May 2021

Stone Harbor INVESTMENT PARTNERS

Investment Policy Statement

A monthly review of the markets

Talking Talking Taper

"Sometimes an active policy is best advanced by doing nothing until the right time"

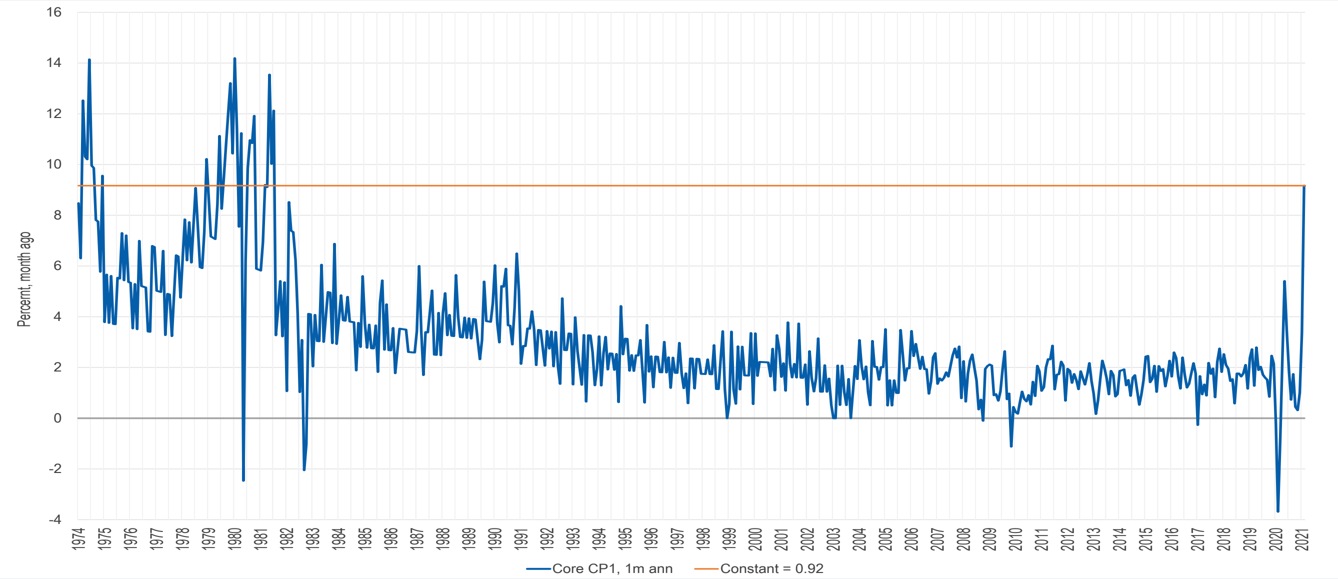
– James Baker, Former White House Chief of Staff

The US economic recovery is predicated on vaccination progress leading to sharply improved economic outcomes. The trend for both vaccinations and economic data has been encouraging, and the recovery has, for the most part, remained on track. At the same time, the US Federal Reserve (Fed) has reiterated its desire to return to the pre-pandemic labor market, which implies patience in removing monetary accommodation. Over the most recent weeks, however, the Fed has been confronted with conflicting data – namely, slower employment growth and higher core inflation. These data points have renewed questions around the Fed's timeline for initiating the taper of bond purchases and then subsequently increasing interest rates. In our view, while the headline figures were certainly surprising and warrant close attention, the underlying data suggest more nuanced dynamics that we think will keep the Fed in a wait-and-see, data-dependent mode, at least in the near term.

The April employment report showed a gain of 266k jobs, which during normal times would be a very solid report. But with an economy that is still short about 8 million jobs relative to the pre-covid path and market expectations at 1000k jobs, the latest figure represented a substantial disappointment, especially as many other parts of the report mirrored the headline softness. However, other metrics of the labor market show more strength. For instance, the ADP report showed more significant private sector job gains of 742k. Regional Purchasing Managers' Index (PMI) employment sub-indexes have been firm; and initial jobless claims continue to move down. Still, the employment report points in the direction of the economy needing more policy stimulus.

