Investment Policy Statement

A monthly review of the markets

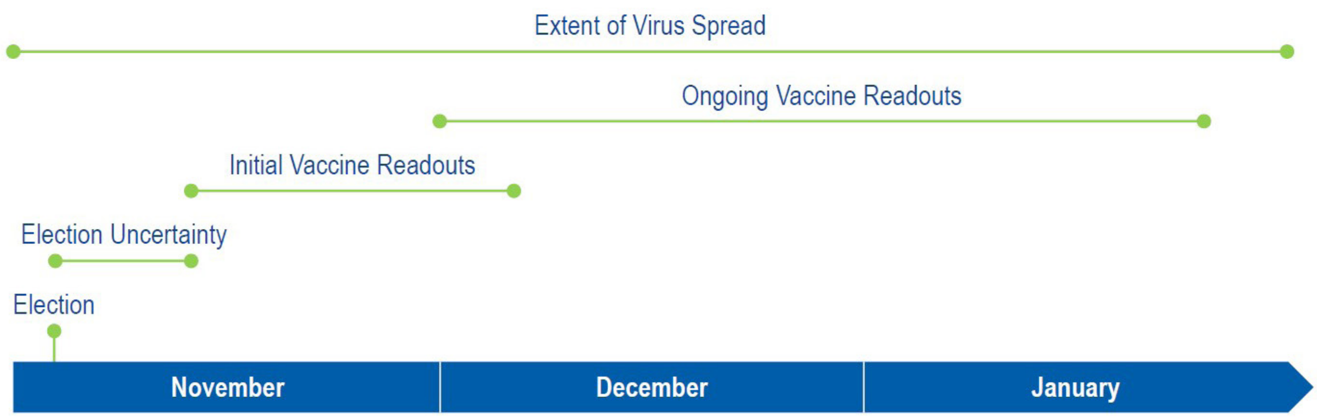
Is It All Ok? We'll Know A Lot More Soon

"Information is the resolution of uncertainty"
– Claude Shannon

Global economic recovery continues, despite recent increases in COVID-19 cases across a number of countries. Incoming data in the US has modestly surpassed our expectations, and we expect growth to continue into year-end, but at a slower pace than in recent months. Europe, in contrast, has disappointed, showing a steady rise in coronavirus cases and a slowdown in activity since our last publication. Similar to the US, recovery in emerging markets (EM) is continuing, but also at a slower pace. On the economic front, data surprises have been generally positive, but we continue to see large dispersion of virus dynamics across EM countries and regions. Looking forward, the global economy is entering a period when substantial new information on many of the key global risks is slated to become available. Most immediately, we will see the results of the ongoing voting in the US presidential election. Given a fixed date, the election commands attention, but the weeks following will likely contain important incremental virus-related news. It appears likely that early readouts on the success, or failure, of some vaccine candidates will be released. In our baseline expectation, we expect that these potential pitfalls will resolve in an economically friendly direction, but we remain focused on closely monitoring risks and implications.

Global economic dataflow has been mixed over the last several weeks. Overall, it remains consistent with growth continuing but at a slower pace relative to the summer. We continue to see substantial divergences across countries, industries and sectors; this reflects both the differential impact of the coronavirus on the ability to conduct economic activity safely and shifts in demand patterns. Across countries, the US has performed relatively well, while European data has disappointed. That could reflect an earlier uptick in the coronavirus case count in Europe, though the risk is

Figure 1: Approximate Uncertainty Resolution Timeline



As of October 2020
Source: Stone Harbor Investment Partners

that the recent increase in the US spills over to the economy. In some more detail on the US economy, the brightest spot remains the housing sector, which is supported by historically low rates and the consensus desire to stay home. US retail sales increased solidly in September (up 1.9% over August), which puts them above the pre-pandemic trend. Part of that improvement comes from a shift from services consumption to goods consumption, and thereby broader services consumption remains very much an area of weakness. The substantial fiscal support from the government has also provided a clear boost to the retail sector.

As we discussed above, US fiscal stimulus has buoyed the economy and we view further fiscal support as key to continuing a robust recovery. Without another stimulus package, a substantial drag on growth over the next several quarters is very possible. As the Chairman of the US Federal Reserve, Jerome Powell, has stated: "too little support would lead to a weak recovery, creating unnecessary hardship for household and businesses, [and] by contrast, the risks of overdoing it seem, for now, to be smaller."

