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Approaching Elections: A Cause for Uncertainty

By Eric Fine, Portfolio Manager

VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

It's starting to look like a bumpy road is in store for EM debt. As the U.S. central bank tightened interest rate policy, European growth faltered, challenging the global Goldilocks scenario[1]. It is not just Europe, as the recent PMI surveys in other major economies suggest that global growth might be plateauing or even topping out. So, keeping these countries in the expansion phase of the business cycle might require additional policy stimulus, which may or may not be forthcoming. Whichever way we look at it, higher global rates are increasingly becoming mixed or bad news.

It is worth a mention that a lot of the causes of this turn were well-telegraphed. The absence of a U.S. dollar ("USD") rally in the face of increasing rate differentials favoring the dollar was very surprising, and we discussed this issue in our past commentaries. European growth concerns, additional government bond issuance in developed markets, a Fed day on autopilot, and a bunch of other worries that were just as valid months ago (China trade war, for example).

An important consideration is that the upward pressure on both U.S. and global interest rates is coming at a time of major elections in key emerging markets, such as Mexico, Brazil, and Turkey. In our view, elections invite risk. In the case of these three countries' markets, concerns about potential policy shifts are quite understandable as these will have material implications for fiscal performance, debt sustainability and structural reforms in the years ahead. Given the more acute global challenges (rates, trade, etc.), we think it is likely that the market will start pricing in the various dangerous scenarios that could ensue.

A "rosy" blanket outlook for emerging markets is out and probing for vulnerabilities is back. It's a standard screening toolset probing for twin deficits, runaway inflation, overheating, and unresponsive central banks, among others. The first country that popped out as "fragile" on this metric was Turkey. It was tested by markets but did nothing in response. The weakness continues, abetted by bad policy and the attention now shifts on how the selloff might affect the forthcoming elections. The market also obviously went against Argentina, with its large external and domestic financing needs, but in this case the reaction was more mixed. In part because of the more pro-active and orthodox policy response. At first, the Central Bank of Argentina ("BCRA") started with currency interventions but authorities quickly realized that this was the dead end and stepped up the policy response. First, the BCRA hiked the policy rate by a mind-blowing 1,275 basis points to 40 percent within 10 days. Second, the government cut its primary deficit target for 2018 from 3.2% to 2.7% of GDP and scheduled parliamentary votes on several important structural bills. Third, the authorities started to work with the IMF on a large-scale loan facility. Locals are still buying the dollar and we do not expect market skepticism to fully evaporate until more details on the IMF deal become available but Argentina has a good chance to emerge a better credit with less need to issue debt (in part, because such programs usually cover countries' near-term financing gaps).

All of this, including the narrower reference to Argentina, point to near-term headwinds to emerging markets FX from the USD side. Our duration concern remains, but the sharp selloff in U.S. yields has been based on expectations that past policy initiatives will improve the country's economic prospects. This outlook is unchanged for now and in fact, it is finally driving USD higher. Credit, on the other hand, cheapened throughout this year. Against this backdrop, we have reduced local and increased USD credit exposure in our portfolio.

In local, we reduced our exposure to Mexico, Russia, South Africa, and Ukraine – country-specific reasons for the portfolio changes reflected our bottom-up investment process. In Russia, we continue to stress that the macroeconomic policy framework remains exemplary (especially on the monetary and fiscal sides). However, the geopolitical noise refuses to subside, creating major uncertainties about the asset classes (or individual names) that might be caught in the next wave of sanctions. In a similar vein, South Africa's new (and vastly improved) policy direction under President Ramaphosa continues to get high marks from us, however a lot of good news is already priced in, thus limiting potential upside. Mexico's macroeconomic outlook finally started to improve (disinflation appears to be well on track, domestic activity looks stronger, and the current account deficit is narrowing down). However, the presidential elections pose a major uncertainty for structural reforms (including the ones that had already been approved) so we prefer to stay on the sidelines until more clarity emerges in several weeks. Finally, the pace of structural reforms in Ukraine might be stalling as we are getting closer to the presidential elections and this might affect the disbursement of the much-needed IMF tranche.

In hard currency, we increased our exposure in Argentina and Brazil. Our investment process pointed us in the direction of corporate and quasi-sovereign debt and away from the traditional sovereign "smorgasbord". In Argentina, strong corporate fundamentals but a sometimes volatile sovereign can provide attractive entry points for corporate bonds. Specifically, we were able to purchase bonds of a utility with leverage below 2x at a slight discount to its longer-dated sovereign comparable. Thanks to that credit strength and the discount, these have outperformed their comparable sovereign during this most recent bout of volatility (a testament to our unconstrained approach). In Brazil, we added some new issues to the portfolio with very specific characteristics. In one case, we were able to buy the credit of an operating company for slightly shorter duration and flat spread versus its holding company, a compelling value with the added plus of greater secondary market liquidity offered by new issues. Our other Brazilian foray allowed us to buy a bond at a more than 300 basis point spread to its investment-grade, U.S. parent, with cross-default protection.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: Argentina, Brazil, Poland, Uruguay, and South Africa.

