Investment Policy Statement

A monthly review of the markets

Trade War Winners - Are There Any?

By most accounts, developed markets ("DM") growth remains on a healthy path and looks to hold relatively steady this year before slowing in 2019. Limited cyclical or systemic risks in the intermediate horizon have been a key consideration in the current growth outlook; however, heightened trade tensions and more aggressive tariffs from the U.S., combined with retaliatory measures, remain the central risk and may induce greater degree of growth uncertainty and market volatility. While this potential growth disrupter is leading headlines with a set of assumptions, a closer look highlights what we view as several "misconceptions", which include: 1) the impact of a trade war on the U.S. is less, relative to other regions, 2) the impact on China translates to a significantly negative global impact, with adverse consequences for emerging markets ("EM") economies, in particular, and 3) the impact of the current U.S. economic boom is limited for the rest of the world. These market views appear misguided to us based on available trade data; importantly, we believe that in the case of a full on trade war, select EM economies potentially stand to benefit from the trade dislocation.

First, in our view, the impact of a trade war on the U.S. may be greater than what markets anticipate. If we compare the dependence of the U.S. on exports with the dependence of the rest of the world on exports to the U.S., we can see that the U.S. is two times more exposed to exports to the rest of the world than vice versa (Figure 1). While the U.S. does hold substantially more bargaining power over specific trading partners, especially Mexico and Canada, due to large trade imbalances and the

Figure 1: The U.S. is more exposed to exports to the rest of the world than vice versa (U.S. share of global GDP<25%)

U.S. Trading Partner	U.S. exports to (in % of U.S. GDP)	U.S. imports from (in % of trading partner GDP)
Mexico	1.3%	27.2%
Canada	1.5%	18.1%
China	0.7%	4.1%
EU	1.7%	2.5%
World	8.0%	3.9%

Source: Haver Analytics; U.S. Department of Commerce; Stone Harbor Investment Partners LP. Data for 2017.

large relative size of the U.S. economy, the same can not be said for China, EU, and the rest of the world in aggregate. This means that if the trade war were to become more disruptive, the impact would clearly be felt in the U.S. This, in turn, would necessitate a de-escalation of tensions by the U.S.

Second, the impact of tariffs on China may not be as far reaching as markets fear, based on our analysis. The U.S. efforts to change global trade began with the threat of exiting North American Free Trade Agreement (NAFTA), but the efforts since have shifted and are acutely focused on China. While markets generally think that the implementation of suggested tariffs on Chinese goods would have a reverberating impact, in our view, the indirect impact of China tariffs through supply chains would mostly be contained within Asia, leaving the largest part of the investable EM debt universe mostly outside of the main reach of U.S. trade threats. Moreover, we see the potential for select EM economies to pick up market share and benefit from the trade dislocation. Many of the EM manufacturing countries, e.g., Hungary, Malaysia, Mexico, Poland, Taiwan, and Thailand, may be among the beneficiaries, in our view. Even commodity producers, such as Brazil, may experience increased demand for natural resources that are affected by Chinese tariff retaliation (e.g., soy beans).

Finally, we believe the impact of the current economic boom in the U.S. should not be underestimated. GDP in major advanced economies is growing above potential and the expansion of domestic demand is pulling in more imports from EMs. This is particularly evident in the U.S., where total imports grew by 9.2% year-over-year ("y/y") in Q1 2018. However, the economic reality is that the U.S. currently looks to be at its peak growth, and it would be a mistake to extrapolate that going forward. Fading tailwinds, primarily due to tax cuts, and strengthening headwinds, primarily due to trade-wars, point to a weaker U.S. growth going forward.

Historically, periods of widening advanced economy current accounts have been closely related to strong returns in EMD markets. The last time we saw a widening of similar scale was from 2002 to 2008 when we also saw strong performance across EMD assets. And it is worth pointing out that this also happened during a period of rising U.S. interest rates: U.S. Federal Reserve ("Fed") hiked rates by 425 basis points (bps) between 2003 and 2007. In this current cycle, the Fed has so far hiked rates by 175 bps and markets are pricing in roughly another 75 bps. From the perspective of global economic growth, we believe the effect of the trade war on growth is likely to be mildly negative across developed markets, but manageable. For emerging markets, the effects could indeed be positive for select economies with a competitive manufacturing base or natural resources, based on our analysis. Going forward, there is both the potential for further escalation or resolution, so while growth risk is clearly elevated, the direction of the risk is balanced, in our view.

