

WIDE MOAT QUARTERLY CONFERENCE CALL TRANSCRIPT

Moderator: Brandon Rakszawski
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Operator: Please stand by. Hello and welcome to the Van Eck Quarterly Wide Moat Focus Index review. Today's call is being recorded. At this time I would like to turn the conference over to Brandon Rakszawski. Please go ahead, sir.

Brandon Rakszawski: Thank you, Alicia and good afternoon everyone. Welcome to our quarterly Market Vectors Wide Moat ETF (MOAT) update call where we will discuss recent developments related to MOAT's Index, the Morningstar® Wide Moat FocusSM Index. My name is Brandon Rakszawski. I'm a product manager with Market Vectors ETFs. Before we begin, I will read a few important disclaimers.

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Please remain on the line following the conclusion of today's call. Important regulatory disclosures will be read at that time.

Today we hope to cover several topics. First, a recap of second quarter Morningstar Wide Moat Focus Index performance. Second, the results of this quarter's Index review in which seven companies came in and out of the Wide Moat Focus Index. And third, we'd like to answer your questions.

So if you do have questions throughout the call, please email marketvectors@vaneck.com. And we will make sure to address all of those questions throughout and at the conclusion of today's call.

Joining us today from Morningstar is Mike Hodel. Mike was recently named chairman of Morningstar's economic moat committee, a group of senior members of the equity research team responsible for reviewing all economic moat ratings issued by Morningstar. Mike has covered the technology and telecom sector for a large portion of his tenure at Morningstar, which began back in 1998. Mike, thank you for joining us today.

Michael Hodel: Hey, thanks for having me.

Brandon Rakszawski: So before we jump into today's content, I want to give a quick overview of the MOAT ETF and the Morningstar Index that serves as the Fund's benchmark. The Market Vectors Wide Moat ETF, ticker symbol MOAT, which stands at approximately \$740M in assets, seeks to replicate as closely as possible before fees and expenses, the price and yield performance of the Morningstar Wide Moat Focus Index.

This index has been calculated and published live for over five years, beginning in February of 2007. I like to describe the MOAT ETF as the way for investors to access the best of Morningstar's equity research.

The index methodology results in a unique combination of quality and value, as identified by Morningstar equity research. And this comes in the form of Economic Moat Ratings on the quality side and fair value estimates and fair value assignments on the valuation side.

With that background information, let's jump right into the performance results. Year-to-date through yesterday, the Wide Moat Focus Index has underperformed the S&P 500 Index roughly 85 basis points. Much of that can be explained by very poor performance from Weight Watchers International in the first quarter this year.

Weight Watchers, which was discussed at length during last quarter's call, had a moat rating downgrade and was removed from the Index in March. But despite Weight Watcher's detraction from performance, the Index has largely kept pace with broad equity markets in the U.S. year-to-date.

And for the second quarter 2014 Index rebalance period, we're talking the third Friday of March through the third Friday of June. The Wide Moat Focus Index actually outperformed the S&P 500 by roughly 100 basis points or 1%.

Mike, if you could dive into some broad themes and specific drivers of the Index's performance over the last several months?

Michael Hodel: Yes, sure. So, you know, one of the biggest contributors to the outperformance in the second quarter was the logistics services companies. So the portfolio held two names, C.H. Robinson and Expeditors International that both provided logistic services to shippers. We've seen steadily increasing demand for shipping services over the past several quarters.

And that's been coupled with tight capacity in certain areas, especially in the U.S. truckload shipping market. And that's boosted demand for logistical services. When you see capacity get tight in a certain area, the transportation industry shippers often look for folks that can help them mitigate or manage that constrain on supply.

So that's boosted demand, in particular, for C.H. Robinson. And both C.H. Robinson and Expeditors, thanks to their wide moat, we believe, have continued to take market share over the past several quarters, which has led to solid revenue growth and also an improving outlook for the balance of 2014. Both C.H. Robinson and Expeditors have performed very well with C.H. up 21% and Expeditors up 15% over the past quarter.

And both of those names now trade pretty close to our fair value estimates. And they both have come out of the portfolio this quarter. In addition to logistic services, we've also seen decent performance out of the oil services field with Schlumberger actually the top performer in the index over the past quarter.

Schlumberger continues to benefit from some of the same long term trends that we've identified in the past. Specifically, demand for increasingly complex oil field services. And unconventional activity, so to refill natural gas storages has helped as well over the past quarter or so.

