Investment Policy Statement

A monthly review of the markets

Market Signals: Are They Loud and Clear?

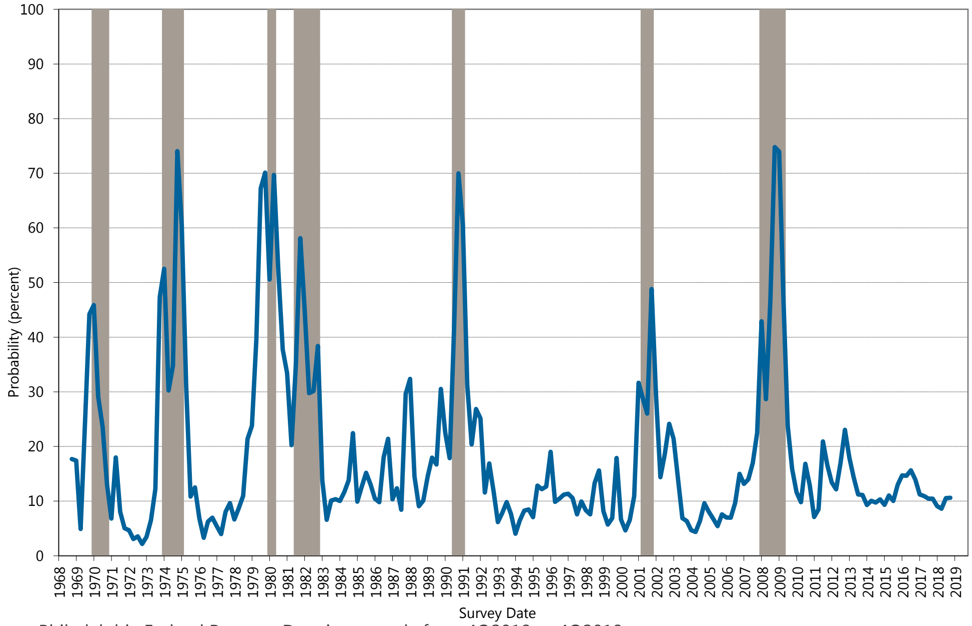
"My boy, one small breeze doesn't make a wind storm"

– John McGraw

Against the backdrop of a slowdown in global growth, increasing market volatility, and ongoing US – China trade tensions, we see investors evaluating signals that have historically been good indicators of economic health. At the same time, the US monetary policy continues to be a focus, given the heightened sensitivity around potential policy errors as the Federal Reserve ("Fed") maintains its path of quantitative tightening. Likewise, in Europe, the European Central Bank ("ECB") is being closely scrutinized for its policy moves. Despite pockets of softer-than-expected data, it is fair to say the economic outlook, in general, has not changed significantly in early 2019; however, what has changed is perception of market risks, as implied by the changing shape of the yield curve. The inversion of the yield curve (i.e., interest rate environment in which long-term debt instruments have a lower yield than short-term debt instruments of the same credit quality) has attracted much attention in recent months as the barometer for predicting an imminent recession. But, in our view, we have not reached the tipping point of recession as some may believe. We highlight below key considerations that inform and guide our perspective as we navigate the current investment environment, and offer a brief asset class outlook.

The Fed: In the final months of 2018, markets seemed convinced that the Fed was likely to drive the US economy into an eventual recession through the perceived restrictive monetary policy. In an attempt to calm markets, following a sharp sell off in equities and further flattening of the yield curve, Chairman Powell stated that the Fed is not on a predetermined path to raise the Fed funds rate, and he reiterated that the Federal Open Market committee ("FOMC") is very much data dependent and is capable of adjusting policy immediately to respond to weaker economic conditions by exhibiting patience and balance sheet flexibility. Importantly, he also highlighted that the Fed is watching and listening to financial markets, in addition to monitoring incoming data.

The Anxious Index: Probability of Decline in Real GDP in the Following Quarter



As of 13 November 2018. Source: Philadelphia Federal Reserve. Data is quarterly from 4Q2018 to 4Q2018

Our current expectation is only one more tightening towards the middle of the year.

