



## SEAFARER OVERSEAS VALUE FUND

# Portfolio Review

Third Quarter 2022

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Portfolio Manager

During the third quarter of 2022, the Seafarer Overseas Value Fund returned -5.63%.<sup>1,2</sup> The Fund's benchmark index, the Morningstar Emerging Markets Net Return USD Index, returned -9.95%. By way of broader comparison, the S&P 500 Index returned -4.88%.

The Fund began the quarter with a net asset value (NAV) of \$12.44 per share. It paid no distributions during the quarter and finished the period with a value of \$11.74 per share.<sup>3</sup>

### Performance

During the third quarter, the Value Fund continued to widen its year-to-date performance differential versus the benchmark, albeit accompanied by a disappointing decline in the NAV. The Fund's total return from the beginning of the year to September 30, 2022 was -9.62%, compared to the benchmark's -25.23%.

The Fund's third quarter and year-to-date performance relative to the benchmark might suggest that its portfolio is "defensive." But examination of the stock price behavior of its holdings reveals a different explanation for its performance.

One of the Fund's positive contributors to return for the quarter was **Melco International** ([Asset Productivity](#) and [Breakup Value](#) source of value; see [Figure 1](#) for definitions of the sources of value referenced in this review), a casino owner and operator in Macau. While the company operates in a cyclical industry that is sensitive to a potential deceleration in global gross domestic product (GDP) growth, it has already undergone two years of recessionary conditions since the start of the pandemic in early 2020 when visitors to Macau declined to historical lows. Furthermore, the Fund has continued to add to its position in the stock since the beginning of the pandemic, enabling it to purchase future cash flows at an attractive price. Both factors combined led to a positive contribution to the portfolio's return in the third quarter despite global equity prices swooning on the prospect of a global recession.

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*This portfolio review addresses the third quarter of 2022 (7/1/22 to 9/30/22). As of 9/30/22 the annualized performance of the Fund's Institutional class was: 1 year -8.35%, 3 year 3.00%, 5 year 2.05%, and since inception (5/31/16) 5.16%; the net expense ratio was 1.05% and the gross expense ratio was 1.35%. 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).

The Fund's Brazilian holdings – such as **Itaú Unibanco** ([Asset Productivity](#)), Brazil's largest private bank, and **Ambev** ([Structural Shift](#) and [Asset Productivity](#)), a Brazil-based brewer in the Americas – also made positive contributions to the Fund, following weakness earlier in the year. In my interpretation, after initially discounting the impact of tighter monetary conditions in Brazil, the market eventually bid up the share price of both stocks based on their operational resiliency. Ambev appears to be gaining market share while raising prices. Itaú has been posting good results in an environment in which GDP is growing in the low single digits, even though the Brazilian central bank's SELIC Overnight Rate increased from 2.0% at the beginning of 2021 to 13.75% as of September 30, 2022.

I would thus describe the Fund's performance not as defensive but as validation of Seafarer's value ethos of investing in companies whose management teams serve as true stewards of capital – an approach that is not necessarily pursued by all value investors, as I point out in [How the Value Team Finds "Gems" in Emerging Markets](#)<sup>4</sup> – and as demonstrating discipline with regard to the price paid for the future cash flows these management teams are likely to deliver. Put differently, Seafarer does not lower its required rate of return threshold even if the market's discount rate is at historic lows.

The Fund also owns non-cyclical companies that have outperformed the market for a long time, in absolute and relative terms, and continued to do so this quarter. **Tabreed** ([Deleveraging](#)), a supplier of district water cooling services, and **Qatar Gas Transport** ([Deleveraging](#)), an owner and operator of transport vessels for liquefied natural gas, operate businesses based on multiyear revenue contracts that are unaffected by global GDP growth expectations.

