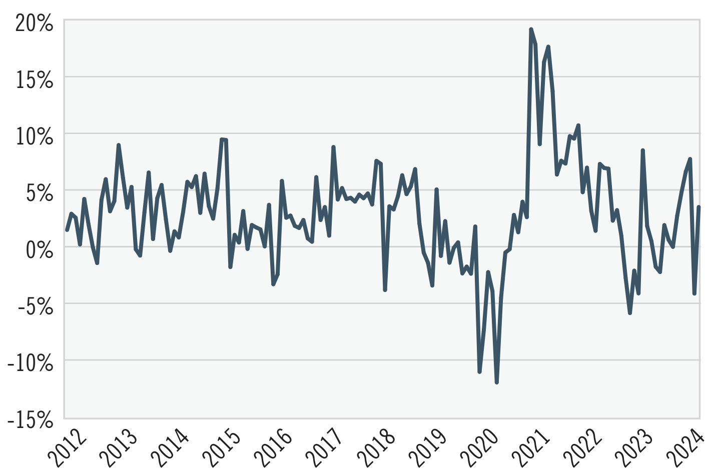
MARKET REVIEW

Gains from emerging markets (EM) debt moderated somewhat during the second quarter, as market participants continued to scale back expectations for the pace of U.S. Federal Reserve (Fed) easing in light of still-stubborn U.S. inflation readings. Core U.S. Treasury yields rose as the markets adjusted to a higher-for-longer level of U.S. short term interest rates. Total returns for emerging market hard currency sovereign securities remained positive, despite higher core rates and some widening of risk premia for the high yield sector of the market following two quarters of strong gains. Hard currency emerging market corporates outperformed during the quarter, supported by improving growth conditions in several key countries. Local currency emerging market debt underperformed, as the repricing of U.S. rate expectations supported the dollar on the foreign exchanges, and local yields also rose modestly, as tighter monetary conditions in the U.S. led to some scaling back of rate-cutting expectations. There was some improvement in the U.S. inflation data towards the end of the quarter, and—importantly—other developed markets central banks began their rate-cutting cycles, with easing by the European Central Bank (ECB), Swiss National Bank, Bank of Canada, and the Swedish Central Bank.

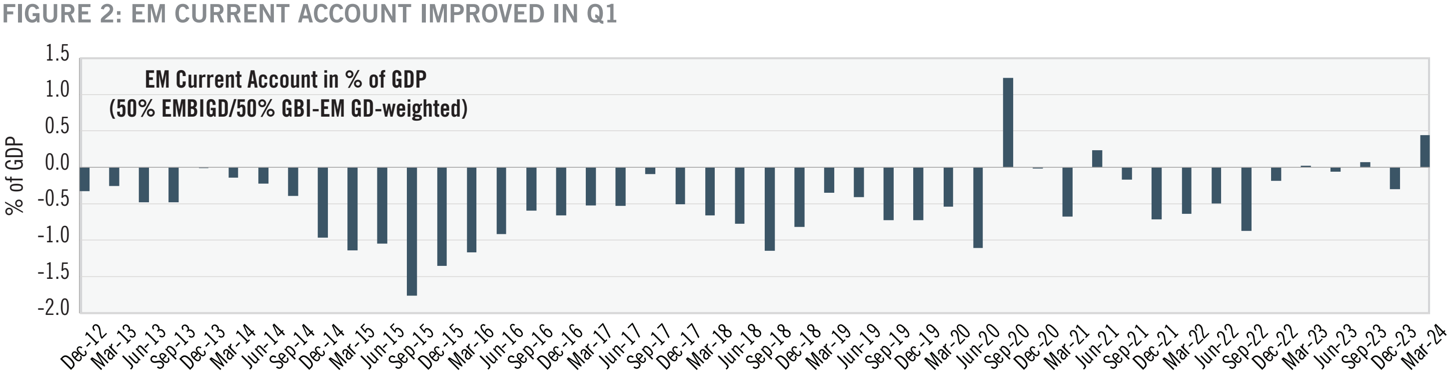
From a fundamental point of view, emerging markets continued to see, generally, easing inflation pressures. Growth readings have been supported by evidence of an upturn in the global trade cycle, with export volumes for emerging markets moving decisively higher for the first time since the pandemic-related surge in global goods demand faded in 2022 (see Figure 1). This should help to underpin growth in EM economies despite the move higher in core interest rates. Growth should also be supported as recent rate cuts feed through into activity. Evidence of an improvement in the external position for emerging markets can be seen in the current account data. External current account balances improved markedly in the first quarter of 2024 and, relative to GDP, reached the highest level in more than ten years (see Figure 2). Commodity price gains have been supportive, and EM currencies have generally been competitive as they have been held down by U.S. dollar strength. In addition, some countries—Argentina, Turkey, and Nigeria—have embarked on macro-stabilization programs, which involve a compression of import demand through a combination of tighter fiscal and/or monetary policy and often weaker exchange rates. This is an important development for the emerging markets, as stronger current accounts reduce external financing needs, allow FX reserve accumulation, and could underpin future FX appreciation.

