STONE HARBOR EMERGING MARKETS DEBT OUTLOOK

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Global Economic Outlook

Our global economic outlook remains largely unchanged from end-2012 (see Stone Harbor Emerging Markets Debt Outlook, December 2012). The key global backdrop is the continuation of the moderate recovery in the U.S., slightly negative growth in the Eurozone, and broadly stable growth in China.

In the U.S., the recovery is supported by the continued improvements in the housing sector and gradual gains in employment. The fiscal cliff at the end of 2012 resulted in only moderate fiscal tightening, but the recent trigger of the sequester and doubts about the ability to compromise on fiscal policy will continue to weigh on sentiment and result in some fiscal drag.

Austerity and deleveraging in Europe continue to be a drag on growth. We expect only weak growth in core Europe and continued recession in the periphery resulting in overall slightly negative growth for most of 2013. Compared to end-2012 the outlook has deteriorated somewhat, mostly on account of the political difficulties in forming a new government in Italy and continued weak economic data.

China's growth remains highly dependent on investment. The housing market has improved markedly prompting the government to impose measures to curb further price increases. However, in other areas the government is actively stimulating the economy, i.e. by promoting infrastructure investment. We expect growth of about 8% in 2013, slightly higher than in 2012.

Based on this global backdrop, we expect slightly higher EM growth in 2013, driven mainly by Latam and Asia, as CEEMEA continues to be weighed down by poor growth in the Eurozone. Inflation pressures in EMs remain muted at this point but we expect acceleration later this year as growth improves and food prices pick up in many EMs. The monetary easing cycle is largely over by now and we expect to see some rate hikes this year, led by Brazil. As long as global growth remains subdued and inflation under control we expect many EM central banks to lean against FX appreciation.

Local Currency Debt Markets Outlook

We think that many local currencies are still priced at attractive levels given our outlook on EM growth. So far this year, spot FX depreciation has reduced total returns on the J.P. Morgan GBI-EM Global Diversified by over 1.25% as of 21 March. Strength in the U.S. dollar due to improving economic conditions in the U.S. and weakness in the Euro have been key factors in EMFX underperformance, in our view. Going forward, we expect that conditions for U.S. dollar strength may be favorable to EMFX, particularly for Latin American and Asian currencies, but that further weakness in the Euro may weigh on FX markets in countries with the strongest ties to the Eurozone.

Unlike the first quarter of 2012 when returns of all countries in the index were positive, the divergence of returns increased by country and region this quarter. In general, bond markets and currencies from Latin America and Asia performed well while those from CEEMEA, particularly Hungary and South Africa, weakened. Mexico's peso has been the best performer so far this year, up over 5%, while the South African rand continued its underperformance as ongoing concerns about labor strikes and growth have driven the currency nearly 9% lower versus the U.S. dollar as of 21 March.

We expect currencies to appreciate over the next 12 months by 2-3% in aggregate, led by Latin America and Asia. But not all currencies are likely to appreciate, in our view. Countries where we see a higher likelihood of currency depreciation relative to the U.S. dollar include Hungary, Poland and Turkey.

As interest rates have fallen in most EM countries, we believe that current markets for bonds at the long end of domestic yield curves may be mispricing the prospect for rising inflationary pressures later this year. As a result, in general our portfolios are underweight duration relative to the benchmark in

every country except Brazil and Colombia. As an example, we recently reduced the contribution to portfolio duration in Mexico as yields fell and the curve flattened. Mexico's bond markets appear to believe that a recent drop in inflation gives the central bank room for repeated cuts in the monetary policy rate, a view we do not share. On the other hand, in Brazil we have tactically extended duration to take advantage of a steeper yield curve and have added exposure to the real. In our view, inflation poses a political risk to President Dilma Rousseff (presidential elections will be held in 2014), so monetary policy in coming months may increasingly try to anchor inflation expectations. In this event, the central bank of Brazil may be more willing than it was in 2012 to allow for a stronger real. While we do not anticipate a sharp rise in inflationary pressure in the near term, we have maintained exposure levels in inflation-linked debt in bond markets where break-even inflation rates have fallen below current inflation rates. We currently hold linkers from Brazil, Colombia, Mexico, Poland, Thailand, and Turkey.

In general, other shifts in our portfolios during the quarter reflected considerations of valuations relative to our fundamental credit outlook in each country. We have gradually added exposure in Nigeria as yields have risen and the naira has come under modest pressure. Following appreciation of the leu in January, we reduced our Romania positions. In Poland and Turkey we have increased our underweights as yields have fallen in both countries and remain too low, in our view, particularly at the long ends of the yield curves. Finally, we maintain a hedge on the Colombian peso as the government has threatened to intervene to weaken the currency. We continue to favor Colombia local interest rates on expectations of future cuts in the monetary policy rate.

External Sovereign Debt Outlook

Our base case scenario for external sovereign debt (EMD) returns over the next 12 months assumes a modest rise in U.S. Treasury yields and tightening of credit spreads. While we were correct last quarter in anticipating ongoing demand for high quality sovereign debt and continued improvements in credit fundamentals, EMD delivered negative returns year to date as of 21 March. Non-investment grade sovereign debt outperformed higher rated bonds as investors continued to hunt for yield. In aggregate, index spreads widened, but the bulk of the widening came from high quality credits as yields on U.S. Treasury ten year notes drifted higher on expectations of an improving growth outlook in the U.S.

