

# The No-Load Fund Investor

I N T E R V I E W S

## Andrew Foster

*Seafarer Overseas Growth & Income*



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BASED ON A SEPTEMBER 19, 2012 INTERVIEW.

**T**hough only in his late 30s, Andrew Foster has a long record of investing in Asian stocks that pay dividends. For six years beginning in early 2005 (the last three years as lead portfolio manager), he helmed **Matthews Asian Growth & Income** (MACSX). In October 2006, he launched and co-managed **Matthews Asia Dividend** (MAPIX), which he co-managed for more than four years. In fact, he was so respected at Matthews that the firm made him acting chief investment officer in 2008-09, during the height of the financial crisis.

So it was of particular interest to us when Andrew left Matthews International Capital Management and founded Seafarer Capital Partners in 2011, followed by the launch of a mutual fund, **Seafarer Overseas Growth & Income** (SFGIX; 855-732-9220; \$2,500 minimum initial investment), in February 2012.

In our discussion, below, Andrew describes his investment process, including his preference for sustainability of growth over high rates of growth. He also explains why he takes a close look at investment ideas in countries that he believes are underrepresented in emerging markets index benchmarks, and how the distinction between ‘developed’ and ‘emerging’ markets can be arbitrary while offering opportunity for investors.

—Mark Salzinger, Editor and Publisher

► **Andrew, how does the approach you use to pick stocks for your own fund compare with how you did so at Matthews?**

The single biggest shift is that I now include a broader range of geographies across Eastern Europe and Latin America and even a bit in South Africa. We would even consider part of the Middle East in our scope, although we have no holdings there today.

► **What have you done to bring yourself up to speed on equity analysis for companies outside Asia?**

We’ve broadened the team here. We have one person with a deep background in Latin America. It’s really just on the ground and fundamental research of the very same sort I would do at Matthews in incorporating a new market into our approach.

► **Please describe in some detail the characteristics you look for in purchase candidates, including growth characteristics, valuation, financial strength, financial reporting and dividends.**

The most important thing we focus on is sustainable growth. We are looking for growth

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companies that can compound growth, hopefully steadily, over long periods of time. With that, we are looking for companies with high-quality business models that are capable of generating very high quality cash flow. So, it's not just earnings growth, but actually cash-flow growth, because then we look for that to be manifested in a high and rising yield over time.

We look for financial stability. If the company is able to survive what are often very volatile market circumstances in these emerging markets, then they are able to be successful ultimately and grow that dividend.

► **Is there a threshold of growth you won't go below?**

No, but I would say that our sweet spot is the 7% to 12% range, possibly up to 15%. What's unique about this sweet spot is that in the context of emerging markets, if you are only growing 7% to 12%, you are often considered by a lot of emerging market investors to be a mature company, or just not very exciting. We find that thinking sort of absurd.

► **Is the sweet spot 7% to 12% growth because a lot of other emerging market investors ignore that area so the valuations on those stocks are very attractive?**

That's precisely right. There is sometimes a premium of valuation awarded to faster-growing companies. So, we think there's a bit of an inefficiency that tends to

impact the market in that growth range.

► **Does that inefficiency reflect itself in better downside protection or better upside potential?**

It's mostly the latter. If you grow at 7%, you are going to double every 10 years. That sort of growth does eventually attract higher valuations, especially if the

***“In the context of emerging markets, if you are only growing 7% to 12%, you are often considered by a lot of investors to be a mature company, or just not very exciting. We find that thinking sort of absurd.”***

growth ends up being faster than that. You do see reasonably good performance from the upside over time.

I think the downside protection we strive for is more a function of that current yield and its sustainability. Irrespective of the company's forward growth, if the current yield is reasonably high it tends to act as an anchor in falling markets. Like any anchor on a ship, at first when you cast an anchor it will tend to drag on the bottom. When stock markets begin to fall, a stock that pays a dividend often falls more or less in line with the rest of the market. But, at some

point, that current dividend yield, particularly if it's secure, starts to attract a number of different types of investors. The pace of decline of that stock tends to slow, and ultimately the stock catches bottom sooner just like an anchor dragging on the ocean floor would catch a bottom.

