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Uncorrelated Wins

By Eric Fine, Portfolio Manager

VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

We outperformed in November, with the fund (Class A share) down 0.02%, compared to -1.82% for local currency debt (GBIEM), -0.48% for hard-currency debt (EMBIG), and -1.15% for the fund's 50/50 benchmark made up of those two indices. Our outperformance was due to Argentina (in hard currency), Ukraine (in hard and local currency), and Uruguay (in local currency). Brazil also boosted performance as it was a big loser for the indices, but a positive for the fund, where we had no local-currency exposure, and only corporate exposure (in hard currency). The fund's low duration and 30% exposure to local currency (a good part of which are not in the big index components) also helped.

We end November with a portfolio that generates 8.1% in carry, has low duration of 5.1, and local currency exposure at approximately 30%; we increased exposure to South Africa (local currency), Angola (hard currency), Chile (local currency), and Uruguay (local currency). Our largest country exposures include Argentina, Mexico (Pemex), Brazil (corporates), Indonesia, El Salvador, Uruguay, and Ukraine. We increased our exposure to South Africa (local currency) as their bond yields rose to very cheap levels according to the core of our investment process. Our concern over a downgrade from Moody's – which had kept us away from South Africa – is less powerful now because the agency has now changed the rating outlook to negative, so our concern is now arguably priced. Also, Angola issued hard-currency bonds and we participated. The bonds appear cheap, in our view, in the core of our investment process, the IMF-recommended currency devaluation is defending hard-currency reserves, and we expect progress towards an IMF program. We increased our exposure to Chile (local currency) as we continue to think the market over-reacted to social unrest (we had no exposure going into the unrest, and saw a buying opportunity). We also increased our exposure to Uruguay (local currency), where we continue to see the (now elected) government to address fiscal issues.

Argentina remains the main reason behind the fund's YTD underperformance, and its stability/strength in recent months is helping unwind this. Recall that we increased our exposure to Argentina in the July/August selloff, and continue to view it as an extremely rare opportunity for significant upside. We expect uncertainty to abate once a cabinet is named and debt negotiations start in early December. We also expect the government to stay current on payments while negotiating (the carry is 15%-plus, depending on the bond), and we believe the government (like many analysts, including ourselves) sees a liquidity problem, not a solvency problem. This means terming out debt will be the bulk of any restructuring, rather than principal haircuts. In other words, we see September as just the beginning of a rally, October a pause, and continue to expect much more going into the end of the year.

We continue to see Ukraine on a secular winning path. Reforms are profound, and include land reform, which could boost potential growth and the country's external accounts significantly. Peace with Russia would also have significant upside implications for growth. The IMF mission to Ukraine was completed without a new program, though. Nonetheless, it appears that there is just one more prior action required, and we expect a deal before the end of the year. All that said, we did reduce our exposure slightly, selling GDP (gross domestic product) warrants, as they had rallied to what we view as very high prices and are a very popular trade, and we see better opportunities inside Ukraine, potentially.

Key global macroeconomic developments influencing the portfolio include upside risks to global growth (!), in a world that just saw the IMF warn of global synchronized downturn.

Basically, there is stimulus in the pipeline from Chinese monetary and fiscal policy and European fiscal policy. Moreover, a "trade deal" between the US and China would likely reverse the recent global downturn, particularly for the more "open" EM economies. Finally, recent IMF meetings saw investors with what we see as low-ish EMFX exposure (due to backward-looking growth disappointments). Investors also appeared to expect US "rates" to head towards 0%, dragging other rates with them. Thus, if we are right that there is a bit too much bearishness in the near-term on growth, duration could be vulnerable even if EMFX does well. This is part of what's behind our increased EMFX exposure and low duration. Though, as usual, the main reasons remain bottom-up, and our explanation of our new attraction to Uruguay local currency below will be an example of this.