FIGURE 1: EM EXPORT VOLUME HAS MOVED HIGHER (Y/Y)



As of April 30, 2024. Sources: Netherlands Bureau for Economic Policy Analysis, Stone Harbor Investment Partners. For illustrative purposes only.

FIGURE 2: EM CURRENT ACCOUNT IMPROVED IN Q1



As of June 30, 2024. Sources: Haver Analytics, Bloomberg, Stone Harbor calculations. Based on 52 EM countries reporting quarterly BOP data covering 97% of the J.P. Morgan EMBI Global Diversified Index. Data presented includes countries that have reported actual BOP data and Stone Harbor estimates for countries that have yet to report. For illustrative purposes only.

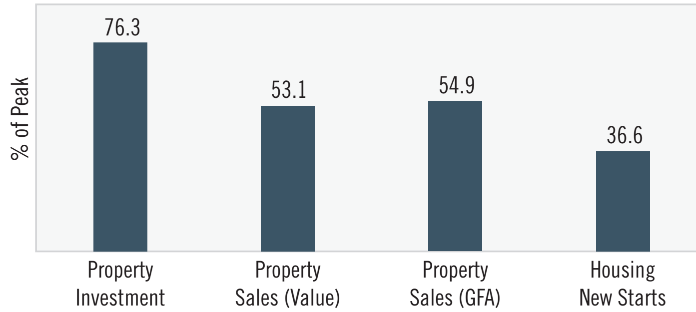
In China, the focus remains on whether the authorities will be able to reach the 5% GDP growth target against a backdrop of a still-weak property sector. There have been a number of piecemeal easing measures announced over the course of this year (see Figure 3), and there is some evidence that non-property sectors—primarily exports—are taking up some of the slack in the economy. However, further easing is likely to be required over the course of the year to try and rebuild fragile domestic confidence levels, and to try and stabilize the housing sector, which has been in decline for three years. Housing starts are running at just 40% of the peak levels (see Figure 4). In addition, China's Consumer Price Index (CPI) continued to hover close to deflationary levels, while producer price inflation has been negative since late 2022. With uncertainty likely to rise in the wake of the U.S. Presidential election, we would anticipate further easing measures over the balance of this year from the authorities in order to reach their growth target.

FIGURE 3: CHINA'S PROPERTY MARKET EASING MEASURES

Date	Areas	Policies
1/22/24	Capital Markets	State Council meeting discussed capital markets
1/24/24	Monetary, Property, Capital Markets	RRR cut and relending rate cut; SOE market cap Management
1/26/24	Property	Funding support for developers through "whitelist"
1/27/24	Property	Guangzhou eased purchase restrictions
2/6/24	Capital Markets	Central Huijin expanded scope of ET purchases
2/20/24	Property	25bps cut in 5yr LPR rate
2/23/24	Demand Side	CFEC meeting on large-scale equipment upgrade and trade-in schemes
3/5/24	Fiscal	Confirmed a modestly expansionary fiscal package for 2024
4/8/24	Monetary	Tighter regulation of "manual adjustment" of interest rates
4/29/24	Property	To tighten land supply in cities with higher housing inventory
4/30/24	Property	Politburo mentioned property destocking for the first time since 2016
5/9/24	Property	Hangzhou, Xi'an eased purchase restrictions
5/17/24	Property	Policy combo for property with downpayment ratio cut, mortgage rate floor removal, PBoC's relending to support government buyback
5/27/24	Property	Shanghai followed up with purchase restrictions easing and mortgage cuts
6/8/24	Property	State Council meeting pledged further policy support for property destocking

As of June 30, 2024. Sources: Citigroup, Stone Harbor Investment Partners.