► **How fertile is the ground now for dividend paying stocks with growth characteristics in the emerging markets?**

There's been an enormous amount of interest generated in my little niche of dividend income in the emerging markets. Consequently, the valuations are not quite as attractive as they once were. What I would say is undervalued right now are companies that can grow faster but may not pay quite as high a yield.

► **What are some of the most appealing Asian stocks at recent prices?**

One of the stocks I like in Singapore is SIA Engineering. It trades at 17 times historical earnings, which is not especially cheap, but because it has a very generous payout ratio it has a very high dividend yield of 5%. The company has no debt, and \$400 million in cash on its balance sheet. The company is involved in the business of aircraft maintenance and overhaul and conversion. And then they have a very lucrative side business, where they do passenger to freight conversions,

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where they will take a 747 or other major aircraft that was historically focused on passenger traffic and convert it over to a cargo plane. That's an example of a company that I think can grow very sustainably in the high single digits, possibly even in the low teens for a long time to come.

Another company about which I am very excited is Citic Telecom International; the market capitalization is just about \$500 million. This company is capable of growing in excess of 10%. It manages all sorts of small services on behalf of larger carriers in the telecom arena. It has no debt, very substantial cash flow and trades for a very low earnings multiple—in this case, about 7.5 times earnings. It pays a dividend over 6%.

► **The fund has about 10% of its assets in Polish stocks. In general terms, what's appealing about investing in companies from that Eastern European country?**

One, I am deeply impressed with the caliber and quality of the workforce. There are many young, bright energetic Poles that are driving that economy forward. This country's full potential has quite clearly not been tapped. The bank we own there, Bank Pekao, is an incredibly well-run bank that has avoided most of the challenges that have impacted some of the other European banks at present, and has an incredibly solvent and liquid balance sheet. Nonetheless, it produces very high returns on

assets and equity. It also has a reasonably attractive dividend yield.

► **Brazilian and Mexican stocks also account for nearly 10% of assets. What are your points of view on those markets?**

Mexico is hugely underrated as a Latin American investment destination; the narcotics have scared a lot of people off. The Mexican companies in which we have invested are very well managed. They are largely independent from the problems.

***“What I would say is undervalued right now are companies that can grow faster but may not pay quite as high a yield.”***

Compared to Brazil, Mexico enjoys better valuations and a more stable currency.

Our biggest concern about Brazil a year ago was that the valuations and the currency were overheated. Our most recent trip to Brazil, however, suggests that a lot has changed. The currency has fallen about 22% in the last 15 months. The stock valuations haven't fallen a great deal, but they have become a little more tempered. The current presidential administration is taking up some very difficult challenges and taking some needed medicine. I don't think the immediate outlook is

particularly robust, but I think the country will be on much firmer footing over the next five and especially 10 years.

► **Under what risk constraints do you operate, including currencies, limits on individual positions sizes, sectors, industries, countries or market capitalization?**

We have a constraint never to be more than 25% in a single country. On a practical level, 4% or 5% in any one stock would be an extremely big position for me.

► **How, if at all, do you incorporate foreign currency analysis into your stock picking?**

I do almost no currency hedging. We do some very basic research on currencies to try and grade them as to whether they are investable or uninvestable. Uninvestable currencies are ones we think have a very substantial downside over the next year or two, or are potentially susceptible to currency controls. We tend to stay away from these altogether rather than try to invest in the countries and somehow hedge out the currency risk.

In markets with investable currencies, we accept a certain amount of currency volatility. We think it's a bit of a benefit to have some speculative exposure to these currencies, actually.

► **The name of your fund doesn't say Emerging Markets only. Do you have limits of how much you**

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would put in developed markets, say Japan, Europe, Australia and Canada?

The prospectus says that we will be at least 50% in countries we deem to be emerging markets. It also says that we will have at least 20% in countries that we deem to be developed markets.

