VanEck®

EM Debt: Lasting Love for Laggards

By Eric Fine, Portfolio Manager

VanEck - Unconstrained Emerging Markets Bond UCITS

USD R1 Inc: IE00BYXQSJ74
USD I2 Inc: IE00BYXQSG44
EUR Hedged I1 Inc: IE00BYXQSD13
USD I1 Inc: IE00BYXQSF37
USD M Inc*: IE00BYXQSH50
EUR Hedged I2 Inc: IE00BYX22V58

Average Annual Total Returns (%) as of 30 June 2020

	1 Mo†	3 Mo†	1 Yr	3 Yr	Life
USD R1 Inc (Inception 12/6/14)	6,93	21,87	-2,32	0,86	-1,22
USD I1 Inc (Inception 20/8/13)	7,01	22,16	-1,39	1,69	1,68
USD I2 Inc (Inception 20/8/13)	7,02	22,19	-1,31	1,86	1,81
USD M Inc* (Inception 18/9/14)	6,99	22,10	-1,59	1,61	-0,28
EUR Hedged I1 Inc (Inception 6/10/15)	6,86	21,69	-4,36	-1,06	1,69
EUR Hedged I2 Inc (Inception 22/08/17)	6,87	21,66	-4,37	-	-1,58
50% GBI-EM/50% EMBI USD[1]	1,99	11,05	-1,10	2,43	2,96

* *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) gained 7.01% in June compared to a gain of 1.99 % 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 Indonesia, Thailand, and Domiinican Republic. Its biggest losers were Brazil, Mexico and Russia. The EMBI's biggest winners were Angola, Oman, and Sri Lanka. Its losers were Russia and Venezuela.

Market Review

We outperformed our benchmark (50% J.P. Morgan EMBI-EM GD and 50% J.P. Morgan GBI-EM GD) by 502bp in June, with the fund (Class USD I1) up 7.01%.

The biggest contributors to performance were Angola and Argentina, followed by Indonesia and El Salvador and then Uruguay and Jamaica. We believe these details of our performance are very consistent with the idea that the action going forward will continue to be in laggards, particularly those with re-rating cases. Perhaps this bias toward selectivity is further underlined by the fact that local currency (as represented by the GBIEM) was up barely 50 bps in June. Despite the Fund having had around 40% in this poorer-performing part of EM debt, it was still able to significantly outperform. The local currency markets it chose to have exposure to—Indonesia and Uruguay, especially—turned out to do well for country-specific reasons. Again, we think this underlines the view that this is a country- and company-pickers' market, not a "global macro view" market.

The team remains very bullish, still seeing a "Buy of the Century" opportunity created by March's liquidity crisis. To recap, the Fund increased risk in March and April. But, the argument is now even more about specific opportunities, and even less about "EM's" resilience, which is arguably already priced-in at the index level. A simple version of this point occurs in Exhibit 1, which shows where asset-class price levels were post-GFC, post-COVID-19 and currently. It shows that, if all you can do is buy the asset-class, the bullish argument is weaker—the GBIEM and EMBIG have already recovered a lot. The team's bullishness, therefore, is now largely driven by its "day job"—the country- and company-specific opportunities that remain, following the COVID-19 liquidity crisis.

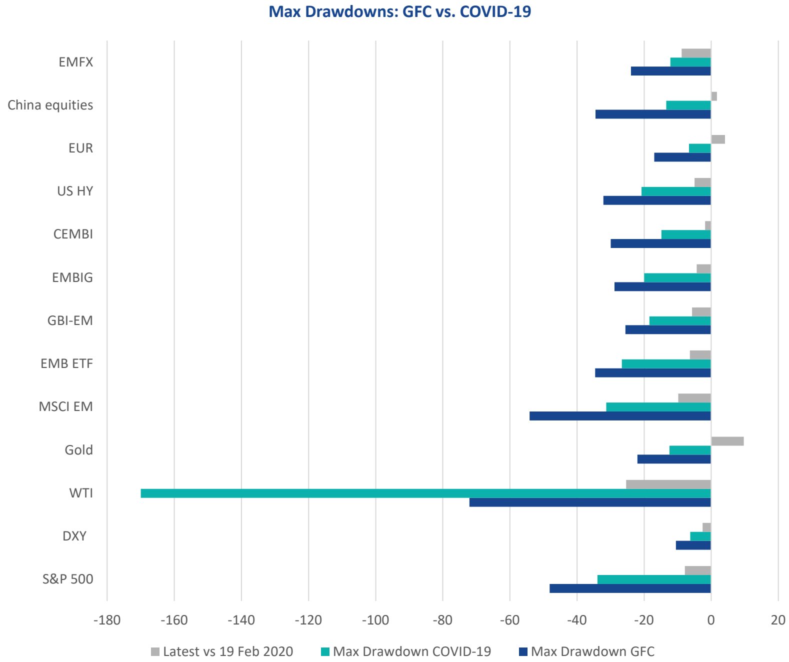


Exhibit 1 – Index-Level Returns Already Mean-Reverted?

