Investment Policy Statement

A monthly review of the markets

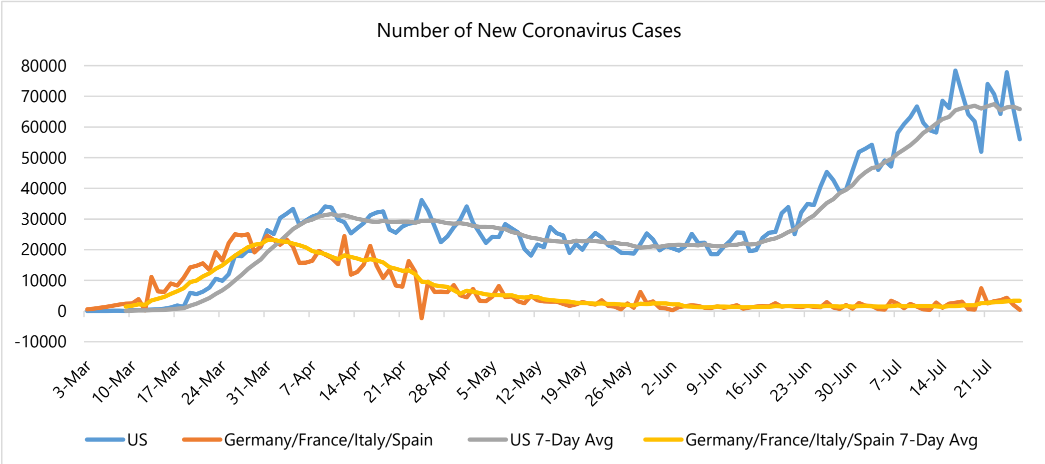
Behavioral Adaption Becomes an Important Modulator as Coronavirus Hotspots Shift Globally

"It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change."
– Charles Darwin

The coronavirus pandemic and its widespread impact remain a central concern as countries around the world struggle to balance the resuscitation of economic activity with the implementation of prudent virus containment measures. Since our June publication, significant regional and global divergences in coronavirus cases and the associated economic impact have emerged. Varying degrees of easing in lockdown measures, as well as self-imposed behavioral modifications are playing a key role in directing these outcomes. Even five months from the onset of the pandemic, its trajectory remains elusive; case hotspots have shifted across countries and regions. However, despite the current state of flux and uncertainty, important sources of support remain in place, in our view -- namely, ongoing commitment by governments across the globe to provide fiscal support, continued progress in the development of a vaccine and treatments, as well as better patient management protocols. In our latest assessment, we do not anticipate reimposition of broad lockdown measures and a halt in economic activity to the extent we experienced at the height of the pandemic, but we acknowledge several key risks that could potentially undercut the progress made thus far.

The US is case in point highlighting regional divergences. States that had suffered the most in the spring have been generally successful in suppressing the spread of the virus, while other states are now experiencing an explosion of cases. The economic impact of renewed virus spread is a marked slacking in the pace of improvement in activity, as we have observed through select high-frequency US measures of economic data. After improving throughout May and June, data on hours worked and opentable bookings, for example, are flatlining. And while consumer spending is still up from depressed levels, the pace of improvement also appears to be slowing.

Figure 1: European Cases Kept Going Down – US Cases Did Not



Data as of 26 July 2020.
Confirmed coronavirus (2019-nCov) case counts compiled by Bloomberg Newsroom. Counts are subject to change as governments survey and confirm cases. Data are based on reported values as of Midnight EST. Sources include Johns Hopkins University, World Health Organization, DXY, NHC, BNO News, European CDC, US CDC, and Italy Ministry of Health.

In contrast, better virus containment, combined with the progress toward a Euro-wide support package, have led us to adjust higher our relative view of European growth. Substantial improvement in select high-frequency data supports this view. Power demand returned to pre-crisis levels in France, with Germany, Italy, and Spain down only modestly in year-over-year terms. Though not all metrics are as firm across these countries, and Spanish cases have increased in a manner that warrants close monitoring, the overall picture is of strong economic performance relative to the US. In large part, we attribute this outcome in the Euro area to the effectiveness of containment measures, support packages, continued EU-wide coordination, and maintaining employer/employee relationship in many cases through the use of furlough schemes and work-sharing programs during the height of the pandemic. In Asian developed markets, we are seeing tentative signs of employment pickup, though we note that much of this improving outlook is not reflected in growth forecasts, given the fluid nature of the pandemic.

