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Manager Commentary

Weaker Global Growth and Lower Commodity Prices Reinforce Case for Hard Currency

By: Eric Fine, Portfolio Manager

Executive Summary

- Russia-Ukraine geopolitics remain unstable, with Russian macroeconomic backdrop weakening
- Growth indicators are slowing across both emerging and developed markets economies
- In our view, any new president in Argentina is likely to be a positive catalyst for the country

Overview

The results of our bottom-up investment process remain the same. We continue to prefer hard-currency over local-currency debt. We have no Russia-/Ukraine-related exposure. We have selective exposure to duration in steep credit curves of high-rated sovereigns.

Russia-Ukraine geopolitics continued to be unstable, with the Russian macroeconomic backdrop weakening. The cease fire announced last month seems uncertain, with reports of fighting in Eastern Ukraine conflicting with overtures of cooperation and negotiation. Ukraine's parliamentary elections in late October could put strain on President Poroshenko's position, and colder weather now brings concerns regarding natural gas supplies. We believe a notable – and worrisome – development of the past weeks is that Moscow's official talk about the former Soviet republics has become more militant. In our view, Russian sanctions are expected to continue at current levels, and could have further negative impact on the already weak Russian economy (especially on Russian companies' and banks' ability to roll over their debt). In addition, multiple-uses-of-reserves is a potential growing risk. As of the end of September, reserves had decreased by 11% for the year. This has been further exacerbated by a ramp up in recent days. As such, the current upside/downside balance for Russia- and Ukraine-related assets continues to look unattractive.

The result of our investment process to own hard-currency denominated debt over local-currency denominated debt has been reinforced by weaker global growth and lower commodity prices. Although emerging markets Purchasing Managers Indices – on average – remain in expansionary territory, growth indicators have been slowing across both emerging markets and developed markets economies. Lower growth across regions would likely drive commodity prices lower. In addition, Eurozone data continued to be weak, with German industrial production posting its sharpest decline since the 2008/2009 crisis (-4.0% month-on-month in August). This is negative for emerging markets currencies, but positive for duration. U.S. Treasuries were further anchored by historically low Japanese Government Bond (JGB) and German Bund (Bund) levels.

Market sentiment towards Venezuela has been negative, in spite of maturity payment. Venezuela is also due to have significant sovereign maturity payments, as well as Petróleos de Venezuela, S.A. (PDVSA) maturity payments, in October. On October 8, Venezuela paid its US$1.5B of 2014 sovereign bonds. In spite of this, the market is currently pricing a 47% probability of default within the next 12 months (assuming a recovery value of 40 cents). We believe the market is too bearish, and repayment proceeds received in October could flow into the next liquid bond. In spite of this weakness, we grew our position during recent weeks, expecting payment of October maturities.

Argentina also has high idiosyncratic risk, with a possible resolution in 2015 post elections. With Cristina Kirchner constitutionally unable to run for elections in 2015, we view any new president as a positive catalyst for the country. In our view, we expect to see a more orthodox economic policy and a likely resolution with holdouts, giving the country access to international finance and re-pricing its sovereign debt. We aim to grow our exposure to our maximum allocation before the election expectations are priced in. Argentina has been a winner for the fund year-to-date due to our specific sovereign and corporate bond choices in the country.

During the month we selectively positioned ourselves in high-rated steep sovereign curves. In high-rated countries like Mexico, Peru, Colombia and Israel, and, to a lesser extent, the Dominican Republic and Indonesia, we found potential opportunities to position the Fund defensively to seek to benefit from steep curves. High ratings mean they may benefit from U.S. Treasury rallies. Our investment process drives these conclusions because of attractive pricing for strong fundamentals, as well as strong signals from our various portfolio tests, including a test for "vulnerability", which, for example, measures the impact of short-term external financing pressures.

Institutional investor meeting takeaways. We came away from our recent meetings with institutional investors with two main takeaways. First, they are looking increasingly at unconstrained funds, leaving the allocation between hard- and local-currency denominated debt, and sovereigns and corporates, to fund managers. This raises concerns about emerging market currencies, as we believe local-only has been a popular focus for several years. We incorporate this into our process through our "vulnerability" test. Second, institutional investors appear to be concerned about duration. This means that for long-duration names, such as the ones we find attractive, we are assigning even better "vulnerability" test scores.

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.

Exposure Types and Significant Changes

The changes to our top five positions are summarized below.

Our largest positions are currently: Venezuela, Argentina, Peru, Indonesia and Mexico.

Biggest Country- and Bond-Level Changes

- We increased our exposure to Argentina, based on opportunistic purchases of select corporate and sovereign bonds.
- We increased our exposure to Venezuela, based on our expectation that October PDVSA and sovereign maturities would be paid.
- We also increased hard-currency sovereign exposure to select high-quality sovereigns: Colombia, Israel, and Peru.
- We increased hard-currency sovereign exposure to the Dominican Republic, with improving fundamentals, a steep credit curve, and a beneficiary of declining oil prices.
- We slightly decreased our exposure in Mexico, as certain bonds reached our target prices. Our fundamental view remains constructive.
- We reduced our exposure to Brazil corporates, due to possible weaker results in 2015, regardless of the election outcome
- We maintained our positions in Indonesia, adding long-end quasi-sovereign and sovereign bonds and trimming select corporate bonds.

Fund Performance

The Fund (Class A shares excluding sales charge) lost -2.58% in September, compared to -5.11% for the GBI-EM local-currency index and -1.81% for the EMBI hard-currency index. The Fund's biggest winners were Argentina, Vietnam and Paraguay, in hard-currency denominated debt. The Fund's biggest losers were Venezuela, Mexico and Brazil also in hard-currency denominated debt.

Turning to the market's performance, the GBI-EM's only winner for the month was China. It was followed by Chile and India as second and third best performers, but each with negative returns for the month. The biggest losers in this tough month for local-currency denominated debt were Brazil, South Africa and Turkey. The EMBI's biggest winners for the month of September were Argentina, Ghana and Belarus, and its biggest losers were Venezuela, Uruguay and Ecuador for the same period.

Average Annual Returns (%) as of September 30, 2014

	1 Mo	QTD	YTD	1 Yr	Life
Class A: NAV (Inception 7/9/12)	-2.58	-2.39	7.07	9.14	5.78
Class A: Maximum 5.75% load	-8.18	-7.96	0.93	2.88	3.01
GBI-EM Index	-5.11	-5.66	-0.01	-1.54	--
EMBI Index	-1.81	-0.59	8.02	9.67	--

Data Sources: Van Eck Research, Factset. All portfolio weightings and statements herein as of September 30, 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. 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.

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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.

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.

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. Purchasing Managers' Indexes (PMI) are economic indicators derived from monthly surveys of private sector companies.

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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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