We continue to gain confidence in Schlumberger's ability to generate sustainable long term economic profits. And we've actually increased our fair value estimate 12% over the past quarter. But the stock has done even better. It's up 22% and no longer looks cheap to us.

And that's another name that's come out of the portfolio. So that's on the positive side where we've seen, you know, key contributors to the performance of the fund in the second quarter.

On the negative side, we've had a couple of key underperformers. The first of those is Core Labs, which is in the same field as Schlumberger. But unfortunately management had built up expectations to unrealistically high levels earlier in 2014 and was forced to revise expectations lower when the firm reported first quarter earnings in April and then re-revised expectations even lower in mid-May.

Project timing is the biggest culprit here. This isn't, we believe, any major change in Core Lab's core competency. But rather, that a couple of projects that they were expecting to come online in earlier in 2014 have been pushed out to the future.

Core Labs is a pure play on oil field reservoir management, which we believe is a critical portion of the oil field industry. And we still view Core Labs as one of the widest moats and one of strongest competitively advantaged firms in the energy sector. And the Index continues to hold its position in Core Labs.

The second key contributor to - on the negative, on the downside to the portfolio is eBay. Several small items have hit eBay over the past couple quarters, including a data security breach, problems with a change in Google search algorithm which hurt eBay's search rankings, and the launch of Amazon payments.

We don't believe these items are particularly significant to eBay over the long term, but they have pressured the stock over the past couple quarters. And, like I said, none of these items has any impact on eBay's long term competitive position.

We continue to view eBay as one of the strongest network effect businesses in existence. And we actually have not changed our fair value estimate for that firm. And eBay continues to be an Index constituent.

Brandon Rakszawski: Thank you very much. Here at Market Vectors ETFs, as we speak with clients and investors, we tend to push the long term merits of the Index that is being implemented by the Morningstar index team and the Morningstar research team.

Morningstar's moat ratings are long-term, forward-looking ratings. The index then incorporates a valuation factor, which has helped performance historically. There are going to be times where the Index outperforms or underperforms on the short-term.

But we like to look at the simple measure of batting average, which assesses strategy or index performance versus another benchmark. And in this situation, we like to compare the Wide Moat Focus Index to the S&P 500 Index. Batting average measures, over a period of time, the number of periods where the Morningstar Index has outperformed the S&P 500 index.

In the short-term, when you look at short periods of time such as one month or three months, there's mixed results. 50% of the time, roughly, the Morningstar Index has outperformed the S&P 500. But as soon as you increase those time periods, those holding periods, the numbers improve exponentially.

To the point where, historically, since the Wide Moat Focus Index has been published live, in 2007, if you look at five year rolling periods over that five year time period, so you're looking at 20-plus time periods, the Morningstar Wide Moat Focus Index has outperformed the S&P 500 Index 100% of the time – 1.000 batting average.

The long-term core holding merits of the strategy is what we like to stress with investors. It may not be right for someone that's looking for quick exposure to the U.S. equity markets – it may, it may not. But we like to look at it as more of a long-term core position in an investor's portfolio.

Let's move on to the results of the Index review. The index rebalance and reconstitution took place last week. It went into effect at the end of trading of Friday, June 20th and was implemented and effective when markets reopened this week on Monday.

To recap how the review process works: In order to be eligible for the Wide Moat Focus Index a company must have a wide economic moat rating from Morningstar's equity research team.

The equity research team has a very thorough, very robust process where they identify companies with sustainable competitive advantages, in their view. And we'll discuss that more in length as we go through some of the additions to the Index.

The other criteria that must be met to qualify for the index is that a company must be one of the 20 most attractively-priced wide moat companies in the coverage universe according to the Morningstar equity research team.

The way the Morningstar index team identifies this is they'll look for the price to fair value ratio for each of these wide moat companies. And they'll rank the wide moat companies by that ratio and the 20 most attractively priced are placed in the Index each quarter. Each of those stocks are equally weighted at 5% at the beginning of the quarter.

The Index review this quarter resulted in seven additions and seven deletions. I'll name the deletions fairly quickly and then we'll jump into each of the seven companies that were added.

Removed from the portfolio, and Mike mentioned some of these when discussing performance, were General Electric, Schlumberger, C.H. Robinson, Expeditors International, Spectra Energy, National Oilwell Varco, and Phillip Morris International.