In areas of emerging markets, cases of the virus are still accelerating and their share of COVID-19 deaths is increasing, despite the stabilization of deaths on a global basis. Areas with the highest concentration and per capita virus-related deaths include Latin America, Middle East, Russia, and South Africa. Similar to the US, virus outbreaks are shifting and effective containment has been dependent upon people's response to restrictions. On the other hand, much of Eastern Europe (e.g., Turkey, Poland, Hungary, and Czech Republic), has been successful in suppressing the spread of the virus and sustaining very low rates of infection. Then there is the case of Israel, which is experiencing a serious second wave of the coronavirus following a rapid and widespread reopening of the economy in May. In looking across the various emerging markets regions, we note that the level of restrictions and self-regulation do not necessarily correspond to the level of outbreak. In Argentina, for example, despite tight lockdown measures, high infection rate persists. And in other countries, easing of lockdown measures continue despite rising infection rates.

The resulting impact on economic data continues to show a wide range across emerging markets countries. Even countries that managed well through the peak of the pandemic, will likely be impacted by a global recession moving forward. For now, Asia has shown better exports data; and retail sales have started to recover in most EM countries. Against this backdrop, China has been the exception, showing a very sharp GDP rebound in the second quarter. But the pace of the rebound has slowed and consumption is lagging, suggesting to us that self-regulation despite easing of restrictions is playing a significant role in tempering the impulse to re-establish normal activities.

Recognizing that virus hotspots will continue to shift on a regional and global basis, and that some countries have been more effective than others in controlling the spread of the virus, we are cognizant of risks that may further impair countries currently under significant health and economic stress. In the US, the lack of cohesion across the states and the lack of political will that lead to ongoing virus issues, and consequently, a lag in US growth is a concern. In this case of US exceptionalism, where the US underperforms the rest of the world, we would anticipate significant portfolio implications as the US dollar weakens meaningfully due to US growth underperformance and a narrower interest rate differential.

Our base case scenario, however, assumes that coronavirus transmission continues in the US but widespread spikes stabilize in response to localized government measures and endogenous social distancing, thereby preventing a nationwide lockdown. Across the globe, we expect ongoing fiscal support to buttress economies and consumers that remain under stress. Tensions between the US and China appear likely to remain high into the US presidential election. We expect a broad recovery in 2021 as economic activity normalizes further. According to the IMF, 2021 GDP growth in developed economies may accelerate to 4.8%; we expect a 6.5% rebound. Even with that rebound, developed market GDP will be below pre-crisis levels until the back half of 2021. In EMs, the expected 2021 growth is higher and should be sufficient to surpass GDP levels of 2019, but not for all countries, according to the IMF. With continuing uncertainty and divergences across the developed and emerging markets, not all countries will perform uniformly. For fixed income asset managers, in-depth credit analysis and ability to steer through the current environment in a nimble manner will prove to be critical moving forward.

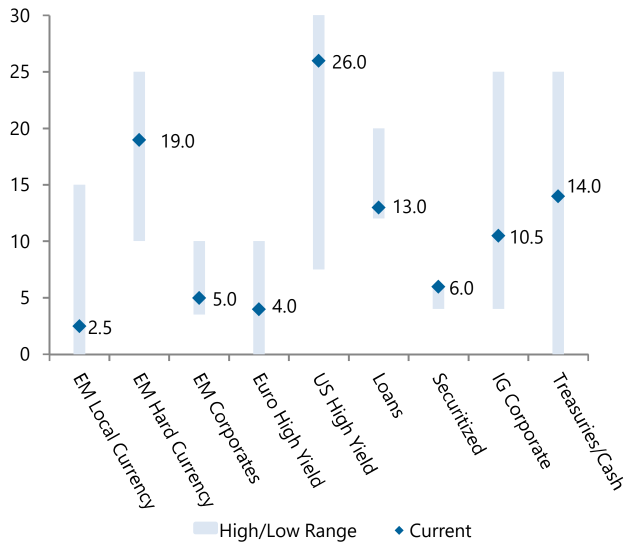
US MACRO RISK SCENARIO ASSUMPTIONS AND MARKET OUTLOOK[1]

