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Manager Commentary

Emerging Markets Debt Acquitted as an Asset Class

By: Eric Fine, Portfolio Manager

Executive Summary

- Emerging market debt acquitted as an asset class, but subsequent rally surprisingly rapid
- Significant portfolio changes made over the past month
- With "fundamentals" "working", we believe value is in emerging market, not developed market, debt

Overview

Our thesis at the height of the panic exit from emerging markets (EM) debt two months ago was that the "fundamentals" were basically fine – debts were low, financial systems were healthy – so, a reasonable policy reaction, in our view, was to allow currency weakness and hike interest rates. We think both of these actions, on the part of monetary policy, would be sufficient to reduce the current account deficits that seemed to be the focus of market concern. The markets that attracted the most attention – India, Indonesia, and Brazil – all saw their monetary policy-makers implement some combination of tighter liquidity and higher interest rates. In each case, the currencies stabilized and rallied. Even countries that we believe have deeper problems which could remain unaddressed, like India, saw stability and then strength during September.

We had also argued that only one sentence on the Federal Reserve's (the Fed) taper should be uttered: the Fed will taper if it can, and if it cannot, it will not. Our point was, and continues to be, that Fed tightening is bounded – if it bites, the Fed will back away. The bottom line being that we do not think the Fed is not going to kill growth nor bankrupt the U.S. government. Now, repeating this indefinitely and the Fed likely loses credibility (or, loses more credibility)...but that is a key tailwind for EM debt. Namely, if central bank balance sheet expansion ("money printing" to some) is the primary reaction function of developed economies, the emerging central bank balance sheets are not expanding as much as the Fed's...print a lot of one thing and less of another and one of these likely becomes less valuable

We will not belabor this opinion beyond our exhibit on the next page. According to this exhibit, EM bonds are currently paying higher real rates than developed markets (DM) bonds, and this is especially been so when fundamentals are taken into account. Other central banks see this, in our opinion, which is why the Chinese central bank has cut its holdings of U.S. Treasuries almost in half over the past decade. Some Asian central banks have also offered swap lines to central banks such as Indonesia's. It appears that they want to face strong EM countries.

Inflation might be rising in some EM countries and some big-name countries, like India or even Brazil, are currently facing downgrades. We remain worried about India, South Africa, Turkey, and Malaysia. A U.S. dollar rally spurred by U.S. growth would hit EM foreign exchange. U.S. Treasury sell-offs would do the same. Our response, though, is the same. In our opinion, investors should own countries that can weather this, and position defensively (and always in liquid instruments) when risks are high, which we do not think is the case right now.

For the record, Brazil rallied so quickly that we were forced to temper our bullishness from the panic-time. Here's what changed: Most importantly, the currency rallied 10% from its weak point. Although we typically have a 6- to 12-month investment horizon this does not mean we automatically wait that long to realize profits or losses. Second, investors did a real 180-degree turn on Brazil, increasing exposure significantly after it rallied. One of our key arguments for bullishness was the lack of positioning by foreigners – that is no longer the case. Third, we believe recent ratings downgrades will test President Roussef – she will either prove to be an ideologue or a pragmatist; the ideologue will essentially ignore market signals, whereas the pragmatist will work with them, as her predecessor, President Lula, did.

Exposure Types and Significant Changes

We made a lot of changes to our portfolio, based largely on a) EM's acquittal as an asset class, and b) on a very-rapid rally in some of our exposures. While we cannot make asset-prices take the slow six to 12 months to rally, so if they do in one or two months what we thought would take six or more months, we are biased to close certain positions. There was no "theme" to describe our changes, so we give a detailed description of the changes below.

Our top five positions are currently Indonesia, Mexico, Argentina, Philippines, and Colombia. Our top five positions last month were Brazil, Indonesia, Nigeria, Russia, and Argentina. This is big change for us, and we emphasize again that if the market moves quickly, we believe we have no choice but to do so as well.

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.



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Biggest Country- and Bond-Level Changes

- We closed our Russia position, changing the exposure from 9% to 0%. Russia's policy-making seems to be aimed at weakening the currency, in our opinion, and recent weak growth and high inflation gave fixed income securities poor risk/return, particularly after the market (and the currency's) rally.
- We increased the Fund's Mexico exposure from 8% to 15%. The Mexican peso and the Mexican local yield curve sold off excessively, in our opinion. It was one of the few markets that did not benefit from the Fed's non-taper and the market's stability. Real interest rates remain high, and we are attracted by its lack of performance, as we were by the weak performance of Brazil's currency a couple of months ago.
- We decreased Greece from 8% to 2%. Greek hard-currency bonds rallied to near our target price, while politics have gotten a little hairier, in our estimation.

