Investment Policy Statement

A monthly review of the markets

Coronavirus Impact Across Asset Classes: Will Uncertainties Mask the Differential?

"The oldest and strongest emotion of mankind is fear, and the oldest and strongest kind of fear is fear of the unknown."
-H.P. Lovecraft

After strong returns across most asset classes last year, it appeared moving into 2020 that many of the macroeconomic risks from 2019 had been, if not resolved, then diminished. US GDP growth and employment data entered 2020 on a solid path; US equity markets hit all-time highs; the trade war tensions between the US and China eased as "a phase one" deal was signed in January; and finally, uncertainty surrounding Brexit receded as the UK exited the European Union on January 31, 2020. Other data were more mixed, as Europe saw ongoing weakness in manufacturing though survey data had turned higher. Nevertheless, fundamentals for 2020 appeared generally positive, with slow, steady growth creating favorable conditions for risk assets.

News from central China abruptly changed that narrative. The initial reports and impact of the coronavirus (officially named "COVID-19") evolved rapidly, and the subsequent spread of the respiratory illness disrupted the global economy and plunged equity markets into turmoil.

Amid alarming headlines and TV screens flashing red, we think it's important to place the current volatility into context. First, the choppy markets in 2020 have followed very robust returns across a range of asset classes in 2019. Figure 1 shows returns for a broad set of indices, including equities and fixed income markets, for 2019 and year-to-date through March 3, 2020. We believe it's important to remember that the abrupt declines in US and global stocks are on the heels of strong performance in 2019. Even with the declines in 2020, equity indices are still substantially higher than at the beginning of 2019: the closing price of the S&P 500 Index on March 3, 2020 is almost 20% higher than the close on January 2, 2019.[1]

[1]Source: Bloomberg

Firgure 1: A Tale of Two Time Periods

Category	2019 Return (%)	YTD 2020 Return (%)
US Equities	+33.1	-7.8
Global Equities	+28.4	-7.3
Emerging Markets Debt - USD	+15.0	+1.9
Emerging Markets Debt - Local Currency	+13.5	-1.9
Emerging Markets Corporate Bonds	+13.1	+2.0
European High Yield	+14.1	-0.8
US High Yield	+14.4	-0.5
Broad US Bond Market	+6.3	+4.2
Broad Global Bond Market	+6.8	+3.3

Data as of 3 March 2020.
US Equities represented by the S&P 500 Index. Global Equities represented by the MSCI World Index. Emerging Markets Debt - USD represented by the J.P. Morgan EMBI Global Diversified Index. Emerging Markets Debt - Local Currency represented by the J.P. Morgan GBI-EM Global Diversified Index. Emerging Markets Corporate Bonds represented by the J.P. Morgan Corporate Emerging Markets Bond Broad Diversified Index. European High Yield represented by the ICE Bank of America Merrill Lynch European Currency High Yield 2% Constrained Ex-Financial Index. US High Yield represented by the ICE Bank of America Merrill Lynch US High Yield Constrained Index. Broad US Bond Market represented by the Bloomberg Barclays US Aggregate Index. Broad Global Bond Market represented by the Bloomberg Barclays Global Aggregate Index.
Past performance is not a guarantee of future results. Index performance is calculated on a total return basis with dividends reinvested and do not reflect the impact of management fees. Investments may not be made directly in an index. For illustrative purposes only.
Source: Bloomberg, MSCI

Figure 1 also demonstrates that in times of market stress, asset classes are not always correlated. While in 2019 major equity and bond indices all generated positive returns for the year, 2020 has presented a different story. As equity markets plummeted, broad US and global bond markets—represented by the Bloomberg Barclays US Aggregate Index and the Bloomberg Barclays Global Aggregate Index—generated positive returns for the first two months of the year. In addition, US dollar-denominated emerging markets debt (EMD) also generated a positive return, though local currency-denominated EMD declined, primarily due to the effects of the strengthening US dollar. Even the decline of local currency EMD in 2020 follows 2019's double-digit positive performance for the asset class. Again, we believe that it's important to keep this level of volatility in perspective.

One area we continue to watch is the effect of the coronavirus on oil and commodity prices. China is the world's second-largest consumer of oil and is the world's largest oil importer.[2] As a result, a slowdown in China due to the coronavirus will likely have an outsized effect on crude oil and commodity prices. In the first two months of 2020, Brent crude oil prices fell by close to 22%, from a closing price of $66.25 per barrel on January 2, 2020 to a closing price of $51.86 on March 3, 2020.[3] Historically, lower oil prices have been a boon to the US economy, providing relief to the wallets of drivers and boosting real consumption. With the boom in US oil production over the past decade, however, the effects are much more nuanced. Lower oil prices tend to suppress mining investment, offsetting a good chunk of the boost to the consumer. In today's economy, the level of interconnectivity means that a virus that originated halfway around the world in China could lead to pain in West Texas.

