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VanEck FUNDS

Pressure Released

By Eric Fine, Portfolio Manager

VanEck - Unconstrained Emerging Markets Bond UCITS

USD R1 Inc: IE00BYXQSJ74

USD I1 Inc: IE00BYXQSF37

USD I2 Inc: IE00BYXQSG44

USD M Inc: IE00BYXQSH50

EUR Hedged I1 Inc: IE00BYXQSD13

EUR Hedged I2 Inc: IE00BYX22V58

Average Annual Total Returns (%) as of 31 December 2018

	1 Mo†	3 Mo†	1 Yr	3 Yr	Life
USD R1 Inc (Inception 12/6/14)	0.01	-2.43	-7.52	2.79	-3.03
USD I1 Inc (Inception 20/8/13)	0.10	-2.18	-6.63	3.64	0.63
USD I2 Inc (Inception 20/8/13)	0.10	-2.16	-6.67	3.82	0.78
USD M Inc (Inception 18/9/14)	0.09	-2.24	-6.82	3.56	-2.17
EUR Hedged I1 Inc (Inception 6/10/15)	-0.26	-2.95	-9.29	1.53	1.40
EUR Hedged I2 Inc (Inception 22/08/17)	-0.27	-2.98	-9.33	-	-5.71
50% GBI-EM/50% EMBI USD[1]	1.33	0.43	-5.15	5.61	2.19

†Periods greater than one year are annualized.

[1]Life performance for the 50% GBI-EM/50% EMBI - USD benchmark is presented in U.S. Dollars (USD) as of Class I1 inception date of 20/8/2013

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Fund Review

The VanEck - Unconstrained Emerging Markets Bond UCITS (Class USD I1) gained 0.10% in December, compared to a gain of 1.33% for the 50/50 J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) local currency and the J.P. Morgan Emerging Markets Bond Index (EMBI) hard-currency index.

The Fund's biggest winners were Brazil, Thailand, and China. The Fund's least contributors were South Africa, Indonesia, and Ukraine. Turning to the market's performance, the GBI-EM's biggest winners were Mexico, Thailand, and Hungary. The biggest losers were Chile, Russia, and South Africa. The EMBI's biggest winners were Uruguay, Lebanon, and Turkey. The biggest losers were Oman, Argentina, and Venezuela.

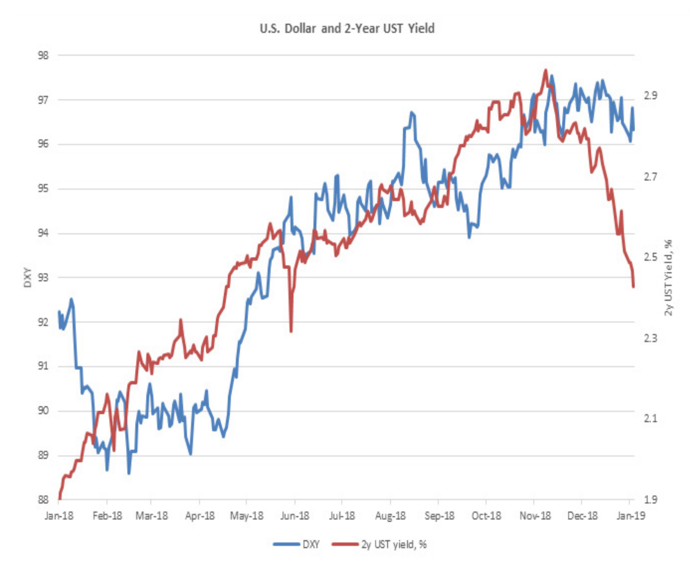
Market Review

What a month December was, following an eventful November … and an eventful October, for that matter! Let's just say it was a volatile month quarter year. Two key market drivers of 2018 – the U.S. Federal Reserve and "China" – continued to whip all asset classes back and forth in December. In addition, two key asset prices – those of U.S. stocks and U.S. Treasuries – dominated sentiment. To make things more complicated, EM debt didn't move in lock-step with U.S. and global equities, perhaps because it went through the wringer first (our hard assets colleagues would quip "No, it didn't!", rightly saying resource equities went through the wringer first), and because the U.S. Treasury market finally provided some cushion for fixed income generally. The fund had

been positioned defensively (in the sense of low allocations to local currency relative to our 50/50 benchmark), and our performance bore that out during the quarter given a mixed November and a strong December. We'd also note that the fund became less defensive over the quarter as we steadily increased our local currency exposure. Anyway, where do we stand now?

We continue to reduce our defensive stance for three reasons – signals from the U.S. Treasury market (and the Fed), indications that "China" is not a key near-term risk, and a significant cheapening of a number of local currency markets. Let us start with the U.S. Treasury market and the Fed. The U.S. 10-year rate dropped roughly 30 bps in December (!) to its January 2018 low. More importantly to us, the U.S. 2-year rate dropped, but only to its May low. In our view, this points to further downside to 2-year rates if trends continue. This is more important to us because it indicates significant downside risks to the USD, in our opinion. (We typically do not use charts in these publications, but a 12-month chart of 2-year yields and the DXY would show that the U.S dollar has lagged the rally in 2-year rates, and the r2 of the relationship between the 2-year yield and DXY is 0.71 over the past 12 months). Moreover, speculative short positioning in 5- and 10-year Treasuries (according to the U.S. Commodity Futures Trading Commission) has only declined by roughly half, and in the 2-year has barely declined at all (!). This tells us that the "pain trade" is lower 2-year rates and a lower USD. Note that Treasury futures markets are already pricing in some rate cuts (approximately 8 bps) by the Fed next year. Given Fed reactions to the Treasury rally, ongoing economic malaise could easily be met with further Treasury rallies, and the Fed could conceivably be turned into a market tailwind (!).