Scenario	Assumptions
Base Case: Economies Reopen to ~90+%, Slow Grind Higher (45%)	• Coronavirus transmission continues in the US, but spike stabilizes in response to localized government measures and endogenous social distancing. • US avoids another severe nationwide lockdown. • Travel, restaurants, sports, conventions and large gatherings remain deeply depressed until a vaccine is available around late Q1-21. • Across the globe, further fiscal support put into place to buttresses economies and consumers that remain under stress. • Tensions between the US and China remain high. Rhetoric elevated between the two countries; this is partly for electoral reasons in the US and comes from both parties. Some further retaliatory trade & tech actions put into place, but both sides pull back from initiating full trade war. • Central banks mainly focus on implementing existing policies. For the Fed, that means the wide-ranging extension of credit worth about $2tr along with ongoing direct purchases of Treasuries and MBS. In accordance with recent signals, they strengthen forward guidance. • Financing from Fed and Treasury successful in bridging over the demand shortfall for most companies. Defaults and bankruptcies increase but remain under control. • European work-sharing programs support employment. EU-wide coordination improvement continues. • Oil remains stable: $35-40/barrel WTI, Brent $40-45/barrel. • Dollar flat to slightly weaker, partly due to closing of interest rate differentials.
US Exceptionalism… But Not in a Good Way (25%)	• Rapid virus spread continues in the US. Policy response remains disjointed. Virus spread and deaths remain markedly higher in the US than other DMs; Europe and Asia continue to contain spread significantly better. • Europe makes solid progress on coordinated fiscal support programs. • US growth lags significantly due to ongoing virus issues. Dollar weakens significantly due to wide growth differential and narrower interest rate differential. • Though US growth is softer, it is not soft enough to push the Fed into substantial further action. • EM virus control, and hence economic impact, mixed—some countries follow European path and some US. Latam continues to do poorly. • Oil prices hit by lower growth: ~$30-35/barrel for WTI; Brent ~$35-40.
Major Second Wave of Coronavirus Spread Reactivates Lockdowns Globally (15%)	• Coronavirus spread continues in the US at rapid clip. Deterioration in Europe as progress reverses after borders opened and restrictions eased. • Asian (China, South Korea etc.) countries are not immune as second wave pops up there as well. • Lockdowns broadly reinstituted as a result. Those remain quite restrictive until a vaccine starts to be available around Q1-2021. • The hit to economic activity is severe and many temporary layoffs turn permanent. • Fiscal measures are ramped up further. Government intervention/support in the economy increases notably (e.g. production coordination for virus-related equipment). • Fed institutes yield curve control (YCC) and pegs 10y at 0.25%. Numerous additional financing facilities put in place, and Fed pushes further out risk spectrum. • Defaults and bankruptcies increase meaningfully. • EU issues Eurobonds. ECB substantially expands asset purchases. • Oil returns to $20/barrel for WTI & $25 for Brent.
V-Shaped Recovery (15%)	• US spike controlled while Europe and Asia remain in relatively good shape. • Treatment improvements are substantial as pharmaceutical progress exceeds expectations; death rates move down. • Vaccine comes early—late 2020 rather than early 2021. • With better-than-expected outturns on treatment, restrictions are eased and supportive fiscal and monetary policies gain traction, boosting growth. • By the start of Q4 the economy is operating at only a slightly depressed level. Unemployment rise restrained by additional labor necessary to maintain containment. • Fiscal policies start to be dialed back. • Fed maintains accommodative policy, but doesn't feel need to push further. Similarly for ECB. • Oil: WTI at $45-50/barrel; Brent $50-55/barrel.

	Base Case: Economies Reopen to 90+%, Slow Grind Higher (45%)	US Exceptionalism…But Not in a Good Way (25%)	Major Second Wave of Coronavirus Spread Reactivates Lockdowns Globally (15%)	V-Shaped Recovery (15%)
US Real 20 GDP (%)	-7.00	-8.00	-9.00	-5.00
US Real 21 GDP (%)	8.00	6.00	4.00	8.50
US Core PCE (%)	1.25	1.10	1.00	1.75
Fed Funds (%)	0.13	0.13	0.13	0.13
2yr Treasury (%)	0.13	0.13	0.13	0.50
10yr Treasury (%)	0.60	0.45	0.25	1.25
10yr Bund (%)	-0.45	-0.35	-0.75	-0.30
China 20 GDP (%)	2.10	1.90	-0.50	3.00
China 21 GDP (%)	9.90	9.90	10.00	9.50
EM 20 GDP (%)	-1.10	-1.40	-2.70	1.50
EM 21 GDP (%)	7.30	7.30	8.00	6.50

[1]Forecast Period: Next 12 months. Source: Stone Harbor.