Overall, the situation remains fluid, and we are monitoring the incoming information and economic data closely to try to understand the reach, duration and impact of the coronavirus on the global economy. We expect risk assets will continue to be very sensitive to that incoming information. As the coronavirus continues to spread around the world in 2020, central banks that have policy room, a concept we discussed in this space last year, appear likely to use it to offset some of the downside risks of the coronavirus to the global economy. The Federal Reserve ("Fed") has already cut its key benchmark rate by 50 basis points, and indicated that further action could be taken depending on conditions. Following the Fed's lead, the Bank of Canada and the Reserve Bank of Australia both cut rates as well. Many emerging markets (EM) countries have rates well above zero, and hence room to cut rates too. Though monetary policy cannot fully offset economic damage if the coronavirus spreads further, it does provide an important, though partial, offset.

[2]Source: Bloomberg
[3]Source: Bloomberg

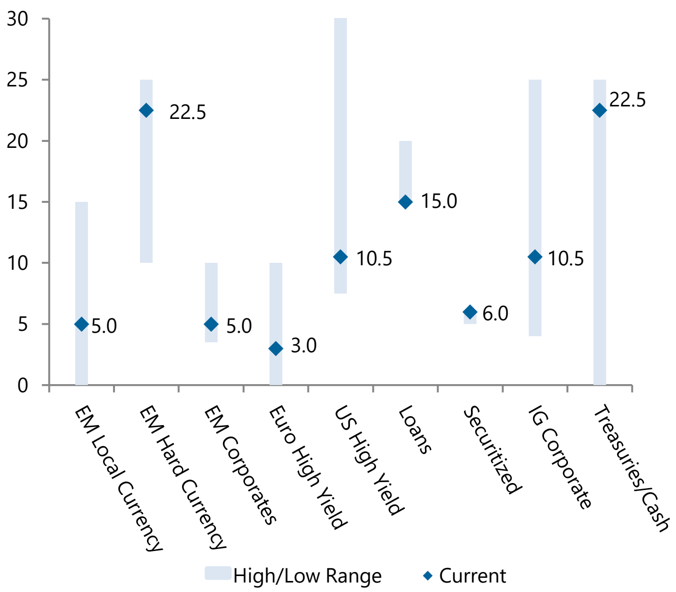
US MACRO RISK SCENARIO ASSUMPTIONS AND MARKET OUTLOOK[1]

Base Case: Coronavirus Drags On Global Growth (45%)	• Coronavirus continues to spread, both in developed and emerging markets. Some seasonal relief in Northern Hemisphere, but infections pick up in Southern Hemisphere going into their winter. Virus picks up again into North's winter. • Chinese production continues to return, but some disruptions remain in place. • Moderate global supply chain disruptions. • DM growth slips as virus-containment measures hit economies. Impact on DM economics moderated by better health systems. • Soft environment for oil and other commodities. • Fed follows up the 50bp intermeeting cut with another 25bp cut in the spring due to a/ risk from broader virus spread and b/ signs of slower growth. • Lower rates support growth, but cannot fully offset negative supply shock. Notably slower US growth. • Other DM countries have less policy space to respond, though some modest further loosening. • Growth knock-on effects across EM, commodities an important channel. Countries with policy space lower rates in an attempt to provide some offset. • Corporate profitability drops.
V-Shaped Post-Coronavirus Rebound; Not Significant US Political Disruptions (25%)	• Disruptions due to the coronavirus are mostly limited to Q1; growth rebounds partially into Q2 and more fully in Q3. • End result is mostly more of the same: a/decent but uninspiring US growth of around 1¾%; b/ European growth improves back toward 1½%, substantially narrowing the differential with US and c/ EM growth also drifts up modestly. • Fed stands pat at March meeting waiting to see effect of 50bp cut. Better news on virus spread into spring leaves them on hold. Wages move toward 3½%; Fed still notes lower-than-desired inflation. • Expectations are for the US election to result in gridlock—either Trump or centrist Democrat with the House and Senate remaining Democratic and Republican respectively—resulting in only modest changes to broad macro policy. • Trade "phase one" deal sticks, current tariffs remain in place. Back-burner until after the election but no lasting resolution. • ECB shows little appetite for further monetary stimulus. Modest fiscal loosening for the Eurozone as a whole, but no sign of a substantial package. • EM growth of just over 4%; growth differential to US widens relative to 2019. • Corporate profits grow, but slowly.
Shallow Recession; Progressive Democrat Wins Landslide (20%)	• Growth slows further from combo of coronavirus, fiscal drag and trade tensions. Market concerns about sustainability of profits leads to an equity sell-off and spread widening. Non-linear dynamics take over—the US tips into recession. • Unemployment rises notably (~2.5pp). Recession is mild: the 2001 shallow slump rather than 2009. • The Fed cuts rapidly and deeply in response; rates are quickly taken back to the ZLB and forward guidance reinstated. Either QE restarted or rate caps on longer-term rates; short-term rates at 0. • The US electorate reacts as they typically do to a recession: tossing out the party in power. Democrats, led by one of the left-wing options. • With little policy space to respond, Europe and Japan also enter mild recessions. ECB cuts a further 10bp and substantially increases the size of asset purchases along with ongoing discussions about buying equities in size. • EM growth decelerates rapidly; some countries see output contract. Flight to quality boosts dollar against EM. • Expectations for a substantial increase in US anti-trust enforcement. Healthcare reform mooted. Russia sanctions a very real possibility. • Corporate profitability takes a substantial hit.
Cyclical Rebound Combines with Policy Easing To Push EM Growth Higher (10%)	• Growth acceleration into the coronavirus episode more rapid than realized. The effects of the virus prove largely transitory but policy eases in response and pushes growth higher. V-shaped recovery. • Largest growth pickup is in Asia, but the firming also extends to the rest of the world. Other EM economies also benefit. US growth picks up while Eurozone growth improves to ~1½%. • In the US, core PCE inflation rises to slightly above 2%; the FOMC treats the acceleration as a positive development in context of framework review. • Fed remains on hold through the election cycle; expectations of modest 2021 rate increases build. • Trade issues remain on the back-burner. • Oil drifts up. Commodity exporters broadly benefit. • Trump wins easily. Republicans narrow the size of the Democratic House majority and pick up a couple Senate seats (<60). Talk of another tax cut package, though unclear if can pass Congress. • Moderate EM FX strength relative to DM. • Improvement in corporate profitability, especially companies leveraged to Asia.

