

Manager Commentary

Technically-driven sell-off hurts most EM currencies in May

By: Eric Fine, Portfolio Manager

Overview

Emerging market (EM) debt remains vulnerable to a double-whammy of a rising dollar and rising U.S. Treasury yields. EM debt is being buffeted not only by the sell-off in duration that has hit all fixed income asset classes but by additional risks emanating from any generalized rally in the U.S. dollar. Although a few specific buying opportunities (e.g., Philippines, and Uruguay local currency) may have emerged, a generalized buying opportunity (e.g., Mexico local currency) has not yet emerged in our view.

This sell-off is technically-driven, in our opinion. EM debt obviously attracted significant inflows as investors sought countries with strong fiscal policy and central banks that were relatively more focused on maintaining their currencies' purchasing power. It is possible that U.S. growth is generating the duration selloff, but unlikely, in our opinion. Unlikely, because countries that guarantee vulnerable financial systems rather than let them fail, and don't address the causes of any original insolvency, tend to grow slowly with high inflation for long periods of time. Similarly, we do not see any "taper" as behind the rates sell-off. Here, we see a very straightforward game theory, namely, that the Fed will "taper" if they can, and won't if they can't.

The only issue is what pain threshold at which asset price will trigger the "I can't taper any more" reaction from the Fed. Which adds to the troubles for EM debt, as their weakening means little to U.S. monetary authorities focused on U.S. risk-asset prices. Anyway, the EM debt market appears to be punishing the most crowded positions, as evidenced by Latin America's underperformance relative to Asia, for example. This seems similar for broader markets – much-hated gold has been stable despite the rates selloff, for example.

Declining commodity prices, particularly oil, could be another result of a stronger dollar, further pressuring the EM bond market. EM debt is over-represented by commodity exporters relative to the commodity-importers that generally characterize EM equities. Commodity prices, too, have benefited to some extent (the amount is debated) from an investor search for a stable store of value. This, plus the fact that commodities are priced in U.S. dollars, does point to risks of falling commodity prices. We view this as one of the key risks, generally speaking, to EM debt fundamentals.

However, Treasury selloffs are generally positive for EM debt fundamentals, as they reflect improving final demand. We recently analyzed the last 16 bear markets for U.S. Treasuries, and found that on average EM debt (hard- and local-) has generated positive returns during those bear markets, even though the Barclays U.S. Agg generated negative returns. This is consistent with our thinking, in a general sense, that rising yields are consistent with rising final demand, which is clearly positive for emerging economies. Despite this historical record, though, we believe that low spreads in hard-currency debt mean that such a record will not likely be repeated. We are only pointing out the record for its own sake and to reinforce the point that rising yields can be positive for debt that has value.

Also, although EM debt remains vulnerable, we do not see a bursting bubble nor do we see EM economies entering adverse feedback loops, as their balance sheets and policymakers have been honed by their own crises, and tested (more-or-less successfully) by subsequent crises in developed countries (e.g., U.S., Europe). This is not Latin America in the 1980s, when a Latin America that had excessive debt that was dollar-denominated met a rising-rate environment. This is not Asia in the late 1990s, when loose policy allowed banking and real estate assets to become overvalued, which then met another bout of US rate hikes. We are not saying higher rates are good for bond markets. We are saying that higher rates trigger crises due to a countries' initial conditions, and in EM these are largely okay.

To repeat what we've said in a variety of forums, EM economies generally have lower debts and deficits, more inflation-focused central banks, and higher real interest rates. Higher real rates and stronger balance sheets than developed markets are hard to argue with in the long run. EM debt, in our opinion, will be a larger part of global bond portfolios on a secular basis, and central banks will be a big part of this demand, as they seek bond markets backed by strong fiscal stances and central banks that protect the real value of money (relatively). These secular trends look to be set-back, but not derailed, in our opinion.

Our translation of this view (that EM debt is technically vulnerable, is not a bubble and a buying opportunity is brewing) for the portfolio is higher cash and diversification away from some commodity exporters.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time.

Mutual Funds

This risk-off is different than the one in 1Q13. The last risk off we worried about (March 2013), was not one in which U.S. yields rose. As a result, we could accommodate the risk we saw by increasing our allocations to high-rated hard-currency debt, where if the dollar rallied it didn't matter, and if U.S. yields declined you could actually benefit. This helped us perform during that risk-off period.

