EMBAX | EMBCX | EMBUX | EMBYX

Manager Commentary

Negative Factors Ease Although Caution Remains

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Executive Summary

- Despite stabilization in China's reserves and a promise of more policy support, "China" risk seems postponed, not eliminated
- Getting more constructive on local-currency bonds given recent market events and higher real rates
- Long term, caution remains as global growth continues to be weak and with the Fed at the tricky zero-bound

Market Overview

The Unconstrained Emerging Markets Bond Fund's (the "Fund") defensive and cautious positioning hurt performance relative to the benchmarks in February. Both local currency and hard currency debt indices rallied last month with GBI-EM gaining 1.44% and EMBIG gaining 2.02%. Duration in U.S. dollar (USD) also hurt performance as U.S. treasuries started to sell off in the middle of the month on the "risk-on" environment. Some of the reasons behind our carefulness appear to be on hold, at least for now.

There are several reasons that we are getting more constructive on emerging markets (EM) local currency in the near term. First, China's international reserves have stabilized in February after few months of record declines, and authorities seem willing to provide additional stimulus in the form of credit growth and fiscal easing. While this should exacerbate existing imbalances down the road, for now, it is "business as usual" and markets have seemed to react positively. The expectation that these measures should help to stabilize the growth outlook in China provides a floor, although likely temporarily, to commodity prices which are generally supportive of EM exchange rates. In addition, real interest rates in EM local bond markets have risen quite dramatically in the past months, especially when compared to real interest rates in the U.S.

Yet, there are many reasons for remaining cautious. Weak global growth is one despite conventional indicators (such as the differential between short and long interest rates) pointing to a low probability of recession in the U.S. in the next twelve months, durables and capital goods growth in the U.S. seems to be bottoming out and the most recent consumption indicators in Europe beating expectations. The global Purchasing Managers' Indices (PMIs) dynamics are worrisome with most of the manufacturing PMIs turning south in February. Among EMs, the bulk of the macroeconomic surprises we've seen have been negative for the most part, and China's GDP forecast points only to a minor upward correction in the first quarter of 2016. Concerns for weakness in growth have fueled market expectations of the deteriorating fiscal performance for EMs going forward. Consensus currently sees the EM aggregate fiscal gap widening to 3.8% of GDP in 2016 (vs. 2.9% of GDP in May 2015) with the ensuing negative consequences for issuance.

In this environment, an additional reason for caution is that one of the primary triggers for the changed risk environment was the market pricing in future Federal Reserve ("Fed") rate hikes. In countries where central banks introduced negative policy rates to encourage investments, savings still rose while investments growth stalled. We are sympathetic to the view that negative or low interest rates depress future consumption and therefore, potential output. Any of the elements of a "dovish" Fed that may be construed as positive for growth are still not obvious. Put differently, we normally think that Fed hikes are positive for risk, as they are consistent with rising final demand. However, the current motivation for Fed hikes seems to be driven by a need to reestablish credibility, rather than due to an overheating global or U.S. economic conditions.

Portfolio Review

We are looking at changes to the portfolio consistent with the points above – generally, the global environment argues for at least a pause in the negative factors impacting asset prices (e.g., China reserves stabilization, a promise of more policy support and high EM real rates). Meanwhile, key world central banks are either going to remain in an accommodative mode or will likely be withdrawing liquidity gradually.

In particular, we are looking at increasing our EM local currency exposure, primarily in countries with high real interest rates, a link to U.S. (relative) growth, strong central banks that are willing to hike interest rates and currencies that were allowed to depreciate during the risk-off phase. Mexico is one of the countries that fit this set of conditions really well and we initiated a position there in February.

Further, we are looking at selectively increasing our EM corporate exposure in USD, as local-currency corporates remain too illiquid, in our opinion. More specifically, we are looking at corporates that have low beta to the economy (i.e. defensive sectors) and which are tied to U.S. treasuries. We focus on corporates that have proved liquid (trading-wise), and that have significant local-currency costs and thus benefiting from EM exchange rate weakness.

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Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: South Korea, Argentina, Israel, Brazil, and Mexico.

- We added hard currency sovereign debt exposure in Israel and the Philippines which we consider higher-rated risk-off diversifiers with high international reserves adequacy.
- We also increased exposure to hard currency sovereign debt in Poland and hard currency corporate debt holdings in Peru. We believe the market's reaction to Poland's surprising downgrade, for reasons which remain unclear, presented a buying opportunity. We expect hard currency bonds in Peru to benefit from the improved outlook for the forthcoming presidential elections and also from better copper price dynamics.
- We reduced hard currency sovereign exposure in Mexico and hard currency sovereign and longer-duration quasi-sovereign exposure in Russia. In Mexico, we reduced hard currency quasi-sovereign in order to add to local currency sovereign exposure which we expect to outperform in the current environment. In Russia, we became concerned that the easing of the sanctions regime might not happen as fast as anticipated.
- We also reduced hard currency sovereign exposure in Nigeria, Croatia and Belarus. In Nigeria, we see greater economic policy risks as authorities continue to focus on "currency stability" at the expense of international reserves which have begun to decline again.

Fund Performance

The Fund (EMBAX) gained 1.44% in February, compared to a 1.68% gain for a 50% local-50% hard-currency index.

The Fund's biggest winners were Argentina, Brazil, and South Korea (all hard currency). The Fund's biggest losers were Mexico and Colombia.

Turning to the market's performance, the GBI-EM's biggest winners were Indonesia, Chile, and Russia. The biggest losers were Malaysia, India, and Colombia.

The EMBI's biggest winners were Venezuela, Gabon, and Ecuador, while its biggest losers were Belize, Mongolia, and Ukraine.

Average Annual Total Returns (%) as of February 29, 2016

	1 Mo	3 Mo	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	1.44	-1.15	0.86	-13.19	-6.42	-1.71
Class A: Maximum 5.75% Load	-4.36	-6.88	-5.00	-18.20	-8.26	-3.29
50% GBI-EM GD/50% EMBI GD	1.68	-0.08	1.76	-5.87	-3.83	-

Average Annual Total Returns (%) as of December 31, 2015

	1 Mo	3 Mo	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	-1.99	1.03	-13.60	-13.60	-5.71	-2.03
Class A: Maximum 5.75% Load	-7.68	-4.81	-18.57	-18.57	-7.54	-3.68
50% GBI-EM GD/50% EMBI GD	-1.81	0.63	-7.14	-7.14	-4.58	-

Diversification does not assure a profit or prevent against a loss.

Expenses: Class A: Gross 1.32%; Net 1.25%. Expenses are capped contractually until 05/01/16 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 Net Asset Value (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.

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Data Sources: VanEck Research, FactSet. All portfolio weightings and statements herein as of Febuary 29, 2016. Unless otherwise indicated.

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. 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. The **Employment Cost Index** tracks the changes in the costs of labor for businesses in the United States economy.

All indices are unmanaged 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 50/50 benchmark (the "Index") is a blended index consisting of 50% J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified and 50% J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM). 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. J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified 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 J.P. Morgan Emerging Country Currency Index (EMCI) is a tradable benchmark for emerging markets currencies versus the U.S. Dollar (USD). The Index compromises 10 currencies: BRL, CLP, CNH, HUF, INR, MXN, RUB, SGD, TRY and ZAR. The Consumer Confidence Index (CCI) is an indicator designed to measure consumer confidence, which is defined as the degree of optimism on the state of the economy that consumers are expressing through their activities of savings and spending.

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Investing involves risk, including loss of principal. 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.

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 for performance information current to the most recent month end and for a free prospectus and summary prospectus.

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