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Cooling Late-Cycle Economy Could Rekindle Interest in Gold

By Joe Foster, Portfolio Manager

VanEck International Investors Gold Fund

INIVX / IIGCX / INIIX / INIYX

Fund Review

The International Investors Gold Fund's Class A shares returned 2.09% for the one month period ending March 31, 2018 (excluding sales charge), while the NYSE Arca Gold Miners Net Total Return Index (GDMNTR)[1] returned 2.84% for the same period. The Fund is actively managed and invests mainly in gold-mining equities.

Average Annual Total Returns (%) as of March 31, 2018

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	2.09	-4.80	-6.51	-3.80
Class A: Maximum 5.75% load	-3.73	-10.24	-7.61	-4.37
GDMNTR Index	2.84	-2.33	-9.33	-6.51

Average Annual Total Returns (%) as of December 31, 2017

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	7.54	13.03	-8.95	-2.47
Class A: Maximum 5.75% load	1.38	6.48	-10.02	-3.04
GDMNTR Index	4.56	12.21	-11.88	-5.58

†Monthly returns are not annualized. **Please note that precious metals prices may swing sharply in response to cyclical economic conditions, political events or the monetary policies of various countries. Investors should be aware that recent market conditions resulting in high performance for the gold sector may not continue.**

Geologist Joe Foster has been part of VanEck's gold investment team since 1996. The Fund is managed by a specialized investment team that conducts continuous on- and under-the-ground research to assess mining efficiencies and opportunities.

Market Review

Gold's price action in March was very constructive, even though it only advanced $6.62 (0.5%). Since the Fed began raising rates in December 2015, the gold market has shown weakness in the weeks ahead of each rate decision. This pattern was repeated once again, as the low for the month was $1,306 per ounce on March 21, the day the Fed announced its sixth 0.25% rate increase since it began raising rates. The Fed-induced lows in 2017 were in the $1,200 to $1,240 per ounce range, whereas the March 2018 low ($1,306) was much higher, extending the positive trend of higher lows to over two years. Gold was propelled to its high for the month of $1,356 per ounce on March 27 following the Trump Administration's announcement of tariffs targeting Chinese goods. China's immediate response was modest in comparison and gold finished the month at $1,325 per ounce.

Expenses: Class A: Gross 1.35%; Net 1.35%. Expenses are capped contractually until 05/01/18 at 1.45% for Class A. Caps exclude certain expenses, such as interest.

The tables present 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 from index constituents have been reinvested.

Investing involves risk, including loss of principal; please see disclaimers on last page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month end.

Physical demand in India has been weak for a couple of years now due to import restrictions, taxation, and currency changes. We have been expecting demand to return to normal. However, in February, Bloomberg reported weak Indian imports which suggests the gold market in India continues to struggle. While we wait for favorable developments from India, the positive trend in prices has been driven by investment demand for gold bullion exchange traded products (ETPs). Global bullion ETPs have seen steady inflows since early 2017 and holdings have now reached levels last seen in 2013.

Gold equities outperformed gold bullion in March, as the NYSE Arca Gold Miners Index (GDMNTR) gained 2.8%, while the MVIS Global Junior Gold Miners Index (MVGDXJTR)[2] advanced 2.2%. Perhaps gold stocks have begun to claw back the performance they have lost relative to gold this year. In the first quarter, gold equities underperformed gold by 7.2%, while junior miners underperformed by 7.8%. We normally expect gold equities to advance with gold, which has gained 1.7% so far this year. There are several reasons for the underperformance:

- **A lack of interest in safe-haven[3] investments:** While volatility has returned to markets this year, it has yet to reach worrying levels that might motivate investors to hedge their exposure. RBC Capital Markets reports the six-month trailing beta to gold of the VanEck Vectors® Gold Miners ETF has declined to 1.5x, compared to a historical average of 2.0x. The corresponding betas for the VanEck Vectors® Junior Gold Miners ETF is 1.7x and 2.2x, respectively. General investor apathy towards the miners was also evident at the BMO Global Metals and Mining Conference 2018 in late February. BMO commented anecdotally that institutional investor interest in precious metals was at levels last seen in the early 2000s, before gold's bull market.
- **Market worries that a new cycle of mining cost inflation has begun:** Several companies have guided to higher all-in mining costs in 2018 and we have seen some press and research that suggests costs are beginning to rise. Since 2012, industry average all-in mining costs have fallen roughly 25% to around the $900 per ounce level in 2017. Based on company guidance so far, we reckon these costs will likely rise to roughly $925 in 2018. After talking with many producers about their cost drivers, we believe cost concerns are overblown and that costs will fluctuate around the $900 level for the foreseeable future. Many companies have long-term contracts for materials and consumables. Some have hedged fuel and currencies at low levels. It seems the labor market has tightened somewhat in Australia, but companies are not reporting any wage pressures globally. In fact, BMO Capital Markets sees the all-in costs of the gold companies in their coverage universe declining 8% in 2019.
- **Gold stocks have yet to recover from the early February sell-off:** Investors viewed the general market sell-off as an overdue correction, rather than the reemergence of systemic risks. This interpretation precluded a flight to safe havens, causing gold and especially gold stocks to sell-off with the market in early February. As a result, RBC Capital Markets notes that the gold producers are trading at a roughly 20% discount to their historic valuations. So far, the general sell-off has been too short to benefit safe havens. In a February report, Goldman Sachs finds that it usually takes a month or so of equity drawdown for gold to start to act like a hedge.

