Manager Commentary

Mixed Outlook for Emerging Markets Debt

By: Eric Fine, Portfolio Manager

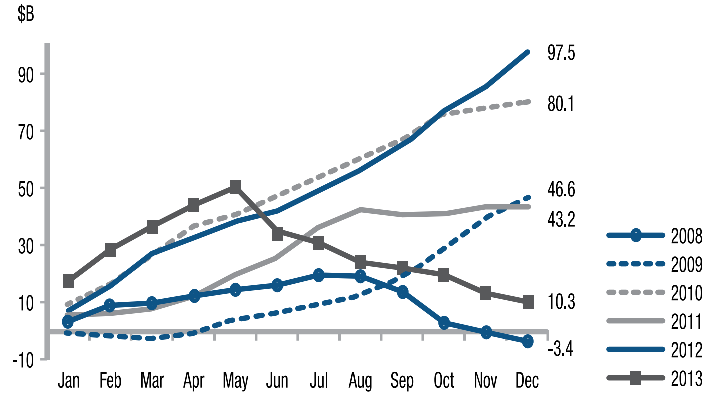
Executive Summary

- General outlook for emerging markets (EM) debt is mixed
- The Federal Reserve's (the "Fed") taper continues to dominate headlines and market discussions
- Idiosyncrasy exists and country selection remains important

Overview

We believe the general outlook for EM debt is mixed. The tailwinds are good long-term fundamentals. And headwinds are potential sell-offs in U.S. treasuries as the Fed tapers its bond purchases. EM fundamentals are good, and we believe value can be found. But rising "risk-free" interest rates seem likely, and will also likely be a significant headwind. Our main response to this mixed outlook is to diversify, while maintaining our focus on idiosyncratic value.

Exhibit 1 - Flows at Lows since Global Financial Crisis



Source: J.P. Morgan estimates, Bloomberg, EPFR Global. As of December 2013.

To us, among the supports for EM debt is a seeming anti-EM and anti-bond market consensus. The Fed's taper continues to dominate headlines and market discussions. The focus on the Fed taper emanates from strong U.S. data, with the Fed's stated unemployment threshold (currently at 6.5%) for less loose monetary policy approaching quickly. This appears to have led the market to two conclusions: First, avoid bonds as all yields are rising (according to this line of thinking), and, second, put money into developed markets (DM) over EM, as DM is growing faster. That may actually be a reasonable argument (more on this later), but our point is that this seems to be a popular view. The real evidence for where market sentiment actually is will be revealed in the response to data releases. And the EM debt and bond markets' positive reaction to December's change in non-farm payrolls in the U.S. (which were much weaker than expected, thus pushing Fed taper concerns further away) seems to validate our description of the consensus view.

Strategic inflows into EM debt look set to continue, with individual investor flows having already exited. Looking at 2013 flows into EM debt highlights a few observations. First, 2013 saw individual investor outflows, but steady strategic/institutional inflows. Second, individual investor outflows were the worst since 2008, a year of global financial crisis. Third, overall flows were the worst since 2008. We do not believe that a rising interest rate environment is as much of a risk as was the global financial crisis.

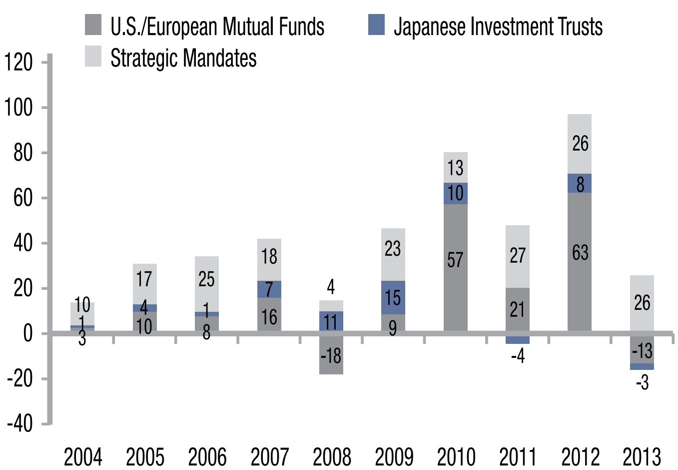
Idiosyncratic asset price moves indicate to us that there is room for good countries to give joy and bad ones to give pain…but argue against looking at EM debt as a monolith. In December, hard-currency EM debt was stronger, while local-currency EM debt was weaker. EM countries' monetary policies vary considerably, despite expectations of Fed (and eventually even ECB) monetary tightening. Korea might cut rates, Hungary is still cutting rates, Brazil is hiking (but perhaps nearing a pause), and Indonesia hiked and paused. When Goldman Sachs came out with its early-January call for Korean interest rate cuts, the currency sold off almost 100bps, despite other EM foreign exchange markets being generally strong. Our point is that idiosyncrasy exists, and country selection remains important, as opposed to over-arching bullish or bearish views on EM debt.

