Manager Commentary

Hard currency debt posts strong performance in August

By: Eric Fine, Portfolio Manager

Summary

In August, the J.P. Morgan Emerging Markets Bond Index Global Diversified (EMBI) index, representing hard currency debt*, returned 1.18%, and the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) index, representing local currency debt*, returned -0.11%. In hard currency (HC) debt, returns were led by Africa and Europe, and all regions generated positive returns. In local currency (LC) debt, losses were focused on Europe, the Middle East and Africa (EMEA) and Asia, with Latin America generating a small positive return.

The Eurozone remains the market driver in this space, and it now appears to be moving markets higher, even though risks remain. The European Central Bank's (ECB) willingness to buy large amounts of Eurozone sovereign debt greatly reduces the probability of self-reinforcing crises, in our view. In the U.S., the Fed's third round of quantitative easing does not have a defined limit and will likely continue until the labor market improves. Continuing weakness in global growth, especially in China, is an obvious risk factor. But we see this as being discounted, with room for policy responses.

The U.S. election, though largely irrelevant in our opinion, has a new risk component in the form of Republican posturing against quantitative easing. Finally, expanding and escalating conflicts in the Middle East and North Africa remain a serious risk factor, in our opinion.

The current portfolio emphasizes higher-yielding, higher-beta[1] hard currency and local currency debt. The biggest changes to our portfolio from July were the addition of local currency debt in Russia, South Africa, Turkey, Ghana, Thailand and the Philippines.

Performance Review

The Van Eck Unconstrained Emerging Market Bond Fund's Class A shares gained 1.01% for the month (excluding sales charge). Launched on July 9, the Fund is actively managed and focuses on emerging market debt instruments all over the globe. The biggest contributors to Fund performance were Venezuelan HC debt, Nigerian LC debt, and Argentine HC debt. The biggest detractors in August were South Africa, Russia, Turkey and Mexico – all in LC. The graph below details returns by country including each country's price, interest and currency components.

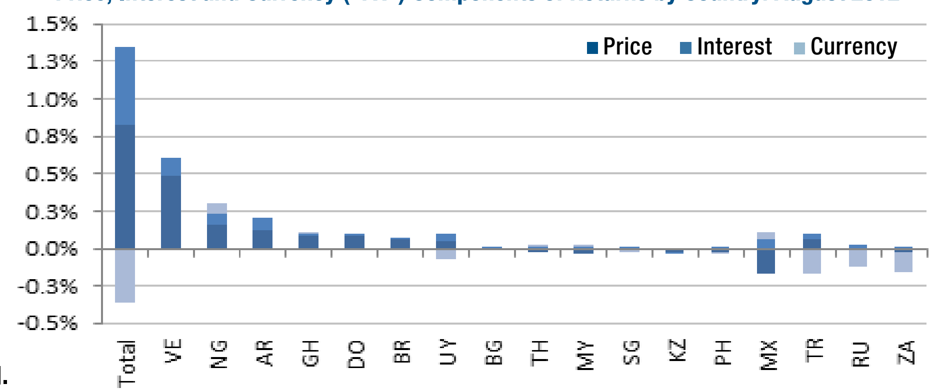
Average Annual Total Returns (%) as of August 31, 2012

	1 Mo*	1 Yr	Life
Class A: NAV (Inception 7/9/12)	1.05	--	2.19
Class A: Maximum 5.75% load	-4.78	--	-3.67

*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.

Price, Interest and Currency ("FX") Components of Returns by Country: August 2012



VE = Venezuela
NG = Nigeria
AR = Argentina
GH = Ghana
DO = Dominican Republic
BR = Brazil
UY = Uruguay
BG = Bulgaria
TH = Thailand
MY = Malaysia
SG = Singapore
KZ = Kazakhstan
PH = Philippines
MX = Mexico
TR = Turkey
RU = Russia
ZA = South America

*See definitions on last page.

Source: Van Eck Global.

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

Current Views

News out of the Eurozone appears to be pushing markets higher – perhaps sustainably, in our view. The last few years have seen all bond markets heavily influenced by European developments. So far, every European and G-20 summit has had short-lived effects. Now, however, the accumulation of policy tools hold out the prospect of at least containing Eurozone contagion.

