SEAFARER OVERSEAS VALUE FUND

# Portfolio Review

## First Quarter 2023

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During the first quarter of 2023, the Seafarer Overseas Value Fund returned 4.97%.[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 $12.68 per share. It paid no distributions during the quarter and finished the period with a value of $13.31 per share.[3]

### Performance

While both the Value Fund and the benchmark index posted positive quarterly returns, their performance gyrated sharply throughout the quarter. The Fund's quarterly performance reached an intra-quarter high of 7.81% in early February, subsequently fell to a more modest 1.03% gain by mid-March, before finishing the full quarter up 4.97%. The Fund's benchmark saw even wider performance swings: it reached an intra-quarter high of 8.85% in late January, subsequently fell to a -1.36% intra-quarter loss by mid-March, before finishing the full quarter up 3.55%.[4]

The biggest driver of this volatility appears to be the evolving expectations of China's economic re-opening after the abrupt end to its draconian zero-Covid restrictions in December 2022. Chinese equities surged in the weeks following this policy shift and continued to rise for most of the month of January as investors priced in a swift normalization of consumption. This rally reversed course as the quarter unfolded; investors grappled with uncertainty surrounding the pace of the recovery as more economic data was released and management outlooks trickled out with 2022 earnings releases in the latter half of the quarter.

While much is still murky on the true state of China's re-opening, the euphoric expectations early in the quarter were likely overblown. It appears that Chinese consumers are still shell-shocked from the drastic U-turn in messaging from the Chinese Communist Party about the dangers of Covid-19, which had been used as a justification for the severity of the lockdowns. Likewise, consumer confidence may take longer to recover given lingering fears over the Chinese property sector

*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 1.79%, 3 year 17.85%, 5 year 4.52%, and since inception (5/31/16) 6.99%[1]; 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.*

### 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.

and job security in a slower-growth, more-uncertain economic environment. Comparisons to the rapid economic recoveries in developed markets like the U.S. may not fit the Chinese mold where there were no government stimulus checks and where fears of additional pandemic waves may persist for some time in cautious consumer behavior. This isn't to say that a normalization of consumption won't occur, but investors should be prepared for a bumpy ride along the way.

This volatility aside, optimism towards China's re-opening did lift the share prices of many of the Fund's China holdings, which collectively represented the largest contributor, by country, to performance in the quarter. Returns were particularly strong for businesses that had been most adversely impacted by Chinese travel and mobility restrictions, including **Shangri-La** (Breakup Value and Asset Productivity sources of value; see **Figure 1** for definitions of the sources of value referenced in this review), a hotel owner and operator in Asia; **Melco International** (Asset Productivity and Breakup Value), a Macau casino owner and operator; **Giordano International** (Structural Shift), a fashion retailer operating in Asia and the Middle East; and **Pico Far East** (Segregated Market), a designer and organizer of trade show exhibitions and conferences in China. These companies had seen a sharp deterioration in profits in their Chinese operations due to the pandemic; their share prices rebounded from a low base as investors began to recognize their underlying value in a re-opened economy.

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As long-term investors, the exact pace of China's recovery matters little to us compared to the underlying idiosyncratic drivers of value we see in each position. It is important to note that the Fund entered most of its China holdings well before the pandemic and continued to hold them (or in some cases add to them as prices swooned), keeping in mind that most of a company's intrinsic value is derived from cash flows beyond the next two to three years. Similarly, we would expect the Fund to continue to hold these names beyond a return to pre-Covid levels of profitability, whenever this may occur. Should such a normalization eventually play out, the potential return to pre-Covid stock prices (many still trade well below this level) may provide additional upside beyond what existed pre-pandemic.

During the quarter there were several other notable contributors to performance outside of China. **Genting Singapore** (Asset Productivity), a casino owner and operator in Singapore, rose 18.11% amid a recovery in the city-state's tourism industry and expectations of a return of Chinese visitors.[4] Other positive contributors were much less expected and driven more by company-specific drivers. **Odontoprev** (Structural Shift), a Brazilian dental insurance provider, rose 27.54% during the quarter against a weak equity market backdrop in Brazil and little fundamental news.[4] This rise may be attributable to the company's low valuation relative to its cash flows and dividends. Likewise, **Moneta Money Bank** (Asset Productivity), a Czech Republic bank, rose 19.46% despite turmoil in the U.S. banking system and the emergency take-over of Credit Suisse by UBS.[4] Moneta still offers a high single digit dividend yield after this rally.

**Samsung SDI** (Structural Shift and Breakup Value), a South Korean battery manufacturer, rose 20.46% during the quarter despite growing recessionary fears in developed markets.[4] The company has emerged as a key supplier of electric vehicle batteries to the global automotive industry, and news surfaced of a potential joint venture with General Motors to set up a battery plant in the U.S. Lastly, **PetroVietnam Technical Services** (Management Change and Asset Productivity), a Vietnamese oil services company, rose 19.51% during the quarter, despite a fall in global oil prices, as the company looks to expand its services into offshore wind farm projects.[4]

On the negative side of the ledger, the single largest detractor to quarterly Fund performance was **XP, Inc.** (Structural Shift), a Brazilian investment management platform company. XP's stock price had come under pressure in recent quarters as high Brazilian interest rates diverted savings to fixed income securities at the expense of its more profitable equities segment and as new money flows to its platform slowed. Selling pressure came to a head during the quarter following the release of the company's fourth quarter results, which showed an earnings contraction compared to the same period in 2021, driven in large part by the company's growing cost base. XP nearly doubled its workforce from 2020 to 2022 as it developed new revenue streams to cross-sell to its existing customer base and further diversify its business. Revenues failed to keep pace with these rising overheads during the quarter.