The current risk-off period (assuming it is not over), though, is characterized by both the dollar rallying and yields rising, so there is no obvious place to re-allocate as we did last time. As a result, raising cash is one answer. We'll allocate to some EM bond markets that sell-off too much in the near term, but the big lowering of cash would likely come when Mexico becomes attractive again (using Mexico as both a specific example of where we'd like to invest, and also as a barometer of EM currency generically), which we discussed above.

Commodity prices are a key translation mechanism from the dollar, U.S. rates, and global demand. The variable through which this particular risk-off period can affect us is commodity prices, as a strong dollar is generally consistent with declining commodity prices. As a result, we have a portfolio now that is a barbell of commodity exporters and importers.

For the exporters, we have high nominal and real yields that carry during periods of instability, and can revert the moment there is stability. In addition, they have strong balance sheets that can back a relatively stable currency (which inflation-focused central banks implement). Nigeria in local currency, high-yielding Venezuela in hard-currency, and Brazil in inflation-linked local currency are expressions of this.

On the other end, the importers, we have high real yields (not high nominal yields, which is a short-term risk) that could become even higher if commodity price declines are persistent. So, the protection of high real rates is already there, and disinflation or deflation will only strengthen that. Any period of stability would likely see the real yields decline (i.e., rates rally). Europe and Asia are nice locations for this. In Europe we have a still-deflationary region with countries such as Poland already in outright deflation. Romania is our preferred expression of this as they have the highest real yields, as well as a recent government and IMF program. The Philippines is another country with high real yields that could benefit from any decline in global inflation.

We should emphasize that we do not have generalized theories on the dollar, commodity prices or global interest rates, at least not to start. Our process is to find countries where we see value in their debt, and only then test the asset prices we like by asking "what if the market's worries about such-and-such continue?" Of course we have opinions on these broad variables, but my point is that this is not the starting point of the portfolio.

For example, Russian local currency debt is no longer in the portfolio due to its low real yields and because we see the country's budget as too optimistic about oil prices (current prices are below their assumption, which is not true for other countries) when we test it for this scenario.

Exposure Types and Significant Changes

We increased cash to around 7.50% from around 4.50%.

We further reduced our local-currency exposure to commodity-exporter Russia (to 0% from 8.9%), and increased our exposure to commodity-importers Philippines (to 10% from 7.7%), Romania (to 7.2% from 4.5%), and Poland.

Biggest Country- and Bond-Level Changes

- Our top five country exposures changed, and are now Nigeria (local), Venezuela (hard), Uruguay (local), Brazil (local), and Mexico (local and hard). Last month, our top five included Nigeria, Uruguay, and Mexico, but also had Russia, and Turkey in the top five.
- We increased our exposure to Venezuela hard-currency debt (to 14.2% from 6.9%), due to its continued sell-off, the partial pricing-in of political turmoil, and the chance that the recently-elected and embattled President could moderate his policy stances. It also continues to be difficult to find dollar-denominated debt that has value, and Venezuela is one of the few countries to have it. This means one leg of the technical pressure in EM debt markets – the dollar rally – is not a headwind for such positions.
- We closed our exposure to Russia (to 0% from 8.7%) due to the currency's vulnerability in the event of a sharper sell-off in commodity prices, and its lower real interest rates compared to alternative bond markets.
- We also increased our exposure to Philippine local and Brazil local, and closed our exposure to Malaysia local. All of these changes were relatively small.

Fund Performance

For May, the Fund returned -4.46%, compared to -6.25% in the local-currency index (GBI-EM Index), and -3.57% in the hard-currency index (EMBI Index). So far, the Fund has been able to navigate a tough year, generating a 0.30% year-to-date return, compared to -3.00% for the hard-currency debt index and -3.15% for the local-currency debt index (see standard returns on page 4).

The Fund's biggest winners in May were Indonesia (hard), Hungary (hard), and Malaysia (local), though they were "winners" mainly by not going down a lot. The Fund's biggest losers were Mexico (local and hard), Brazil (local), and Venezuela (hard). The market's best performers of the past month were Pakistan, Argentina, and Georgia in hard currency, and Hungary, Nigeria, and India in local currency. The markets' worst performers of the past month were Peru, Uruguay, and Colombia in hard-currency, and South Africa, Brazil, and Mexico in local-currency.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time.

