EM Debt: Adjusting the Sails

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 30 September 2020

	1 Mo†	3 Mo†	1 Yr	3 Yr	Life
USD R1 Inc (Inception 12/6/14)	-1.96	5.04	4.71	1.19	-0.39
USD I1 Inc (Inception 20/8/13)	-1.89	5.28	5.70	2.17	2.36
USD I2 Inc (Inception 20/8/13)	-1.88	5.31	5.80	2.20	2.49
USD M Inc* (Inception 18/9/14)	-1.90	5.23	5.50	1.94	0.57
EUR Hedged I1 Inc (Inception 6/10/15)	-1.95	4.98	2.96	-0.64	2.60
EUR Hedged I2 Inc (Inception 22/08/17)	-1.96	5.00	2.95	-0.66	0.10
50% GBI-EM/50% EMBI USD[1]	-1.93	1.47	-0.02	1.89	3.08

* Investment through authorized financial institutions only.

† 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

Past performance of the Sub-Fund is no guarantee for future performance. Any performance presented herein is for illustrative purposes only. Historical information is not indicative of future results; current data may differ from data quoted. Performance information does not take into account the commissions and costs incurred on the issue and redemption of units. Performance information is presented net of fees, but gross of tax liabilities. Each index listed is unmanaged and the returns include the reinvestment of all dividends, but do not reflect the payment of transaction costs, fees or expenses that are associated with an investment in any fund. An index's performance is not illustrative of a Fund's performance. You cannot invest in an index.

Fund Review

The VanEck Unconstrained Emerging Markets Bond UCITS (Class USD I1) lost -1.89% in September compared to -1.93% 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.

Turning to the market's performance, GBI-EM's biggest winners were Uruguay, South Africa, and Philippines. Its biggest losers were Brazil, Russia and Poland. The EMBI's biggest winners were Ecuador, Romania, and Philippines. Its losers were Sri Lanka, Argentina and Mexico.

Market Review

In September, the biggest detractors were Sri Lanka, Mexico and Indonesia, while the biggest contributors were Uruguay, Suriname and Mongolia. We continued to make risk-reducing changes in September. The main thematic drivers of those country-specific adjustments were lower margins for error in a number of bond markets, many EM debt markets at pre-COVID-19 highs, country-specific setbacks and risks of second COVID-19 waves/U.S. election uncertainty.

We have closed a number of positions that worked well, for a combination of valuation and fundamental reasons. We have entirely closed our Argentina sovereign exposure, as telegraphed in our monthlies. Our view on Argentina was simply that bond prices didn't reflect the likely deal that would be reached with creditors, not that it was attractive beyond that. Argentina contributed positively to the Fund YTD. We closed our Indonesia local currency position because we believe the government is engaging in risky monetary experimentation, it's a popular overweight and markets have barely reacted to these new risks. We also closed our exposures to Angola, Gabon and Sri Lanka. Here, we essentially continued to take profits as price targets were hit and fundamental developments worsened. All of these contributed positively to the Fund YTD.

We also increased exposures to China in local currency, adding to our Chinese corporate bonds in USD. In local currency, China pays higher real rates following its selloff of recent months, its external accounts have improved sharply, steady index inclusion is creating supportive technicals and policy credibility is slowly making Chinese local bonds a safer haven. We also increased our exposure to Thailand local currency.

We end September with a carry of 6.6%, duration of 5.7 and approximately 25% in local currency. Our largest exposures are now China (USD corporates and local currency sovereign), Mexico (local currency and USD), and Uruguay (local currency). No other positions were higher than 5% of the Fund, so diversification increased further in September.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions in September were: China, Mexico, Uruguay, South Africa and Thailand.