- We reduced Nigeria from 14% to 5%. We have held a large position in Nigeria since the inception of the Fund. However, we have been telegraphing in our monthly and other reports that we are increasingly worried about politics, as well as the scheduled departure of the country's central bank head. As a result, we currently only hold short-duration bills, and reduced our overall exposure.
- We reduced Brazil from 15% to 6%. We described the reasons above, but Brazil basically experienced a significant rally in its currency, and has a President that now needs to prove whether she is pragmatist or ideologue. Stay tuned.
- We increased Colombia from 0% to 10%. Their monetary policy remains strong, the currency reflected overall crisis-pricing in EM, in our opinion, and there was an over-done exit of foreigners from positions. Real interest rates are also very high, and we see ratings upgrade potential.
- We increased Philippines from 0% to 10%. We saw a too-fast exit from these bonds leading to very attractive levels, in our opinion. Once our thesis of market stability was more broadly held, we were attracted by the seemingly delayed reaction of Philippine local debt.

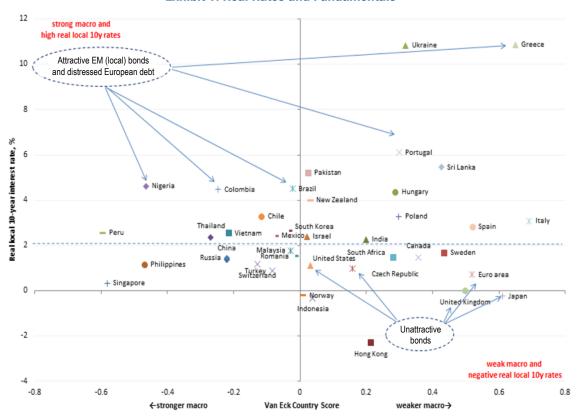


Exhibit 1: Real Rates and Fundamentals

Source: Bloomberg, Van Eck Research. Data as of September 30, 2013. Van Eck's country score is a rank that each country obtains after normalizing fundamentals.

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Fund Performance

For September, the Fund returned 3.41%, compared to 4.40% in the local-currency index (GBI-EM Index), and 2.61% in the hard-currency index (EMBI Index). The Fund's biggest winners in September were Brazil (local), Argentina (hard), and Russia (local). The Fund's biggest losers were Ukraine (hard), Euro hedge (hard), and Hungary (local).

The market's best performers during the past month were Argentina, Indonesia, and Egypt in hard currency, and Brazil, Hungary, and Philippines in local currency. The markets' worst performers of the past month were Ukraine, Dominican Republic, and Costa Rica in hard-currency, and Indonesia, China, and Chile in local-currency.

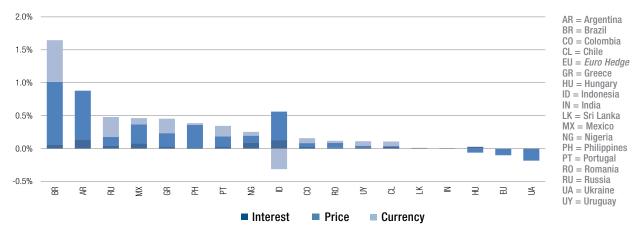
Average Annual Total Returns (%) as of September 30, 2013

	1 Mo*	YTD	Life
Class A: NAV (Inception 7/9/12)	3.41	-6.51	3.11
Class A: Maximum 5.75% load	-2.57	-11.86	-1.73
GBI-EM Index	4.40	-7.56	
EMBI Index	2.61	-6.67	

Average Annual Total Returns (%) as of June 30, 2013

	1 Mo*	YTD	Life
Class A: NAV (Inception 7/9/12)	-8.77	-8.50	1.62
Class A: Maximum 5.75% load	-14.00	-13.74	-4.20
GBI-EM Index	-4.13	-7.15	
EMBI Index	-4.91	-7.77	

Price, Interest and Currency ("FX") Components of Fund Returns by Country for September 2013



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 quarantee 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.

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Data Source: Van Eck Research, Factset. All weightings as of September 30, 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.

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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.

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