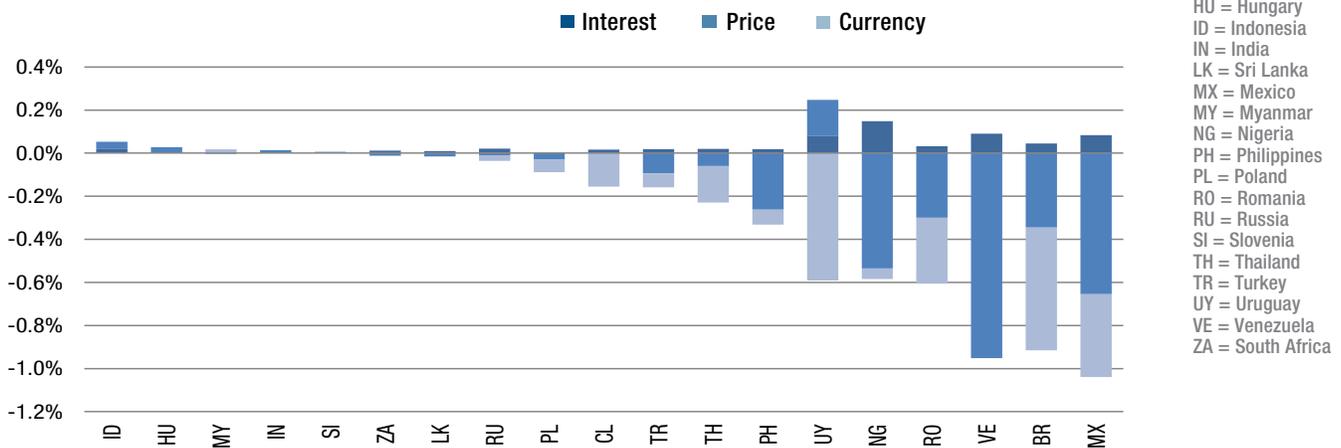
Mutual Funds

History of U.S. Treasury Sell-Offs - Impact on Emerging Market Bonds

Rising Rates Start Date	Rising Rates End Date	Length (Months)	10-Year Treasury Yield Change	Barclays Aggregate Index Return	GBI-EM Index Return	EMBI Index Return
1/31/1996	8/30/1996	7	1.4%	-1.8%	--	11.2%
11/29/1996	3/31/1997	4	0.9%	-1.5%	--	1.3%
10/5/1998	1/21/2000	16	2.6%	-2.3%	--	36.0%
11/7/2001	4/1/2002	5	1.2%	-2.4%	--	8.2%
6/13/2003	9/3/2003	3	1.5%	-4.5%	-3.7%	-3.8%
3/16/2004	6/14/2004	3	1.2%	-4.3%	-3.1%	-6.5%
6/1/2005	6/28/2006	13	1.4%	-1.3%	4.7%	4.8%
3/5/2007	6/12/2007	3	0.8%	-1.8%	7.1%	-0.9%
3/17/2008	6/16/2008	3	1.0%	-2.2%	-1.3%	0.6%
12/30/2008	6/10/2009	5	1.9%	-0.5%	7.3%	14.9%
11/30/2009	4/5/2010	4	0.8%	-0.5%	6.0%	4.9%
10/8/2010	2/8/2011	4	1.3%	-3.1%	-2.4%	-3.5%
9/22/2011	10/27/2011	1	0.7%	-1.7%	6.9%	3.0%
1/31/2012	3/19/2012	2	0.6%	-1.2%	1.3%	3.1%
7/24/2012	9/14/2012	2	0.5%	-0.7%	5.4%	4.0%
12/6/2012	3/11/2013	3	0.5%	-1.0%	3.7%	-0.3%
Average on periods with GBI-EM data			1.0%	-1.9%	2.7%	1.7%
Average on periods with EMBI data			1.1%	-1.9%	--	4.8%

Source: Bloomberg Research, Van Eck Global.

Price, Interest and Currency ("FX") Components of Fund Returns by Country



Source: Van Eck Global. Data as of May 31, 2013.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time.