The ECB's willingness to buy vast amounts of Eurozone sovereign debt comes about as close to U.S.-style quantitative easing as could be expected. With the ECB's latest tool – Outright Monetary Transactions (OMT) – Eurozone countries under monitoring programs (i.e., "austerity") may be able to count on an ECB "put" against excessive spreads. Although OMT bond-buying is confined to debt maturities of less than three years, countries could string together back-to-back three-year issues to finance long-term needs. Moreover, it does not seem likely the ECB would exit from OMT just because a country misses austerity targets.

In the U.S., the Fed's third round of quantitative easing does not have a defined limit and will likely continue until the labor market improves.

Continuing weakness in global growth, especially China, is an obvious risk factor, but we see this as already heavily discounted, with room for more policy responses, if required. China has the scope to ease monetary policy via both interest rates and bank credit policy. Although the current scope for more rate policy easing is limited in the U.S. and other developed markets, emerging market (EM) countries have far more room to ease. A modest slowdown for countries with strong balance sheets, good policies, and non-zero interest rates doesn't strike us as crisis territory.

Anticipated (Forecasted) Policy Rate Path from Current Levels

	Current	3Q12	4Q12	1Q13	2Q13
Developed Markets	0.52	0.42	0.43	0.44	0.45
Emerging Markets	5.90	5.80	5.73	5.7	5.79
Latin America	6.48	6.15	6.15	6.15	6.15
EMEA EM	6.30	6.28	6.01	5.78	5.78
EM Asia	5.55	5.51	5.48	5.52	5.66

Source: J.P. Morgan

There are risks to global debt markets, and once again Europe gets top billing. One major risk apparently was removed on 9/12, when the German Constitutional Court ratified the Eurozone bailout package. However, the Euro currency continues to decline in popularity among voters within some European constituencies. Ultimately, they may have their say through the ballot box, despite policymakers' efforts.

The US election now projects a new risk component in the form of Republican posturing against quantitative easing. In our view, the Republican Party has a more substantial focus on fiscal sustainability. However, we see U.S. fiscal gaps as being so large that the country's tolerance for austerity will be quickly reached. We believe the Republican resistance to QE is mostly election rhetoric, and neither party really has much appetite for importing European-style austerity to the U.S.

Is inflation a creeping risk factor? Some commodities have increased because of "financialization" – easier investment access through funds and derivatives. Food prices clearly are rising with droughts in several of the world's great grain belts, including the U.S. In emerging markets, food price increases can be especially potent because food commands half or more of consumer spending. Even before recent droughts, it's worth recalling that rising food prices were directly responsible for the Arab Spring uprising. Supply shocks from greater instability in the Middle East might be considered a collateral inflation-induced risk.

Nonetheless, when we look at macro inflation trends, we see stickiness rather than significant upside risks. Moreover, as we have argued before, countries with strong balance sheets and independent central banks should see upward pressure on their exchange rates in the event of tighter monetary policy.

Finally, the potential for expanding and escalating conflicts in the Middle East and North Africa remain a serious risk factor, in our opinion. Iran's population of 70+ million, combined with the resistance of Russia and China to NATO aims regarding Iran, is troublesome. Further political radicalization in Egypt would be a risk factor, and Algeria is worth keeping on the radar, in our opinion.

Projected (Forecasted) Increases in the Consumer Price Index (%)

	2012		2013	
	End of May	Current	End of May	Current
Developed Markets	1.6	1.6	1.5	1.5
Emerging Markets	5.1	4.4	5.0	4.9
Latin America	6.1	6.0	7.0	7.0
EMEA EM	5.5	5.2	5.3	5.2
EM Asia	4.4	3.4	4.0	3.9

Source: J.P. Morgan

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Current Positioning

The current portfolio has low cash and is emphasizing higher-yielding, higher-beta hard-currency and local currency debt. With the reserve currencies now set for low interest rates and ongoing balance sheet strains for a prolonged period, the best carry and balance-sheet attributes fall toward emerging markets (EMs), in our opinion. We anticipate secular inflows into EM debt from retail and institutional investors, as well as central bank buyers. Developed markets are now characterized by weak balance sheets and policymaking geared to keeping government borrowing costs low. EMs, on the other hand, offer strong balance sheets and policymaking focused on long-term fiscal balance, including central banks that will raise borrowing costs on governments that do not maintain balance.

