

## Manager Commentary

### Emerging Markets Anticipate Central Bank Actions

By: Eric Fine, Portfolio Manager

#### Executive Summary

- Key investments themes remain unchanged, including a preference for hard-currency debt, no exposure to Venezuela or Ukraine/Russia, and selective exposure to corporates and high-quality sovereigns
- We continue to monitor the impact of the ECB's QE program and a potential rate hike by the Fed on Emerging Markets
- New opportunities emerge in Hungary and Poland
- Key market factors support our duration exposure, but it also remains a risk to our portfolio

#### Overview

The key investment themes that characterize our portfolio remain the same. We prefer hard-currency debt over local currency (positions denominated in Polish Zloty [PLN] and Hungarian Forint [HUF] are our only local currency debt exposures). The main reasons include the weak growth outlook in emerging markets (EM), the negative impact of low commodity prices on EM assets (especially on EM currencies), low real interest rates in many countries and the re-examination of local-only risk outflows.

We have no Venezuela or Russia/Ukraine-related exposure. Although we acknowledge the cheapness in Russian assets, the downside risk of Russian bonds remains too high to compensate for potential reward. In addition, the geopolitical and economic ramifications of the region's conflict and Western sanctions also make investment in the region troublesome. We are comfortable with duration and continue to maintain exposure to selective higher-rated/higher-quality liquid sovereign bonds (most of these countries are net creditors which are defined here as countries where international reserves exceed the public sector's external debt). We continue to limit our exposure to corporate debt due to concerns about the "liquidity illusion", record issuance, and potential currency mismatches between debt and sources of revenue. We continue to have exposure to idiosyncratic bonds in Argentina and Vietnam.

Less than a quarter of the portfolio's weight is allocated to higher-rated, liquid sovereigns. All are net creditors and in our opinion might benefit from shortages due to likely Euro-denominated bond issuance this year. Such credits look appealing in an environment in which yields are either close to zero or negative on many higher-rated sovereigns in the developed markets.

Exposure to selected idiosyncratic opportunities in Argentina and Vietnam (whose credit ratings, in our opinion, could be re-rated) remains important for our portfolio. We are cognizant of Argentina's macroeconomic risks. We also realize that the resolution of the holdouts issue will require time. However, the forthcoming presidential elections (to be held later this year) are, in our view, likely to be a positive catalyst for the country as the constitution does not allow the current president, Cristina Kirchner, to re-run for office. As a result, a more orthodox policy is likely to emerge and this should create opportunities for Argentina to eventually access international markets. An important consideration is that Argentina's total indebtedness remains low in comparison with the single B rated economies and a positive change in the policy vector could give a boost for the sovereign bonds to re-price.

Vietnam is a robustly growing economy with a healthy current account surplus and a balanced approach to its currency's exchange rate; the central bank lets the Dong depreciate gradually allowing the country to conserve its international reserves. Vietnam is a net energy and metals importer. As such, its economy – and especially the external balance – could stand to benefit from the currently low commodity prices.

A new aspect of our portfolio is local currency-denominated debt exposure in Hungary and Poland. We have avoided the region since the onset of the Ukraine crisis in November 2013. A number of factors make these two countries attractive to us. First, the real local interest rates in both Hungary and Poland are among the highest in EM (while the local curves are reasonably steep). Second, both countries are sizeable net commodity importers, which is a boon for their external balances and growth. Third, the growth dynamics in both Poland and Hungary finally started to improve in 2014, in large part due to stronger domestic demand. Fourth, inflation in both countries is expected to stay below zero for a large part of 2015, indicating that local central banks are unlikely to start tightening any time soon. Finally, the government debt in Poland and Hungary might benefit from the expected further yield compression in Europe on the back of the European Central Bank's quantitative easing.

There are many factors that support our current duration exposure. Recent Purchasing Managers Index (PMI) readings point to a slowing manufacturing growth momentum in the U.S., the macroeconomic surprises have turned negative, while inflation pressures and inflation expectations are still low. There is an argument that a lack of structural reforms in the U.S. in the post-crisis period might have depressed the potential output going forward. The interest rate differential between U.S. Treasuries and German Bunds is at the highest level since 1989, while a growing number of the so-called "risk-free" bonds are yielding less than 1% (with many having negative yields). This makes Treasuries look attractive and, at a minimum, should put upward pressure on the U.S. dollar, which by itself, would likely be a headwind to growth.

Still, duration remains a key risk to our portfolio. First, the disconnect between expectations for the Fed Funds Target Rate, implied by the Fed's forecasts (which are based on a complex economic construct), and the market (as expressed by Fed Funds Futures) remains large. This might have a negative impact on duration if the market perceives a change in the Fed's tone as hawkish. Second, many labor market indicators continue to improve, pushing the overall Labor Market Conditions Index (LMCI) in the U.S. well above the long-term average. Third, there are tentative signs that the wage growth in the U.S. might accelerate in the coming months. However, a persistently low money velocity and the renewed increase in the U.S. savings rate have the potential to weigh on inflation going forward, while the latter can also affect household consumption and growth, offsetting the positive effect of lower oil prices.