During the first quarter of 2013, the largest contributors to returns in the J.P. Morgan EMBI Global Diversified included some of the weakest EM credits. In our view, Belarus, Belize, Ecuador, El Salvador, Ivory Coast, Lebanon, and Ukraine—countries whose sub index return contributions were surpassed only by Venezuela's—have significant flaws in their credit fundamentals but ranked as the top eight credits in total return year to date. Venezuela benefited from a one-time 46% devaluation of the bolivar and ongoing speculation on the declining health of Hugo Chavez, who died on 5 March. Bond markets in Venezuela remained volatile after Chavez's death in anticipation of election related uncertainty. Venezuela elections will be held 14 April to determine Chavez's successor.

The market's technical conditions remain favorable, in our opinion. According to J.P. Morgan's survey in February, investors are positioned more defensively in EM sovereign external debt than they have been since October 2008, just after the Lehman collapse. While fund flows have slowed from the pace set in 2012, they remain positive. So far this year, investors have invested up to $8 billion in hard currency EM strategies. In the current environment, even weak credits have been able to secure funding and perform well in the secondary markets. As an example, Tanzania recently issued $600 million of six year amortizing, floating rate notes at Libor +600 basis points. Dealers reported $2.7 billion in international demand for this issue and the bond spread tightened over 100 basis points in the first weeks of secondary trading. According to the IMF, Tanzania has a current account deficit of 16% and a fiscal deficit above 5%, two reasons we avoided

participating in this issue. Demand remains constructive for EM sovereign debt, in our view.

At the index level, spreads remain wide of the tightest historical levels despite today's stronger country fundamentals, and, in our view, also appear attractive relative to comparably-rated developed market fixed income alternatives. Total returns on the sector are likely to be negatively impacted by an increase in U.S. interest rates, but we see little risk of sharply rising rates in the near term. We believe the J.P. Morgan EMBI Global Diversified spread can tighten by 25-50 basis points over the next twelve months.

During the past two months, we made several shifts to our portfolios based on relative value considerations. In general, we reduced exposure to Russia and South Africa, taking advantage of spread compression in both countries. We added U.S. dollar denominated bonds in Turkey and Brazil as spreads widened. In addition, we added exposure in local markets where we believe local markets may outperform external debt, particularly Brazil and Mexico. Finally, we added external debt of Venezuela and modestly extended duration on weakness in Venezuela bonds following Chavez's recent death.

Corporate Debt Outlook

Total returns on EM corporate bonds, led by high yield corporates, exceeded all other emerging market debt sectors year to date. In hard currency EMD, we believe this outperformance will continue in 2013. Key drivers of returns for the sector remain improving credit quality, the yield advantage over comparably rated developed market corporate debt, and lower duration of the sector relative to external sovereign debt alternatives. We continue to favor EM corporates given our view on credit fundamentals in a gradually rising interest rate environment.

In our view, relative valuations remain attractive, if not compelling on an absolute yield basis. EM corporates continue to offer value relative to U.S. investment grade corporates. Though spreads and yields have declined in the BB sector for both EM and DM (developed markets), we continue to focus our efforts in this sector of the high yield market. In our view, double B-rated companies in many EMs continue to benefit from deleveraging, low net debt levels and credit re-rating despite the fact that credit rating downgrades have exceeded upgrades so far in 2013.

Issuance of new debt and rising inflows into the asset class have supported this view. According to J.P. Morgan, issuance year to date in the corporate sector exceeded last year's record pace. While March issuance slowed from January and February's record levels, the pipeline of new issuers continues to grow. As of 21 March, EM corporates had issued $87 billion in new debt, $11 billion more than the record set last year at this time. In addition, demand for new issuances remained strong. As an example, Mexico's CEMEX issued U.S. $600 million of six-year maturity bonds rated B/B+ (S&P/Fitch) in March. According to dealers, the issue was 14 times oversubscribed. High yield issuers and Asian companies have dominated new issuance, accounting for 43% and 50% of all issuance, respectively, while first time issuers of bonds comprised roughly a quarter of year to date activity.

Inflows into the sector remain robust despite reported withdrawals from hard currency EM fixed income funds. Based on ongoing demand expressed through requests for proposals and meetings with clients, we continue to believe that demand for EM corporates will further support asset prices.

Positioning in our portfolios reflects this view in addition to credit, country and industry considerations. From a regional perspective, we believe Latin America remains our key overweight, with Brazil as the dominant country in the region and in our portfolios. During the first quarter, we have added exposure in Brazil, focusing on companies that depend on the rising growth of middle class consumers. Examples of industries we have invested in include the Brazilian beef and ethanol production sectors. We have also added exposure in Peru. On the other hand, we have cut investments in Mexico, particularly in the housing sector, which

has come under pressure recently as housing companies retrench to comply with new building regulations.

In CEEMEA, valuation considerations led us to cut exposure in Qatar, Saudi Arabia, South Africa, and Turkey. We increased exposure to the region by adding Russian corporate debt, which had lagged the broader rally in the first few weeks of the year. We continue to find value in Russia, particularly in the banking, telecom, and energy sectors and expect Russia to be a large contributor to excess returns for the market in 2013. Year to date, Russia corporate debt has underperformed the J.P. Morgan CEMBI Broad Diversified.

From a ratings perspective, we have continued to reduce exposure to very high quality investment grade debt that trades at low yields and spreads. These moves have reduced our portfolios' overall exposures in Asia and the Gulf and have reduced country positioning in Hong Kong, Singapore, South Korea, Qatar, and Saudi Arabia. At the same time, we have been active in the new issue market, adding to positions in Brazilian and Russian BB- rated credits. We also modestly reduced our underweight in Asia high yield credits by adding to China industrials.

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