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Manager Commentary: Emerging Markets

Cautious Optimism Continues in Emerging Markets

By: David Semple, Portfolio Manager

Performance Review

The Van Eck Emerging Markets Fund (the "Fund") lost 0.14% in the first quarter of 2014 (excluding sales charge), modestly outperforming its benchmark, the Morgan Stanley Capital International Emerging Markets (MSCI EM) Index, which lost 0.37% for the same period. To compare, the MSCI Emerging Markets Small Cap Index increased 3.59% for the same period.

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

	1Q14[1]	1 Yr	3 Yr	5 Yr	10 Yr
Class A: NAV (Inception 12/20/93)	-0.14	5.68	2.91	24.57	10.15
Class A: Maximum 5.75% load	-5.85	-0.39	0.89	22.91	9.50
MSCI EM Index	-0.37	-1.07	-2.54	14.83	10.45
MSCI EM Small Cap Index	3.59	0.71	-1.15	20.04	11.80

[1]Quarterly returns are not annualized.

Expenses: Class A: Gross 1.63%; Net 1.60%.
Expenses are capped contractually until 05/01/15 at 1.60% for Class A. Cap excludes 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. Index returns assume that dividends of the Index constituents in the Index have been reinvested. Performance information current to the most recent month end is available by calling 800.826.2333 or by visiting vaneck.com.

In the 2013 calendar year, the Fund gained 11.31%, outperforming both the benchmark MSCI EM Index and the MSCI Emerging Markets Small Cap Index, which returned -2.27% and 1.35%, respectively.

Market Review

Following mostly flat performance by emerging markets ("EM") in 4Q 2013, 2014 began with a sharp selloff on unexpected weak data from the U.S. and China, renewed concerns of tighter global liquidity and pockets of political turmoil in select EM "hotspots". EM currencies sold off sharply in January, escalating to include equity and debt markets. At first, the selling focused on profit taking, but then became more indiscriminate until EM indices reached a low in early February. Following the February low, EM stocks rallied back hard to close the quarter largely flat. This late Q1 rally was led by some of the more unpopular countries, e.g., Brazil, India, Turkey and Indonesia. Materials, a heavily underweighted sector by the Fund, also rebounded strongly. Higher quality, more expensive growth stocks participated less in this rally.

From a macro perspective, synchronized global expansion seems to be a trend, albeit a relatively weak one. There are encouraging signs from this year's EM election cycles, especially in India and Indonesia, and potentially Brazil. In Turkey, the status quo is expected to remain in place which is, in our opinion, market friendly in the short term. One positive from the most recent quarter is that EM governments and central banks appear to have been responding to market pressures and have elected to use the various tools at their disposal in an attempt to stabilize currencies, level reserves, and back up capital markets. There is continued evidence of reforms in EM, especially in Mexico and China where we expect the latter to undertake a mild and quiet stimulus in an effort to shore up the slowing economy. We believe that this can be instrumental for this region and might help unlock growth in EM companies. On the other hand, Ukraine and Russia still represent a relevant tail risk for emerging markets.

The story in Ukraine and Russia continued to evolve over the quarter. It seems the conflict is going to take some time to resolve. After the annexation of Crimea, troubles in eastern Ukraine surfaced. Neither side, it seemed, would back down, which increased the probability of a Russian invasion. Concurrently, the West has been increasing pressure on the Russian government by announcing a series of sanctions targeting Russian officials and businesses. We believe those sanctions may affect the Russian and global economies and might send the Russian economy into recession.

Outflows from the emerging markets equity asset class continued for most of the quarter; however, positive inflows were registered towards the end of the quarter for the first time after 27 weeks of continuous outflows. We sense evidence of increased concern from underweight investors that they may miss the potential comeback in emerging markets. We continue to maintain an overweight allocation in China and India, where we believe more attractive expected returns exist.

The Fund maintained its position in Russia as we believe value still exists; however, geopolitics being far too unpredictable may have a negative effect on share prices in the short term. The Fund initiated a few selective new positions in Latin America, Turkey, Philippines, and China, and took profit from some of the "growthiest" stocks, such as Galaxy, due to valuation concerns. There were no material changes to sector exposures.

We believe emerging markets are now experiencing a period of "value catchup", as pockets of overcrowding are being unwound in popular consumer sectors such as staples, gaming, and internet companies. Following the sharp recoveries in currencies and equity markets, due in part to measures undertaken to adjust currencies and interest rates, we tilted the portfolio towards "reasonable price", which translates to more value and less growth. Overall valuations seem moderately attractive and fair.

Fund Review

During the past quarter, the Fund's portfolio was buffeted by the events described above. Although outperforming for the period, the portfolio was still not able to match the MSCI Emerging Markets Index in March, underperforming the sharp reversal of the Index, which was led by poor quality value stocks that are heavily represented in the MSCI Index. Van Eck focuses on and primarily holds structural growth companies priced at growth-at-a-reasonable-price ("GARP") multiples, which are not well represented in traditional indices. We believe this "pilgrimage back into the index" is one of many we have seen over the past few years and will be similarly transitional in nature.