While XP's disappointing quarterly results may have caused some investors to reassess overly optimistic growth assumptions, we are less pessimistic for the company over the long-term, especially in light of its new lower valuation. Its assets under custody have continued to grow with positive net inflows, which will underpin future revenue growth. Likewise, the company has undertaken a rightsizing of its cost structure to fit the current economic environment. Management also provided an estimated net income guidance range for 2023, which forecasts a resumption of earnings growth for the year and a return on equity of over 20%.[5]

## Allocation

During the first quarter, the Fund established a new position in **UPL Limited** (Asset Productivity and Breakup Value). UPL is an India-based multinational agricultural chemicals company that has grown to become the fifth-largest crop protection company globally by sales, with a sales and distribution network in over 40 major markets. The company has invested heavily in both its manufacturing capabilities (to become a low-cost producer) as well as its intellectual property – namely, its extensive portfolio of post-patent crop protection products and "BioSolution" products derived from plants and microorganisms.

Unlike other Asset Productivity-driven value names where there has been a cyclical downturn following a period of tangible asset expansion, UPL's source of value comes from increasing utilization of its intangible asset base. This includes its global distribution network, its product registrations (which can take up to five years to secure in each market), the customer trust it has built up over the years, and the field data and market feedback it collects to tailor its product offering to address farmer pain points. These intangible assets may drive volume growth as well as gross margin expansion as the company sells a greater proportion of differentiated products that are priced based on their value to farmers in improving yields rather than their cost to manufacture. The company also recently announced a reorganization into three main operating units: a global crop protection business (excluding India), a global seeds business, and an India-focused crop protection and agricultural technology business. This restructuring, which coincided with private equity investments, may also help unlock Breakup Value in the stock over time.

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The Fund exited its position in **Greatview Aseptic** (Segregated Market and Asset Productivity), a Chinese aseptic packaging company for products such as shelf-stable milk. During the quarter, the company announced that it had received notice of an agreement for the sale of the 28% minority stake in the company held by **Jardine Matheson** (coincidentally a separate position held by the Fund) to a Chinese entity owned by one of Greatview's largest customers.[6] Should this transaction come to fruition, it risked order cancelations by the remainder of Greatview's customer base concerned about potential commercial intellectual property leakages to an entity perceived to be controlled by a rival. As the company faced this existential commercial risk on top of an already challenging competitive environment that had pressured margins in recent years, it was time to jettison the position.

## Outlook

For once, this time may be different after all. The preconceived notion that a monetary contraction in the world's reserve currency, the U.S. dollar, necessarily leads to an emerging market (EM) crisis has proven a dream, at least thus far. To quote from Alice in Wonderland, "For, you see, so many out-of-the-way things had happened lately, that Alice had begun to think that very few things indeed were really impossible."

Some "out-of-the-way things" took place during the first quarter of 2023. There were two bank failures in the U.S. and one in Switzerland, and the prices of many commodities, such as crude oil, natural gas, wheat, and urea fertilizer, continued to decline during the past year despite consumer prices rising rapidly. Financial headlines associate the bank failures to date with U.S. Federal Reserve rate increases and the end of quantitative easing. In our view, similar to Alice's world where "things" are not what they seem, the root cause of these failures is the monetary expansion that preceded the rate increases, without which the balance sheet structure of these banks would have proven untenable to begin with. While financial headlines focus on high, though decelerating, consumer prices, we see persistent negative rates. In other words, the Federal Reserve has raised interest rates, but in real terms – after accounting for inflation – they remain negative, as before the tightening phase. Given the bank failures to date, "very few things indeed" are really possible.

To quote Alice, what we find very "curiouser and curiouser" indeed is the response of EM stock indexes and currencies to the U.S. dollar monetary contraction, and the associated consequences not only in the U.S., but other developed markets, such as Europe and Japan. While a discussion of the consequences of the U.S. dollar monetary cycle in other developed countries falls outside the scope of this quarterly review, *what is relevant to EM investors is the changing perception of relative risk between developed economies and the emerging markets, as evidenced in market prices.*

Indeed, in this upside-down world, the -12.00% total return in the S&P 500 Index from December 31, 2021, its approximate apex, to March 31, 2023, did not spell ruin for the emerging markets. The Morningstar EM Net Return USD Index performed only marginally worse, returning -15.39%. The Bloomberg Emerging Markets Large, Mid, and Small Cap Currency Implied Yield Index declined a modest -2.5% over the same time frame.[4]

We would venture to say that, in a departure from historical precedent (i.e., an overall EM "correction" relative to developed economies), changes in the global investment backdrop are impacting the emerging markets more at the micro level, rather than the macro level. Of course, there is a macroeconomic impact in the countries in which Seafarer invests – resulting from changes in the U.S. dollar monetary cycle – but the Value Fund is experiencing it more acutely at the individual security level.