We are watching the Greek/Europe developments carefully (we currently maintain a neutral view on the Euro [EUR]). A potential exit from the monetary union might ultimately prove positive for EUR in the longer-term, but is likely to cause near-term weakness and volatility. Even though the short-term valuation metrics point to EUR cheapness, short/bearish positioning persists.

### Country Exposures and Significant Changes

Our largest positions in February were Argentina, Brazil, Mexico, Poland, and South Korea. Significant changes in our portfolio are summarized below:

- Added exposure to local currency bonds in Hungary and Poland. Inflation is expected to remain subdued in both countries, which indicates that local central banks are unlikely to start tightening any time soon.
- Increased exposure to Brazil (hard currency) as the government's reform agenda is progressing well.
- Added to positions in high-quality/long-duration bonds in Chile and Vietnam, as well as EUR-denominated bonds in Argentina (as the political outlook improved somewhat).
- Reduced our exposure in China's local currency debt due to greater currency and liquidity risks. We also reduced our exposure in Peru due to the noisier political environment.
- Took profit and reduced our positions in the Philippines and South Korea.

**Data Sources:** Van Eck Research, FactSet. All portfolio weightings and statements herein as of February 28, 2015. Unless otherwise indicated.

**Expenses: Class A: Gross 1.42%; Net 1.25%.** Expenses are capped contractually until 05/01/15 at 1.25% for Class A. Caps exclude certain expenses, such as interest. Please note that, generally, unconstrained bond funds may have higher fees than core bond funds due to the specialized nature of their strategies. 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 investors' 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 have been reinvested. Investing involves risk, including loss of principal; please see disclaimers on next page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.

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.

### Fund Performance

The Unconstrained Emerging Markets Bond Fund ("the Fund", Class A shares excluding sales charge) declined 1.06% in February, compared to a 1.34% loss for the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) local currency index and a 0.85% gain for the J.P. Morgan Emerging Markets Bond Index (EMBI) hard currency index. The Fund's biggest winners were Argentina, Chile and China (all in hard currency). The Fund's biggest losers were Brazil, Korea and Peru.

Turning to the market's performance, the GBI-EM's biggest winners were Russia, Chile and Hungary. The biggest losers were Nigeria, Turkey and Brazil. The EMBIG's biggest winners were Venezuela, Ghana and Argentina, while its biggest losers were Ukraine, Turkey and Uruguay.

#### Average Annual Total Returns (%) as of February 28, 2015

	1 Mo	3 Mo	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	-1.06	-4.20	0.39	0.98	3.03
Class A: Maximum 5.75% load	-6.80	-9.75	-5.39	-4.81	0.75
GBI-EM Index	-1.34	-6.88	-1.01	-5.83	--
EMBI Index	0.85	-0.57	1.79	6.86	--

#### Average Annual Total Returns (%) as of December 31, 2014

	1 Mo	3 Mo	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	-4.57	-4.90	1.83	1.83	3.06
Class A: Maximum 5.75% load	-10.10	-10.34	-4.01	-4.01	0.64
GBI-EM Index	-5.93	-5.71	-5.72	-5.72	--
EMBI Index	-2.31	-0.55	7.43	7.43	--

**Duration** measures a bond's sensitivity to interest rate changes that reflects the change in a bond's price given a change in yield. This duration measure is appropriate for bonds with embedded options. **Quantitative Easing** by a central bank increases the money supply engaging in open market operations in an effort to promote increased lending and liquidity. **Monetary Easing** is an economic tool employed by a central bank to reduce interest rates and increase money supply in an effort to stimulate economic activity. **Correlation** is a statistical measure of how two variables move in relation to one other. **Liquidity Illusion** refers to the effect that an independent variable might have in the liquidity of a security as such variable fluctuates overtime. **Purchasing Managers Index (PMI)** is an economic indicator of the health of the manufacturing sector which encompasses new orders, inventory levels, production, supplier deliveries and the employment environment. The **Federal Funds Target Rate** is the interest rate at which member depository institutions trade balances held at the Federal Reserve with each other. A **Holdouts Issue** in the fixed income asset class occurs when a bond issuing country or entity is in default or at the brink of default, and launches an exchange offer in an attempt to restructure its debt held by existing bond holding investors.

**Emerging Markets Hard Currency Bonds** refers to bonds denominated in currencies that are generally widely accepted around the world (such as the U.S.-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. The **European Central Bank (ECB)** is the central bank for the euro and administers monetary policy of the Eurozone, which consists of 19 EU member states and is one of the largest currency areas in the world. The **Labor Market Conditions Index (LMCI)** is a dynamic factor model index that combines 19 labor market indicators to provide an assessment of overall labor market conditions.

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 denominated 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 **Consumer Price Index (CPI)** measures changes in the price level of a market basket of consumer goods and services purchased by households. The **Producer Price Index (PPI)** program measures the average change over time in the selling prices received by domestic producers for their output. The **reserve requirement ratio** is a regulation employed by a country's central bank that sets the minimum fraction of customer deposits and notes that each commercial bank must hold as reserves.

**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 and portfolio managers of other investment strategies may take an opposite opinion than those stated herein. 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 ©2015 Van Eck Securities Corporation.**

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Investors 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. Please call 800.826.2333 or visit [vaneck.com](http://vaneck.com) for performance information current to the most recent month end and for a free prospectus and summary prospectus.

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