Seafarer Overseas Growth & Income (SFGIX/SIGIX)

By David Snowball, Publisher

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Fund name Seafarer Overseas Growth & Income (SFGIX/SIGIX)

Objective and strategy Seafarer seeks to provide long-term capital appreciation along with some current income; it also seeks to mitigate volatility. The portfolio has two distinctive features. First, the fund invests a significant amount—20-50% of its portfolio—in the securities of companies which are domiciled in developed countries but whose earnings are driven by emerging markets. The remainder is invested directly in developing and frontier markets. Second, the fund generally invests in dividend-paying common stocks but the portfolio might contain preferred stocks, convertible bonds, closed-end funds, ADRs and fixed-income securities. The fund typically has much more exposure to small- and mid-cap stocks than does its peers. On average, 80% of the portfolio is invested in common stock but that has ranged from 71% – 86%.

Adviser Seafarer Capital Partners of San Francisco. Seafarer is a small, employee-owned firm that advises the Seafarer fund in the US and a €45 million French SICAV, **Essor Asie Opportunités**. The firm has about $190 million in assets under management, as of March 2015.

Managers Andrew Foster is the manager, as well as Seafarer's cofounder, CEO and CIO. Mr. Foster formerly was manager or co-manager of **Matthews Asia Growth & Income** (MACSX), Matthews' research director and acting chief investment officer. He began his career in emerging markets in 1996, when he worked as a management consultant with A.T. Kearney, based in Singapore, then joined Matthews in 1998. Andrew was named Director of Research in 2003 and served as the firm's Acting Chief Investment Officer during the height of the global financial crisis, from 2008 through 2009. Andrew is assisted by Kate Jacquet, Paul Espinosa and Sameer Agrawal. Ms. Jacquet has been with Seafarer since 2011; Messrs. Espinosa and Agrawal joined in 2014.

Management's stake in the fund Mr. Foster has over $1 million in the fund. None of the fund's trustees have an investment in *any* of the 32 funds they oversee.

Opening date February 15, 2012

Minimum investment $100,000 for institutional share class accounts, $2,500 for regular retail accounts and $1000 for retirement accounts. The minimum subsequent investment is $500. In a spectacularly thoughtful gesture, individuals who invest directly with the fund and who establish an automatic investment plan on their accounts are eligible for a waiver of the institutional share class's minimum investment requirement. The folks at Seafarer argue that they would like as many shareholders as possible to benefit from lower expenses, so they're trying to manage an arrangement by which their institutional share class might actually be considered the "universal" share class.

Expense ratio 1.25% after waivers for retail shares and 1.05% for institutional shares, on assets of $177 million (as of May 2015). The fund does *not* charge a 12(b)1 marketing fee but does have a 2% redemption fee on shares held fewer than 90 days.

Comments Our contention has always been that Seafarer represents one of the best possible options for investors interested in approaching the emerging markets. It's not a question of whether we're right but, rather, of why we are.

Seafarer has three attributes that set it apart:

A "relative return strategy" pursues growth that's more sustainable than what's typical in developing markets while remaining value conscious.

1. **Its approach is distinctive.** Mr. Foster's hope is to outperform his benchmark (the MSCI EM index) "slowly but steadily over time." He describes the approach as a "relative return strategy" which pursues growth that's more sustainable than what's typical in developing markets while remaining value conscious. It's grounded in the structural realities of the emerging markets.

   A defining characteristic of emerging markets is that their capital markets (including banks, brokerages and bond and stock exchanges) cannot be counted on to operate. In consequence, you're best off with firms who won't need to turn to those markets for capital needs. Seafarer targets (1) firms that can grow their top line steadily in the 7-15% per annum range and (2) those that can finance their growth internally. The focus on the top line means looking for firms that can increase revenues by 7-15% without obsessing about similar growth in the bottom line. It's almost inevitable that EM firms will have "stumbles" that might diminish earnings for one to three years; while you can't ignore them, you also can't let them drive your investing decisions. "If the top line grows," Mr. Foster argues, "the bottom line will follow." The focus on internal financing means that the firms will be capable of funding their operations and plans without needing recourse to the unreliable external sources of capital.

   Seafarer tries to marry that focus on sustainable moderate growth "with some current income, which is a key tool to understanding quality and valuation of growth." His preference is to buy dividend-paying stocks, but he often has 20% or more of the portfolio invested in other sorts of securities. The dividends are not themselves magical, but serve as "crude but useful" tools for identifying firms most likely to preserve value and navigate rough markets.

2. **Its performance is first rate.** That judgment was substantiated in early March 2015 when **Seafarer** received its inaugural five-star rating from Morningstar. They're also a Great Owl fund (as of May, 2015), a designation which recognizes funds whose risk-adjusted returns have finished in the top 20% of their peers for all trailing periods. Our greater sensitivity to risk, based on the evidence that investors are far less risk-tolerant than they imagine, leads to some divergence between our results and Morningstar's: five of their five-star EM funds are not Great Owls, for instance, while some one-star funds are.

   Of 219 diversified EM funds currently tracked by Morningstar, 18 have a five-star rating (as of mid-March, 2015). 13 are Great Owls. Seafarer is one of only 10 EM funds (representing less than 5% of the peer group) that are *both* five-star and Great Owls.

3. **Its commitment to its shareholders is unmatched.** Mr. Foster has produced consistently first-rate shareholder communications that are equally clear and honest about the fund's successes and occasional lapses. And he's been near-evangelical about reducing the fund's expenses, often posting voluntary mid-year fee reductions as assets permit. Seafarer is one of the least expensive actively-managed EM funds available to retail investors.

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In the three years through April 30, 2015, the fund's annualized return was 10.8% which placed it in the top 2% of all EM equity funds. Rather than trumpet the fund's success, Mr. Foster warned, both in letters to his shareholders and on the Observer's conference call that investors should not expect such dominant returns in the future. "Our strategy ideally matches the anemic growth conditions that emerging markets have experienced lately," he says. As growth returns, other strategies will have their day in the sun. Seafarer, meanwhile, will continue pursuing firms with sustainable rather than maximum growth.

Bottom Line Mr. Foster is remarkably bright, thoughtful, experienced and concerned about the welfare of his shareholders. He thinks more broadly than most and has more experience than the vast majority of his peers. The fund offers him great flexibility and he's using it well. There are few more-attractive emerging markets options available.

Fund website *Seafarer Overseas Growth and Income*. The website is remarkably rich, both with analyses of the fund's portfolio and performance, and with commentary on broader issues. One emblem of Mr. Foster's commitment to having you understand what the fund is up to is a **remarkably complete spreadsheet** that provides month-by-month and year-by-year data on the portfolio, dating all the way back to the fund's launch. Whether you'd like to know what percentage of the portfolio was invested in convertible shares in April 2014 or how the fund's regional exposure affected its performance relative to its benchmark in 2013, the data's there for you.

Disclosure The Observer has no financial ties with Seafarer Funds. I do own shares of Seafarer and Matthews Asian Growth & Income (purchased during Andrew's managership there) in my personal account.