China looks to be on hold as a risk factor, and could also be a tailwind, however temporary. U.S. President Donald Trump has promised good news and progress on "trade" negotiations. (Note: we put "trade" in quotation marks because we see the deeper tension as investment, intellectual property, and strategic competition; as a result, a resolution of "trade" tension is small beer and near-term in the grand scheme of things). Perhaps the U.S. executive branch, too, has become spooked by market weakness into doing whatever it takes to get U.S. stocks higher. China, moreover, is injecting fiscal stimulus into its economy, and we are waiting for the impact of 1.5% of GDP of lower taxes in 2018. In addition, it is doing so while keeping its currency stable (using capital and other controls, which we are neither endorsing as good policy, nor saying are durable, but they have been working for the past few years). In our view, this is crucial (while it lasts), as the risk of stimulus in more open economies is that it simply spills out of the country into USD. Surprise weakness in CNY and/or CNH would clearly be negative for EM local currencies (EMFX), and we believe it does not look to be on the cards in coming months.



Finally, EM debt has cheapened significantly. EMBIG yields are around 7%, compared to around 5.5% in January, and GBIEM yields are around 6.7%, compared to around 6.5% in January, but EMFX weakness added to the downdraught (and thus upside potential from here), pushing it down roughly 6.5% for 2018 despite the carry. We go through some country details below. However, we should note that hard currency debt is characterized by heavy positioning, in our opinion. Many investors are "hiding" in this asset class, fearful of the risks that we see unwinding (as argued above). EM local currency debt, on the other hand, has seen significantly reduced positioning, in our opinion, as the flip side of this equation. We do remain selective and concentrated in local currency (plenty of Brazil, where we see a good story – see our recent piece, Brazil: Belle of the Ball – and Thailand, where we see great defensive characteristics, but no Turkey, where we see heterodox economic policy, and no Russia, where we fear the outsized asset-price impact from any more U.S. sanctions, etc.) Our point is that we are increasing risk in local currency, but remain selective and concentrated, and reducing risk in sovereigns and hard currency, where we see too much "hiding".

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: Brazil, Argentina, Thailand, Indonesia, and Ukraine.

- We increased local currency and hard currency corporate exposure in Thailand. We believe the country's local debt valuations are among the best in emerging markets, while massive current account surpluses provide a steady support for the currency, translating into the improved economic and technical scores for the country. The central bank's decision to go for a pre-emptive policy rate hike in December strengthened Thailand's policy score. As regards our corporate exposure in Thailand, we participated in a new issue which came up as inexpensive per our process and versus comparable government bonds.

- We also increased our local currency exposures in Mexico and the Czech Republic. Mexico's valuations look compelling, whereas the market seems to have priced in most negative news. In terms of our investment process, this translates into the improved technical score for the country. We believe exposure to Czech local currency debt is a great way to get a European exposure. The central bank is at the end of its tightening cycle, the fundamentals look clean (no overheating or obvious inflation pressures), the currency is supported by the current account surpluses, while the government bond yields are still well above the previous lows. In terms of our investment process, this translates into strong technical and economic scores.

- We increased our hard currency sovereign exposure in Ukraine and local currency exposure in South Africa. In Ukraine, the IMF's deal boosted the country's policy score. In South Africa, the main drivers were global risk-on after the trade war truce between China and the U.S., good inflation dynamics, and pre-emptive tightening by the central bank. In terms of our investment process, this translated into the improved technical and policy scores for the country.

- We reduced hard currency quasi-sovereign exposure in South Korea and Mongolia, as well as hard currency sovereign exposure in Mongolia. South Korea's position was used as a funder for other risky assets in a situation when valuations are less attractive, lowering the technical score for the country. Mongolia's valuations no longer look compelling, translating into the lower technical score for the country.

- We reduced hard currency sovereign exposure in Costa Rica and Egypt. In Costa Rica, markets are normalizing after the approval of fiscal reform, with more emphasis on implementation, debt dynamics, and large financing requirements, which means a lower policy score for the country. In Egypt, valuations deteriorated significantly in the past weeks, worsening the technical score for the country.

- We also reduced hard currency corporate exposure in Colombia, where changes to a bond's covenants made it a weaker credit.

R-Squared is the percentage of a fund's movements that can be explained by movements in a benchmark index.
DXY is the U.S. Dollar Index that measures the value of the United States Dollar relative to a basket of foreign currencies.

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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.

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. Quantitative Easing by a central bank increases the money supply engaging in open market operations in an effort to promote increased lending and liquidity. Monetary Easing is an economic tool employed by a central bank to reduce interest rates and increase money supply in an effort to stimulate economic activity. Correlation is a statistical measure of how two variables move in relation to one other. Liquidity Illusion refers to the effect that an independent variable might have in the liquidity of a security as such variable fluctuates overtime. A Holdouts Issue in the fixed income asset class occurs when a bond issuing country or entity is in default or at the brink of default, and launches an exchange offer in an attempt to restructure its debt held by existing bond holding investors. Carry is the benefit or cost for owning an asset.

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For investors in Switzerland: The distribution of Shares of the Fund in Switzerland will be exclusively made to, and directed at, qualified investors (the "Qualified Investors"), as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended ("CISA") and its implementing ordinance. A copy of the latest prospectus, the Key Investor Information Document, the annual report and semi-annual report, if published thereafter can be found on our website www.vaneck.com or can be obtained free of charge from the representative in Switzerland: First Independent Fund Services Ltd, Klausstrasse 33, CH-8008 Zurich, Switzerland. Swiss paying agent: Neue Helvetische Bank AG, Seefeldstrasse 215, CH-8008 Zürich Place of performance and jurisdiction is at the registered office of the Representative.

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Please see the prospectus and key investor information document for information on these as well as other risk considerations.