► **Is this still primarily an emerging Asia fund, with some other markets sprinkled in?**

Roughly 60% of the world's fundamentals are located in the emerging markets. The real truth is that the fundamentals of the emerging markets are actually 70% in emerging Asia. Emerging market indexes chronically underweight the Asian part of the emerging markets and overweight the other parts of the world.

► **But, you are not picking Eastern European or Latin American stocks because of their exposure to Asia?**

No. I pick them on their own individual merits. I think the benchmark is going to come to look like the fundamentals over time, so there will be more fertile hunting in the markets where the benchmark is underweight the fundamentals. I plan to train the portfolio on a more dedicated basis on those

markets that will benefit from greater index weights over time.

► **What about having more in Australia, which does have a lot of high-yielding stocks in banks and minerals?**

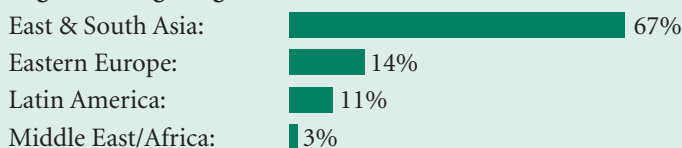
I am not averse to it. I think there is some challenge to being a commodity and materials investor in any market, including Australia. The cyclical nature associated with that sector makes it very hard to model a sustainable long-term growth trend. But, I think the services sector is quite intriguing in Australia and is less cyclical. Australia has a very enlightened policy with respect to tax on dividends, which encourages Australian companies to favor dividends as a way of providing shareholder returns. However, at this moment I am finding greater opportunities elsewhere.

► **Finally, Andrew, what's your single best piece of advice for retail investors as they ponder the next 12 months?**

I would like to give two related pieces of advice. The world is very uncertain. However, I think it is not so much worse than it has been in cycles past. The offset to this is that valuations are generally pretty good. I think that some of the headlines that frighten investors, whether it's Europe or some other market, are real risks, but I think they are exaggerated and are impeding people from investing during a time when valuations are generally fairly good for people who can hold for a while.

The second piece is that the dollar is not dead. People have been so negative on the dollar because of our own fiscal difficulties in this country, and they have been tending to favor emerging market currencies that they think are somehow safer than the dollar. Even as I am a fan of the emerging markets and am dedicating my career to them, don't give up on the dollar, still a strong currency and a haven for the less-risky part of your portfolio. ■

**Regional Weightings:**



*Past performance does not guarantee future results.*

*ALPS Distributors, Inc. is the distributor for the Seafarer Overseas Growth and Income Fund.*

***Investors should consider the investment objectives, risks, charges and expenses carefully before making an investment decision. This and other information about the Fund is contained in the Prospectus, which may be obtained by calling (855) 732-9220. Please read the Prospectus carefully before you invest or send money.***

***Important Risks:*** An investment in the Fund involves risk, including possible loss of principal. International investing involves additional risk. These include risks related to social and political instability, market illiquidity, and currency volatility. Investing in foreign securities may involve certain additional risks, exchange-rate fluctuations, limited liquidity, high levels of volatility, 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. Given the potential increased volatility of the Fund, an investment in the Fund should be considered a long-term investment.

*The Seafarer Overseas Growth and Income Fund is new and has limited operating history.*

*As of 9/30/2012, SIA Engineering Co., Ltd. comprised 4.4% of the Seafarer Overseas Growth and Income Fund; Citic Telecom International Holdings, Ltd. comprised 4.1% of the Fund; and Bank Pekao SA comprised 2.6% of the Fund. Holdings are subject to change.*

***Price to Earnings (P/E) Ratio*** is the market price of a company's common shares divided by the earnings per common share.

***A dividend*** is a distribution of earnings made by a company to its shareholders. A dividend is usually paid in cash, but is sometimes paid in the form of additional stock shares of the issuing company. The dividend amount is decided by the board of directors. A dividend is usually paid at least annually.

***Forward growth rate*** is the forecast growth rate for a company, usually measured in terms of the company's earnings per common share.