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Emerging Markets Debt Beats Expectations in 2016

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VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Our overall views and the portfolio remained largely unchanged in December – a month during which we slightly underperformed our 50/50 benchmark. This followed outperformance of our benchmark in both October and November. Essentially, we believe the trends that drove performance in the last quarter of 2016 (during which the Fund outperformed), and which we've been writing about previously, will continue. In particular, rising U.S. Treasury yields, a stronger U.S. dollar, rising attention to risks in China and Europe, and "protectionism" that could arise following the U.S. presidential election. As a result, our portfolio continues to have very low duration and low emerging markets local currency exposure (the Fund has only 5% exposure in emerging markets local currency, all of it in Brazil).

Why do we see rising U.S. Treasury yields? Normally, if yields are rising due to higher final demand, emerging markets credit spreads, emerging markets exchange rates, and to some extent duration should all do well. However, the question is whether the current uptick in yields is due to the U.S. macro strength. This does not strike us as being the case. It is risk-negative factors that seem to be driving higher yields. Headline inflation continues to rise, with February possibly seeing a 3% print. If oil prices are viewed as generally positive for emerging markets, this should be kept in mind, as the more important impact could be to underline rising U.S. yields to reflect the risks of U.S Federal Reserve rate hikes and even a Fed that is possibly behind the curve. Any fiscal stimulus under a Trump presidency will be occurring in the context of very low unemployment, so the impact on wages and inflation expectations could be pronounced. Another point is that record high U.S. government debt levels (and the monetary forbearance that is part-and-parcel of them), mean real headwinds for growth, as credit, money multipliers, and confidence are weakened.

Why are we concerned about China? While we are breaking no new ground, we continue to emphasize that China is facing the impossible trinity or "trilemma". This holds that a country can only have two of the following three characteristics: a fixed exchange rate, free capital movement (i.e., no capital controls), and an independent monetary policy. China needs to make a choice according to this economic principle, as all countries that have tried to have all three have failed. A simple explanation of the principle would be the following: If local interest rates declined (or U.S. interest rates rose), investors would buy more of the higher relative interest rate and thus put downward pressure on the local currency. If the country keeps its capital account open, then it must sell U.S. dollar reserves to prevent this deprecation. However, currency reserves are finite (and have been declining in China), and if they decline below key levels, the local currency will depreciate.

As we are currently seeing, China is struggling with the "float" of its currency since it is necessitating rising capital controls and volatile upward spikes in local interest rates that the authorities use to curb dollar longs. This is in a country where investment spending is just below 50% of gross domestic product (GDP). Put differently, this appears to us only to be a bad option for the Chinese authorities. Just look at the sharply higher interest rates the Chinese authorities put in place in early January to curb

speculation against the currency. In our opinion, those higher interest rates simply buy time, as they will hit growth, leverage (in a highly levered country), and confidence.

Why are we concerned about Europe? Europe, too, faces a basic contradiction. The Eurozone has one currency, but many fiscal policies and financial systems. If a country can borrow euros at German interest rates, one would expect leverage to grow to unsustainable levels in, let us say, Greece. It did, and blew up into a crisis. European authorities promised that fiscal policy and financial policy would become federalized to solve this contradiction. That promise has not been fulfilled, so it is hard for us to see how, in the future, any new hit to confidence gets credibly addressed. What might those hits to confidence be? We have French elections in April/June (two rounds are likely) in which one of the two leading candidates (Marine Le Pen) supports a referendum on a French exit from the EU. Dutch elections are set for March 2017 and Geert Wilders' party (which is leading in the polls) also supports an exit. An adverse outcome to either or both (or even a rising chance of an adverse outcome that does not materialize) is not in our view reflected in European or global asset prices.

Why might a Trump presidency be negative for emerging markets asset prices (while potentially positive for U.S. asset prices)? President-elect Trump has promised a number of protectionist measures, many of which can be implemented through executive fiat. One of the arguments of his campaign, moreover, was that foreign workers have benefited at the expense of U.S. workers under globalization. However depressing this may sound, though, as an unconstrained blended emerging markets debt fund, we have the flexibility to adjust to this environment. As noted, the current portfolio continues to have low duration and low emerging markets local currency exposure. This was key to our outperformance in the turbulent last quarter of 2016.

What country- and company-specific situations are we excited about in our portfolio?

Brazil. The country's macroeconomic background supports further policy rate cuts. Inflation and inflation expectations are declining steadily – often surprising to the downside – while domestic demand remains soft and the national unemployment rate is still rising (close to 12% in November). International reserves are stable, the current account continues to adjust, and large foreign direct investment inflows mean that the basic balance (12-month cumulative) is at the highest level since 2000. Importantly, the Temer government continues to push forward with major structural changes that should put the country's fiscal accounts on a more sustainable path. Brazil remains our largest allocation.