	Base Case: Coronavirus Drags On Global Growth (45%)	V-Shaped Post-Coronavirus Rebound; Not Significant US Political Disruptions (25%)	Shallow Recession; Progressive Democrat Wins Landslide (20%)	Cyclical Rebound Combines with Policy Easing To Push EM Growth Higher (10%)
US Real GDP (%)	1.4	1.75	0	2.5
US Core PCE (%)	1.75	1.9	1.25	2.15
Fed Funds (%)	0.875	1.125	0	1.625
2yr Treasury (%)	0.95	1.3	0.1	2.2
10yr Treasury (%)	1.15	1.8	0.5	2.25
10yr Bund (%)	-0.5	-0.1	-0.75	0.3
EM Growth (%)	3.9	4.2	3.3	4.6
China Growth (%)	5.0	5.4	4.5	5.8

[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	May-June 2019	-5.0
EM Hard Currency	Dec-Jan 2020	+5.0
EM Corporates	May-June 2018	+1.5
Euro High Yield	Oct-Nov 2019	-3.5
US High Yield	Dec-Jan 2020	-5.0
Loans	Nov-Dec 2018	-5.0
Securitized	Mar-April 2019	+1.0
IG Corporate	Aug-Sept 2019	+3.0
Treasuries/Cash	Oct-Nov 2019	+3.5

[3]Latest allocation change

[2]Since Inception: September 2013. Multi-Asset Credit Representative Target Allocation as of 31 January 2020. Actual allocations within any account may be significantly different from the target allocations shown here. For illustrative purposes only.

JANUARY CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	0.00	1.52	0.56	-1.29	1.54	0.20	2.07
Duration (Returns from Interest Rates %)	1.15	2.96	0.16	2.15	1.73	0.46	2.42
Credit Beta (Returns from Spreads %)	-1.15	-1.44	0.40	-3.44	-0.19	-0.26	-0.35

Credit Market Total Returns reflect performance of representative asset class benchmarks. US HY: ICE BofAML US High Yield Constrained Index; EMD: J.P. Morgan EMBI Global Diversified; Loans: S&P/LSTA Leveraged Loan Index; 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. Past performance is not a guarantee of future results. Index performance is calculated on a total return basis with dividends reinvested and do not reflect the impact of management fees. Investments may not be made directly in an index. 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, Singapore and Melbourne.
- Total assets under management: USD 19.8 billion as of 31 December 2019

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.

New York	Chicago	London	Melbourne	Singapore
31 W. 52nd Street	10 S. Riverside Plaza	48 Dover Street	Suite 3143, Level 31	9 Temasek Boulevard
16th Floor	Suite 875	5th Floor	120 Collins Street	#09-03A Suntec Tower Two
New York, NY 10019	Chicago, IL	London, W1S 4FF	Melbourne	Singapore 038989
+1 212 548 1200	+1 312 492 4251	+44 20 3205 4100	+61 3 9225 5064	+65 6671 9711

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 **MSCI World Index** is a broad global equity index that represents large and mid-cap equity performance across all 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country.

The **S&P 500 Index** is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.

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