The fiscal risk is intertwined with the looming US election as it now looks unlikely that any stimulus deal will be reached before 3 November. In the broadest terms, we see a Joe Biden victory with a Democratic Senate as risk positive, as would be a Trump victory with Republican control of the Senate. In either case, additional fiscal support would likely pass, though more in the former rather than latter, and the international implications of those results would differ substantially. We also see two less risk positive scenarios: a Biden victory but the Republicans hold the Senate, where fiscal stimulus could be substantially smaller than needed; or a contested election, which we would view as detrimental for broader risk appetite.

Our base case incorporates resolution of the virus and political risks outlined above in directions that are generally growth-friendly over the next several months. We expect virus incidence to remain higher than the summer but that endogenous social distancing and localized measures prove sufficient to keep spread at levels the public finds acceptable and avoid a nationwide lockdown. Increased European virus spread has led to increased restrictions. We expect those to negatively impact growth, though not to the degree that they did in spring. The likely result is that, as in the US, recovery continues but at a slower pace. On the US political front, we anticipate that Congress will eventually pass a substantial fiscal package following the presidential election, with the biggest risk being a standoff between an incoming Biden administration and a Republican Senate. If such a package passes, we expect it would provide renewed impetus to growth into 2021. That fiscal boost aligns with a broader distribution of vaccines, in our view, and helps underlie our expectation of rapid 2021 growth.

In emerging markets debt, we believe the recovery remains incomplete. Following the US Federal Reserve's pledge to maintain extraordinarily loose monetary policy, likely pushing rate hikes out until at least 2024, we believe the hunt for yield is accelerating. To our minds, EM debt, both local and external, which on average offer higher real yields than developed market government bonds, provide attractive investment opportunities for investors searching for yield. We also believe that inflows into the sector, which began last quarter and have picked up again in Q3, will continue in light of EM debt's relative value.

US MACRO RISK SCENARIO ASSUMPTIONS AND MARKET OUTLOOK[1]

Scenario	Assumptions
Base Case: Slow Grind Higher (60%)	• Coronavirus transmission continues in the US; endogenous social distancing & localized measures prove sufficient to keep spread at levels the public finds acceptable. • US avoids another nationwide lockdown. • Travel, restaurants, sports, conventions and large gatherings remain depressed until a vaccine starts to become available in Q1-21. Growth continues in the fall at a notably slower pace than the summer. • Increased European virus spread leads to some growth-retarding measures, but not full lockdowns. As in US, recovery continues but at a slower pace. • Post-election Congress passes a substantial fiscal package. That package provides impetus to growth that aligns with vaccine related rebound, but an air-pocket remains in place until then. Other countries also continue to provide further fiscal support. • US/China tensions remain high. Rhetoric elevated, partly US electoral reasons and comes from both parties. More retaliatory trade & tech actions, but both sides pull back from initiating a full trade war. • Central banks mainly focus on implementing existing policies. For the Fed, the amended average inflation targeting framework leads to enhanced forward guidance tied to outcomes and a ramp up of Treasury and MBS purchases around end-2020. • Defaults and bankruptcies—both individual and corporate—increase but remain under control. • Oil remains stable: ~$40/barrel WTI, Brent ~$45. • Dollar broadly weakens, partly due to closing of interest rate differentials and partly from lower US real rates associated with Fed policy shift.
Lasting Global Scars (10%)	• 2020 proceeds largely inline with base case path. • The expected rapid 2021 growth does not materialize. This disappointment could either be the result of failure/delays in the vaccine, or that the lingering scars of business bankruptcy, layoffs and changed behavior are substantial. • Malaise not limited to the US: other DMs and most EMs underperform expectations through 2021. • The hit to economic activity is pronounced; many temporary layoffs turn permanent. • Further US fiscal support stuck in Congress. Lack of fiscal support drags on growth into 2021, contributing to economic scarring. • 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: WTI drops to ~30/barrel; Brent ~$35.
Medical-Led Acceleration Starts in Q4 (20%)	• US virus transmission remains stable. Asia remains in relatively good shape while European increase peters out. • Pharmaceutical progress exceeds expectations. Rollout of monoclonal antibodies helps push death rates down further. Vaccine comes early—late 2020 rather than early 2021. • With better-than-expected outturns on treatment, activity improves substantially. Larger gatherings—including restaurants, sports and conventions—are able to resume at a higher rate. Supportive fiscal and monetary policies gain traction. • Improvement is global as better treatments spread. • By early 2021, output looks on track to return quickly to pre-virus levels. Fiscal policies remain supportive; US passes another support package. • Fed maintains accommodative policy, but doesn't feel need to push further. Similarly for ECB. • Oil: WTI at ~$50/barrel; Brent ~$55/barrel.
2nd Wave as Weather Cools in North (10%)	• Virus spread and infections pick up in the fall as activity moves back indoors with colder weather. Europe struggles: the recent renewed spread picks up further with colder weather. Asia does not escape as case counts increase meaningfully there. • Government restrictions and endogenous social distancing increase with the increase in the virus. The combination arrests the ongoing recovery, though activity remains well above spring lows. • Deteriorating virus situation prods Congress into action—an additional substantial fiscal package. • Fed QE pace higher than in base case, and use of 13(3) programs substantially higher. Despite 13(3) backstops there is a drift up in corporate defaults. • Trade tensions persist, as in the base case. • Dollar sees renewed flight to safety support. • Vaccine progress continues and, as in the base case, vaccinations start in late Q1-21. Activity picks up substantially as a result globally. • Oil prices hit by lower growth: ~$35-30/barrel for WTI; Brent ~$30-35.