MULTI-ASSET CREDIT TARGET ALLOCATIONS (%) SINCE INCEPTION AND RECENT ALLOCATION CHANGES[2]



Allocation Changes[3]

	Month	Change (%)
EM Local Currency	April-May 2020	-2.5
EM Hard Currency	April-May 2020	+2.5
EM Corporates	May-June 2018	+1.5
Euro High Yield	May-June 2020	-2.5
US High Yield	May-June 2020	-2.5
Loans	Feb-Mar 2020	+1.0
Securitized	Mar-April 2019	+1.0
IG Corporate	Aug-Sept 2019	+3.0
Treasuries/Cash	May-June 2020	+5.0

[3]Latest allocation change

[2]Since Inception: September 2013. Stone Harbor Multi-Asset Credit Representative Target Allocation as of 30 June 2020. Actual allocations within any account may be significantly different from the target allocations shown here. For illustrative purposes only.

JUNE CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	0.95	3.51	1.14	0.47	2.75	1.92	1.81
Duration (Returns from Interest Rates %)	0.15	0.15	0.07	0.10	0.11	0.24	0.20
Credit Beta (Returns from Spreads %)	0.80	3.36	1.07	0.37	2.64	1.68	1.61

Performance reflects representative asset class benchmarks.HY: ICE BofAML US High Yield Constrained Index; EMD: J.P. Morgan EMBI Global Diversified; EMDLC: J.P. Morgan GBI-EM Global Diversified; EMDCR: J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified; EUR HY: ICE BofAML European Currency High Yield 2% Constrained Ex Financial; IG Corp: Bloomberg Barclays Global Agg Corporate Index; Loans: S&P/LSTA Leveraged Loan Index; Past performance is not a guarantee of future results. Returns are shown gross of fees. For illustrative purposes only.

Stone Harbor Investment Partners

- Institutional fixed income investment firm focused on credit risk strategies and asset allocation.
- 100% employee-owned
- Over 25-year performance history
- Offices in New York, Chicago, London, and Singapore.

Stone Harbor Investment Partners LP manages institutional clients' assets across a range of investment products including multi-sector credit, emerging markets debt, core fixed income, securitized, high yield, and bank loan strategies. Across all strategies, we seek to generate attractive risk-adjusted returns through a disciplined process of fundamental credit analysis complemented by solid portfolio management skills and sound risk management. Experience, teamwork and dedicated client service - the cornerstones of our success - help us achieve sustainable results.

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Multi-Sector Credit	Investment Grade	Global High Yield	Emerging Markets

Indices referred to herein are broad-based securities market indices. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index.

Index Definitions

The **J.P. Morgan CEMBI Broad Diversified (CEMBI Broad Diversified)** tracks total returns of U.S. dollar-denominated debt instruments issued by corporate entities in emerging market countries and consists of an investable universe of corporate bonds. The minimum amount outstanding required is $350 mm for the CEMBI Broad Diversified. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

The **J.P. Morgan EMBI Global Diversified (EMBI Global Diversified)** limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

The **J.P. Morgan GBI-EM Global Diversified (GBI EM Global Diversified)** consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. The weightings among the countries are more evenly distributed within this index.

The **ICE BofAML European Currency Non-Financial High Yield 2% Constrained Index** contains all non-Financial securities in The ICE BofAML European Currency High Yield Index but caps issuer exposure at 2%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro-rata basis. Similarly, the face values of bonds of all other issuers that fall below the 2% cap are increased on a pro-rata basis.

The **ICE BofAML U.S. High Yield Constrained Index (HUC0)** contains all securities in ICE BofAML U.S. High Yield Index but caps issuer exposure at 2%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro-rata basis. Similarly, the face values of bonds of all other issuers that fall below the 2% cap are increased on a pro-rata basis. In the event there are fewer than 50 issues in the Index, each is equally weighted and the face values of their respective bonds are increased or decreased on a pro-rata basis.

The **S&P/LSTA Leveraged Loan Index** is a partnership between Standard & Poor's and the Loan Syndications and Trading Association, tracking returns in the leveraged loan market and capturing a broad cross-section of the U.S. leveraged loan market - including dollar-denominated, U.S.-syndicated loans to overseas issuers.

The **Bloomberg Barclays US Aggregate Index** is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States

The **Bloomberg Barclays Global Aggregate Bond Index** provides a broad-based measure of the global investment grade fixed-rate debt markets. It is comprised of the U.S. Aggregate, PanEuropean Aggregate, and the Asian-Pacific Aggregate Indexes. It also includes a wide range of standard and customized subindices by liquidity constraint, sector, quality and maturity.

Important Disclosures