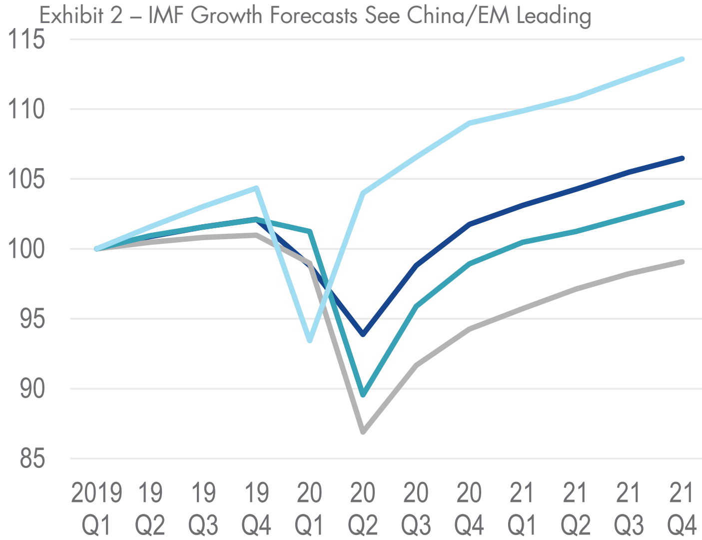
As was the case in May and June, we see the most exciting investment opportunities in "catch-up" situations for poorly-sponsored names, not in generic bullish or bearish stances on EM debt. Index-level performance may likely continue to lag the performance of the types of bonds in the Fund, we believe. The Fund was up approximately 22% in the second quarter, while the GBIEM local currency index was up approximately 10% and the EMBIG hard currency index was up approximately 12%. We think the key message is to avoid generic index exposures, more than be "bullish".

These top opportunities can be characterized as being oversold/ poorly sponsored, but also as having improving fundamentals; they are arguably re-rating candidates, in our opinion. The key ones include Argentina, Angola, Ukraine, El Salvador, Uruguay and Jamaica. A "speed round" of country analyses is as follows:

- Argentina is negotiating with creditors, not fighting with them; that has begun to be priced in. The government's latest offer is worth substantially more (let's ballpark it at 20% more) than the market is pricing. We will get more granular on our strategy when that basic "zip code" of pricing is in place.
- Angola is adhering to a credible IMF program, and benefited from debt forgiveness (quasi) from bilateral sovereign creditors, without requiring bondholders such as the fund to haircut debt. All of this arose in the midst of the COVID liquidity crisis, which in our view represents a potential re-rating process.
- Ukraine remains a juggernaut, and the COVID crisis was just a blip. It's adhering to its IMF program, has market access and is subject to significant upside growth risks … as well as being cheap according to our investment process. It is in the midst of a spat of uncertainty due to the resignation of the central bank governor, but we see this as in line with the noise that's surrounded a deeply reformist impulse.
- El Salvador has a new reformist president whose new party is set to gain new seats in the legislature next year. We believe the long-term policy prospective is positive and there are indications of an IMF program, when the stars align. The problem is that newly-elected President Nayib Bukele has increased spending due to the COVID crisis and his balance between today's need to stimulate and tomorrow's need to moderate is unclear. He wants a good setup into elections and we're supposed to believe he'll do all the right things when he's got full power after them. We basically believe it. But, 2021 is far away. Practically, our view could be at risk from bond issuance in the coming 12 months, correlation risk (we own spread duration), in addition to other factors (and of course, the risk of simply being wrong in our judgment on the long-term policy trajectory).
- Uruguay and Jamaica were written up in our previous monthly and we've made no changes. Events of the past month seem consistent with these remaining re-rating stories.

Rebounding growth data out of China and EM point to a sharper economic recovery than the market had been pricing, we think. Nonetheless, folks will be able to tell themselves any story they want. Bears will be able to point to still-weak levels of growth and employment, while bulls will be able to point to strong changes in growth and employment—that's why we like re-raters that are still catching up, not top-down global themes, where any story can make sense. If you should like a chart, see Exhibit 2, which shows EM PMIs (purchasing managers' indices) bouncing. Detail-wise, we'd emphasize that Asia is doing least-bad. This is consistent with the bullish reports we wrote in April, postulating that Asia would give sequential evidence to our bullish view.

Exhibit 2 – IMF Growth Forecasts See China/EM Leading



Our basic views laid out back in April and May remain in place—we still see incredible buying opportunities in EM debt, similar to those presented during the GFC.

