Manager Commentary

Emerging Markets Debt Continues to Move Higher

By: Eric Fine, Portfolio Manager

Executive Summary

- European Central Bank (ECB) moves to a negative deposit rate
- Fed's communications seem increasingly at odds with strengthening U.S. data
- The ECB's easing and the Fed's dovish communications could point to emerging markets foreign exchange strength

Overview

There are no changes in our basic stance. We continue to prefer hard-currency denominated bonds over local-currency denominated bonds, and want no investments with Russia-/Ukraine-related risk: The China 'de-levering/growing less' narrative seems to be continuing as well. Also, a barbell of high- and low-yielders still best describes our portfolio. However, there have been some big changes in the global landscape - the ECB's move to negative deposit interest rates of -0.10%, and escalating tension between U.S. growth and the Fed's dovish communications.

Let's start with the new global developments at the ECB and Fed, and what they mean. (We won't mention China's property story anymore, as everyone seems to be citing this at this stage.) The first news is that the ECB moved to a negative deposit rate in the face of continuing demand weakness, and a view that inflation pressures are benign. One of the key effects of this is that it represents a revolution in both central bank thinking and behavior; only Denmark has made such a move. If one reserve-currency central bank (the Fed) uses money quantity as a tool, and the other reserve-currency central bank (the ECB) eliminates the zero percent floor for interest rates, then everything is now theoretically on the table in terms of future responses by almost all central banking authorities. More specifically, though, the Fed's quantitative tools effectively anchored the long end of bond curves, and now the ECB's tool could anchor the front end, perhaps for several years. Anchoring the front end is different and important, as it means actual derivative contracts and bonds may roll down to an even lower rate in a relevant time horizon. In short, the ECB's move is good for global bonds and for duration.

The Fed's communications seem increasingly at odds with strengthening U.S. data. The bond market's rally and sell-off (the 10-year Treasury yield rallied by roughly 30 basis points in April and May and then gave almost all of it back in the first week of June) are testament to this. We see this tension as likely to persist, because the longer it continues, the closer we get to a mature economic recovery set to turn downward. In particular, if the Fed waits long enough, historically normal recoveries point to an eventual downturn that may make tightening discussions problematic.

Related to this, if the Fed does begin to tighten (or rather, communicate in that direction), it may mark a major change in the most important determinant of all asset prices, and, any resultant adverse feedback (for example, weaker confidence and real estate prices) may put downward pressure on longer-term yields, and even risks backfiring completely. **In our opinion, this tension is likely positive for the U.S. dollar over the Euro, and points to volatility for duration.**

The ECB's easing and the Fed's dovish communications could point to emerging markets currencies (EMFX) strength, challenging our view of owning hard-currency over local-currency. The ECB is forcing savers out of cash and investors out of the front end of the yield curve into anything else. The Fed has already done this, but is saying it will continue to do so. This combination typically points to a major risk-on trade, and EMFX and other risk trades behaved accordingly in the days surrounding these developments.

Given this, why are we sticking with our hard-over-local view? We should emphasize that our view on emerging markets (EM) local-currency is based on bottom-up analysis of each country, and the above is only saying that there may be some top-down challenges to our view. Most importantly, when we look at the major EM local-currency markets, we remain concerned. Russia, Brazil, Turkey, South Africa and Indonesia can all be characterized as having problematic inflation and weak growth. This means they are in a potential corner in which a weak currency addresses the growth dynamic, while interest rate policy needs to remain tight. Flows into and out of EM local-currency were central to last year's sell-off, the fact that the countries that dominate the indices can be characterized this way should be underlined.

In addition, we continue to worry about the EM growth outlook and continued inflation pressures, particularly from the food price component (which has the added risk of social instability). The recent growth disappointment in Mexico (the only major local-currency market we didn't mention as problematic above), caused its central bank to implement a surprise interest rate cut, hitting the peso, for example.

Another risk to our positioning is that we may be wrong on our no Russia view over the coming weeks or months. On Russia, quasi-sovereign bonds (such as Gazprom) appear cheap on our models. (They fail our investment process, though, as the initial models are subject to subjective tests such as political risks.) Moreover, following the election of Ukraine's new president, there is some momentum for broader powers such as Russia, the U.S., and Belgium to contain/stabilize the low-level civil war. As this is happening, the International Monetary Fund (IMF) is likely to provide liquidity, regardless of the economic logic. Finally, the market seems underweight, providing potential trading support.

Why are we sticking with our no Russia-/Ukraine-related risk view? We continue to believe that looking at the situation from the top-down, the 'What will Putin or Obama do?' perspective is wrong, and that it should be viewed from the bottom-up, Ukrainian, perspective. To us, this situation is still best characterized as one of radicalization and escalation. For example, even following the election, the Kiev government escalated its attacks on Eastern enemies, despite Russian recognition of the election result. Unfortunately, we've been able to provide such examples in our monthly commentaries at the junctures at which a potential stabilization was settling in. Moreover, we believe that the upside/downside in Russian (and Ukrainian) bonds makes no sense if this framework is correct. Essentially, the potential upside is the spread (230 basis points over U.S. Treasuries for a five-year credit default swap in Gazprom) with some compression potential. The downside may be renewed sanctions that can cause the bonds to trade on a price basis. The market has reacted to this by being 'underweight'. We are reacting by being 'zero-weight'.