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On the negative side of the ledger are Fund holdings that, while enjoying valuation support, have earnings with more room to decline than those of companies that have already undergone a severe industry or company-specific recession, such as Melco International. An example is **Innocean Worldwide** ([Balance Sheet Liquidity](#)), a South Korea-based global advertising company, whose net cash on the balance sheet equates to 84.9% of its market capitalization. In principle, Innocean's stock price should prove resilient on the basis of valuation and a defensive balance sheet. The stock, however, detracted from the Fund's performance this quarter, as the market focused more on the potential for earnings downgrades in the advertising industry generally and the auto sector (an area of specialization for Innocean) in particular. The stock price behavior of **Samsung C&T** ([Breakup Value](#)), the holding company for the Samsung Group, displayed a similar dynamic, declining because of a deterioration in its earnings outlook despite trading at 0.69 times price to book value.

Finally, the Fund's Eastern European holdings performed poorly, as a result of concerns about energy (particularly natural gas) shortages in Europe (caused by the war in Ukraine) and weakening currencies (caused by the inflation associated with the war). **Mondi PLC** ([Structural Shift](#)), a global paper and packaging company with operations in the region, faltered due to concerns about a reduction in demand caused by the prospective energy shortage, even though the company sources only 10% of its production energy from natural gas. The stock price of **Moneta Money Bank** ([Asset Productivity](#)), a bank operating in the Czech Republic, also declined, because of the threat of a windfall tax on banks designed to help subsidize the cost of energy.

## Allocation

This quarter the Fund purchased a new stock, **Siam Cement Group** ([Asset Productivity](#) and [Breakup Value](#)), a Thailand-based industrial conglomerate that operates in Southeast Asia. Contrary to what the company name suggests, Siam

Cement's largest business segment is petrochemicals. It also operates a packaging division, which went public in 2020, and a cement and building materials business, which started operations more than a century ago.

The company distinguishes itself through its excellent balance sheet management, regional expansion, and dividend payments despite operating in cyclical industries. The attraction of purchasing the stock at the end of the third quarter was that its

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price had declined, as a result of the downturn in the global petrochemical industry. I do not pretend to know when the cycle will bottom or enter the recovery phase, but this security potentially offers an attractive dividend yield in the meantime, with the possibility of earnings growth as a result of the planned opening in 2023 of a new petrochemical plant in Vietnam. Unlike other industrial companies, Siam Cement generates consistently high rates of return on equity without resorting to excessive leverage, while concurrently delivering high rates of growth over the long term. A possible listing of the petrochemical division adds to the stock's attraction from a [Breakup Value](#) perspective, as two of the three divisions would then have separate public market valuations.

The Fund did not exit any positions during the third quarter.

## Outlook

Developed markets are the new emerging markets. The developed market policy response to the Covid-19 pandemic since the beginning of 2020 has been a showcase of advanced economies enacting the policy they historically advised emerging markets against: deficit spending financed by debt monetization. The Outlook section of my portfolio reviews for the [first](#)<sup>5</sup> and [second](#)<sup>6</sup> quarters of 2020 discussed the likely implications of these policies for prospective investment returns.

Now, in the second half of 2022, the global economy is gripped by inflation. Responding to the supply disruption stemming from the pandemic – compounded by the war in Ukraine – with policies designed to artificially boost demand through credit expansion could not have had any other result. The policy-induced inflation the world is now facing should have been eminently predictable.

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Advanced economy currencies are now behaving like currencies in emerging markets.

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The point of this preamble is the recognition that advanced economy currencies are now behaving like currencies in

emerging markets. In the nine months ended September 30, 2022, major developed market currencies, as measured by the DXY Index, depreciated 14.7% against the U.S. dollar. In contrast, the basket of emerging market currencies, as represented in the MSCI Emerging Markets Currency Index, depreciated just 8.2% over the same time period.

Yes, the date range above is selective and short, but it is meaningful because it represents the real-time denouement of long-running and ill-advised policymaking in advanced economies. Put differently, the risk differential, related to economic policy and currency stability, between developed and emerging markets is narrowing.

This updated risk assessment of advanced economy currencies, combined with generally acknowledged high valuations in the securities markets of these countries, may result in a "push factor" away from developed market assets, as investors seek higher risk-adjusted returns elsewhere. Whether the emerging markets asset class can demonstrate a "pull factor" for those savings by offering relatively stable currencies, lower valuations, and higher growth rates remains to be seen.

