Investment Policy Statement

A monthly review of the markets

ESG: How is it Relevant and Impactful in Fixed Income Investing?

"You can never have an impact on society if you have not changed yourself."

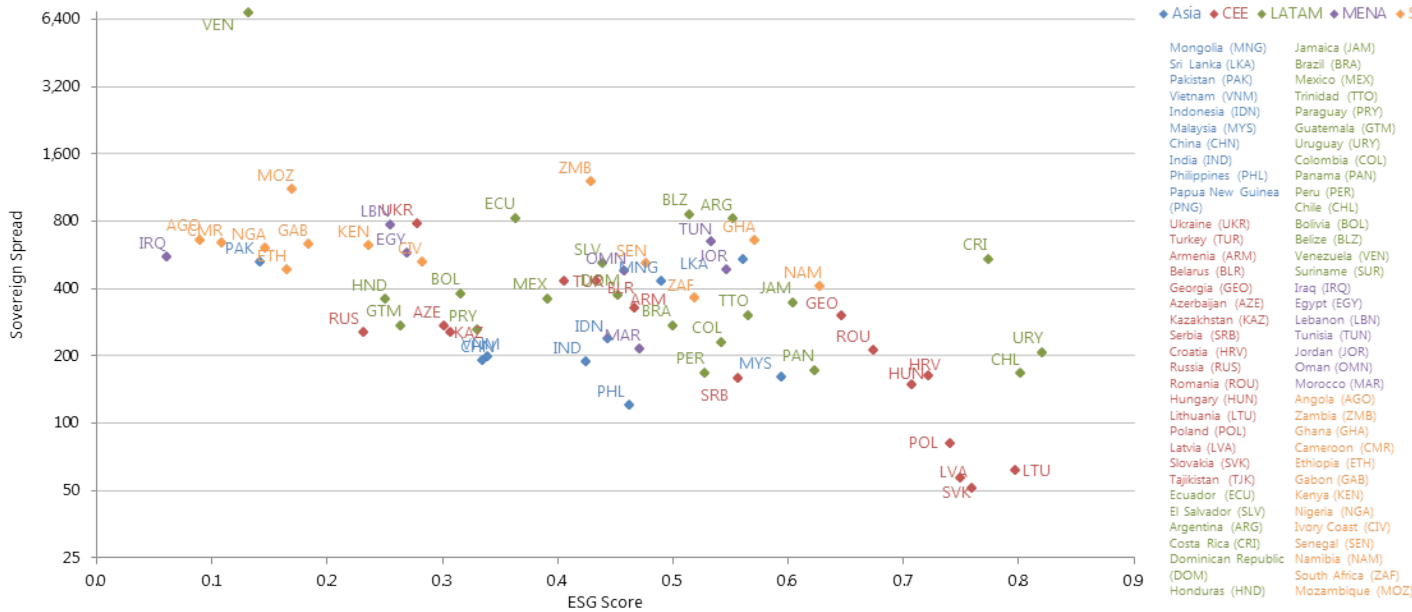
– Nelson Mandela

Over 25% of professionally managed assets globally (i.e., $22.9 trillion) are invested in responsible investment strategies, according to Global Sustainable Investment Alliance. And while the majority of these assets are invested in equity strategies, bond investors are actively participating in the growth of ESG investing through various approaches, including purchasing green, social and/or sustainable bonds, setting up ESG funds, benchmarking against ESG indices, and embedding ESG factors into the overall investment framework. From the perspective of many fixed income investment managers, integrating ESG factors into the investment process is complementary with fundamental credit analysis and engagement activities with sovereign and corporate issuers.

Of the primary ESG factors, governance is particularly important to bondholders due to the impact it can have on improving institutions and on the rule of law that supports economic development. From a bondholder's view, the sovereign's commitment to political stability and security, and the strength of the institutional framework that supports the financial sector should improve creditworthiness. Considerations that are particularly relevant in connection with corporate issuers include management incentives to ensure that their actions do not disadvantage bondholders in favor of stockholders, the historical record of the treatment of bondholders, the structure of the board of directors, the nature of the shareholding structure and the reputation and track record of shareholders having dominant stakes.

