VanEck FUNDS

The Fed is Now Activated

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VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

In February, we continued to re-evaluate our views on both duration and emerging markets local currency exposure. In the past nine months, our reluctance either to extend duration or to assume more emerging markets local currency risk has reflected our concerns about rising interest rates in the U.S. as markets embarked on the reflation trade. Stretched valuations reinforced our opinion that vulnerabilities were asymmetric (and would result in more downside if our views proved correct). Our defensive positioning was vindicated in fourth quarter of 2016 and January 2017 when we outperformed in the global rates selloff.

In the past weeks, however, we have been getting signals that room for both further increases in rates and the strength of the U.S. dollar might be limited. First, the original push for higher rates and a stronger U.S. dollar was predicated on expectations that sizeable fiscal stimulus, tax reform, and deregulation under the Trump administration would revive animal spirits and push both actual and potential growth up (along with inflation). The outlook for the Trump reform agenda is, however, getting more uncertain and the probability that the fiscal plans will not be implemented this year appear to be increasing. Second, even though the U.S. labor market remains tight, we have yet to see signs of sustained wage pressures that might ultimately feed into core inflation. The recent Atlanta Fed Wage Index readings were particularly disappointing in this regard, with the overall wage growth easing to 3.2% from 3.9% in October-November 2016. Under these circumstances, there are growing concerns that the Fed's determination to tighten will make the economy more vulnerable – leading to lower growth, disinflation, and another "leg down" in nominal rates. The fact that the U.S. economy is in the late stage of the business cycle amplifies these risks. Third, even though the Fed appears to be in hawkish mode right now, the forthcoming changes in the composition of the Federal Open Market Committee (FOMC) might result in a more dovish voting roster later this year. Soft capacity utilization prints and the continuing decline in money velocity undermine the fundamental case for the reflation trade. Fourth, the selloff in U.S. rates in the second half of 2016 closed the big fundamental valuation gap that had opened up in late 2014. (At their low in July 2015, nominal rates were consistent with extremely depressed expectations for long-term inflation and output growth.) Valuations are now more in line with fundamentals and the next "leg up" in rates would require long-term inflation expectations rising to 2.3% and long-term real growth rising to 1.8% (currently 1.9% and 1.6% respectively). Finally, the recent policy cues from Chinese authorities indicate that real GDP growth will be slower and this might also affect the global reflation trade.

As we have evaluated these developments, we have decided to make small adjustments in our local currency and duration exposures, increasing the former to 25% (from around 19% in January) and the latter to 5.4 (from 3.1 in January). With regard to local currency exposure, our focus is on names that get high allocation recommendations on the basis of first and second step of our investment process (Argentina, Brazil, Indonesia, Peru, and Russia). These names pay high real interest rates relative to fundamentals. They also have powerful idiosyncratic stories (both macro and policy) that give them high scores in the third step tests of our investment process.

Still, we want to be cautious and tactical on local currencies because the Fed is now activated - markets expects another hike in June-July and the Fed's guidance/forecast/dots might change at that time leading the two-year U.S. Treasury yield to move in response, potentially overwhelming our bottom-up views. We like MXN, BRL, RUB, PEN, and ARS, but if the Fed tightens more than expected, we should have room to buy and not take hits. As regards duration, we have already pointed out that the Trump administration's stalling fiscal stimulus, high debt levels (the business sector leverage is close to pre-crisis levels), and the fact that the U.S. economy is late in the business cycle might anchor it more than previously expected. As a result, we feel a little bit more comfortable extending our duration exposure.

In local currency, we have noteworthy exposures in Brazil, Mexico, and Argentina. A key reason we like these countries is a combination of the central banks' orthodoxy (this now includes the Banxico) and newly found fiscal conservatism (Brazil and Argentina). In Argentina, we now have stronger signs of disinflation (the central bank's decision to stay on hold despite the near-term costs for growth, should help to bring inflation down further in the coming months), a more realistic fiscal plan for 2017, and a currency that is supported by foreign currency inflows (from bonds and the harvest). In Brazil, the real policy rate is among the highest in the world, disinflation has become entrenched, inflation expectations are edging lower, and market expectations for policy easing are still conservative. The latest fiscal numbers were better than expected, due to smaller discretionary spending – a welcome sign. Meanwhile, the Temer government continues to make progress on the structural front (pension reform) allowing the central bank to continue monetary easing and support growth. In Mexico, we are cognizant that fiscal performance is a major challenge and that the central bank might need to tighten more in order to address inflation pressures stemming from the second-round inflation effects and pass-through from past currency weakness. However, a deal of bad news seems to be priced in, while the fundamental support for the currency appears stronger. We continue to evaluate our exposure to Mexico – there is a chance that our position there might be more tactical than elsewhere in the region if the aforementioned positive trends are not sustained.

