September 2021

Stone Harbor INVESTMENT PARTNERS

Investment Policy Statement

A monthly review of the markets

Global Recovery Advances as Growth Impetus Rotates Across Regions

"We were standing on one side of a massive river of uncertainty and hardship….we're now seeing the other side of the river."

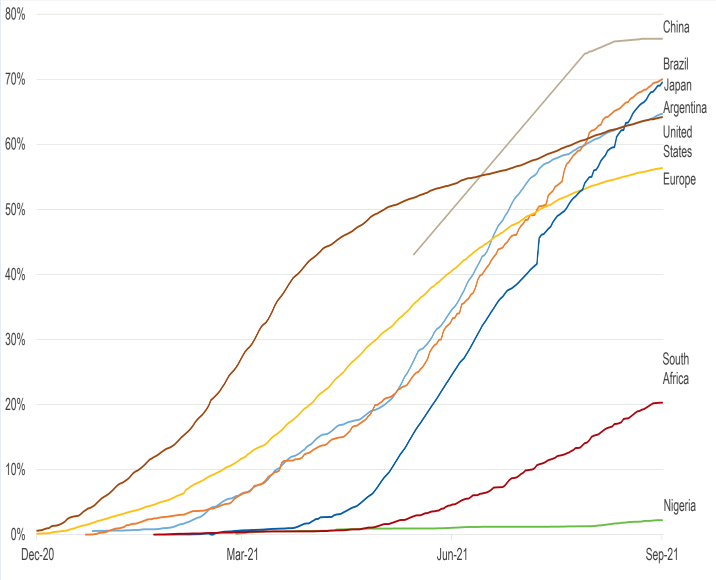
– Christine Lagarde, President, European Central Bank

Vaccinations and fiscal stimulus drove the rapid US economic recovery over the first half of this year. As we approach the final quarter of 2021, we expect global growth to remain strong and we still expect vaccinations and recovery from the pandemic to be important sources of support, but to be more pronounced in countries that had previously lagged the US. The Eurozone, parts of Asia, and many emerging markets countries are positioned to lead the next phase of a global economic rebound, in our view, as the growth impetus rotates into these parts of the world.

The US economy grew at an annual rate of about 6.5% over the first half of this year–the fastest two quarter growth rate since the early 1980, excluding the recovery from pandemics. Vaccinations allowed for broad-based re-openings while fiscal stimulus provided support for consumption. However, US growth is now moderating from the strong pace we witnessed earlier, driven by these same two factors. On the stimulus side, most fiscal stimulus has already been deployed and expanded unemployment benefits are also coming to an end. On the vaccine front, and perhaps more consequentially, the Delta variant spread is up, while the pace of vaccinations in the US is now lagging compared to peers. We believe, however, the scenario of shutdowns from a rise in virus cases are unlikely, given how we have learned to adjust our behavior to mitigate virus risks, although more Covid prevalence does limit the resumption of some activities. Lastly, it is important to note that a slower growth is not the same as slow growth and growth still remains well above trend.

In Europe, after lagging early this year, the vaccinations rate has surpassed the US and continues to increase, though at a slower pace than in the summer (Figure 1). As a share of the population, Europe now has more fully vaccinated residents than the US. This translated to improved growth; GDP in Q2 increased at an annual rate of 8.4% following the contraction in Q4 2020 and Q1 2021. We see scope for the rebound to extend into Q3 as the Eurozone has not yet reached the pre-Covid peak, in contrast to the US (Figure 2). We also see potential for further fiscal support, especially in southern Europe, as well as potentially in Germany, where upcoming elections may bring in a less fiscally conservative coalition.

Figure 1: Share of the Population That has Received at Least One Dose of a COVID-19 Vaccine



As of 27 September 2021
Sources: Our World in data, Stone Harbor Investment Partners LP Calculations
Total number of people who received at least one vaccine dose, divided by the total population of the country.

Figure 2: Lagging GDP Recovery In Europe and Japan Leaves More Room to Rebound

As of 27 September 2021
Sources: CAO, EUROSTAT, BEA, Haver Analytics
Q4 2019 = 100

Japan lagged the US by even more than Europe earlier this year, but the recent pace of vaccinations has been very strong and share of population vaccinated is now only just below the US. Likewise, South Korea is moving to higher rates of vaccinations. After contracting in Q1, Japan's economy grew faster than expected on stronger business spending in Q2. While Japan's economic gap is smaller relative to other developed market counterparts, partly as a function of slower underlying growth, output is still at depressed levels and we anticipate further room for growth acceleration for the remainder of this year. In other areas of Asia, such as Australia and New Zealand, vaccinations are still lagging. But as we have seen, vaccines will eventually rotate and support growth.