The Yield Curve: Headlines have pointed out that every recession since WWII has been preceded by an inverted yield curve. Historically, recessions have materialized 6-24 months after the inversion of the yield curve; but current rates of consumption, investment, and employment in major developed markets are inconsistent with historical data that preceded a recession. Given the characteristics of the protracted economic cycle, a question we ask is; "could a recession, signaled by an inverted yield curve, take longer than what history tells us?" Our assessment leads us to assign a higher probability of a soft landing versus a recession.

US-China Trade War: As of now, from the perspective of global economic growth, the effect of the US - China trade war is likely to be mildly negative across global economies, but manageable. In recent weeks, the 90-day truce (which ends March 1) has helped to at least temporarily tone down the rhetoric and has provided markets with some relief. And while we acknowledge that the risk of escalating tensions still remains if no agreement is reached in upcoming negotiations, we also note the possibility that the situation dissolves with some level of satisfaction on both sides. The truce is clearly positive, the negotiations are difficult and protracted; however, willingness to reach a deal is evident, in our view. We wait to see if this situation proves to be more theatrical or if this conflict is a manifestation of an intractable disagreement over the future of global trade and supply-chains.

Investment Grade: The spread widening in the final weeks of 2018 and improvement in valuation levels have moved us to call for investment grade corporate spread tightening in 2019. The credit spread tightening, however, does not mean that the late cycle behavior witnessed in 2018 (i.e., higher volatility, increasing corporate "accidents") has been eliminated as a risk for this year. Our tightening of spreads is predicated on a view that the US economy (and the global economy for that matter) is in the midst of a slowdown, but not on the verge of a recession. The risk to our spread forecast is that the soft landing we anticipate turns into a more serious downturn that would negatively impact credit spreads.

Leveraged Finance (High Yield, Bank Loans, and European High Yield): We believe that the significant spread widening experienced in the fourth quarter 2018 provides a favorable total return opportunity for US high yield in 2019. We believe a supportive profit environment with modest improvement in corporate earnings, combined with strong company balance sheets and solid available liquidity should result in continued low default rates. Likewise, we believe the loan asset class looks attractive after the broad market sell off in the fourth quarter of 2018. In Euro high yield, we expect that the risks that have impacted 2018 will continue; and furthermore, as the credit cycle continues to age, we see risks for a growing number of companies taking actions more shareholder-friendly at the expense of bondholders. Overall, our concerns for 2019 include increased volatility related to the uncertain path of Fed policy, oil prices, trade negotiations, equity markets, and geopolitical issues. Italian budgetary negotiations, Brexit planning, as well as potential new political challenges created by Angela Merkel's departure, a new ECB president, and EU parliamentary elections will weigh on the European market.

Emerging Markets: We believe the risk to investors is to be too cautious in emerging market debt exposure in 2019, following the underperformance of the asset class in 2018. The recent 90-day postponement by the US of a proposed increase of tariffs is positive for EM growth prospects. Nevertheless, the largest downside risk for emerging markets today, we believe, is an escalation of trade tensions between the US and China. In addition, while we see attractive valuations in local currency assets and anticipate weakness in the US dollar, we are cognizant that local currency assets are likely to experience volatility given the direct currency exposure in a global slowdown. In general, our base investment case remains that moderating global growth, limits to the rise in core bond yields, a likely weaker US dollar, modest external sovereign refinancing requirements and positive fundamental developments in several EM countries, along with better valuations, are favorable conditions for EM debt over the next twelve months.

STONE HARBOR ECONOMIC AND MARKET OUTLOOK (31 December 2018; Forecast Period: Next 12 months)

	Rapid Growth	Moderate Growth	Slow Growth	Recession
ECONOMY				
Real GDP	3.1	2.2	1.5	0.0
Inflation	2.7	2.2	1.9	1.2
MARKETS				
Fed Funds	3.2	2.7	2.2	1.4
2yr Treasury	3.5	2.9	2.3	1.7
10yr Treasury	3.8	3.1	2.5	2.0
PROBABILITY (%)[1]	20	50	20	10