All seven of those companies were removed because of the evaluation side of the equation. These seven stocks were no longer one of the 20 most attractively priced in the universe. However, each retained their wide moat rating.

With that being said, let's jump into some of the additions, Mike. Let's start off with Amazon.com. I think everyone has heard of Amazon.com. They came out with some news on their Fire smartphone shortly before the company was added to the Index. Can you elaborate on this company's wide moat?

Michael Hodel: Yes, sure, I'd love to. Amazon, we view as one of the wider moats in the consumer sector. And we believe the firm is disruptive in both the retail industry, the digital media market and in the cloud computing market.

But the core, in our view, of Amazon's competitive advantage stems from its network of - or its user base of 250 million active users, which we think creates a network effect whereby Amazon attracts a large group of third party sellers, some selling directly to Amazon customers. It becomes self-reinforcing.

And in addition to that user base, Amazon has built out the infrastructure that's needed to support that customer base. So that interplay between a large user base and the infrastructure needed to support that user base creates a network that may be very difficult for another online retailer to replicate.

And you mentioned the Fire smartphone. We think that investments in things like that product and the Kindle products generally, provide growth opportunities. But they also provide opportunities to enhance that network effect. So to make customers stickier to the Amazon platform, make it easier to buy goods and services or content from Amazon.

So, not only do they provide, like I said, some growth opportunity, the more important function feature is that it increases the size of Amazon ecosystem and enhances that network effect. You know, the stock has come under pressure recently but we think this is an issue where the market is sort of missing the long-term potential for Amazon to continue to take retail market share. And as they do so, to leverage the investments that they've been making over the past several years to expand margins and drive results.

It's really a classic example of sort of short-term versus long-term. Really focusing on the long-term potential of this business and where it's economic profits will go to, rather than where they are today, we think creates an opportunity here.

Brandon Rakszawski: Thank you. And before we move onto the next addition, I just want to remind everyone that you can email any questions you have throughout the call to marketvectors@vaneck.com. All right, Mike, let's move onto Amgen.

This is a biotech firm that is actually rejoining the index this quarter. I know that they had a fair value increase from \$125 to \$131 per share in early June. I assume that probably weighed on the addition to the Index this quarter?

Michael Hodel: It did. And for Morningstar, that's a fairly modest change to our fair value estimate. Most likely just reflecting sort of the passage of time and the cash flow that that firm has generated from one update to the next.

You know, Amgen, the source of their competitive advantage really stems from the patents around the firm's products that have produced extremely high margins and returns on capital for a very long time. You know, going back to the early 1990s.

Amgen does face competition from both branded and bio-similar rival products. That has weighed on the firm's results. But they've been able to - the firm has been able to grow reasonably well despite this pressure and pressure from reimbursement policies around some of their drugs as well.

We've become increasingly comfortable with our wide moat rating on the firm because of improving results in Amgen's research and development strategy. We see two very promising products in late stage trials and our analysts also see a very solid mid-stage pipeline as well. So we think the firm, you know, has managed well through some of the competitive issues around its existing products, while also doing a nice job of building a drug pipeline that may provide for growth down the road.

Brandon Rakszawski: Great. Let's move on to the Intercontinental Exchange, ICE. There's a lot going on right now, related to the 2013 acquisition of NYSE Euronext. I know they had a turbulent day just yesterday, shortly after being added to the Index. They were down roughly 4% yesterday.

Michael Hodel: Yes, the stock has been volatile over the past week or so. They just finalized the proceeds that they expect to get from the IPO of Euronext which is a business that, you know, that came on with that acquisition. They wanted the spin off and it didn't really fit with their long term growth strategy.

So there's been some volatility, I think, as you've seen investors go in and out of Intercontinental Exchange as the IPO process around Euronext was completed. But, you know, looking, again, long-term, the combination of both clearing an exchange functions within InterContinental Exchange, we think creates very high switching costs for customers.

Many of the derivative products that are traded on the firm's exchanges are not interchangeable with other exchanges. So it's very difficult for customers to move to a rival exchange. The company also benefits from, obviously, network effects of having a large group of buyers and sellers coming to its exchanges every day.

And also scale advantages and a portfolio of well-known brands. You know, there are long-term risks to this business that, you know, have come up from time-to-time. You know, regulation could ultimately force the separation of the clearing and exchange operations.