In hard currency, we have noteworthy exposures to Argentina, Mongolia, Brazil, and Mexico. In Argentina, the government reshuffle continues to have a positive impact on governability and fiscal adjustment. A good harvest and additional bond issuance could also ensure a steady inflow of hard currency into the country. The central bank's policy looks conservative, with the aggressive inflation-targeting regime in place and no unnecessary easing. The Mongolian government has finally reached an agreement with the IMF that will help to unlock around $5B in the next three years ($440 million coming from the IMF and the rest from other multilateral organizations). The government is also busy building financial alliances in the region (with China, Russia, and South Korea among others) – the recent extension of the $2B swap line with the People's Bank of China for another three years is one such example. These developments give a big boost to Mongolia's debt-service capabilities. In Brazil, we have an attractive combination of the improving basic balance (i.e., the sum of the small current account deficit and very large foreign direct investment inflows) and the continuing progress on structural issues. There are, finally, signs in Mexico that both the economy and policy are turning in the right direction. Mexico's foreign exchange commission finally came to its senses and modified the foreign exchange intervention program "à la Brazil" by offering currency swaps. This provides two major benefits: (a) the program is sizable (up to $20B); and (b) the central bank's international reserves will not be drained in the process. We particularly like this last point because the reserves are simply too small to survive sustained spot interventions. In addition, the current account gap shrank more than expected in the fourth quarter of 2016 and this might be the beginning of the adjustment process.

Overall, we are fairly geographically diversified, with allocations to 29 countries, a carry of 7% and a duration of 5.4. We are still underweight both duration and exposure to emerging markets local currencies. Going forward, the key factors/developments that will affect how our portfolio evolves in the coming months are: (1) clarity on President Trump's fiscal agenda and trade policy; (2) the FOMC's assessment of the U.S. economy's prospects and its response function (this includes changes in the macroeconomic forecasts and the path of the "dots"); and (3) the election outcomes in several key European countries. We are also watching the evolution of China's politics and policy in the run up to the party congress in the fall which could potentially ease or exacerbate the existing macroeconomic and financial imbalances there, affecting both the growth outlook and the exchange rate.

Exposure Types and Significant Changes

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

- We increased quasi-sovereign hard currency exposure in Mexico. The central bank in Mexico surprised with its hawkish attitude, which should help to curb inflation pressures down the road. Further, Mexico's foreign exchange commission introduced a sizeable foreign exchange swap scheme that does not affect international reserves. In terms of our investment process, this has resulted in improved policy and vulnerability scores for Mexico.

- We also increased sovereign hard currency exposure in El Salvador, Turkey, Zambia, and Nigeria. In El Salvador, government officials visited the IMF in order to discuss the precautionary agreement (which translates into the higher policy score for the country). We also increased our hard currency sovereign exposures in Zambia and Nigeria – the latter appears to be moving to a more flexible exchange rate arrangement, while the former is now in consultations with the IMF. In terms of our investment process, this improves policy scores for these countries.

- We reduced quasi-sovereign hard currency exposure in Kazakhstan and Israel. We used the short-duration bonds (which have a worsening correlation score) as funders for our duration exposure.

- We also reduced local currency exposure in Brazil on concerns about the Fed (this also translated into a worsening correlation score for the country).

- We also reduced hard currency sovereign exposure in Egypt and Costa Rica on valuation concerns (and ensuing higher correlation risks). We used these bonds as funders for our duration exposure.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) gained 3.12% in January, compared to 1.90% 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 Mongolia, Brazil and Mexico. The Fund's only loser was Turkey.

Turning to the market's performance, the GBI-EM's biggest winners were Argentina, Philippines and Brazil. The biggest losers were Russia, Hungary and Peru. The EMBI's biggest winners were Mongolia, Egypt and Zambia. The biggest losers were Mozambique, Suriname and Ghana.

Average Annual Total Returns (%) as of February 28, 2017

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	3.12	6.08	4.80	10.20	-1.15	0.74
Class A: Maximum 5.75% Load	-2.83	-0.03	-1.19	3.82	-3.07	-0.53
50 GBI-EM GD / 50% EMBI GD	1.90	5.45	3.79	12.35	2.01	–

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	–

†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. Carry is the benefit or cost for owning an asset.

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.