Market Outlook

It appears that the confidence and complacency that has dominated the U.S. stock market for several years is now beginning to dissipate. Investor psychology is changing, the market is no longer bulletproof, and many of the high flying stocks are coming down to earth. Social media is facing a reckoning, as Facebook has become embroiled in a widening scandal over user data. Unfortunate mishaps for Tesla and Uber suggest autonomous driving may be much more difficult to achieve than expected. Regulators and tax authorities are targeting cryptocurrencies, while hackers target their exchanges.

The U.S. Commerce Department reported retail sales fell in February for the third month in a row, while the University of Michigan Consumer Sentiment Index[4] jumped to a 14-year high and the Conference Board Consumer Confidence Index[5] hovers near 17-year highs. This suggests that while times are good for most people, they have little desire to spend more in an economic expansion that is one of the longest on record. Households may save their gains from the Trump tax cuts, rather than spend in the economy, as the Commerce Department reports the savings rate ticked higher in February.

We believe these are signs that the post-crisis economic and stock market cycle is approaching its end. There are also many signs indicating core inflation could move beyond the Fed's 2% target. The S&P CoreLogic Case-Shiller Index[6] is 6.3% higher than its 2006 peak. A shortage has led lumber to record highs. Freight costs are near

20-year highs. General Mills CEO Jeff Harmening was quoted in *The Wall Street Journal*, "we are seeing an unprecedented rise in logistics costs". In the 12 state Midwestern region, job openings outnumber out-of-work job seekers. Idaho workers led the nation with a 5.3% increase in earnings in 2017 thanks to labor shortages. The Fed's February Beige Book saw employers raise wages and expand benefit packages in response to tight labor market conditions in most districts. Layered on all this are new tariffs that could raise the costs of a wide range of goods.

With core inflation at 1.8%, it is likely that inflation achieves a "two-handle" (2%) soon, and rather than risk falling behind the curve, the Fed might tighten more aggressively. This would also be classic late-cycle behavior. The track record of the 13 hiking cycles since 1950 compiled by Gluskin Sheff[7] leaves little room for optimism:

Fed Hiking Cycles, 10 Landed in Recession

First Hike	Last Hike	Result
October 1950	May 1953	**Recession**
October 1955	August 1957	**Recession**
September 1958	September 1959	**Recession**
December 1965	September 1966	Soft Landing
November 1967	June 1969	**Recession**
April 1972	September 1973	**Recession**
May 1977	March 1980	**Recession**
August 1980	December 1980	**Recession**
March 1983	August 1984	Soft Landing
January 1987	May 1989	**Recession**
February 1994	February 1995	Soft Landing
June 1999	May 2000	**Recession**
June 2004	June 2006	**Recession**
December 2015	???	???

Source: Haver Analytics; Gluskin Sheff

In addition, many other countries are enjoying growing economies. A February report by HSBC economist Stephen King identified all periods since 1990 in which the world economy has delivered synchronized growth. Mr. King finds that each was followed by some kind of economic or financial shock, attributed to excessive optimism and unanticipated shifts in monetary policy.

If we are right in our late-cycle assessment, gold and gold stocks stand to benefit if the current market, characterized by confidence and complacency, transitions to one filled with risks and volatility. We believe that once generalist investors take the time to assess gold stocks, they will like what they see — companies with strong balance sheets, cost containment, and good cash flow run by managements incentivized by profitability and shareholder returns. Under the right conditions, it probably won't take long for the global gold mining sector with a market capitalization of just $250 billion to fill the valuation gap and regain its historic beta to gold.

*All company weightings, if mentioned, are as of March 31, 2018, unless otherwise noted.

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[1]NYSE Arca Gold Miners Index (GDMNTR) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold. [2]MVIS® Global Junior Gold Miners Index (MVGDXJTR) is a rules-based, modified market capitalization-weighted, float-adjusted index comprised of a global universe of publicly traded small- and medium-capitalization companies that generate at least 50% of their revenues from gold and/or silver mining, hold real property that has the potential to produce at least 50% of the company's revenue from gold or silver mining when developed, or primarily invest in gold or silver. [3]Safe haven is an investment that is expected to retain its value or even increase its value in times of market turbulence. [4]A survey of consumer confidence conducted by the University of Michigan. The Michigan Consumer Sentiment Index (MCSI) uses telephone surveys to gather information on consumer expectations regarding the overall economy. [5]The Conference Board Consumer Confidence Index® is an indicator designed to measure consumer confidence, which is defined as the degree of optimism on the state of the economy that consumers are expressing through their activities of savings and spending. [6]The S&P CoreLogic Case-Shiller Home Price Indices are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate both nationally as well as in 20 metropolitan regions. [7]Gluskin Sheff + Associates Inc., a Canadian independent wealth management firm, manages investment portfolios for high net worth investors, including entrepreneurs, professionals, family trusts, private charitable foundations, and estates.

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