Across emerging markets countries and regions vaccine distribution varies widely. Some regions have reached high vaccination rates, while others continue to lag. South America, for example, has made significant vaccination strides over the past several months and, as a result, the spread of the virus is finally subsiding after having experienced some of the world's worst outbreaks over the spring and summer. Contributing to this dynamic is the sharp increase in vaccination rates. More than 55% of the population have already received at least one dose. The share of the population with at least one dose already exceeds the comparable rate in the US for several countries including Brazil and Argentina, though the share of fully vaccinated still lags. Reported daily Covid deaths in South America have now fallen back to levels not seen since late April 2020 during the initial stage of the pandemic. While infection rates vary by country, we see this trend broadly across most countries in South America. We believe these Covid developments put the region in a good position to continue the economic recovery and reap the benefits of strong commodity prices and improved external current account positions.

On the other hand, Africa continues to lag severely. While we expect vaccines to eventually rotate to this region, we think this is unlikely until 2022, after vaccines cycle through Europe and Asia. Lastly, China's zero tolerance stance continues to cause some economic disruptions as cases are met with much more severe restrictions than in most countries: China is still shutting down cities and provinces in response to relatively small numbers of cases. These shutdowns impede production, and cause global ripple effects through interconnected supply chains.

Overall, we maintain the view that a vaccine-led rebound in global growth will continue for the remainder of this year, but at a more moderate pace than we have witnessed thus far, particularly in the US. We continue to expect growth impetus to rotate from the US to Europe, then to other parts of the world. As vaccines become broadly available across emerging markets countries, which is projected for later this year, we believe improving growth will follow.

US MACRO RISK SCENARIO ASSUMPTIONS AND MARKET OUTLOOK[1]

Vaccine Led Rebound Continues, But Slows over Second Half of 2021 (45%)

- Vaccine take-up continues but pace is suboptimal; vaccines continue to provide solid protection against variants. Delta continues at a lower level than late summer.
- Travel, restaurants, conventions and large gatherings slowly improve.
- Vaccines become broadly available across EM countries by late-21/early-22. Recent good vaccinations outturns in some EMs continue.
- US stimulus effects continue to fade over H2 as large disbursements are in the past and enhanced UI has expired. Q2 is the local peak for US growth; H2 growth above trend, but notably slower.
- Other DMs continue to provide fiscal support. Their most rapid growth generally occurs in Q3 and Q4.
- US/China tensions remain cooler, but do not return to pre-Trump status quo.
- The Fed and other DM CBs look through core inflation increase. Core PCE, in YoY terms, drops back to around 2¾% at end-2021 and continues to decline into 2022.
- DM central banks maintain stimulatory policies.
- Fed initiates tapering in late 2021. Discussion continues on timing of rate hikes but growth isn't fast enough to pull expectations further forward.
- More EM central banks start gradual rate hikes.
- Oil remains ~$65/barrel WTI, Brent ~$70.
- 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.

Inflation Accelerates (20%)

- Stimulus induced demand crashes into still constrained supply, and firms respond by raising prices. Facing tight labor supply, firms continue to bid up wages attempting to pull workers off the sidelines.
- Recent inflation surprises prove durable: there is no reversion to below 3%. Wage inflation flows into price inflation through rental measures.
- Core inflation remains elevated and is well over 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. However that starts to shift with a taper that starts in late 2021, but is steeper than expected.
- Along with reduced asset purchases CBs indicate that policy rates will rise much sooner than previously 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 $80/barrel, Brent $85/barrel.

Growth Lags Expectations (20%)

- Long-standing growth issues return to the fore.
- Delta variant spreads north with colder weather. Notable drag on COVID-sensitive industries.
- US growth fades more sharply with the withdrawal of fiscal stimulus. Employer-employee matching takes longer-than-expected restraining growth; LFP withdrawal among older workers continues.
- Only an infrastructure bill makes it through Congress.
- The combination of more delta and less government spending leads to business investment pullback.
- Inflation moves down notably as growth fades.
- Malaise not limited to the US: other DMs and most EMs substantially underperform expectations through 2021 and into 2022.
- Tapering pushed out to mid-2022 and discussion of 2023 rate increases disappears. ECB also extends guidance that rates will remain fixed.
- Trade tensions persist, as in the base case.
- Dollar sees modest upward pressure from renewed flight to safety.
- Oil prices hit by lower growth: ~$50/barrel for WTI; Brent ~$55.