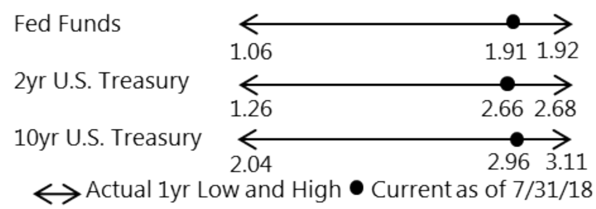
STONE HARBOR ECONOMIC AND MARKET OUTLOOK (31 July 2018; Forecast Period: Next 12 months)

U.S.	Rapid Growth	Moderate Growth	Slow Growth	Recession
ECONOMY				
Real GDP	3.2	2.2	1.5	0.5
Inflation	3.0	2.5	2.0	1.5
MARKETS				
Fed Funds	2.9	2.4	2.1	1.7
2-yr. Treasury	3.4	2.7	2.3	1.7
10-yr. Treasury	3.8	3.3	2.7	2.0
PROBABILITY (%)[1]	15	50	20	15

[1]Stone Harbor assigns probability that each scenario occurs.

GDP Growth (%)					
	2017	Q1 18	Q2 18	Q3 18 (f)	Q4 18 (f)
U.S.	2.3	2.2	3.7	3.4	2.8
Euro	2.6	1.5	1.8	1.6	1.7
EM	5.3	5.4	5.4	5.3	5.4

(f) - forecasted



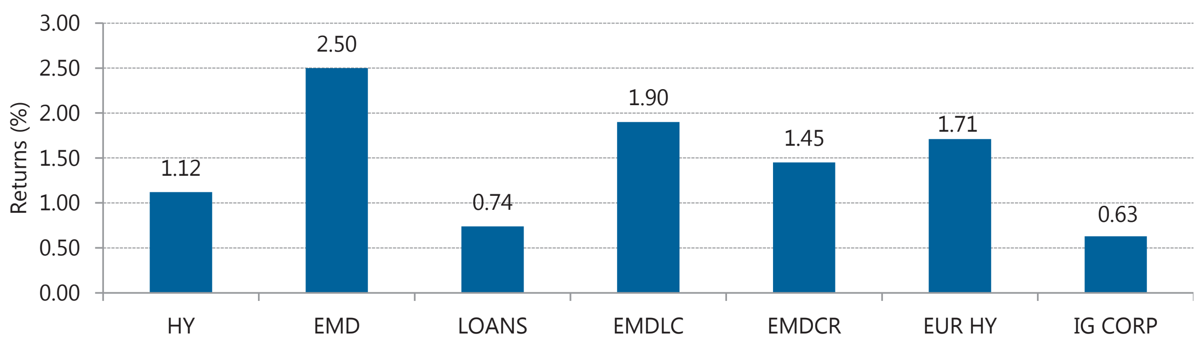
INVESTMENT STRATEGY OUTLOOK

Economic Analysis
- Fed tightening
- European Central Bank (ECB) potentially less accommodating
- Economic sentiment beginning to moderate
- Volatility Index (VIX) has corrected to higher levels

Valuation
- High Yield Corporate assets fair value on our cyclically adjusted view
- Emerging Market Sovereigns better value than High Yield Corporates

Sector Specialist Review
- Within High Yield most industries look moderately expensive, profits okay, some wage pressures
- Within Emerging Markets Debt, real yields and Local Currency look relatively attractive

July 2018 Credit Market Total Returns & Attribution



	HY	EMD	LOANS	EMDLC	EMDCR	EUR HY	IG CORP
Duration (Returns from Interest Rates %)	-0.25	-0.54	0.18	-0.37	-0.30	-0.36	-0.52
Credit Beta (Returns from Spreads %)	1.37	3.09	0.56	2.27	1.75	2.07	1.15

Multi-Asset Credit Representative Account Target Allocation as of 31 July 2018

Target Allocation	12.5%	22.5%	20.0%	10.0%	5.0%	1.0%	29.0%

Credit Market Total Returns reflect performance of representative asset class benchmarks. 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 than 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: 30.8 billion as of 30 June 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 **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 **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 **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 **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.

Important Disclosures