

Manager Commentary

Emerging markets debt posts strong performance in July

By: Eric Fine, Portfolio Manager

Market Review

In July, the J.P. Morgan Emerging Markets Bond Index Global Diversified (EMBI), representing hard currency debt*, returned 4.00%, and the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM), representing local currency debt*, returned 2.64%. In hard-currency, Europe led with returns of 4.31%, followed by Latin America at 4.12%, Asia at 4.00%, Africa at 3.11% and the Middle East at 0.15%. In terms of rating category, investment grade led with 4.23% returns compared to 3.61% for non-investment grade. In local currency's 2.64% return, the higher-beta¹ countries pulled most of the weight, consistent with a risk-on trade, in contrast with hard-currency's more conservatively-based (i.e., investment-grade) performance. In particular, the Middle East/Africa led the regions in local currency with a 3.42% return, followed by Latin America at 3.01%, Asia at 3.00% and Europe lagging with 2.11%. Turkey and South Africa (which returned 3.59% and 3.42%, respectively) dominated their region's performance, Chile and Peru (which returned 7.68%, and 4.22%, respectively) dominated their region's performance, while the Philippines' return of 5.74% dominated its region's performance.

Fund Review

The chart below reviews country-specific performance, since inception on July 9, of the Van Eck Unconstrained Emerging Markets Bond Fund. The main distinctive development was that

Uruguay experienced some country-specific news, with a Moody's foreign currency rating upgrade to investment-grade Baa3 from Ba1. Overall, the Fund's Class A shares gained 1.13% beginning at the Fund's inception on July 9 and ending July 31 (excluding sales charge).

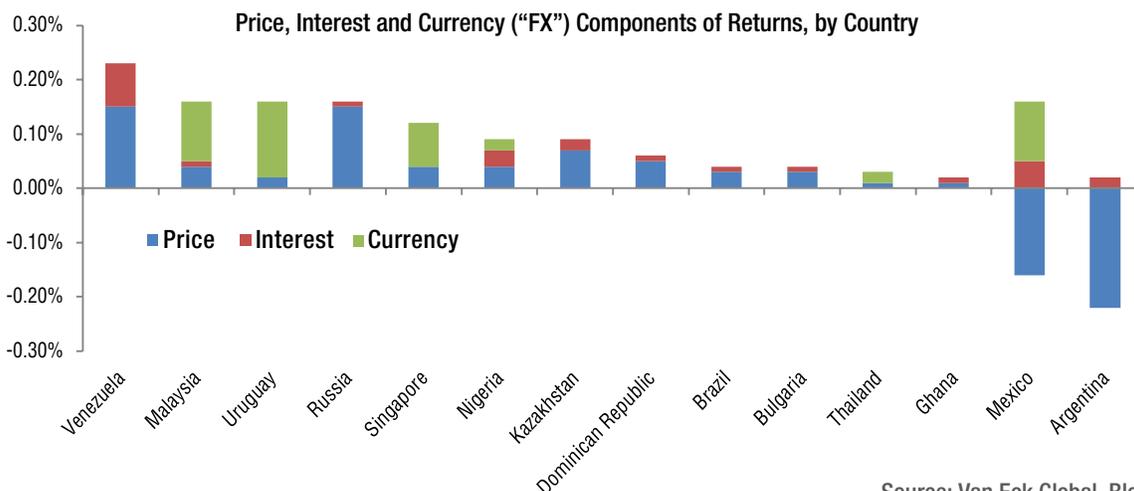
Average Annual Total Returns (%) as of July 31, 2012

	1 Mo*	1 Yr	Life
Class A: NAV (Inception 7/9/12)	--	--	1.13
Class A: Maximum 5.75% load	--	--	-4.67

*Monthly returns are not annualized.

Expenses: Class A: Gross 1.91%; 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 table presents 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.



Source: Van Eck Global, Bloomberg.