Social issues and environmental factors, while still relevant and important, are somewhat more narrowly applicable compared to the governance factor. For a bondholder, the ability to influence social issues (e.g., worker rights, fair pay and adequate living standards, etc.) is limited. However, where these social issues are inequitable, it often raises concerns about the stability of the country are raised, along with questions about the sovereign's

ESG Risks are Priced in EMD Markets: Countries with poor ESG scores face higher borrowing costs



As of 31 December 2018. Sources: Cato Institute, Transparency International, World Bank, Yale Center for Environmental Law, J.P. Morgan EMBI Spreads, Stone Harbor Investment Partners LP. ESG Scores are calculated and assigned by Stone Harbor Investment Partners LP. Higher ESG scores do not guarantee positive or higher performance results. For illustrative purposes only.

ability to service its debt. Environmental factors are extremely important in certain sectors, such as extractive industries. Credit analysts may examine the attitudes of companies toward safety and their responses to lapses and accidents, as mismanagement of environmental risks could have major economic ramifications for the company, affecting its debt servicing capabilities, as well as causing potential fatalities.

Improvements in ESG scores, particularly as they apply to governance, are often connected to better returns as the market prices in the improved fundamental (and thus lower risk premium). Therefore, the incentives for both issuers and investors to take actions to positively impact ESG scores are clear: improved ESG factors tend to be associated with lower spreads and thus better returns, benefitting bondholders; and countries and corporations that experience improving ESG scores also tend to undergo economic development and reduce their borrowing costs.

At Stone Harbor, we determine the impact of ESG factors on country or corporate fundamentals using our proprietary models. We derive aggregate scores based on the investment impact of specific factors, although, governance indicators dominate with respect to credit quality and spreads. Ultimately, we aim to anticipate future changes in ESG factors through our country research, political analysis, and research trips. For our EM corporate investments process, we incorporate a high level of active engagement with existing and potential issuers to ensure they meet or exceed the relevant criteria of our ESG diligence process.

Beyond our analysis of ESG factors, we also offer clients the flexibility to implement their own additional and specific ESG requirements. Stone Harbor has the ability to tailor segregated accounts to screen for geographic, sector or issuer-specific restrictions and upon request, we can create security lists and concentration limits that meet a client's own ESG criteria.

The increasing demand for fixed income ESG products have also led to the development of tools for investors. As a recent example, Morningstar introduced their Sustainability Rating, which measures how well the holdings in a portfolio are performing on ESG factors relative to a portfolio's peer group. The rating is a historical holdings-based calculation using company-level ESG analytics from Sustainalytics, a leading provider of ESG research. Fixed income ESG indices have also been developed to provide a comprehensive and efficient coverage of the investable universe. The JP Morgan ESG indices, for example, include issuers with better overall ESG scores and assigns larger weights to these issuers compared to the EMBI Global Diversified, GBI-EM Global Diversified, and CEMBI Broad Diversified benchmarks; green bonds have larger weight allocation compared to a conventional bond from the same issuer; and issuers that derive revenue from select sectors (e.g., thermal coal, tobacco, weapons) are excluded. For fixed income asset managers, tools that aid in analysis of ESG factors and provide better transparency are critical in managing ESG strategies.

Given the evolving nature and product proliferation of ESG strategies, we believe that fixed income asset managers with long-standing experience applying fundamental credit analysis to the practice of ESG investing, including the ability to monitor, manage and minimize specific ESG risks from portfolios, are poised to harness the growth trajectory of ESG investing and deliver favorable results to investors.

INVESTMENT STRATEGY OUTLOOK

Economic Analysis

- Fed approaching neutral
- ECB potentially less accommodating
- Economic sentiment data more cautious
- China easing

Valuation

- Broad long term valuations approaching fair value, in our view, but with disparity across asset classes
- Emerging Market Sovereigns look very cheap versus High Yield Corporates to us

Sector Specialist Review

- Within High Yield most industries look expensive to us
- Within Emerging Markets Debt, real yields and Local Currency look relatively attractive, in our view
- Markets appear to have priced in idiosyncratic risk

Stone Harbor Investment Partners

STONE HARBOR ECONOMIC AND MARKET OUTLOOK (28 February 2019; Forecast Period: Next 12 months)