[1]Stone Harbor assigns probability that each scenario occurs. 12-month forecasts are 4-quarter growth ending current quarter +1 year

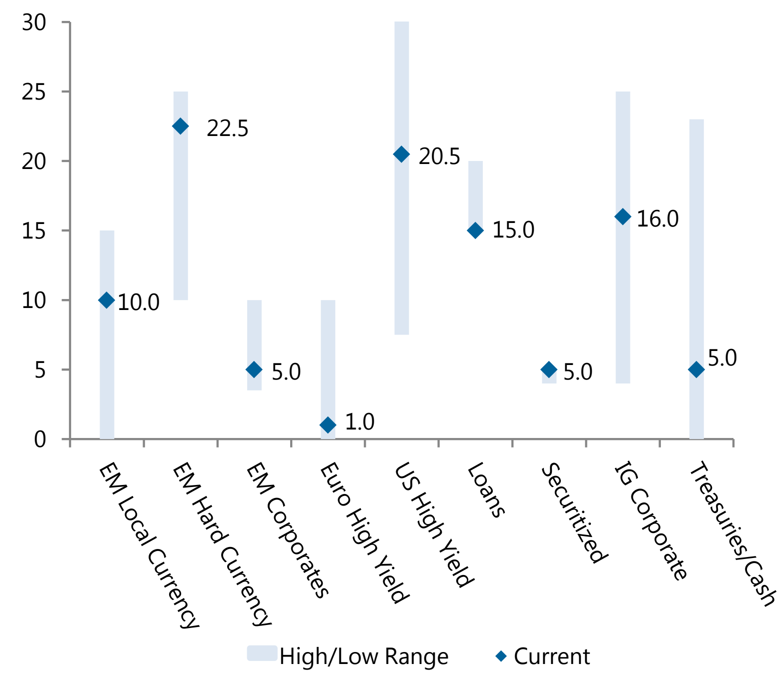
GDP Growth (%)					
	2017	2018	Q1 19 (f)[2]	Q2 19 (f)	Q3 19 (f)
US	2.2	2.7	2.2	2.2	2.0
Euro	2.5	1.7	1.5	1.3	1.5
EM	5.2	4.9	4.6	4.6	5.0

[2](f) - forecasted

Interest Rates (%)[3]			
	Fed Funds	2yr TBill	10yr TBill
Low	1.50	1.88	2.40
High	2.50	2.96	3.24
Current	2.50	2.49	2.68

[3]Current as of 31 December 2018; High-Low over last 12-months

MULTI-ASSET CREDIT TARGET ALLOCATIONS (%) SINCE INCEPTION AND RECENT ALLOCATION CHANGES[4]



Allocation Changes[5]		
	Month	Change (%)
EM Local Currency	April-May 2018	+2.5
EM Hard Currency	Oct-Nov 2018	+3.0
EM Corporates	May-June 2018	+1.5
Euro High Yield	Oct-Nov 2017	-2.5
US High Yield	Sept-Oct 2018	+8.0
Loans	Nov-Dec 2018	-5.0
Securitized	April-May 2018	+1.0
IG Corporate	Oct-Nov 2017	-0.5
Treasuries/Cash	Nov-Dec 2018	+5.0

[5]Latest allocation change

[4]Since Inception: September 2013. Multi-Asset Credit Representative Account Target Allocation as of 31 December 2018.

December 2018 CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	-2.19	1.35	-2.54	1.31	0.72	-0.44	1.18
Duration (Returns from Interest Rates %)	1.61	2.31	0.23	1.91	1.71	0.09	1.74
Credit Beta (Returns from Spreads %)	-3.80	-0.96	-2.77	-0.60	-0.99	-0.53	-0.56

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. Investments may not be made directly in an index. Actual allocations within any account may be significantly different from the target allocations shown here and do not reflect the impact of management 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, Singapore and Melbourne.
- Total assets under management: USD 26.25 billion as of 31 December 2018

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 FTSE High Yield Market Capped Index represents a modified version of the High Yield Market Index by delaying the entry of fallen angel issues and capping the par value of individual issuers at U.S. $5 billion par amount outstanding.

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.

Important Disclosures