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. ¹Beta is a measure of sensitivity to market (benchmark) movement.

Country-wise, performance contributors include Venezuela and Russia in hard-currency and Malaysia, Uruguay and Singapore in local-currency. Argentina in hard-currency was the biggest detractor from performance, and Mexico in local currency was essentially flat, with the currency strength offset by bond price (i.e., duration) weakness.

Our returns lagged the indices for a few reasons, including bid/ask spreads, losses in Argentina, and conservative positioning (i.e., cash). The Fund's relatively high cash is due to our anticipation of more clarity on Europe (and our definition of "clarity" has a low bar given the seemingly incessant back-and-forth). We hedged about one-third of our Mexican peso risk in our Mexican bond position, due to European-crisis concerns (Greece looked set for another default), which limited some of the upside that eventuated. We should note, moreover, that we are currently avoiding countries with direct risks from Europe as we do not see the risks fully reflected in valuations. This eliminates bonds and currencies that tend to rally significantly on European upswings.

Although concerns about Europe dominated July, so did speculation on the timing of presumed central bank interventions. Europe's crisis and weaker global economic news were set against perceived "puts" on risk assets from central banks – this drove the month's see-saw market performance. Spanish and Italian credit spreads hit new all-time highs in July, even as the Purchasing Managers' Index continued to decline. These weak output measures were contained by perceptions (correct, in our view) that central banks have no choice (or think they have no choice) but to act (even if such action may by now be futile or even counter-productive in the long run). There were even days when bad economic news was welcomed as it meant more sugar from the Federal Reserve, so addicted is the market to monetary forbearance.

Market Outlook

First, the good news. While heightened expectations of immediate central bank easing have been disappointed, both the Federal Reserve and the European Central Bank have loaded their guns and identified particular targets. The fact that they didn't shoot during their most recent policy-setting meetings might be problematic for some asset prices, but we think the bottom line is crisis-containment. Market participants may feel that they can perform their day jobs because money-printing will likely be there if necessary. These are "puts," and we'll worry about the fact that these "puts" are a big cause of why we are where we are and that their effectiveness is declining. In addition, in our view, a market characterized by large shorts in the Euro, shorts in European credit spreads and light risk positioning generally means the market may have to crawl a wall of worry for the time being.

We think Europe looks mired, the only question being timing and whether policy makers can get ahead of the crisis. One monetary policy overlaying multiple fiscal policies was the root of Europe's problems, and the market is increasingly insistent that this gets resolved (i.e., create a pan-European fiscal and banking authority). Such a resolution requires overcoming huge political, legal, and technical obstacles for which the market might not have sufficient patience. *We need you to give up your centuries of sovereignty...by Tuesday!* In the meantime, bridges such as the European Financial Stability Facility and the European Stability Mechanism quasi-fiscal authority are being built to allow a transition, but these tools are still in the design phase and nothing is really firm – I would not walk on such a bridge, for example, for the 2% yield one gets on a French 10-year government bond.

Nonetheless, we believe there is an easy (near-term) policy option for European policy makers being set up. With European Central Bank head, Mario Draghi, hinting at much larger interventions in peripheral debt markets (via the Securities Monitoring Program), still conditioned on so-called "austerity," it should not be hard for policy makers to pull that alarm when/if markets re-enter crisis mode. No new tools are required, and German policy makers can claim that any bond-buying by the European Central Bank is conditioned on addressing the root cause of current problems (which to their mind is fiscal policy). Now, with the German Constitutional Court ruling on the constitutionality of the proposed European Stability Mechanism (ESM) on September 12, leaders may be reluctant to openly endorse open-ended bond-buying. Politics are, moreover, likely to be tricky given that in Germany, voters consistently rejected monetary union.