Exposure Types and Significant Changes

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

- We increased our local currency exposure in South Africa. We believe valuations started to look very attractive (top valuation bucket), following Moody's outlook change to negative. The fact that the market has already priced in a rating downgrade should limit any potential downside. An additional consideration is that South Africa's real GDP growth continues to surprise to the downside, whereas the central bank is not in a hurry to lower its policy rate. In terms of our investment process, this improved the country's technical test score.
- We increased our hard currency sovereign exposures in Angola and Ecuador. In Angola, we bought a new issue, which offered attractive valuations, in our view. Further, the IMF program appears to be on track, while the IMF-sponsored currency devaluation reduced pressure on the international reserves. In terms of our investment process, this improved Angola's technical and policy test scores. In the case of Ecuador, the country is going through a tough patch, but the government is seemingly enjoying the U.S. Treasury's support, which improves its policy test score. The latest price action also significantly improved the country's technical test score.
- Finally, we also increased our local currency exposures in Chile and Uruguay. Violent anti-establishment protests in Chile pushed currency and rates' valuations well below their fair value. There is still a great deal of uncertainty, but it looks like the central bank managed to stabilize the situation with its intervention program. In terms of our investment process, this improved the country's policy and technical test scores. In Uruguay, the main factor behind our decision was the outcome of the presidential elections, which we believe is likely to lead to positive changes in fiscal management, as well as the central bank's policy framework. In terms of our investment process, this strengthened Uruguay's policy test score.
- We reduced our hard currency quasi-sovereign and corporate exposures in Brazil, as well as hard currency corporate exposure in Colombia. In Brazil, the government's decision to delay the pro-growth reform agenda (fearing "contamination" from social unrest elsewhere in the region) worsened the country's policy test score. Unexpected political noise (President Jair Bolsonaro's decision to create his own party) and the botched pre-salt oil rights auction acted in the same direction. Additionally, we believe valuations became significantly less attractive, worsening the technical test score for the country. As regards Colombia's corporates, we were driven by allocation issues, as well as by recent operating disappointments combined with weak communication by management.
- We also reduced local currency exposures in Peru and Mexico. In Peru, the reasons were mostly technical—we believe the bonds we owned had a very good rally and the yields were getting low, so correlation with duration started to creep up. The very same reason—correlation with duration (or the worsening technical test score) — was behind our move in Mexico.
- Finally, we reduced hard currency sovereign exposure in Ukraine. The IMF left the country without a staff agreement (contrary to expectations). There were also concerns about potential delays in disbursements/political complications stemming from the impeachment process in the U.S. In terms of our investment process, this worsened Ukraine's policy/political test score.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) lost 0.02% in October compared to a loss of 1.15% 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 South Africa, Malaysia and Turkey. The biggest losers were Brazil, Chile and Mexico. The EMBI's biggest winners were Russia, Turkey and Argentina. The biggest losers were Ecuador, Lebanon, and Dominican Republic.

Average Annual Total Returns (%) as of November 30, 2019

	1 Mo†	3 Mo†	YTD	1 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	-0.02	2.54	8.13	8.52	-0.23	1.50
Class A: Maximum 5.75% Load	-5.71	-3.36	1.84	2.22	-1.41	0.69
50 GBI-EM GD / 50% EMBI GD	-1.15	0.68	9.36	10.81	2.78	2.72

Average Annual Total Returns (%) as of September 30, 2019

	1 Mo†	3 Mo†	YTD	1 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	2.28	-1.65	7.86	5.71	-0.35	1.50
Class A: Maximum 5.75% Load	-3.61	-7.31	1.58	-0.38	-1.52	0.67
50 GBI-EM GD / 50% EMBI GD	0.25	0.37	10.44	10.91	3.19	2.93

† Monthly returns are not annualized.

Expenses: Class A: Gross 2.05%; Net 1.26%. Expenses are capped contractually until 05/01/20 at 1.25% for Class A. Caps exclude acquired fund fees and expenses, interest expense, trading expenses, dividends and interest payments on securities sold short, taxes and extraordinary expenses. Please note that, generally, unconstrained bond funds may have higher fees than core bond funds due to the specialized nature of their strategies.

The tables above present past performance which is no guarantee of future results and which may be lower or higher than current performance. Returns reflect temporary contractual 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 investors' 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 Net Asset Value (NAV). An index's performance is not illustrative of the Fund's performance. Certain indices may take into account withholding taxes. Index returns assume that dividends of the index constituents in the index have been reinvested. Investing involves risk, including loss of principal; please see disclaimers on next page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.

The World Government Bond Index (WGBI) measures the performance of fixed-rate, local currency, investment-grade sovereign bonds. The WGBI is a widely used benchmark that currently comprises sovereign debt from over 20 countries, denominated in a variety of currencies, and has more than 30 years of history available. The WGBI is a broad benchmark providing exposure to the global sovereign fixed income market. 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.

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. Certain indices may take into account withholding taxes. 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 and 50% J.P. Morgan Emerging Markets Bond Index (EMBI). The J.P. Morgan GBI-EM Global Diversified tracks local currency bonds issued by Emerging Markets governments. The J.P. Morgan EMBI Global Diversified 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.

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Investing involves risk, including loss of principal. 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 risks associated with its investments in below investment grade securities, credit, currency management strategies, debt securities, derivatives, emerging market securities, foreign currency transactions, foreign securities, hedging, other investment companies, Latin American issuers, management, market, non-diversification, operational, portfolio turnover, sectors and sovereign bond risks. 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, and the risk that a position could not be closed when most advantageous. The Fund may also be subject to risks associated with non-investment grade securities.

Investors should consider the Fund's investment objective, risks, charges, and expenses of the investment company carefully before investing. Bond and bond funds will decrease in value as interest rates rise. The prospectus and summary prospectus contain this and other information. Please read them carefully before investing. 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.

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