- EM countries have the same basic fundamentals that made them perform and attract inflows post-GFC. Lower leverage and higher real interest rates continue to characterize EM relative to DM.
- There's even more stimulus from the DM in response to the current crisis than there was to the GFC. In contrast to EM, DM have even more leverage and lower interest rates, forcing them into more fiscal and monetary experimentation and supply. This money will likely flow to EM bonds, in our view, as happened post-GFC. Also, in our view, a lot of the DM stimulus for this current crisis is specifically aimed at stabilizing EM.
- Babies were thrown out with the bathwater. We see a great number of EM bonds that were sold at prices reflecting a liquidity crisis. As that gets addressed, as economies stabilize and as COVID-19 naturally abates, we see dramatic upside in a number of situations.

We end June with carry of 7.5%, duration of 5.3 and approximately 30% in local currency. Our largest exposures remain Indonesia (local), Argentina (USD), Angola (USD), Ukraine (USD and local), El Salvador (USD), Mexico (local) and Uruguay (local). All we can say is that we wake up in the morning thinking about our country exposures, not about global macro issues. Performance so far has been consistent with our stance. Our tag-line: (still) oversold and re-rating is (still) a powerful combination.

In June, our biggest change was closing our local South Africa exposure. This reduced local currency exposure, as well as VaR (value at risk), beta and correlation. We increased exposures to the "catch-up" names listed above, many of which were already in the portfolio and were simply increased. We expect these to reduce correlation. Our impression remains that selectivity is driving alpha. So, we remain focused on choosing the cheapest bonds in EM and it is very "neat" to note that this past month, standard risk management metrics would say we actually reduced risks, while we would say we actually took on equal or lower risk. Time will tell and we'll take stock next month, as usual, but we feel that we have to provide that opinion.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: Indonesia, Argentina, Angola, El Salvador and Ukraine.

- We increased our hard currency sovereign exposures in Jamaica and Honduras. Jamaica's sovereign valuations improved after the latest iteration of our valuation model, which was great news given that the country has good macroeconomic policies that should support a relatively speedy exit from the current crisis. In terms of our investment process, this strengthened Jamaica's technical test score. In Honduras, the government gave an update to investors, during which it identified about USD1B from multilateral creditors (concessional credits) which should cover the country's financing needs for 2020. Honduras also expanded its program with the IMF, which runs through 2021 and should serve as a powerful policy anchor. In terms of our investment process, this improved

- We also increased our hard currency sovereign exposures in Angola and Tajikistan. Our position in Angola showed a lot of price appreciation, as investors finally caught up with the fact that the country has good relations with the IMF and that it cleared a lot of debt issues with China. These factors also explain why we decided to add a longer-duration bond to our portfolio. In terms of our investment process, our actions reflect Angola's improved policy test score and still very decent technical test score. As regards Tajikistan, the sovereign had a very high valuation in our model (the highest initial allocation bucket) and it does not look like it will be having near-term problems with debt payments. It applied to participate in the G20 debt relief program and the IMF thinks that the country's debt will be sustainable on current policy commitments. In terms of our investment process, this translated into the improved technical and policy test scores.
- Finally, we increased our hard currency sovereign exposure in Belarus and hard currency corporate exposure in China. Belarus is getting close to the presidential elections, which naturally creates a lot of noise, but without affecting the actual policies (or the country's policy test score). This is reflected in the latest IMF report. So, the risks to sovereign bonds appear limited at this stage. There are uncertainties, of course, which is why we are closely monitoring the situation. As regards Chinese real estate companies, from a macro perspective, we saw them benefitting from an economic recovery and the government's support via improved market access. Individually, most of the credits we chose have demonstrated resilience to less favorable environments, access to markets and an interest in maintaining liquid balance sheets..
- We reduced our hard currency sovereign exposure in Azerbaijan and Mongolia. We used these positions as funders for more attractive opportunities, because bonds' spread-to-yield ratios in both countries were among the lowest in the portfolio. The latter meant that the price action was driven more by global factors than local developments, which resulted in the worsening technical test scores for both Mongolia and Azerbaijan.
- We also reduced our local currency exposure in South Africa and Mexico. South Africa's surging fiscal deficit and debt ratios and plunging real GDP growth pushed the economic test score for the country way down. These factors are behind growing concerns about issuance and financing needs—there is no clear policy on how to address these challenges. So, there is a nagging feeling that large fiscal deficits are likely to persist. In terms of our investment process, this also worsened the policy test score for South Africa. Mexico also managed to generate some bad headlines lately, but the reason we sold a longer-dated local bond is that the valuation became stretched after a rally, worsening the technical test score for the country.
- Finally, we reduced our hard currency sovereign exposure in the Dominican Republic and hard currency corporate exposure in Indonesia. The reason we sold two shorter-dated sovereign bonds in the Dominican Republic is that the novel coronavirus heightened concerns about tourism and overseas remittances. This lowered the economic test score for the country. Regarding Indonesia's corporate exposure, the company that we owned had less upside in a recovering world, which lowered its technical test score. Our local exposure in Indonesia was slightly down as well, but this was due to minor price changes.

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.

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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.

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