FIGURE 4: CHINA'S HOUSING STARTS ARE AROUND 40% OF THE PEAK LEVELS



As of May 31, 2024. Sources: Citigroup, Stone Harbor Investment Partners.

Much of the focus in emerging markets during the second quarter was on the busy electoral cycle. In India, the world's largest democratic elections produced a surprise result, with Prime Minister Narendra Modi's BJP party unexpectedly losing their majority in Parliament, despite the landslide victory that had been predicted by the exit polls. While the BJP remained the largest single party, it now has to rely on its allies within the National Democratic Alliance (NDA) coalition to form a government. While there was some re-pricing of Indian assets in the wake of the results, the underlying strength of the economy, combined with likely policy continuity by the coalition, stabilized sentiment relatively quickly.

In Mexico, Andres Manuel Lopez Obrador's anointed successor—Claudia Sheinbaum—secured a much larger victory for the ruling Morena party than had been predicted by the opinion polls. Morena's control of both chambers of Congress was seen as raising the risks of constitutional reforms that may water-down Mexico's attractiveness for investors. President-elect Sheinbaum has tried to signal policy continuity, fiscal prudence, and respect for central bank independence. However, plans for judicial reform to allow for the public election of justices could potentially degrade the institutional structure in Mexico, as the election of judges could favor the party in power. There was a sharp correction in Mexican asset prices following Sheinbaum's victory, with the Mexican peso falling on the foreign exchanges. The Mexican Central Bank paused its rate-cutting cycle in order to try and re-establish support for the currency.

Finally, the elections in South Africa saw an unprecedented decline in support for the ruling ANC party, which experienced its worst election result since the end of apartheid 30 years ago, losing its majority in Parliament for the first time. The loss of support reflected both disappointment with lackluster

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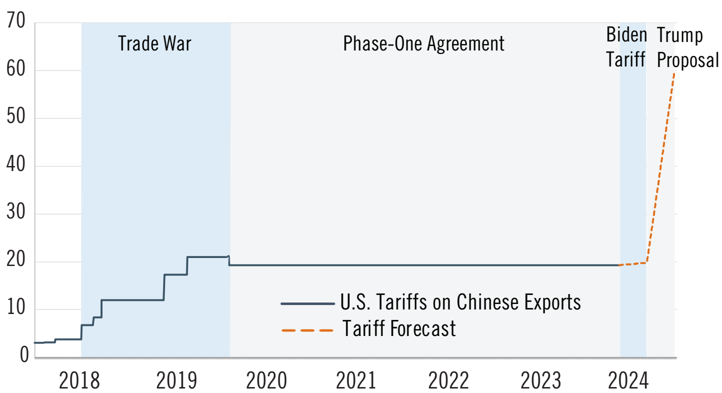
economic growth over recent years, together with a surprisingly strong showing for former President Jacob Zuma's newly-formed MK party. Following the election, President Cyril Ramaphosa announced the formation of a Government of National Unity (GNU), which included members of the Democratic Alliance—historically the largest opposition party to the ANC—in cabinet positions. This move was seen as improving the chances for more meaningful reforms to be introduced in South Africa over coming years, providing the coalition can be kept intact.

Probably the most significant political risk for the emerging markets will be this November's Presidential election in the U.S., where uncertainty remains very high. Much of the focus will likely be on protectionist trade policies (see Figure 5). Recently, President Joe Biden announced a 100% tariff on electric vehicles from China. However, this would likely only increase modestly the average tariff rate on imports from China, owing to its narrow focus. Former President Donald Trump, the Republican nominee for November's election, has in contrast proposed a massive 60% tariff on all Chinese imports. This would have a much clearer impact on Chinese trade and highlights the importance of the discussion around protectionist policies in the run-up to the November elections.

FIGURE 5: U.S. AND CHINA'S PROTECTIONIST TRADE POLICIES THE MOST SIGNIFICANT POLITICAL RISK FOR EMERGING MARKETS (%)



As of June 30, 2024. Sources: Chad P. Bown. 2023. US-China Trade War Tariffs, Stone Harbor Investment Partners. For illustrative purposes only.