But we believe this risk isn't really too big of an issue in the short to intermediate term. And we think that continued share gains and leveraging, that the firm's fixed cost base should provide enough offset, you know, if somewhere down the road, the firm is forced to separate its clearing and exchange functions.

As you mentioned, 2014 is a transition year of the company. And the stock has been weak as a result, overall, as the company's been kind of reformulating the portfolio of businesses that it operates. Kind of culling some of the assets that it didn't want that it brought on with the NYSE acquisition.

Brandon Rakszawski: I see. All right, let's move on to Eaton Vance. This is actually the third asset management firm in the Index, joining BlackRock and Franklin Resources.

Why do so many asset managers seem to have wide moat ratings? And can you touch on how multiple companies in the same sub-industry might have wide moats when they're all competing against each other?

Michael Hodel: Yes. I mean, that brings up a couple of really good points. In our view, the publicly traded asset managers tend to have economic moats or wide economic moats because of switching costs around the products and services that they offer. And also intangible assets.

So let me touch on both of those briefly. Switching costs, we think, in this business, really stand - stem from uncertain benefits from switching. So even if you have - if you're an investor in a fund that's had a period of underperformance, the benefits to switching to a rival fund are clearly uncertain. You can't necessarily predict future market performance or fund performance.

So that tends to drive complacency amongst investors, you know, overall. So we've seen very stable asset retention rates over time, over long periods of time. And we see periods where redemptions can increase or decrease. But over long periods of time we see asset bases being fairly stable.

Then, intangible assets. Reputation is really the biggest and most important of the intangible assets that these firms often possess. So just by the sheer fact that an asset manager gets to a certain size speaks to the fact that investors have trusted that firm in large numbers.

As investors trust a firm and a firm performs well for investors, that reputation grows over time. And, again, leads to increased customer stickiness. So assets tend to stick with firms for a very long period of time.

Eaton Vance, in particular, we think, you know, has carved out a nice niche in tax managed funds which represents about 40% of the assets under management. And it's also carved out a nice position in the closed-end fund market with about 10% of assets under management coming in the closed-end space.

And we think that makes the firm's assets more stickier than average. Even though the firm tends to have a larger concentration of retail investors which, relative to institutional investors are less sticky, the fact that the firm has a very strong position in tax manage funds and is viewed largely, you know, reputationally as a tax specialist, makes those funds particularly sticky with investors.

The company has seen net outflows over the past couple quarters which has contributed to the weakness in the stock price, which has made it more fundamentally attractive in our view. Those outflows have been fairly modest and the asset base is actually - you know, with solid market performance, the asset base has continued to grow. You know, size and scale advantages that Eaton Vance has as well, remain well in tact in our view.

And then from, you know, a portfolio construction perspective, we don't limit the portfolio in terms of industry concentration. So if we see that a particular sector of the market has become undervalued en masse, our strategy allows us to exploit that without worrying about sector concentrations.

As Brandon mentioned, so long as a firm is within the 20 most attractively priced wide moat stocks, or relative for our fair value estimate, we can include it in the Index without any constraints around sector positioning.

Brandon Rakszawski: Yes, that's a great point. I guess it's worth noting and it's a good segue into the next company, that 30% of the Index currently is weighted to financials. Three asset companies and additionally one other financial company being added to the index this quarter is Bank of New York Mellon.

I'm sure their wide moat is somewhat tied to the asset management story, considering they provide a large amount of the custodian services to a lot of these asset management firms. I want you to talk about Bank of New York Mellon's moat rating.

Michael Hodel: Yes, Bank of New York Mellon, it's a little bit unique, well it's very unique relative to the other asset managers. As you mentioned, it is the largest asset custodian in the business with \$27 trillion in client assets.

And in the custodian business scale is absolutely critical to keeping costs down. And at this point we think, you know, with three major custodians in place, it'd be very difficult for a new intern to come in and gain anything close to the scale that you need to be cost competitive with existing players.

Customer switching costs are also very significant in the asset custodian business, as back office disruption could be very detrimental to an asset manager in terms of relating with their own clients and running day-to-day operations of an asset management business. Bank of New York also has a traditional asset management business which is extremely large, \$1.6 trillion in assets under management.

The firm's asset management business tends to focus more heavily on the institutional market, which as I mentioned, tends to be stickier than the retail market. The low interest rate environment that we're in right now has constrained revenue growth at Bank of New York Mellon.

But, that's not something that we're particularly concerned with over the long-term. And really it's that competitive business around the custodial business, and then also in attractive asset business on top of that makes Bank of New York Mellon appealing to us over the long-term.