	Base Case: Slow Grind Higher (60%)	Lasting Global Scars (10%)	Medical-Led Acceleration Starts in Q4 (20%)	2nd Wave as Weather Cools in the North (10%)
US Real 20 GDP (%)	-4.00	-4.50	-4.00	-4.50
US Real 21 GDP (%)	5.50	3.50	7.50	4.50
Fed Funds (%)	0.13	0.13	0.13	0.13
US Core PCE (%)	1.35	1.00	1.75	1.10
2yr Treasury (%)	0.13	0.13	0.50	0.13
10yr Treasury (%)	0.65	0.25	1.15	0.40
10yr Bund (%)	-0.45	-0.75	-0.30	-0.55
China 20 GDP (%)	2.00	2.00	2.50	1.00
China 21 GDP (%)	9.00	7.50	10.00	9.00
EM 20 GDP (%)	-3.00	-3.00	-2.50	-4.50
EM 21 GDP (%)	7.00	4.50	8.50	7.50

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

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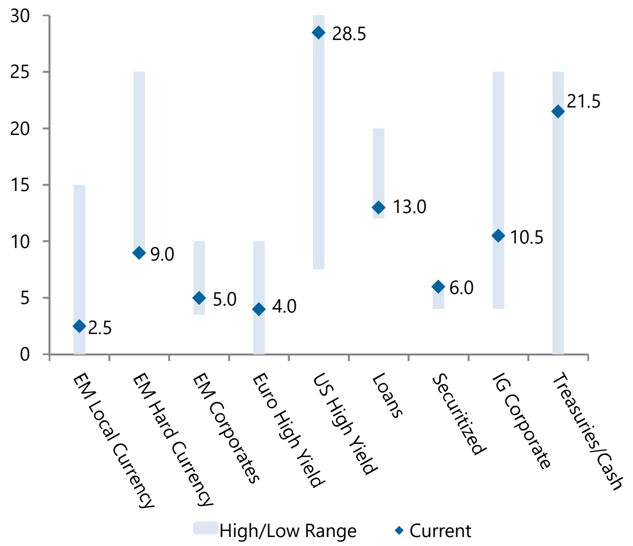
MULTI-ASSET CREDIT TARGET ALLOCATIONS (%) SINCE INCEPTION AND RECENT ALLOCATION CHANGES[2]



Allocation Changes[3]		
	Month	Change (%)
EM Local Currency	April-May 2020	-2.5
EM Hard Currency	June-July 2020	-10.0
EM Corporates	May-June 2018	+1.5
Euro High Yield	May-June 2020	-2.5
US High Yield	Aug-Sept 2020	+2.5
Loans	Feb-Mar 2020	+1.0
Securitized	Mar-April 2019	+1.0
IG Corporate	Aug-Sept 2019	+3.0
Treasuries/Cash	Aug-Sept 2020	-2.5

[3]Latest allocation change

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

SEPTEMBER CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	-1.04	-1.85	0.63	-2.02	-0.48	-0.53	-0.03
Duration (Returns from Interest Rates %)	0.06	0.16	0.01	0.11	0.07	0.25	0.28
Credit Beta (Returns from Spreads %)	-1.10	-2.01	0.62	-2.13	-0.55	-0.78	-0.31

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

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