- We increased our local currency exposures in China and Thailand. China's real rates are grinding higher, as authorities are not flooding the system with cheap credit, sticking to the "drip" stimulus instead. In addition to reducing a risk of asset bubbles, this also reduces inflation pressures going forward. So, as a result, China's local valuations now look much more attractive than several months ago. In addition, FTSE Russell has confirmed that China's government bonds will be included in its benchmark World Government Bond Index (WGBI) starting from October 2021. It is estimated that the inclusion might attract as much as USD120B inflows. This should create a nice technical backdrop for the currency, all things being equal. Another aspect of the inclusion is China's emerging as a "safer haven" investment destination, given that the WGBI focuses on high-quality and highly liquid bonds. These factors strengthened China's policy, economic and technical test scores. As regards Thailand, the country had experienced another political noise spike, but political risks seem to be exaggerated. Local bond valuations are solid and the latest data releases confirmed that the current account is recovering from the COVID-19-related slump. The Thai baht also has one of the highest historic correlations with the Chinese yuan, which improves the technical test score for the country.
- We also increased our hard currency sovereign and corporate exposures in Mongolia and the United Arab Emirates (UAE). Mongolia's new issue was attractively priced. An additional consideration is that Mongolia is uniquely positioned to benefit from China's ongoing recovery. Both factors improved the technical test score for the country. As regards the UAE, a deal with Israel that ends its boycott is a game changer—for the country and for the entire region. This positive shift in relations with Israel gave a huge boost to the country's policy test score. As regards our corporate exposure in the UAE, this UAE-based hydrocarbons storage company came with a small, high-yielding, discount-priced bond (hence the improved technical test score). The company benefits from an excellent location in one of the largest storage hubs, state-of-the-art facilities and a revenue stream of which 50% is represented by take or pay contracts. Management has been prudent and waited until it was fully contracted before expanding operations. In addition, the need for storage is not dependent on oil prices and therefore less volatile.
- Finally, we increased our hard currency sovereign exposure in Costa Rica. This decision reflects a more significant progress (and building consensus) on a new IMF program and the fact that the 2021 budget proposals incorporate agencies. This improved the country's policy test score. The country's valuations also improved, moving the highest initial allocation to Bucket #1, which strengthened Costa Rica's technical test score.
- We reduced our hard currency sovereign exposures in Angola, Sri Lanka and Gabon. The market did not like a passage from the IMF's staff report on Angola, which suggested that more debt relief would be required if the price of oil goes further down. This is hardly a revelation, but it worsened the technical test score for the country. Sri Lanka's IMF issues are much more serious. Contrary to expectations, the new government showed significantly less willingness to engage the IMF immediately after the elections. However, it is still not clear how authorities will be able to manage without the deal. Numerous calls with officials failed to clarify the situation and we lowered the country's policy and economic test scores as a result. As a confirmation of our decision, Sri Lanka got a rating downgrade soon after we divested. Our main concern in Gabon was that domestic policies might be at risk as the positive impact of the G20 debt deal fades. In addition, the country's VaR is quite high, which we thought warranted reducing exposure during the period of global de-risking. In terms of our investment process, this worsened the country's technical test score.
- We also decided to fully exit from our hard currency corporate exposure and local exposure in Indonesia. On the sovereign level, there was some unsettling news on the central bank's independence—specifically, that representatives of Ministry of Finance and other ministers

can sit on the board and vote for policy decisions. The reintroduction of large-scale COVID-19 restrictions in Jakarta introduced new downside risks to growth and fiscal performance. Summing up, the country's economic, policy and technical test scores worsened at the same time. Regarding our corporate exposure in Indonesia, the basic motivation was de-risking and taking profit after having made a decent amount of money.

- Finally, we reduced our hard currency sovereign and corporate exposures in Argentina. We started this process of sovereign divesting after the successful debt exchange and we continued to lock in profits in September. On a corporate level, we also participated in the recent bond exchange, receiving both an upfront payment, plus any and all interest payments that were due. As a general decision to lower our exposure to Argentina, we have begun to take profits in this area as well.

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.

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.

All indices are unmanaged 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 Fund's benchmark index (50% GBI-EM/50% EMBI) is a blended index consisting of 50% J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified (GD) and 50% J.P. Morgan Emerging Markets Bond Index (EMBI) GD. The J.P. Morgan GBI-EM GD tracks local currency bonds issued by Emerging Markets governments. The index spans over 15 countries. The J.P. Morgan EMBI GD 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. Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used or distributed without J.P. Morgan's written approval. Copyright 2020, J.P. Morgan Chase & Co. All rights reserved. The Blended 50/50 Emerging Markets Debt Index is an appropriate benchmark because it represents the various components of the emerging markets Fixed income universe.

IMPORTANT INFORMATION - FOR AUTHORIZED USE ONLY

All documents on VanEck ICAV's sub-funds are for informational/advertisement purposes only and do not constitute any legal or investment advice. It is mainly dedicated to professional investors and is not to be regarded as an offer for the purchase and the sale of the fund's shares. Investors should consult the prospectus and key investor information before subscribing. The prospectus, the key investor information documents and the financial reports can be obtained free of charge from vaneck.com and upon request from VanEck ICAV's registered office at 233 Sir John Rogerson's Quay, Dublin 2, Ireland and the offices of all local information agents. The documents, except for key investor information, are only available in English. Please read these documents before investing and take note of the risk factors. Note: No guarantee can be provided that the Sub-Funds presented will attain their objectives. The value of an investment may decline as well as increase. All persons interested in investing in one of the Sub-Funds presented are recommended to seek advice from independent legal and tax advisors in order to ascertain whether the investment is appropriate to their own objectives.

You can lose money by investing in the Sub-Fund. Any investment in the Sub-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 debt 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, hedging risk, non-diversification risk, and risks associated with non-investment grade securities.

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.

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