turnaround after a decade beset by a high number of acquisitions, followed by currency devaluations and recessions, that led to sub-standard returns on equity (ROE) and stock price performance over the period. This holding transcends the short-term pandemic cycle and focuses instead on capital allocation in time spans of a decade or more.

The Fund also finished establishing a new position in an issuer that it begun purchasing in the first quarter. **Samsung C&T** ([Breakup Value](#)), the holding company for the Samsung Group, owns significant stakes in Samsung Electronics and Samsung Biologics. This multi-faceted holding represents a valuation-conscious vehicle to invest in Samsung Biologics, a high-growth biopharmaceuticals company trading at high multiples that a value-driven strategy might otherwise ignore. Similarly, its value is further bolstered by a significant and underappreciated stake in Samsung Electronics. Lastly, the stock represents a way to capture possible value-unlocking restructuring steps as the Samsung Group continues to simplify its holding structure.

The Fund did not exit any holdings during the quarter.

## Outlook

Finding investment ideas such as Coca-Cola Femsá (KOF), discussed above, makes me excited about the outlook – not for the asset class (emerging markets), or for the investment approach (value), but for the Seafarer Overseas Value Fund.

I feel optimistic about the future when I find a company such as KOF because the reasons the Fund purchased it run contrary to current investor questions concerning the outlook for investment returns. The majority of questions I receive

about the future revolve around the following: a possible incipient “value rotation” in the market; whether emerging markets can finally outperform the S&P 500 Index when next year’s outlook for U.S. corporate earnings is very strong given the potential for a federal stimulus program; and whether emerging markets can outperform in the event of a market drawdown in the context of historically high valuations for the S&P 500.

The problem with the questions above, despite them being perfectly sensible, is that (1) they focus on the trend, or the next market move, (2) they grant undue importance to next year’s earnings, and (3)

they rely on cross-market correlations to make allocation decisions.

The issue is that none of these factors represent the cornerstone of future investment returns.

These variables represent observable, ex-post outcomes, or a curiosity for the historical financial record, and nothing more.

---

The Fund’s purchase of KOF is refreshing because its cornerstone is the company’s mergers and acquisitions (M&A) cycle, which spans a decade

---

Within this context, the Fund’s purchase of KOF is refreshing because its cornerstone is the company’s mergers and acquisitions (M&A) cycle, which spans a decade – not the economic cycle, next year’s earnings, or the expected relative performance of a consumer discretionary company versus a technology stock.

I do not know how the Mexican economy will perform over the next few years, or whether Latin American consumption of carbonated drinks will grow. What I do know is that over the past ten years KOF has suffered a declining ROE, leading to an ever-shrinking company valuation, and stock underperformance. I know that management, once highly regarded, has lost much of its reputation in the market as a result, and that many think of the stock as a value trap. Most importantly, after digging deeper into the numbers, I have concluded that contrary to consensus, the ROE decline relates less to overpaying for acquisitions and more to ill-timing with recessions and devaluations following acquisitions.

In fact, the company’s acquisition and turnaround of the Coca-Cola Philippines operation and its eventual exit from the country demonstrate that it is a competent acquirer and operator of assets in other countries, and that it maintains good capital discipline by choosing to exercise its negotiated put option to the Coca-Cola Company to exit the country once operating conditions no longer justify the price paid for the asset. I know that the company’s acquired assets are underutilized, and that it has more than enough pricing power to eventually pass through commodity cost inflation (and more) to consumers. I know that behind the declining ROE, the underlying profitability of the business remains robust.

In my view, a portfolio consisting of individual holdings that represent variations on the foregoing line of reasoning – which is the purpose behind the seven categories of value identified in the white paper [On Value in the Emerging Markets](#)<sup>3</sup> – has the potential to minimize the impact of market or country factors in overall performance. Ideally, the returns associated with such a portfolio would correlate less with the overall market compared to the returns of other strategies, especially passive ones. Furthermore, assuming good execution, the investment returns of such a portfolio would also capture an upward shift in valuation, not just market growth rates.

From a value perspective, the investment opportunity the coronavirus has delivered is not lower stock prices and their presumed rise in the post-pandemic world, but the possibility of finding companies that have used the pandemic to improve their operating efficiency and market reach in the post versus pre-pandemic economy. Coca-Cola Femsa is one such company, as well as other additions to the Fund over the past eighteen months, such as Itaú, Ambev, and Jardine Matheson.

The Value Fund’s research pipeline contains more stocks of a similar ilk. Finding such opportunities at valuations consistent with attractive future returns, i.e. relatively low valuations, is the reason I am more excited to find ideas now than in previous periods.

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

July 7, 2021

<sup>1</sup>References to the “Fund” pertain to the Fund’s Institutional share class (ticker: SIVLX). The Investor share class (ticker: SFVLX) returned 6.00% during the quarter.

<sup>2</sup>The Fund’s Investor share class began the quarter with a net asset value of \$13.00 per share; and it finished the quarter with a value of \$13.78 per share.

<sup>3</sup>[www.seafarerfunds.com/commentary/on-value-in-the-emerging-markets/](http://www.seafarerfunds.com/commentary/on-value-in-the-emerging-markets/)

## Glossary

**Mergers and Acquisitions (M&A):** the consolidation of companies or assets. A merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed.

**Put Option:** a contract giving the owner the right, but not the obligation, to sell, or sell short, a specified amount of an underlying security at a pre-determined price within a specified time frame. The pre-determined price the put option buyer can sell at is called the strike price.

**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.



### For More Information

#### Individual Investors

☎ (855) 732-9220  
✉ seafarerfunds@alpsinc.com

#### Investment Professionals

☎ (415) 578-5809  
✉ clientservices@seafarerfunds.com

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](http://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: GDUUEGF. 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.

The views and information discussed in this commentary are as of the date of publication, are subject to change, and may not reflect Seafarer's current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles. It should not be assumed that any investment will be profitable or will equal the performance of the portfolios or any securities or any sectors mentioned herein. The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation. Seafarer does not accept any liability for losses either direct or consequential caused by the use of this information.

As of June 30, 2021, Shangri-La Asia, Ltd. comprised 4.0% of the Seafarer Overseas Value Fund, Melco International Development, Ltd. comprised 2.7% of the Fund, Pacific Basin Shipping, Ltd. comprised 5.0% of the Fund, Itaú Unibanco Holding SA comprised 4.0% of the Fund, Ambev SA comprised 4.0% of the Fund, Coca-Cola Femsa SAB de CV comprised 2.1% of the Fund, Samsung C&T Corp. comprised 2.6% of the Fund, Samsung C&T Corp., Pfd. comprised 0.4% of the Fund, and Jardine Matheson Holdings, Ltd. comprised 2.1% of the Fund. The Fund did not own shares in the Coca-Cola Co., Samsung Electronics Co., Ltd., Samsung Biologics Co., Ltd., or Coca-Cola Beverages Philippines, Inc. View the Fund's Top 10 Holdings at [www.seafarerfunds.com/funds/ovl/composition](http://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](http://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.

The Seafarer Overseas Value Fund is not sponsored, endorsed, sold, or promoted by Morningstar, Inc. Morningstar, Inc. makes no representation or warranty, express or implied, to the shareholders of the Fund or any member of the public regarding the advisability of investing in the Fund or the ability of the Morningstar Emerging Markets Net Return U.S. Dollar Index to track general equity market performance of emerging markets.