There are real headwinds to EM debt, the most important being the risk of higher U.S. interest rates, which rocked the asset class starting in May/June of 2013. Now, some of these risks are obviously still priced in. Moreover, the market's adverse reaction forced a number of countries to react, notably Brazil, Indonesia, and India, which all hiked interest rates, and put in place other measures to insulate them from rising rate fears. There are other arguments as to why EM can be resilient, but we've made them in previous monthlies. Our main point here is that rising U.S. rates punished EM debt (via lower EM debt prices and weaker EMFX), and that is likely to happen again (perhaps more mutedly), if front-end U.S. rates sell off the way they did in 2013.

If the U.S. sees higher interest rates, the generic comparison of U.S. and EM real interest rates will likely show less value in “EM local debt”. Some markets, particularly those linked to the U.S. and those with low nominal interest rates, suffered as investors compared EM rates with U.S. rates. Mexico is a poster child for this – it was among the most correlated to U.S. Treasuries and the CBOE Volatility Index (VIX), despite having relatively high real interest rates. Our main reaction to this is to avoid risky countries and own ones with high real rates, but the point remains that 100bps more in U.S. interest rates make the superficial comparison of EM real rates to U.S. real rates look worse.

Finally, another risk is that of Chinese growth that is lower than market expectations. This could hit commodity prices, commodities being the main exports for countries in the EM debt indices. The argument is not that China is falling off a cliff. Instead, the concern is that, as the country rebalances toward domestic consumption, the marginal price-setting bid for a number of commodity prices could fade. We defer to our commodity colleagues, who see a range in oil, but downside risks in soy. But our point is that the continuing slowdown in China likely raises this risk.

Exhibit 2 -
Individual Investor Dominates Outflows, while Strategic Inflows Intact



Source: J.P. Morgan estimates, Bloomberg, EPFR Global. As of December 2013.

Exposure Types and Significant Changes

We made a number of changes to the portfolio in December, with the main goal being to diversify risk on the back of a mixed outlook for EM debt. Generally speaking (see below for details), we reduced positions that were large (Brazil, Mexico and Indonesia), and highly correlated with taper fears (Mexico). We increased positions in hard-currency to 38% from 32%. This sector is not subject to the risk of a U.S. dollar rally that may accompany rising U.S. rates. It also performed well during the “taper tantrums” of 2013. We increased positions in Europe, where we had too little exposure, and where peripheral economies are stabilizing or growing.

Our top five positions are currently Argentina (in hard-currency), Brazil, Hungary, Mexico, and Sri-Lanka (all in local-currency). Our top five positions from last month continue in the case of Argentina, Brazil, and Mexico, but Indonesia and Chile (both in local-currency) were demoted (we still have them, they just aren’t as big as they were).

Biggest Country- and Bond-Level Changes

- We reduced Indonesia (mostly in local-currency, with some in hard-currency) from 13.8% to 3.8%. We expected further interest rate hikes and they did not transpire.

- We reduced Romania (in local-currency) due to concerns over the country’s commitment to an IMF program, and replaced it with Hungary (in local-currency).

- We reduced Mexico, both to reduce our concentration and in anticipation of risks emanating from Fed taper moves.

- We increased Hungary (in local-currency), as inflation continues to decline and the current account surplus continues to strengthen, in the context of high real interest rates.