TECHNICALS

Sovereign debt issuance in Q2 slowed down moderately compared to the large issuance in Q1 from US$85 billion in Q1 to US$28 billion in Q2. Year-to-Date (YTD) issuance now stands at US$120.3 billion, which outpaces 2023 for the same period. Issuance YTD was driven by investment grade issuers, which account for US$94 billion in total issuance. Select HY countries have engaged in primary market activity, mostly from the BB rated category including, Brazil, Serbia, and Dominican Republic.

Corporate debt issuance for Q2 recorded US$96 billion in primary market activity, which is below the 5-year average but higher compared to last year. Net financing for the quarter was negative US$35 billion and was driven by larger cash flows. YTD issuance is US$209 billion, which is up 50% compared to the same period last year.

According to flow tracker EPFR Global Data, EM debt portfolios posted outflows for Q2 2024, totaling approximately US$2.5 billion. Local currency portfolios recorded outflows of US$3.7 billion and hard currency funds experienced inflows of US$1.3 billion. YTD, EM debt portfolios recorded total outflows of US$13 billion.

BENCHMARK PERFORMANCE

External Sovereign Debt

The J.P. Morgan EMBI Global Diversified posted a total return of 0.30% during Q2 2024. Total returns were driven by spread compression and carry, which contributed 0.32%, while rising U.S. Treasury yields detracted moderately from the benchmark's total return. Average EM spreads excluding Venezuela—Venezuela was added to the index in April and contributed to a technical increase in average benchmark spread—declined by 7 basis points (bps). Spreads in all regions, aside from the technical increase in Latin America due to Venezuela, declined. The U.S. Treasury 10-year yield increased by 20 bps to 4.40%.

Investment Grade: The investment grade (IG) segment of the benchmark delivered a total return of 0.32% and the average IG spread declined by 5 bps. The top performing IG countries were Panama, Kazakhstan, and India, which had total returns of 2.2%, 2.0%, and 1.0%, respectively. Mexico, Malaysia, and Urugay were the largest underperformers with total returns of -1.4%, -0.5% and -0.3%, respectively.

Non-Investment Grade: Non-investment grade (HY) bonds in the benchmark performed in line with investment grade bonds and returned 0.28% during the quarter. South Africa (+3.7%), Turkey, (+1.8%) and Argentina (+4.0%) were the largest contributors to total return, while Ecuador (-3.8%), Ukraine (-4.0%), and Venezuela (-8.0%) were the largest detractors.

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Local Currency Debt

The J.P. Morgan GBI-EM Global Diversified delivered a total return of -1.63% for Q2. Negative returns were driven by spot currency returns of -2.5% relative to the U.S. dollar, while return from duration and carry was 0.87%. The U.S. dollar appreciated by 1.3% relative to its largest trading partners.

Currencies: EM currencies depreciated by 2.5% relative to the U.S. dollar. Currencies from Latin America were the largest underperformers with Brazil, Mexico, and Colombia delivering spot currency returns of -9.8%, -9.1%, and -6.7%, respectively. Currencies from Mexico underperformed on election volatility. Brazil underperformed its peers as inflation edged slightly higher to 3.9% in May from 3.7% in April, which caused markets to price in potential rate hikes. The top performing currencies were from the Middle East and Africa. The South African rand was the top performing currency, appreciating by 3.7% following the election, which we believe may open up the path for meaningful reforms.

Interest Rates: The local currency benchmark average yield followed U.S. Treasury yields higher and increased by 33 bps to 6.6%. Returns from duration and carry were led by countries from the Middle East and Africa, where yields declined on average by 75 bps. Yields from South Africa and Turkey were the top performers as yields declined by 75 bps and 87 bps, respectively. The largest increase in yields came from Brazil, Uruguay, and Mexico, where yields increased by 166 bps, 65bps, and 62bps, respectively.

Corporate Debt: The J.P. Morgan CEMBI Broad Diversified delivered a total return of 1.49% for the quarter. Total return was driven by returns from spread and carry of 1.0% as the average spread tightened by 11 bps. The HY segment outperformed the IG segment as spreads tightened by 24 bps for HY bonds and 9 bps for IG bonds, on average. The HY segment posted a total return of 2.1%, while the IG segment returned 1.1% for the quarter. EM corporate bonds, on average, outperformed the U.S. IG and U.S. HY asset class for the period.