Brandon Rakszawski: Let's move along, two more companies were added, both of which I think everyone has heard of. Let's start with big box retailer, Costco.

Michael Hodel: Yes, Costco might seem somewhat counterintuitive given we talked about Amazon earlier and the disruption that Amazon is pushing onto the retail marketplace. But Costco is actually an example of a firm where we've increased our moat rating from narrow to wide recently which has made it eligible for the index.

And by increasing our moat rating, we've also increased our fair value estimate on the firm. So, the stock hasn't moved a whole lot in 2014, but with that increase in the moat rating and increase in our fair value estimate, it made Costco available to the index.

With Costco we think the firm has two mutually reinforcing advantages, one being cost and the other brand. The firm is all about low costs. Managing, you know, a very limited number of products per store so that the firm can exert as much negotiating leverage as they possibly can with the suppliers of that limited number of products; and then pushing those products through logistics and through the stores extremely efficiently.

So, the sales per square foot at a Costco is typically significantly higher than you'd even see at Wal-Mart or a Sam's Club because of that relentless focus on efficiency, a focus on a small number of products and focus on low cost, low prices. And then that focus has created a reputation with consumers for low prices.

And as those two things, you know, as that reputation builds, the store is may be able to capture more volume which then allows for yet more increased negotiating leverage with suppliers and increasing focus on bringing cost down as well. So, again, those two we think that low cost position and that reputation for low prices is sort of a nice reinforcing mechanism that continues to build Costco's competitive advantages.

In addition to that, you know, countering the Amazon threat specifically, Costco we think has done a nice job of focusing on gas and fresh produce as loss leaders that are less likely, that are impossible in the case of gas, to migrate to Amazon's model. So the focus on loss leaders that are difficult for online retailers to replicate is an advantage for Costco.

And the last thing I'd point out with Costco is that membership fees actually drive the vast majority of profits. So, in exchange for selling you goods at close to cost, close to whole sale prices, Costco charges you a membership fee. And that membership fee is actually what drives the majority of the firm's profitability.

Brandon Rakszawski: Okay, so the final addition to the index this quarter was MasterCard, everyone knows of MasterCard. I guess this is a classic network effect company.

Michael Hodel: Yes, absolutely. This is about as clear an example of a network effect as you can find with merchants and users of the card reinforcing each other. The more you have each, the more valuable the network is to both parties.

The thing about MasterCard that we like is that 85% of global transactions are still made with cash. So there's still a great long-term growth opportunity, especially in emerging markets as customers embrace electronic payments, MasterCard already generates more than half of its revenue overseas. So it's already started to tap into that opportunity and we expect that growth to continue for a long time.

The biggest threats to this business tend to be regulatory, but in hindsight, even major changes to the regulatory structure such as the interchange fee cuts that were introduced by the Durbin Amendment a couple years ago. That turned out to be buying opportunities for the stock.

You know, we expect pricing for MasterCard to decline overtime. And to us, that's just the price the firm has to pay to keep volumes growing across its network which then in turn reinforces the network effect to make the firm that much stronger over the long-term.

Brandon Rakszawski: Great, thanks. So I'll recap here real quick. The seven additions to the index were Amazon.com, Amgen, InterContinental Exchange, Eaton Vance, Bank of New York Mellon, Costco and MasterCard – seven in and seven out this quarter.

At this point, we're about a half-an-hour into the call and I would like to leave time for Q&A. So, a reminder, any questions please email them to marketvectors@vaneck.com. And as I let some of those queue in the inbox, Mike, why don't you start off by explaining the Morningstar moat committee. You were recently named chairman. Can you explain how the committee works, how often you meet and how the voting process works when reviewing economic moat ratings?

Michael Hodel: Yes, sure. The committee is comprised of about ten senior members of the Morningstar research staff. So, we've got about 85 analysts in total covering equity and credit across Morningstar's research group.

And as I've said, ten of those, the most senior folks comprise the moat committee. We meet two or three times a week. We try to schedule meetings so that analysts in our European and Asian offices can participate as well. So we find times that work for - as best possible for all groups of analysts at Morningstar around the globe.

And in preparation for those meetings, analysts who are presenting a company are expected to create a moat write-up explaining what moat rating they would like to see for their firm, either none, narrow or wide. And the reasons why they believe the firm deserves the moat rating that the analyst has proposed.