	Rapid Growth	Moderate Growth	Slow Growth	Recession
ECONOMY				
Real GDP	3.1	2.2	1.5	0.0
Inflation	2.4	2.2	1.9	1.2
MARKETS				
Fed Funds	2.9	2.4	2.2	1.4
2yr Treasury	3.2	2.5	2.3	1.7
10yr Treasury	3.4	2.8	2.3	1.9
PROBABILITY (%)[1]	20	40	20	20

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

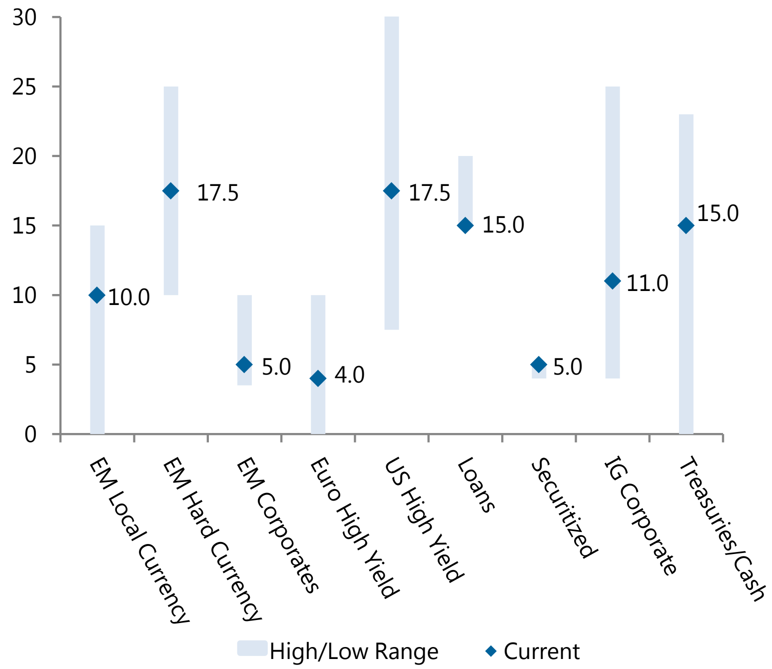
GDP Growth (%)					
	2017	2018	Q1 19 (f)[2]	Q2 19 (f)	Q3 19 (f)
US	2.2	2.9	1.4	2.0	2.1
Euro	2.5	1.8	1.3	1.5	1.6
EM	5.3	5.1	4.8	4.9	5.1

[2](f) - forecasted

Interest Rates (%)[3]			
	Fed Funds	2yr TBill	10yr TBill
Low	1.50	2.21	2.55
High	2.50	2.96	3.24
Current	2.50	2.51	2.71

[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]



[4]Since Inception: September 2013. Multi-Asset Credit Representative Account Target Allocation as of 28 February 2019.

Allocation Changes[5]		
	Month	Change (%)
EM Local Currency	April-May 2018	+2.5
EM Hard Currency	Dec-Jan 2019	-5.0
EM Corporates	May-June 2018	+1.5
Euro High Yield	Dec-Jan 2019	+3.0
US High Yield	Jan-Feb 2019	-3.0
Loans	Nov-Dec 2018	-5.0
Securitized	April-May 2018	+1.0
IG Corporate	Jan-Feb 2019	-5.0
Treasuries/Cash	Jan-Feb 2019	+5.0

[5]Latest allocation change

FEBRUARY 2019 CREDIT MARKET TOTAL RETURNS & ATTRIBUTION

	US High Yield	EM Hard	Loans	EM Local	EM Corp	Euro High Yield	IG Corporate
Total Return	1.69	1.00	1.59	-1.09	1.08	2.08	0.43
Duration (Returns from Interest Rates %)	-0.08	-0.31	0.20	-0.20	-0.13	-0.11	-0.27
Credit Beta (Returns from Spreads %)	1.77	1.31	1.39	-0.89	1.21	2.19	0.70

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

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 **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 U.S. Corporate Investment Grade Index** is a sub-index of the U.S. Aggregate Index. It measures the investment grade, fixed rate, taxable corporate bond market and includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.