Lastly, it is important to highlight how the Value Fund pursues investment returns within the foregoing investment context. I have noted in previous quarterly commentaries that, unlike policymaking in advanced and developing economies that invariably focuses on boosting demand, the Fund searches for value by also paying attention to the supply side. This quarter's addition of Siam Cement is a case in point. The reader may rightly wonder why the Fund purchased a cyclical stock at the beginning of a downcycle. Part of the answer is that stock prices, with more or less efficiency, anticipate the cycle and the opportunity cost of waiting for better times. The other part of the answer is that Siam Cement is opening a new petrochemical plant in Vietnam, a country intent on developing the domestic supply of oil and gas, and that needs a degree of domestic petrochemical supply for its industrialization. In other words, the company's provision of domestic supply is needed regardless of whether demand is in an upswing or downward phase. At a broader level, Siam Cement caters to the long-term industrialization of Southeast Asia, which itself forms part of the geographic diversification of supply chains that is currently taking place with geopolitical shifts. The beauty of this stock is that it combines this top-down, supply-driven *raison d'être* with unusually sound financial management, which should enable the company to survive demand cycles, including those exacerbated by unorthodox policy making in advanced economies.

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

October 19, 2022

<sup>1</sup> References to the "Fund" pertain to the Fund's Institutional share class (ticker: SILVX). The Investor share class (ticker: SFVLX) returned -5.64% 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.

<sup>2</sup> 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).

<sup>3</sup> The Fund's Investor share class began the quarter with a net asset value of \$12.41 per share; it finished the quarter with a value of \$11.71 per share.

<sup>4</sup> [www.seafarerfunds.com/commentary/how-the-value-team-finds-gems-in-emerging-markets](http://www.seafarerfunds.com/commentary/how-the-value-team-finds-gems-in-emerging-markets)

<sup>5</sup> [www.seafarerfunds.com/funds/ovl/portfolio-review/2020/03/Q1#outlook](http://www.seafarerfunds.com/funds/ovl/portfolio-review/2020/03/Q1#outlook)

<sup>6</sup> [www.seafarerfunds.com/funds/ovl/portfolio-review/2020/06/Q2#outlook](http://www.seafarerfunds.com/funds/ovl/portfolio-review/2020/06/Q2#outlook)

## Glossary

**Gross Domestic Product (GDP):** a macroeconomic measure of the value of a country's economic output. GDP includes only those goods and services produced domestically; it excludes goods and services produced abroad, even if such goods and services are produced by factors of production (i.e. companies) owned by the country in question.

**Net Cash:** a company's cash position, calculated by subtracting the company's total debt from its total cash.

**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.

**SELIC Overnight Rate:** the Brazilian Central Bank's overnight rate; the interest rate at which a depository institution lends or borrows funds in the overnight market.



## For More Information

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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 MSCI Emerging Markets Currency Index is an index that tracks the performance of emerging market currencies relative to the U.S. dollar. The Currency Index measures the total returns of the currencies of countries in the corresponding MSCI equity index (i.e. MSCI Emerging Markets Index). Index code: MXEF0CX0. 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. The U.S. Dollar Index is an index that tracks the performance of developed market currencies relative to the U.S. dollar. Index code: DXY. It is not possible to invest directly in an index.*

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*As of September 30, 2022, Melco International Development, Ltd. comprised 3.6% of the Seafarer Overseas Value Fund, Itaú Unibanco Holding SA comprised 3.2% of the Fund, Ambev SA comprised 3.1% of the Fund, National Central Cooling Co. PJSC (Tabreed) comprised 3.9% of the Fund, Qatar Gas Transport Co., Ltd. comprised 4.2% of the Fund, Innocean Worldwide, Inc. comprised 3.1% of the Fund, Samsung C&T Corp. comprised 2.7% of the Fund, Samsung C&T Corp., Pfd. comprised 0.2% of the Fund, Mondi PLC comprised 2.2% of the Fund, Moneta Money Bank AS comprised 2.2% of the Fund, and Siam Cement PCL comprised 1.7% of the Fund. The Fund did not own shares in The Samsung Group. 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.*

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