The second data point – core Consumer Price Index (CPI) inflation – pointed toward less accommodative policy as it increased 0.9% month-on-month, representing the fastest increase since the early 1980s, which pushed year-over-year inflation up to 3.0% (see Figure 1). We had been expecting an increase, but this outsized move in inflation was much faster than anticipated. Importantly, the latest figure was a very high sequential reading, which is the metric we are watching more closely. Details of the report show that pandemic-related categories drove a significant amount of the surprise. Used

Figure 1: Highest Month of Core CPI Inflation Since Early 1980s



As of April 30, 2021
Source: Bureau of Labor Statisitcs, Haver Analytics, Stone Harbor Investment Partners LP
1 Month Percent Change

car prices increased 10% in April, accounting for over a third of the increase. This was the largest one-month increase since early 1950s. There is also very clear impact of the reopening in select areas related to travel. For example, prices in airfares, lodging away from home, and car rentals were all considerably higher month-on-month. Nonetheless, in terms of levels, airline fares and lodging remain below pre-Covid rates, which implies potential for some further reversion higher over the next several months. Car rental prices, on the other hand, are currently far above pre-Covid levels. Given the size of the upside surprise to sequential inflation, we have marked up the probability of an accelerating inflation scenario in our macroeconomic risk scenarios from 10% to 15% as we continue to monitor any changes closely.

Against this backdrop of conflicting economic data, the minutes of the Federal Open Market Committee (FOMC) meeting revealed first hints of tapering discussion. According to the minutes, "A number of participants suggested that if the economy continued to make rapid progress toward the Committee's goals, it might be appropriate at some point in upcoming meetings to begin discussing a plan for adjusting the pace of asset purchases." In general, we view this statement as being consistent with our expectations of a likely path forward, which assumes that tapering discussion will commence around the upcoming Jackson Hole meeting in the summer, followed by implementation in late 2021 or early 2022. The exact timing will depend on the evolution of the economic data, in particular, the pace of employment gains, subject to an inflation constraint.

Subsequent to the FOMC meeting, Fed speakers have broadly reinforced Chairman Jerome Powell's stance that it is too early for discussions around tapering to start. The messaging on the inflation side is particularly notable, with the word "transitory" appearing in almost every FOMC member's discussion of the topic. That said, we are starting to, in the most recent communications, see hints that the discussion could start at the meetings over the summer, if the data cooperates. The most important example of this was a recent interview with vice-chair Richard Clarida that noted an openness to the discussion.

The caveat above—"if the data cooperates"—is a very important and binding one. The Fed will undoubtedly be paying close attention to incoming data to determine the timing of tapering and further policy adjustments. For that summer discussion to make sense, the pace of labor market improvement needs to reaccelerate substantially. We think that is likely to happen, especially with other labor market data continuing to look firm and average weekly hours at high levels. This is a "show me" Fed, and it will take the actual realization of better numbers for them to move. With those caveats, our current baseline is that the Fed begins talking about tapering over the summer. Jackson Hole seems to us the most likely venue for presenting that publically, but the timeline could be pulled forward to the June or July meetings if the April payroll report proves to have been an anomaly. In that case, the timeline would have tapering start late this year or early next year. We currently think it is extremely unlikely to see any rate hikes before the tapering is complete. Which means the earliest plausible rate increase would be in late 2022 or early 2023.

Beyond that, under the Fed's new flexible average inflation targeting (FAIT) framework, we will need to reach what they consider full employment – a return to the path employment was on pre-pandemic – before interest rates begin to increase. Though that is subject to an inflation constraint, we do not think the inflation constraint will ultimately bind as we expect inflation to moderate over the course of 2021. That leaves us thinking rates will likely remain at the lower bound until sometime late in 2023 or early 2024, though that view may evolve as we get more information on the recovery over the next several months.