Biggest Country- and Bond-Level Changes

- We increased Peru to about 8% from 2%. We found a long-date Peruvian bank bond that is cheap in our models and is a good way to seek to access a stable sovereign. It happened to get upgraded after we bought it.
- We also increased Venezuela to around 14% from 10%. We still like it a lot, and one of the investment team members returned from a visit that generated positive feedback. We have also liked Venezuela every time we have looked at other comparables.
- We made small increases to our Israel and Colombia exposures. These were largely based on new issues that made new bonds available at attractive levels.
- We closed our Nigeria exposure, from 8% last month. The new central bank governor appears less independent than his predecessor, and the central bank and the currency are central to anchoring the economy, and more. This is happening in an election year with reserves at not-so-great levels. We had also made our expected profit and wanted to exit given these risks.
- We closed our Greece exposure from 5% due to its rally and its now low nominal yields.
- We reduced Indonesia due to concerns over politics in the context of its rally; Argentina due to concerns over political infighting, as well as its rally; and Angola largely because it looked less-appealing given other opportunities.

Fund Performance

The Fund (EMBAX) gained 2.43% (without sales load) of net asset value in May, compared to 2.08% for the GBI-EM local-currency index and 3.10% for the EMBI hard-currency index. The Fund's biggest winners were Mexico, Brazil, and Indonesia, all in hard-currency. The Fund's biggest losers were Argentina, Greece, and Venezuela, all in hard-currency.

Turning to the market's performance, the GBI-EM's biggest winners were Russia, Philippines, and Chile. The biggest losers in the GBI-EM were Thailand, Indonesia, and Nigeria. The EMBI's biggest winners were Ukraine, Russia, and Mongolia. The EMBI's biggest losers were Argentina, Ecuador, and Vietnam.

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

	1 Mo*	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	2.43	9.04	3.61	7.86
Class A: Maximum 5.75% load	-3.43	2.79	-2.34	4.55
GBI-EM Index	2.08	4.94	-1.37	--
EMBI Index	3.10	8.28	5.77	--

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

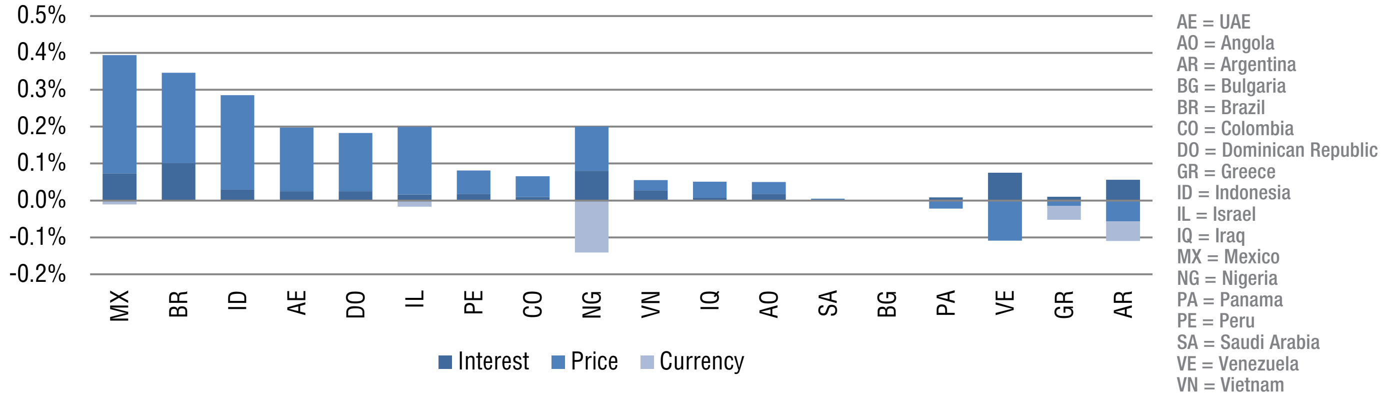
	1 Mo*	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	2.57	3.84	-3.83	5.62
Class A: Maximum 5.75% load	-3.31	-2.12	-9.35	2.07
GBI-EM Index	2.81	1.90	-7.14	--
EMBI Index	1.37	3.73	0.56	--

Data Source: Van Eck Research, Factset. All portfolio weightings and statements herein as of May 31, 2014. 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. 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. Investing involves risk, including loss of principal; 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.

Price, Interest and Currency ("FX") Components of Fund Returns by Country for May 2014



Source: Van Eck Global; Bloomberg. Data as of May 31, 2014.

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

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.

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 ©2014 Van Eck Securities Corporation.

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.