Venezuela and Argentina remain our largest allocations among hard currency debt. We like them both simply because their credit spreads are higher than fundamentals warrant, in our opinion. We do not base our Venezuela weight on the outcome of upcoming Presidential elections, as we see a Chavez re-election as neutral for bonds we hold. Also, we view the election of opposition candidate Capriles as a positive catalyst for these bonds. Venezuela has issued less hard currency debt this year than anticipated, boosting technicals.

As heterodox as Argentine policy has been, most headline risk has been priced in, in our opinion. We expect that commodity price rallies should boost external accounts, and policy is undergoing a quiet fine-tuning. One risk factor is a potential adverse ruling in a U.S. court that could benefit bond-owning holdouts in Argentina's defaults. This is why we favor shorter-dated Argentine-law debt. If and when that cloud is lifted, we may increase duration and shift to U.S.-law debt.

Mexico, Turkey, Nigeria, Russia, Uruguay, Ghana, and South Africa are our largest allocations among local currency debt. We are reluctant to generalize beyond any single country, but we view these as having strong balance sheets and yields that are either consistent with inflation trends or supportive of stable currencies.

In Mexico, newly elected President Pena Nieto's relative majority in Congress gives hope that a reform agenda can make progress. Big "structural reform" changes that require constitutional amendments are unlikely. Even so, we view this as an improvement over the Mexico of recent years. Industrial production has been trending around 3.7% this year, and inflation risks make the central bank cautious about easing.

In Turkey, we've seen some divestment, in our opinion, due to regional tensions (e.g., Syria). Export demand has outperformed expectations, boosting growth forecasts. Inflation pressures, which are usually a concern, have waned. The central bank has gained credibility in conducting an unorthodox monetary policy, managing a soft landing so far.

In Nigeria, we basically expect the naira to trade within a range. With T-bill rates mostly in the mid-teens, we see this as an attractive investment. The country's ongoing inflation concerns, driven by food prices, are driving a conservative monetary policy. In Russia, solid growth is the recent trend. Facing a low output gap and 6.3% inflation rate, just above the 5%-6% target range, the central bank unexpected raised rates likely to tame this high inflation. Most importantly, fiscal policy remains strong due to high oil prices. We see fiscal accounts as vulnerable only if Brent prices fall below $80.

In Uruguay, we like yields in a currency that we believe to be roughly supported by fundamentals. The country's trade deficit has narrowed recently, and its current account deficit seems set for a sustainable 2.8% of GDP. Moreover, moderating growth and inflation could give the central bank scope to cut rates before year-end. In Ghana, we are attracted to the country's strong balance sheet, the currency's selloff, and high yields. However, year-end elections hold risks, and the country's fiscal position is notoriously difficult to determine.

Portfolio Changes and Prospective Changes

The biggest changes to our portfolio from July were the addition of local currency debt of Russia, South Africa, Turkey, Ghana, Thailand, and the Philippines. In South Africa, we feel we are taking advantage of recent weakness related to labor turmoil. In Turkey, we believe Europe's reduced pressure on neighboring markets will allow increases in a lightly-owned bond market.

The biggest changes we are evaluating going forward are purchases of Portuguese bonds, a sale of our small position in Kazakh hard currency bonds and a sale of our small position in Singapore bonds. Portugal is complying with its EU/IMF program, and it could become a beneficiary of ECB support. Kazakhstan's yields are no longer attractive, given the less threatening European situation. In Singapore, we view the currency as defensive and a quasi-safe-haven, which we aren't seeking currently. Finally, we sold our Dominican Republic hard currency bonds as they hit our price target.

All weightings as of August 31, 2012.

*Emerging Market Bonds Defined Below

Hard Currency refers to 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 Consumer Price Index (CPI) measures changes in the price level of consumer goods and services purchased by households.

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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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