- As mentioned, we increased local and hard currency corporate exposure in Argentina and Brazil. We also increased quasi-sovereign exposure in Argentina. Argentina's government and the central bank are actively redeeming themselves policy-wise after making several ill-timed mistakes earlier this year. In terms of our process, this translates into the improved policy/politics score. In Brazil, the election outlook cleared significantly following ex-president Lula's removal from the race. This happened while the Brazil's inflation outlook remains very benign and there are no indications that the central bank will start tightening any time soon. In terms of our investment process, this resulted in the improved policy score for the country.

- We further increased local exposure in Uruguay. Valuations remain attractive (on the back of a major sell-off), while the short-term macro outlook is supportive. There are no signs of overheating, the government remains committed to its 2018 fiscal targets, and the inflation pressures appear contained for now. In terms of our investment process, this translates into the improved vulnerability metrics.

- We increased local sovereign exposure in Malaysia and the Dominican Republic. In the latter, we would like to mention supportive fundamentals (low inflation, robust growth, smaller current account deficit). An additional consideration is that the global bond is currently under review for the GBI-EM inclusion. In terms of our investment process, this translates into the improved vulnerability and correlation scores. One obvious risk to local exposure in the Dominican Republic is the need to boost the international reserves in order to meet the IMF requirements.

- We reduced local and hard currency sovereign exposure in Ukraine. The country's progress with reforms required to receive the next IMF tranche has been painfully slow, and the risk of delaying the disbursement looks much higher now. In terms of our investment process, this worsens the country's vulnerability and policy scores.

- We also reduced local currency exposure in Mexico, including the supra-national bonds denominated in the Mexican peso. We are getting increasingly concerned about the risks associated with the presidential elections outcome – the reversibility of reforms is one particular concern that stands out. In terms of our investment process, this worsens the country's policy score.

- We also reduced local currency exposure in South Africa and Russia. South Africa's local bonds no longer look cheap relative to fundamentals, while a lot of positive news on the political, policy, and ratings fronts have already been priced in. In terms of our investment process, this translates into the worsening vulnerability

metrics for the country. In Russia, the policy framework remains stellar, but the geopolitical factors reduce "investability" to zero. In terms of our investment process, this worsens the country's policy/politics score.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) lost 2.02% in April compared to a loss of 2.21% 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 Uruguay, Dominican Republic and Colombia. The Fund's losers included Mexico, Russia, and South Africa. Turning to the market's performance, the GBI-EM's biggest winners were Uruguay, Dominican Republic and Colombia. The biggest losers were Russia, South Africa and Argentina. The EMBI's biggest winners were Armenia, Latvia and Paraguay. The biggest losers were Turkey, Zambia and Lebanon.

Average Annual Total Returns (%) as of April 30, 2018

	1 Mo†	3 Mo†	YTD	1 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	-2.02	-1.00	0.58	6.00	-0.99	1.80
Class A: Maximum 5.75% Load	-7.63	-6.66	-5.24	-0.11	-2.15	0.77
50 GBI-EM GD / 50% EMBI GD	-2.21	-3.06	-0.91	4.82	0.96	–

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

	1 Mo†	3 Mo†	YTD	1 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	1.72	2.66	2.66	8.77	-0.18	2.19
Class A: Maximum 5.75% Load	-4.17	-3.28	-3.28	2.51	-1.36	1.15
50 GBI-EM GD / 50% EMBI GD	0.66	1.33	1.33	8.61	2.04	–

[1]Investopedia: A goldilocks scenario is an "economy that is not so hot that it causes inflation, and not so cold that it causes a recession."

†Monthly returns are not annualized.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time.

Diversification does not assure a profit or prevent against a loss.

Expenses: Class A: Gross 1.71%; Net 1.26%. Expenses are capped contractually until 05/01/19 at 1.25% for Class A. Caps exclude certain expenses, such as interest. 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. 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.

International Monetary Fund (IMF) is an international U.S.-based organization of 189 countries focused on international trade, financial stability, and economic growth.

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 indicies may take into account witholding 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.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time and portfolio managers of other investment strategies may take an opposite opinion than those stated herein. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Non-VanEck proprietary information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission of Van Eck Securities Corporation ©2018 VanEck.

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.