At the industry level, all sectors had positive total returns. The real estate and metals & mining sector were the top performers, while the industrial sector lagged the benchmark. Within the real estate sector, China, Singapore, and Hong Kong were the top performers as further aid for China's property market was announced, easing restriction on property purchases in several of China's largest cities. Peru, India, Zambia, and South Africa all had strong positive returns in the metals and mining sector, while Israel and Ukraine were the largest detractors in the industrial sector.

At the regional level, all regions delivered a positive total return. Africa was the top regional performer with a total return of 2.7%, led by South Africa and Zambia, while bonds from the Middle East lagged the benchmark modestly with a total return of 0.9%.

OUTLOOK

Our Base Case (40% probability) assumes that inflation will continue to gradually decline, opening up the path for a data-dependent Fed to begin cutting interest rates this year, with further cuts also from the ECB and emerging market central banks. China is expected to enact further stimulus measures to reach their GDP growth forecast of 5% for this year. The major risks we have identified consist of inflation remaining stubborn, but we have also tried to analyze the risks in both declining and sticky inflation environments under a potentially new Administration following the U.S. Presidential election. The likely implementation of widespread tariffs under a Trump presidency would likely occur both in the declining and stubborn inflation environments, leading to some lowering of growth expectations if they were to be implemented.

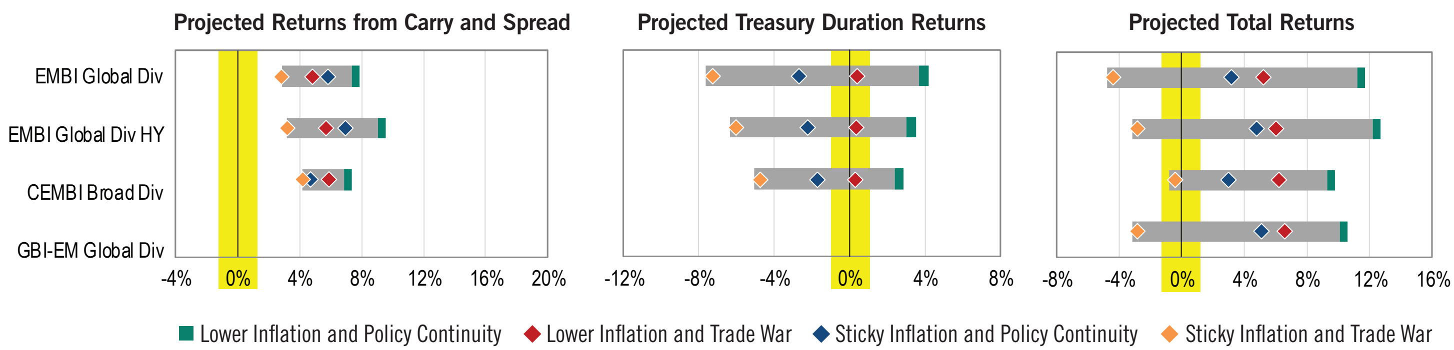
For external markets, returns in the Base Case will likely be driven primarily by lower U.S. Treasury yields in a benign environment, with modest scope for tighter risk premia in an environment of improving credit quality among emerging market sovereigns. Total return expectations would be pared back if still-high inflation keep the Fed on hold for a longer period of time, and the imposition of widespread tariffs would also lead to somewhat higher risk premia, as there would be greater uncertainty and downside to global growth expectations.

Within the local currency space, the Base Case of Fed interest rate reduction would likely open the path for some modest currency appreciation of emerging currencies versus the U.S. dollar. At the same time, ongoing monetary easing in EMs would remain intact, bringing yields somewhat lower. Again, the main risk from a total return viewpoint would be a lack of action from the Fed, especially if combined with the introduction of tariffs, which would likely incentivize local governments to weaken their currencies in order to maintain competitiveness of their exports.