The risk of conflict with Iran (whether directly, or via proxy in Syria), as well as broader regional risks is noteworthy as we see such a conflict as being very different than previous regional ones. The key differences between the current burgeoning conflict and previous ones are threefold, in our opinion. First, Iran's population of 80 million makes it unique in the context of recent wars. Second, Russia and China are simply not playing ball with the U.S., Israel and NATO (whose previous role is morphing in these conflicts). Third, the ongoing Arab Spring means new risks when populations in, for example, Egypt and Saudi Arabia, are reminded that their governments side with Israel. We wouldn't relish making that case. Anyway, our view is that ongoing and upcoming developments threaten the very borders of the region, and that there could be serious consequences. One nearly unmentioned scenario, for example, is instability in Algeria, which supplies about one-quarter of Europe's natural gas.

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Emerging markets are so far de-coupled, due to their strong balance sheets and the absence of an obvious crisis moment. Purchasing Managers Indices continue to decline in China, for example, but the market is respectful of the authorities ability to lever up (via bank lending directives and interest rates, among other tools) in the face of a more severe slowdown. Moreover, inflows into emerging markets debt markets continue to be a juggernaut. Importantly, they represent not just an attraction to low-debt and low-deficit countries, but an exit from high-debt and high-deficit countries, and neither of those conditions appear to be changing. The bottom line on emerging markets, in our opinion, is that it has about one-third of the debt and one-third of the deficits, compared to developed markets. So-called emerging markets also have more independent central banks that will both raise rates if warranted by inflation, and be far more reluctant to get trapped into a position of having to lend to governments at non-market-determined rates, unlike the Federal Reserve, for example.

Current Positioning

Our biggest positions are in Venezuela hard-currency, Mexico local-currency, and Argentina hard-currency. Venezuela, in our opinion, is currently one of the cheapest hard-currency credit spread of any emerging economy. Venezuela's five-year credit spreads are around U.S. Treasury+885 basis points, but we believe Venezuela's credit quality makes it partially comparable to countries with credit spreads closer to the U.S. 10-Year Treasury + ("T+") 300 basis points (bps). We do not see significant downside in the event of a Chavez victory in upcoming presidential elections, and see significant potential upside in the event of a Chavez loss. In Mexico local-currency debt, we see a somewhat cheap currency. The U.S. - Mexico's biggest trading partner and neighbor - looks set for a very long period of low interest rates and an expanding central bank balance sheet. Recent elections, moreover, give more help for some kind of reform agenda relative to earlier years. In Argentina hard-currency debt, we are not expressing any confidence in their heterodox economic policies. In fact, the policy making process, and society in general, seem deeply dysfunctional to us. However, the country has a current account and debt levels in line with countries that trade around T+350 bps, compared to Argentina's T+1130 bps. It's cheap, in our opinion, but not wonderful. Actually, once a pending U.S. court case between Argentina and holdouts from its earlier default is resolved, we expect that will shift to longer-dated Argentine bonds.

Thematically, we have somewhat of a barbell strategy, with high-beta countries in hard-currency debt, but an overall low level of usually-more-volatile local-currency. Within hard-currency, our two biggest positions are Venezuela and Argentina, which tend to be higher-beta names. Over time, their value is that the carry and spread are worth more than the risk, in our opinion. In the near-term, though, any adverse price moves threaten any given day's carry. In local-currency, our most significant investment is in the long end of the local Mexican bond market. This is also higher-beta, and happens to be a popular position. I would characterize the rest of our positions as low-beta, thus our "barbell" label. In particular, Singapore, Malaysia and Thailand in local currency, as well as Russia, Brazil, Ghana and Bulgaria in hard-currency should be viewed as lower-beta names.

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All weightings as of July 31, 2012.

*Emerging Market Bonds Defined Below

“Emerging Markets Hard Currency Bonds” are bonds denominated in foreign 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.

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 Purchasing Managers’ Index (PMI) is an indicator produced of financial activity reflecting purchasing managers’ acquisition of goods and services.

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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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335 Madison Avenue | New York, NY 10017