- We increased Portugal and Venezuela (in hard-currency). In Portugal, we see continued commitment to the reform program. In Venezuela, we see some tentative improvements (meaning less horrible) in economic policy. Both bonds are, obviously, cheap on our models.

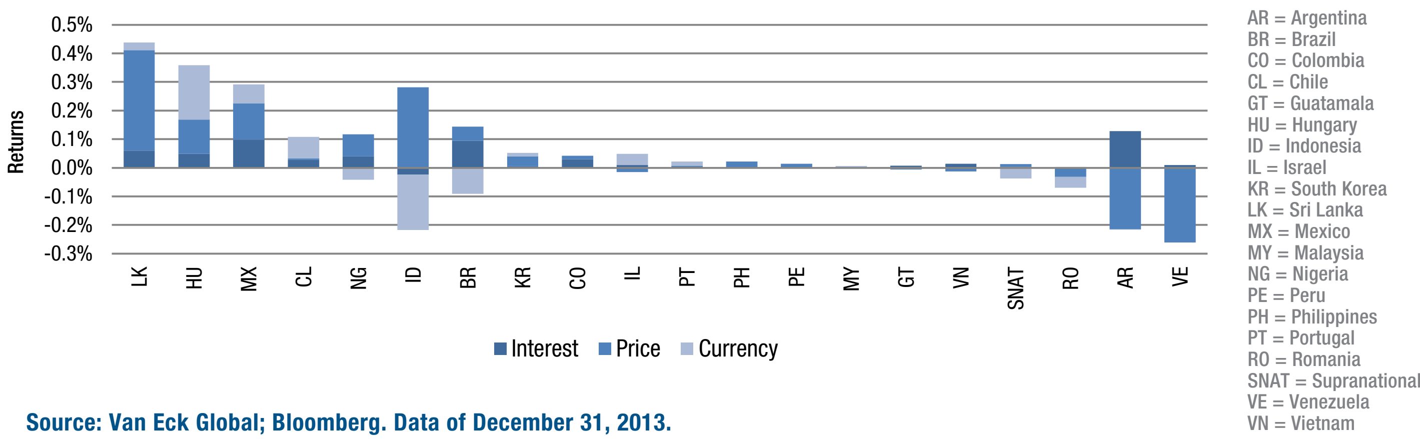
- We also increased Korea (in local-currency) based on continuing current account surpluses, as well as its ability to weather the type of market fear that swept up the asset class in 2013.

Fund Performance

For December, the Fund's Class A shares at NAV returned 0.54%, compared to 1.04% in the local-currency index (GBI-EM Index), and 0.04% in the hard-currency index (EMBI Index). The Fund's biggest winners in December were Sri Lanka, Hungary, and Mexico (all local-currency). The Fund's biggest losers were Venezuela and Argentina in hard-currency, and Romania in local-currency.

The market's best performers during the past month were Ukraine, Venezuela, and Belarus in hard currency, and Hungary, Poland, and Russia in local currency. The markets' worst performers of the past month were Argentina, Turkey, and Malaysia in hard-currency, and Turkey, South Africa, and Malaysia in local-currency.

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



Source: Van Eck Global; Bloomberg. Data of December 31, 2013.

This chart is for illustrative purposes only. Historical information is not indicative of future results; current data may differ from data quoted.

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

	1 Mo*	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	0.54	-4.70	-4.70	3.91
Class A: Maximum 5.75% load	-5.22	-10.16	-10.16	-0.15
GBI-EM Index	-0.55	-8.98	-8.98	--
EMBI Index	0.51	-5.25	-5.25	--

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

	1 Mo*	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	3.41	-6.51	-0.80	3.11
Class A: Maximum 5.75% load	-2.57	-11.86	-6.48	-1.73
GBI-EM Index	4.40	-7.56	-3.74	--
EMBI Index	2.61	-6.67	-4.06	--

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 above 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. All investments contain risk and may lose value; please see disclaimers on next page.

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.

Van Eck Global SINCE 1955

Data Source: Van Eck Research, Factset. All portfolio weightings and statements herein as of December 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. The CBOE Volatility Index (VIX) uses options on S&P 500 Index stocks to gauge expected or implied volatility and is widely used as a measure of risk in the equity market.

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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