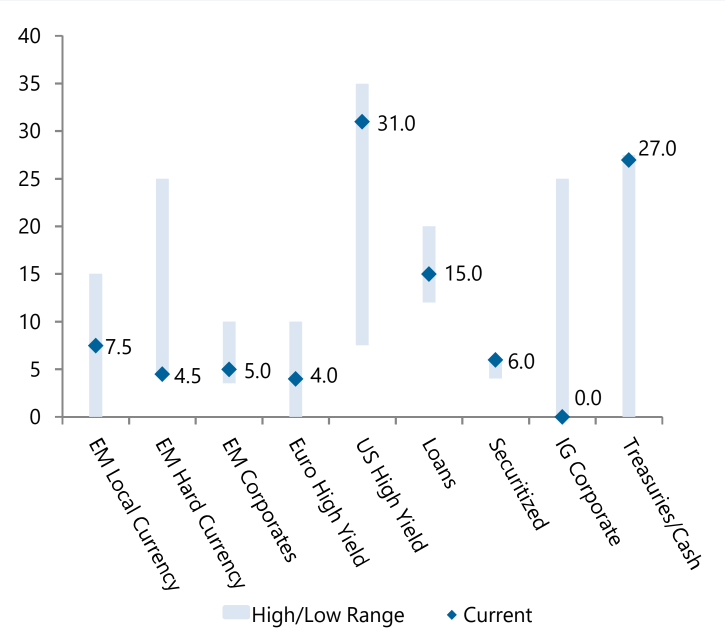
Stimulus & Vaccines Power Rapid Growth into 2022 (15%)

- Economic activity reaccelerates into Q4. Payroll growth rebounds to ~1mn/month.
- High vaccinations rates in Europe allow the activity rebound to extend into the fall; H2 growth higher than the US as more ground to be made up.
- DM Asia continues to vaccinate at a rapid pace, which spills into activity.
- EM vaccination also proceeds relatively rapidly, and also see the activity benefits.
- US fiscal—both infrastructure and reconciliation bills—pass over the fall and start providing support to output by early 2022.
- Supportive monetary policies gain traction and inflation moderates.
- Fed tapering as above. Discussion of rate increases moves to late 2022 in the context of more rapid labor market gains.
- Activity improvement is global.
- Oil: WTI at ~$75/barrel; Brent ~$80/barrel.

	Vaccine Led Rebound Continues, But Slows over Second Half of 2021 (45%)	Inflation Accelerates (20%)	Growth Lags Expectations (20%)	Stimulus & Vaccines Power Rapid Growth into 2022 (15%)
US Real 4Q GDP (%)	3.00	3.00	1.50	5.00
Fed Funds (%)	0.13	0.13	0.13	0.13
US Core PCE (%)	1.80	2.75	1.60	2.10
2yr Treasury (%)	0.55	1.10	0.13	0.80
10yr Treasury (%)	1.75	2.75	0.90	2.35
10yr Bund (%)	-0.20	0.85	-0.75	0.10
China 4Q GDP (%)	5.50	5.50	4.50	6.00
EM 4Q GDP (%)	7.00	6.50	4.50	8.00

[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	June-July 2021	-1.5
EM Corporates	May-June 2018	+1.5
Euro High Yield	May-June 2020	-2.5
US High Yield	June-July 2021	+4.0
Loans	Jan-Feb 2021	+1.5
Securitized	Mar-April 2019	+1.0
IG Corporate	June-July 2021	-2.0
Treasuries/Cash	June-July 2021	-0.5

[2]Since Inception: September 2013. Stone Harbor Multi-Asset Credit Representative Target Allocation as of 31 August 2021. Actual allocations within any account may be significantly different from the target allocations shown here. For illustrative purposes only.

AUGUST CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	0.55	0.98	0.47	0.77	0.71	0.39	-0.26
Duration **(Returns from Interest Rates %)**	-0.14	-0.20	-0.01	-0.16	-0.13	-0.25	-0.26
Credit Beta **(Returns from Spreads %)**	0.69	1.18	0.48	0.93	0.84	0.64	0.00

Month Ended 31 August 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.

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