Members of the committee review those submissions in advance of the meeting. The meetings are used then to ask questions of the analyst to clarify points and also to debate the merits of the case between the committee members.

The voting process consists of a randomly selected group of five members of the committee vote on each moat proposal, and it's majority rules. So, you know, an analyst proposes narrow, if three of the committee members believe that the firm's moat should be wide, a wide moat rating would be assigned to that firm.

Brandon Rakszawski: I'll follow-up to that because I do get a lot of questions related to how often companies are re-evaluated from - both from an economic moat rating perspective as well as fair value. Can you touch on the frequency of re-evaluation there?

Michael Hodel: Yes, analysts are continually evaluating the competitive situation surrounding the firms and their covers list. So the typical analyst at Morningstar covers 17 or 18 companies and the responsibility of the analyst would be continually monitoring the competitive situation around those firms.

We try to be, obviously, as forward looking as we possibly can. You know, from time to time there are situations that arise that catch us by surprise. Weight Watchers last quarter is a great example of that where we weren't as forward looking as we would have liked to have been.

But generally speaking, the analyst's job is to be looking out five to ten years into the future trying to ascertain where a company might be headed. And be doing that process, working through that exercise continually as companies report news, as new developments occur, as companies report earnings. Those news events, those items are taken into consideration in real-time.

In terms of moat review, the members of the moat committee are free to request an analyst to defend a moat rating at any time. So if, you know, part of the responsibility of the moat committee member is to be reviewing and reading analyst research across the department and looking for areas where we could, you know, potentially be needing to take fresh look at a name.

So, all I have to say, the moat review process really does happen in real-time and as continuously as possible. The same is true of our fair value estimates, looking for areas where we need to revise up or down a company's fair value estimate is part and parcel to the daily activities of an equity analyst at Morningstar.

Brandon Rakszawski: I have a question in from Walter. I might be able to actually take a stab at this and, Mike, if you have anything to add, please do.

Walter actually submitted a few names that he had been following and looking at in his own screening process and was curious why certain names may or may not have made it into the Index this quarter. And I think it's worth just touching on some of the eligibility requirements that are part of the Index review process that I think may help answer some of your questions regarding these companies.

So as I mentioned, a company must have a wide economic moat rating to qualify for the Wide Moat Focus Index. But, the wide moat focus portion of the Index also requires it to be one of the 20 most attractively priced.

So, those companies that are one of the 20 most attractively priced wide moat companies will be included. There are certain types of securities that may not be very conducive to a ETF or a 40-act fund structure – namely, limited partnerships. So, limited partnerships can cause issues from a tax perspective under subchapter M of the tax code.

Limited partnerships are not eligible for the index, ADRs and ADSs are also not eligible. And just to remind everyone, this is a U.S. index, so companies must trade on one of the three major exchanges, the NYSE, Amex, or NASDAQ and also have a U.S. country assignment by Morningstar.

So those are some of the criteria. I think one of the major ineligibility factors would be the limited partnerships which would cover some of the companies that you submitted, Walter. So, I'll leave it at that. But you definitely can screen for some of these companies.

Moving on, I have another question in that I actually think may apply to me because it's more specific to the ETF structure. It's a comment on the high turnover in the Index and the fact that there have been on average, six to eight companies coming in and out of the index each quarter historically.

And there's concerns in this question from Ken that relates to the costs of that high turnover for an ETF portfolio. I think one thing to understand and one of the advantages and benefits of the exchange-traded fund structure from a tax perspective.

At rebalance time if a portfolio holding is liquid and deliverable through the creation and redemption process, an exchange-traded fund many times is able to deliver both in and out of the portfolio, rebalanced securities in-kind to and from Authorized Participants. And in-kind transactions currently are not viewed by the IRS as a sale.

As a result, MOAT which has been in existence throughout two different tax years and despite the high turnover in the portfolio has not paid a capital gains distribution to shareholders to date. So I hope that will help address that particular question.

Another one coming in has to do with the moat rating process, Mike, and how much of that process is quantitative versus qualitative. Can you touch on that?

Michael Hodel: Yes, sure. I would say that the moat process - moat rating process starts with a quantitative aspect. So, part of the process of covering stocks at Morningstar is to build an economic model and a forecast model for every company covered.

And analysts build those models within a standard framework at Morningstar. And that framework helps us analyze a company's return on invested capital. And that's one of the key metrics that we look at in determining whether or not a company has a moat, whether it can earn returns on capital that are consistently above its cost of capital.