For example, during the monetary expansion phase that accompanied the beginning of the pandemic, the discourse surrounding some holdings, such as multinational brewers **Anheuser-Busch Inbev** (Asset Productivity and Deleveraging) and **Ambev** (Structural Shift and Asset Productivity), centered on raw material cost inflation and associated margin contraction. Two years later, commodity prices are declining in tandem with monetary tightening, and the debate has shifted to concerns over volume growth as economic growth slows, possibly negating the benefit of price increases by these brewers in response to the preceding raw material cost inflation. In other words, *the Value Fund is experiencing the volatility associated with policy making surrounding the U.S. dollar in the fundamentals of individual stocks more so than in the form of fund flows or currency movements in the EM*.

Similarly, **Mondi** (Structural Shift), a multinational paper and packaging company, and **Petrovietnam Fertilizer and Chemicals** (Management Change and Asset Productivity), a Vietnamese fertilizer manufacturer, have suffered share price swings since the beginning of the pandemic, associated with the rise and fall of energy prices. Again, from the Value Fund's perspective, the consequences of U.S. dollar monetary policy on commodity price inflation and deflation has had a greater impact at the individual stock level thus far, than in the overall EM universe.

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The question to ask then is how the Value Fund navigates the present policy-induced volatility. The answer is that the Fund approaches its investment decision the same way regardless of whether the volatility is micro or macro in nature. Long-term cash flow generation is what matters to intrinsic value, not short-term earnings momentum. The Fund understands that pricing power and input costs follow their own cycles, which are rarely synchronized in the real world, even if financial analysts like to pretend that they should be in sync in their idealized financial modeling. Instead, Seafarer's value approach prefers to focus on a company's profitability through the entire business cycle, and uses periods of poor earnings momentum – when the share price tends to be lower – to increase the position in the stock.

In our view, Seafarer's value approach is an evergreen way to think about the investment decision, but especially so at a time when "things" may not be what they seem in this upside-down world, where the risk perception gap between developed and emerging markets is narrowing, and where the policy regime surrounding the U.S. dollar is shifting.

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

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*and*

Brent Clayton
Co-*Portfolio Manager*

April 20, 2023

[1] References to the "Fund" pertain to the Fund's Institutional share class (ticker: SIVLX). The Investor share class (ticker: SFVLX) returned 4.98% 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/ovl/performance.

[3] The Fund's Investor share class began the quarter with a net asset value of $12.64 per share; and it finished the quarter with a value of $13.27 per share..

[4] Source: Bloomberg.

[5] XP, Inc. Q4 2022 Earnings Presentation. 16 Feb. 2023. https://api.mziq.com/mzfilemanager/v2/d/d1820734-8b3f-4a23-8642-331a3a8561a6/58e5604a-31a3-68ad-e403-34189e32a45b

[6] Source: Company reports.

## Glossary

**Dividend Yield (Trailing 12-Mo):** a measure of the sum of the dividends paid per share during the trailing 12 months divided by the current share price.

**Gross Margin:** a ratio of profitability calculated as the difference between revenue and cost of goods sold (COGS), divided by revenue. The ratio measures a company's ability to generate gross profit from each unit of sale.

**Net Income (NI):** a measure of a company's profitability, calculated as revenues minus expenses, interest, and taxes.

**Quantitative Easing:** the attempt by a central bank to inject more money into the economy and to keep long-term interest rates low through the purchase of large amounts of assets, often held by financial institutions. (Source: MITnews, "Explained: Quantitative Easing," August 17, 2010)

**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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*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.*

*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 March 31, 2023, Shangri-La Asia, Ltd. comprised 3.3% of the Seafarer Overseas Value Fund, Melco International Development, Ltd. comprised 3.5% of the Fund, Giordano International, Ltd. comprised 2.0% of the Fund, Pico Far East Holdings, Ltd. comprised 1.3% of the Fund, Genting Singapore, Ltd. comprised 3.0% of the Fund, Odontoprev SA comprised 2.1% of the Fund, Moneta Money Bank AS comprised 2.8% of the Fund, Samsung SDI Co., Ltd. comprised 3.1% of the Fund, PetroVietnam Technical Services Corp. comprised 2.6% of the Fund, XP, Inc. comprised 2.8% of the Fund, UPL, Ltd. comprised 2.9% of the Fund, Jardine Matheson Holdings, Ltd. comprised 2.7% of the Fund, Anheuser-Busch InBev SA comprised 2.8% of the Fund, Ambev SA comprised 2.3% of the Fund, Mondi PLC comprised 2.8% of the Fund, and Petrovietnam Fertilizer & Chemicals JSC comprised 1.6% of the Fund. The Fund did not own shares in Credit Suisse Group, UBS, General Motors Co., or Greatview Aseptic Packaging Co., Ltd. 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.*

*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.*