US MACRO RISK SCENARIO ASSUMPTIONS AND MARKET OUTLOOK[1]

Base Case: Slow Grind Transitions to Sharp Vaccine-Led Rebound (40%)

- Vaccine distribution acceleration continues; vaccines continue to provide decent protection against variants.
- Travel, restaurants, sports, conventions and large gatherings continue further with wider vaccination.
- Vaccines become broadly available across EM countries by late-21/early-22. Some EMs ramp up vaccination by the summer.
- US stimulus disbursed over next several quarters boosting recovery. Other countries continue to provide further fiscal support.
- US/China tensions remain cooler, but do not return to pre-Trump status quo.
- The Fed and other DM central banks look through the current increase in core inflation. Core inflation—in yoy terms—drops back to ~2% by mid-summer.
- DM central banks maintain stimulatory policies. Fed starts to talk about tapering in late summer and implements early in 2022. More EM central banks start gradual rate hikes.
- Oil moderates slightly: ~$60/barrel WTI, Brent ~$65.
- Dollar broadly weakens over 1-year horizon, partly due to closing of interest rate differentials and partly from lower US real rates associated with Fed policy shift.

Medical & Stimulus Led Acceleration (35%)

- Economic activity accelerates as stimulus and vaccination turn into a full-on boom for the US. No surge in the US with the ongoing lifting containment measures.
- Europe follows the same path, with a lag, as their vaccinations continue at the current rapid pace. European activity rebounds rapidly in the summer; growth even higher than the US as more ground to be made up.
- Asia remains in relatively good shape. EM countries start ramping up vaccines by late summer.
- The Democratic Senate moves on to infrastructure and passes a meaningful bill, further accelerating the recovery.
- Supportive monetary policies gain traction and inflation remains contained. Fed tapering as above, but expectations for the first rate hike come forward as labor market gains remain rapid.
- Improvement is global.
- Oil: WTI at ~$70/barrel; Brent ~$75/barrel.

Variants Derail Vaccine-Led Recovery (10%)

- Coronavirus variants prove resistant to current vaccines; the new strains spread rapidly. As a result the recovery dips back down as government reinstate social distancing and other restrictions.
- With activity falling back down, economic scars turn lasting.
- The scars come from a variety of lingering effects: 1/ business bankruptcies increase; 2/ risk taking sentiment is depressed leading to less investment and fewer new business formations; 3/ layoffs turn permanent and unemployment rates increase in many countries and 4/ elevated sovereign balance sheets lead to payment stress in some countries.
- Malaise not limited to the US: other DMs and most EMs substantially underperform expectations through 2021 and into 2022.
- Fed institutes yield curve control (YCC) and pegs 10y at 0.25%. Additional financing facilities put in place; Fed pushes further out risk spectrum.
- Trade tensions persist, as in the base case.
- Dollar sees renewed flight to safety support.
- Oil prices hit by lower growth: ~$35-30/barrel for WTI; Brent ~$30-35.

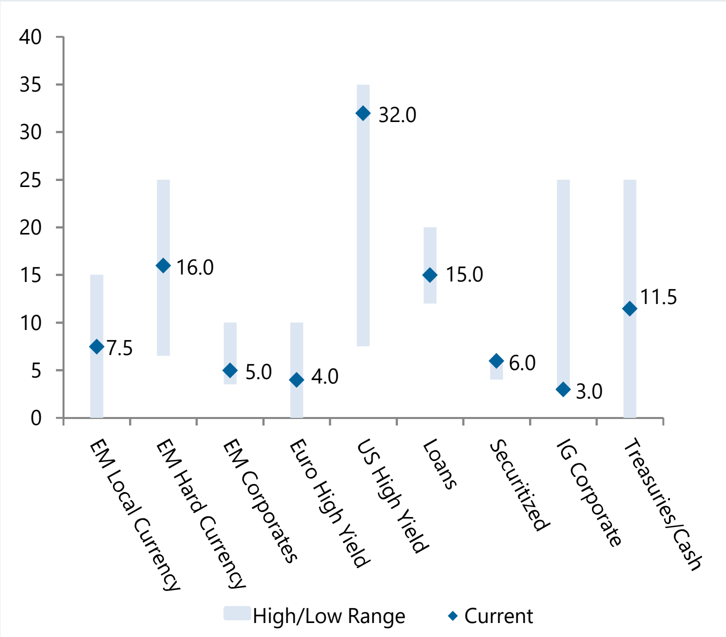
Inflation Accelerates (15%)