But that's really the starting point. Once we've identified a firm that generates returns that are above its cost of capital, we really want to understand why that is the case and whether those reasons why are sustainable.

So we look for things like network effects, switching costs, intangible assets, cost advantages, minimum efficient scale within a given market. Those are more qualitative attributes of a company that enhance our understanding of again, why a company might generate attractive returns on capital and whether those returns on capital are sustainable for a very long period of time.

Brandon Rakszawski: I have another question in, this one from Jason. It has to do with minimum holding periods for the Index. Are there any guidelines as to how long a company must remain in the index? Specific example he cites is Costco which was just added. Can that come out next quarter, and I would answer that: absolutely.

There are no holding period requirements for any of the companies in the Index. In fact, there are instances where companies will come in, be removed the next quarter and then come back in the following quarter.

So, it's very much driven by the price-to-fair value ratio and how that company may appreciate, depreciate, or in addition, whether or not the Morningstar analysts may reassess the fair value – intrinsic value assignment. Mike, I don't know if you have anything to add to that, but that's pretty straight forward.

Michael Hodel: No, that's exactly right.

Brandon Rakszawski: I do have another question. Can you talk about spin-off as a whole? This question specifically relates to eBay and the potential, in the future, that there may be a point where PayPal is spun off from eBay.

I know you can't predict the future and how you would rate certain companies if something were to happen. But generally can you walk through the process when companies spin-off significant business units and how you start to look at those companies either as a whole or individually?

Michael Hodel: Sure. And I think it's pretty much as you'd expect. We would look at, you know, in the case of eBay, if they spun off PayPal, we would look at the remaining assets of eBay and look at the PayPal separately and then assign moat ratings to each of those businesses independently.

Our moat rating on eBay today reflects our consideration of the entire set of assets that firm has. You know, both the marketplace business where we think there's a strong network effect and the PayPal business where there's also we think a strong network effect.

Once you pull those two businesses apart, we would start to look at them independently without any sort of reinforcing benefits between the two businesses. But it would be, you know, I can't speculate to say on where we would fallout on whether the loss of those cross-benefits would be enough to cause either the firm's standalone businesses to fall to a narrow moat. But that would be certainly something that the committee and the analysts would be debating as that spin-off process took place.

Brandon Rakszawski: Can touch a little bit more on your discounted cash flow model and how you come up with your fair value ratings?

There's a question related to other fundamental metrics for companies such as Amazon as an example that might have price-to-book and price-to-earnings ratios that don't necessarily reflect what many people might consider undervalued companies.

Michael Hodel: Yes. Sure, absolutely. And it's a good example of how our fair value estimate, you know, it really is a response to our reflection of our moat rating. Our analyst's model five to ten years of explicit financial performance for each firm that we cover.

So, modeling out the cash flow is what we expect a business to generate over the next five to ten years based on factors that we see in the market today. And then our model, like I mentioned earlier, we use a standardized model for all companies that we cover at Morningstar, then takes over with a two-stage terminal. It's three stages in total, that explicit forecast period and then two stages comprise our terminal value. The first of those stages is a fade period where a firm's returns on capital fade to its cost-to-capital. And then a stage three terminal period where returns on capital equal the cost of capital.

The length of that fade period is determined by the moat rating that we have on a firm. So a firm with a wide moat rating, we'd expect to earn excess returns for a longer period of time than a firm with no moat. In fact, a firm with no moat, we'd likely expect not to earn an excess returns at all.

And our moat rating also informs how we think about the explicit forecast period. So the case of Facebook is a great example, where we're willing to assume a firm like Facebook with a wide economic moat is able to earn excess returns as it matures over the next decade.

We wouldn't be willing to make that assumption with a firm that we didn't believe had built a strong competitive advantage. So our moat rating does directly influence how we think about cash flow modeling and going forward how much excess return we're willing to assume in our fair value estimates.

Brandon Rakszawski: All right. Well, thanks, I actually don't have any more questions in the inbox. So, I think we're going to go ahead and conclude today's call. Mike, thank you very much for joining us today.

Michael Hodel: My pleasure.

Brandon Rakszawski: And for everyone else that called in and participated in today's call, thank you very much. I'm going to conclude by reading some disclaimers. Thank you.

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Operator: That does conclude today's conference. We thank you for your participation.

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