Mutual Funds



Average Annual Total Returns (%) as of May 31, 2013

	1 Mo ¹	YTD	Life
Class A: NAV (Inception 7/9/12)	-4.46	0.30	11.39
Class A: Maximum 5.75% load	-9.95	-5.45	5.01
GBI-EM Index	-6.25	-3.15	--
EMBI Index	-3.57	-3.00	--

Average Annual Total Returns (%) as of March 31, 2013

	1 Mo ¹	YTD	Life
Class A: NAV (Inception 7/9/12)	-0.30	2.89	14.27
Class A: Maximum 5.75% load	-6.07	-3.01	7.72
GBI-EM Index	-0.52	-0.12	--
EMBI Index	-0.62	-2.26	--

Expenses: Class A: Gross 1.67%; Net 1.25%. Expenses are capped contractually until 05/01/14 at 1.25% for Class A. Caps exclude certain expenses, such as interest. The tables present past performance which is no guarantee of future results and which may be lower or higher than current performance. Returns reflect applicable fee waivers and/or expense reimbursements. Had the Fund incurred all expenses and fees, investment returns would have been reduced. Investment returns and Fund share values will fluctuate so that investor's shares, when redeemed, may be worth more or less than their original cost. Fund returns assume that dividends and capital gains distributions have been reinvested in the Fund at NAV. Index returns assume that dividends of the Index constituents in the Index have been reinvested.

Data Source: Van Eck Research, Factset. All weightings as of May 31, 2013.

Emerging Markets Hard Currency Bonds refers to bonds denominated in currencies that are generally widely accepted around the world (such as the US Dollar, Euro or Yen). **Emerging Markets Local Currency Bonds** are bonds denominated in the local currency of the issuer. **Emerging Markets Sovereign Bonds** are bonds issued by national governments of emerging countries in order to finance a country's growth. **Emerging Markets Quasi-Sovereign Bonds** are bonds issued by corporations domiciled in emerging countries that are either 100% government owned or whose debts are 100% government guaranteed. **Emerging Markets Corporate Bonds** are bonds issued by non-government owned corporations that are domiciled in emerging countries. A **Supranational** is an international organization, or union, whose members transcend national boundaries and share in the decision-making. Examples of supranationals are: World Bank, IMF, World Trade Organization.

Any indices listed are unmanaged indices and include the reinvestment of all dividends, but do not reflect the payment of transaction costs, advisory fees or expenses that are associated with an investment in the Fund. An index's performance is not illustrative of the Fund's performance. Indices are not securities in which investments can be made. The J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) tracks local currency bonds issued by Emerging Markets governments. The index spans over 15 countries. The J.P. Morgan Emerging Markets Bond Index Global Diversified (EMBI) tracks returns for actively traded external debt instruments in emerging markets, and is also J.P. Morgan's most liquid U.S-dollar emerging markets debt benchmark. The Barclays U.S. Aggregate Bond Index is a market capitalization-weighted index representing most U.S. traded investment grade bonds. The index comprises government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the market. The maturity of the bonds in the index are over one year.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Non-Van Eck Global proprietary information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission of Van Eck Securities Corporation ©2013 Van Eck Securities Corporation.

You can lose money by investing in the Fund. Any investment in the Fund should be part of an overall investment program, not a complete program. The Fund is subject to risks associated with its investments in emerging markets securities. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. As the Fund may invest in securities denominated in foreign currencies and some of the income received by the Fund will be in foreign currencies, changes in currency exchange rates may negatively impact the Fund's return. Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. The Fund may also be subject to credit risk, interest rate risk, sovereign debt risk, tax risk, non-diversification risk and risks associated with non-investment grade securities. Please see the prospectus and summary prospectus for information on these and other risk considerations.

Please call 800.826.2333 or visit vaneck.com for performance information current to the most recent month end and for a free prospectus and summary prospectus. An investor should consider the Fund's investment objective, risks, and charges and expenses carefully before investing. Bond and bond funds will decrease in value as interest rates rise. The prospectus and summary prospectus contain this as well as other information. Please read them carefully before investing.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

vaneck.com | 800.826.2333

Van Eck Securities Corporation, Distributor
335 Madison Avenue | New York, NY 10017