- Stimulus induced demand crashes into still constrained supply, and firms respond by raising prices. Facing tight labor supply, firms start to materially bid up wages attempting to pull workers off the sidelines.
- Recent inflation surprises prove durable; inflation does not revert back down in the summer.
- Core inflation remains elevated and is 3% heading into the end of 2021 for the US. Inflation also drifts higher in other DMs.
- Despite the rise in inflation, central banks initially maintain accommodative policies. But with inflation remaining high tapering is pulled into the end of 2021 rather than early 2022 and the taper is steeper. Along with reduced asset purchases the central banks indicate that policy rates will rise substantially sooner than anticipated.
- Rates move sharply higher along the curve.
- Interest rate sensitive sectors start to drag, but that is offset in the broader economy by growth elsewhere.
- Oil prices rise notably with growth and inflation fears: WTI to $75/barrel, Brent $80/barrel.

	Base Case: Slow Grind Transitions to Sharp Vaccine-Led Rebound (40%)	Medical & Stimulus Led Acceleration (35%)	Variants Derail Vaccine-Led Recovery (10%)	Inflation Accelerates (15%)
US Real 4Q GDP (%)	5.50	7.00	2.00	5.50
Fed Funds (%)	0.13	0.13	0.13	0.13
US Core PCE (%)	1.80	2.00	1.10	2.75
2yr Treasury (%)	0.50	0.75	0.13	1.10
10yr Treasury (%)	1.85	2.35	0.25	2.75
10yr Bund (%)	-0.15	0.20	-0.75	0.85
China 4Q GDP (%)	5.50	6.00	4.50	5.50
EM 4Q GDP (%)	5.00	6.00	3.50	4.50

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

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



Latest Allocation Changes	Month	Change (%)
EM Local Currency	Dec-Jan 2021	+2.5
EM Hard Currency	Feb-Mar 2021	+8.5
EM Corporates	May-June 2018	+1.5
Euro High Yield	May-June 2020	-2.5
US High Yield	Mar-Apr 2021	+5.0
Loans	Jan-Feb 2021	+1.5
Securitized	Mar-April 2019	+1.0
IG Corporate	Mar-Apr 2021	-5.0
Treasuries/Cash	Feb-Mar 2021	-8.5

[2]Since Inception: September 2013. Stone Harbor Multi-Asset Credit Representative Target Allocation as of 30 April 2021. Actual allocations within any account may be significantly different from the target allocations shown here. For illustrative purposes only.

APRIL CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	1.09	2.22	0.51	2.26	0.60	0.71	0.75
Duration (Returns from Interest Rates %)	0.43	0.97	0.07	0.62	0.49	-0.20	0.55
Credit Beta (Returns from Spreads %)	0.66	1.25	0.44	1.64	0.11	0.91	0.20

Month Ended 30 April 2021. 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 30-year performance history
- Offices in New York, 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.

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.

Stone Harbor
INVESTMENT PARTNERS

CONTACT

Main Office - New York

31 W. 52 Street
16th Floor
New York, NY 10019
+ 1 212 548 1200

London Office

48 Dover Street
5th Floor London,
W1S 4FF
+ 44 20 3205 4100

Singapore Office

3 Killiney Road
Winsland House 1
Singapore 239519
+ 65 6671 9711

www.shiplp.com