Again, stock selection was a main contributor to first quarter performance, while asset allocation detracted from performance. Given our bottom-up investment process, we continue to seek out companies that we believe have strong business models and long term structural growth potential. In the short term, prices might be choppy; however, in the longer term, we are confident that the share price of well managed companies is likely to catch up to earnings growth.

At the sector and country level, the Fund's portfolio outperformed strongly in information technology, industrials, India and South Korea, and underperformed within energy, consumer cyclicals, Taiwan and Indonesia.

At the stock level, the Fund continued to enjoy strong positive attribution from Chinese clean energy companies Boer Power (1.32% of Fund net assets)* and China Synges (0.97% of Fund net assets)*, as well as long holdings in Brazil – BR Malls (1.69% of Fund net assets)* and Estacio Participacoes (1.79% of Fund net assets)*, the post-secondary education company. The bottom performers were dominated by Russian companies including retail company Magnit (2.24% of Fund net assets)*, dominant financial Sberbank (0.72% of Fund net assets)* and Eurasia Drilling (0% of Fund net assets)*, which the Fund exited early in the quarter.

Market Outlook

China remains an issue for investors. Growth is, we believe, quite clearly, slowing. But this has always been our base case: not only can China not continue to grow as fast it has been, but there has also been a shift in policy. While the reforms being undertaken by the current Chinese leadership could be thought of as very bold, there could, as a consequence, be less growth in the shorter term. But, in the longer term, there could also be cause for optimism – if the reforms do actually succeed. This is a big "if", and there will, of course, be challenges along the way. However, we are quite optimistic that certain parts of the Chinese economy should do well.

Since China is a very policy-driven market, and policy is focused on specific areas such as clean air and clean water, we could gain meaningful insights by looking at the natural aspirations of the Chinese to advance and succeed as they become wealthier. Whether these aspirations are focused on education, healthcare, travel, and even social media, these are all policies driven by the natural aspirations of the Chinese and that have structural growth profiles.

Elsewhere in the emerging markets, we are entering into a period of some significant elections, from Indonesia to India, Turkey, and Brazil. We believe some of these elections are more important than others. The elections that we are focusing on, in particular, are that of India, where the market is expecting there to be a change in the leadership of the government, with the Bharatiya Janata Party (BJP) picking up seats from Congress – generally perceived as being positive for the market; Indonesia, where the popular governor of Jakarta, Joko Widodo, is likely to be a candidate for presidency – we see that this could be positive in terms of sentiment, but we don't want to overestimate his ability to make things happen; and, finally, Turkey, where we believe elections will have a major impact. Turkey recently help municipal elections, which we've reckoned to be a referendum on the ruling the "Justice and Development party", known as AKP. From what we can see so far, it looks as though it effectively will be a one-party government again, which, in the short term, is probably also good for that market.

We continue to see an increased idiosyncratic environment in emerging markets; therefore, we recommend not viewing those markets as one beta block, but rather to be selective as tailwinds of globalization, lower growth, technology and labor cost advantages are reduced. As a result, we feel that only companies with solid management will be able to translate growth into shareholder returns.

We project an increased reward for reform, escaping the "middle income trap". We believe governments will need to pursue reforms to make up for lower growth by increasing the ease of doing business, investing in soft infrastructure such as education, decrease crony capitalism and corruption, implement the rule of law and equality among others. Some countries will succeed but others will not; hence the increased idiosyncrasy.

We will continue to focus on solid companies that embody our structural growth philosophy. Those companies should possess a visible arc of persistent sustainable growth that de-emphasizes cyclicality and opportunism. We also continue to focus on strong management that has experience building companies from the bottom up in a competitive environment and have demonstrated some ability to over achieve in a lower growth environment. Although the obvious structural growth themes reflect domestic demand, other themes exist in prosaic industries, some even exist in cyclical industries and other themes are plays on developed market growth but have an advantage because of where they are located.

*All country and company weightings as of March 31, 2014.

All 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 Morgan Stanley Capital International (MSCI) Emerging Markets Index covers over 2,700 securities in 21 markets that are currently classified as emerging market countries. The MSCI Emerging Markets Small Cap Index targets companies that are not in the standard emerging markets index. The MSCI China Indices consist of a range of country, composite and non-domestic indices for the Chinese market, intended for both international and domestic investors.

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 the risks associated with its investments in emerging market securities, which tend to be more volatile and less liquid than securities traded in developed countries. The Fund's investments in foreign securities involve risks related to adverse political and economic developments unique to a country or a region, currency fluctuations or controls, and the possibility of arbitrary action by foreign governments, including the takeover of property without adequate compensation or imposition of prohibitive taxation. The Fund is subject to risks associated with investments in debt securities, derivatives, commodity-linked instruments, illiquid securities, asset-backed securities, CMOs and small- or mid-cap companies. The Fund is also subject to inflation risk, short-sales risk, market risk, non-diversification risk and leverage risk. The use of leverage magnifies losses. Please see the prospectus and summary prospectus for information on these as well as other risk considerations.

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. The prospectus and summary prospectus contain this as well as other information. Please read them carefully before investing.

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