Argentina. The macroeconomic background remains supportive with: (a) the new reformist government; (b) debt ratios still low, and; (c) improved access to capital markets. Fiscal policy has suffered setbacks recently, but it is our view that this is only to get through this year's local elections, after which reform momentum will continue. The recent resignation of Finance Minister Prat-Gay makes us more confident of this view of the future, as he was behind a slower adjustment of fiscal policy.

Mongolia. The new government surprised on the positive side with a strong reform push delivering more than the International Monetary Fund (IMF) would have expected. The IMF program is a major policy anchor – Mongolia's case is expected to be discussed by the IMF board in mid-January. Once the program is approved (which we expect it to be), the country's access to capital markets should improve markedly. The IMF program should unlock additional funding from multilaterals, while the government is working with Japan, China, South Korea, and Russia on getting bilateral support.

Russia. The economic and monetary policy setup remains excellent in our opinion. The central bank is focused on bringing inflation down while letting the currency float freely. The medium-term fiscal policy framework looks conservative and there is more evidence (latest Purchasing Manager Indices or PMIs, for example) that the growth outlook is gradually improving. The election results in the U.S. could end the escalation of sanctions – a good prospect for the country, as it has simply paid down its debt and de-levered during the sanctions period.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: Brazil, Argentina, Mongolia, Russia, and Peru.

- We increased sovereign hard currency exposure in Mongolia, where the government is making good progress towards an IMF program. In terms of our investment process, this resulted in an improved policy/politics score.

- We also increased local currency exposure in Brazil. The government is making solid progress on structural issues (approving fiscal legislation), while steady disinflation and soft domestic activity should pave the way for more policy easing. In terms of our investment process, this led us to assign a higher policy score to the country.

- We also increased hard currency corporate exposure in Russia and corporate and quasi-sovereign hard currency exposure in Argentina and Kazakhstan. Russia looks set to benefit from the expected post-election rapprochement in relations with the U.S., which might see the sanctions regime eventually relaxed. In terms of our investment process, this translates into an improved policy/politics country score. In Argentina, the appointment of the new economics minister suggests the possibility of a more aggressive fiscal adjustment going forward. In terms of our process, this improves the country's idiosyncratic credentials – along with its correlation score.

- We reduced sovereign hard currency exposure in Ukraine due to concerns about a lack of progress with the IMF. This resulted in a lower politics/policy score for the country.

- We also reduced hard currency corporate and quasi-sovereign hard currency exposure in South Korea. The increasing political uncertainty in South Korea makes the defensive case for this country weaker. This led us to assign a lower politics/policy score.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) gained 1.22% in December, compared to 1.60% 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 Brazil, Mongolia and Argentina. The Fund's biggest losers were Suriname, South Korea and Belarus.

Turning to the market's performance, the GBI-EM's biggest winners were Russia, Brazil and South Africa. The biggest losers were Turkey, Romania and Mexco. The EMBI's biggest winners was Venezuela, Gabon and Ghana. The biggest losers were Costa Rica, Hungary and Oman.

Average Annual Total Returns (%) as of December 31, 2016

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	1.22	-1.43	6.06	6.06	-2.28	-0.28
Class A: Maximum 5.75% Load	-4.61	-7.07	-0.11	-0.11	-4.18	-1.58
50 GBI-EM GD / 50% EMBI GD	1.60	-5.05	10.16	10.16	1.00	–

Average Annual Total Returns (%) as of September 30, 2016

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	0.33	0.66	7.60	8.71	-1.18	0.05
Class A: Maximum 5.75% Load	-5.41	-5.09	1.35	2.43	-3.11	-1.34
50 GBI-EM GD / 50% EMBI GD	1.21	3.37	16.02	16.75	2.75	–

†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 1.44%; Net 1.25%. Expenses are capped contractually until 05/01/17 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 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 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). Index returns assume that dividends of the index constituents 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.

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.

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.

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 50/50 benchmark (the "Index") is a blended index consisting of 50% J.P. Morgan Emerging Markets Bond Index (EMBI GD) Global Diversified and 50% J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM GD). The J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM GD) tracks local currency bonds issued by Emerging Markets governments. The index spans over 15 countries. J.P. Morgan Emerging Markets Bond Index (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. The J.P. Morgan Emerging Country Currency Index (EMCI) is a tradable benchmark for emerging markets currencies versus the U.S. Dollar (USD). The Index compromises 10 currencies: BRL, CLP, CNH, HUF, INR, MXN, RUB, SGD, TRY and ZAR. The Consumer Confidence Index (CCI) 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.

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 emerging markets 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, non-diversification risk and risks associated with non-investment grade securities. Please see the prospectus and summary prospectus for information on these and other risk considerations.

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