continued

FIGURE 6: 12-MONTH MACROECONOMIC SCENARIOS AND PROJECTED RETURNS AS OF 15 MAY 2024

	Gradually Declining Inflation and Policy Continuity	Gradually Declining Inflation Interrupted by Trade/Tariff Wars	Sticky Inflation and Policy Continuity	Sticky Inflation Exacerbated by Return of Trade/Tariff Wars
Probabilities	40%	25%	15%	20%
Inflation	Lower	Lower	Elevated	Elevated
Growth	Stable	Stable	Stable	Stable
Macroeconomic Assumptions				
U.S. Real 4Q GDP (%)	1.75	1.50	2.50	2.00
EM 4Q GDP (%)	4.00	2.75	4.50	3.00
China 4Q GDP (%)	4.75	2.50	5.00	2.75
Brent	$80 bbl	$75 bbl	$90 bbl	$100 bbl
U.S. Core PCE (%)	2.25	2.75	3.00	3.50
Fed Funds (%)	4.38	4.88	5.38	5.38
2yr U.S. Treasury (%)	3.75	4.75	5.10	5.50
10yr U.S. Treasury (%)	3.75	4.25	4.75	5.50
10yr Bund (%)	2.00	3.50	3.00	3.50
SHIP Total Return Forecasts (%)				
EMBI GD	11.3	5.3	3.2	-4.4
EMBI GD HY	12.3	6.0	4.8	-2.8
CEMBI BD	9.4	6.2	3.0	-0.4
GBI-EM GD Local Rates	9.1	9.6	6.7	2.9
GBI-EM GD FX	1.1	-3.0	-1.6	-5.7



Source: Stone Harbor Investment Partners. The projected returns are not a prediction of the future results of any Stone Harbor portfolio. The portfolio management team refers to the charts above as one of various factors when making allocation decisions. The charts demonstrate scenarios assumptions which Stone Harbor uses in analysis to determine projected returns. Unless otherwise specified, scenario assumptions and base case returns summarize the team's 12 month return projections and outlook. Data reflects the views of the portfolio management team as of the date hereof and is subject to change without notice. Our analysis does not guarantee performance results. For illustrative purposes only.

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Authored by:

The Stone Harbor Emerging Markets Debt Team

Stone Harbor Investment Partners is a global credit specialist with expertise in emerging and developed markets debt, with three decades of informed experience allocating risk in complex areas of the fixed income markets. The firm manages credit portfolios for clients globally.

The **J.P. Morgan 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 (EMBIG)** tracks total returns for U.S. dollar-denominated debt instruments issued by emerging markets sovereign and quasi-sovereign entities: Brady bonds, loans, and Eurobonds. 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** 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 **Bloomberg Treasury Index** tracks the obligations of the U.S. Treasury with a remaining maturity of one year or more. The **ICE BofA US High Yield Constrained Index** contains all securities in the US 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 index is calculated on a total return basis. The **Bloomberg U.S. Aggregate Bond Index** measures the U.S. investment grade fixed rate bond market. The index is calculated on a total return basis. The **Bloomberg U.S. Corporate Investment Grade Bond Index** measures performance of investment grade corporate bond funds. The index is calculated on a total return basis. The **Bloomberg Global Aggregate Bond Index** measures the global investment grade fixed rate bond market. The index is calculated on a total return basis. The **U.S. Dollar Index** is a relative measure of the U.S. dollars strength against a basket of six influential currencies, including the euro, pound, yen, Canadian dollar, Swedish korner, and Swiss Franc. The **J.P. Morgan CEMBI Broad Diversified Investment Grade Index** tracks total returns of U.S. dollar-denominated debt instruments issued by corporate entities in emerging market countries rated BBB and higher. The index uses a limited portion of the current face amount outstanding of larger countries within the CEMBI index. Minimum face amount outstanding required is $300 mm. The index limits the weights of 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 CEMBI Broad Diversified High Yield** 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 that have a rating of BB and below. The **J.P. Morgan EMBI Global Diversified High Yield** tracks total returns for U.S. dollar-denominated debt instruments issued by emerging markets sovereign and quasi-sovereign entities: Brady bonds, loans, and Eurobonds that have a rating of BB and below. The **J.P. Morgan EMBI Global Diversified Investment Grade Index** tracks total returns for U.S. Dollar-denominated debt instruments issued by emerging markets sovereign and quasi-sovereign entities: Brady bonds, loans, and Eurobonds that are rated BBB and higher. The indexes are unmanaged, returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

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