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Persistent Gap Between Fed and Markets

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VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

Most elements of our views at the end January remain intact. We see few reasons to question a global synchronized economic recovery. The consensus global growth forecast for 2018 remains steady at 3.7%, while the J.P. Morgan Global All-Industry Output Index grinds higher (a very healthy 54.8 in February). Stronger global demand is generally supportive of emerging markets fundamentals. But there are risks – higher inflation being the key one. The inflation surprise indices in the U.S. and Japan are once again rising, while those in emerging markets and the Eurozone are no longer falling. A combination of higher inflation and stronger growth prospects is likely to push global nominal yields higher. This will be especially true if the situation with abnormally low term premia in developed markets (still negative for 10-year U.S. Treasury yields!) starts turning – not an unreasonable assumption/ expectation given that major central banks are considering (or are already) withdrawing policy accommodation, which is set to increase net government bond issuance. Last (but not least), the widening twin deficits in the U.S. might also contribute to higher nominal yields – the historic relation between the two is quite strong. In our view, these are primarily risks to duration, and we've had low duration in our portfolio for over a year now.

Expectations of stronger growth and inflation in developed markets continue to clash with extremely cautious market expectations for the pace of policy normalization by major central banks. In the U.S., markets foresee only four additional rate hikes by the Fed in the next three years – with most of them happening in the next twelve months – hence the persisting gap between market consensus and the Fed's longer-dated "dots" and significant room for nominal yields' upward adjustment (at least under some circumstances). A sizable gap between the 2-year rates in the U.S. (2.24%) and the long-term expectations for short-term rates (3.18% – as implied by the ACM model) tells a similar story.

Given the backdrop of stronger fundamentals but significant risks, stretched asset price valuations are a reason to be cautious and selective. The EMBIG spread is close to the 5-year lows, and the GBI-EM rallied back to the post-taper tantrum highs. The emerging markets local debt risk premia (measured as emerging markets local rates spreads over the U.S. adjusted for emerging markets credit spread) continue to push lower: the 10-year risk premium is now the lowest since late-2013, while 2-year and 5-year risk premia are the lowest since 2011.

One conclusion from this has been to maintain low duration, and this continues. Risk-free duration is challenged by global growth, and especially by rising inflation pressures in the U.S., Germany, and now Japan. Credit spread duration is challenged by stretched valuations, as well as the many risks to global synchronized growth – outflows from bonds, accelerated monetary tightening, and the risks that come when rates rise following increased debt. We expected and continue to expect upward pressure on interest rates and thus maintain low duration.

Another conclusion is to favor idiosyncrasy. In hard currency, we prefer bonds and credits whose outcomes are not mostly driven by the global macro crosswinds buffeting asset prices. These names have higher spreads and spread-to-yield ratios, improving fundamentals, and – preferably – strong policy anchors in the form of International Monetary Fund (IMF) programs (aspirations work as well in some cases). Our current exposures include such diverse names as Armenia, Belarus, El Salvador, Mongolia, Ukraine, and Venezuela. All

of these bonds are short duration (2023 is the longest one) and have strong idiosyncratic drivers. The IMF programs are important factors in Ukraine and Mongolia: in the former, the government can count on receiving one more tranche in the second quarter of the year, while in the latter the government and the IMF have just reached a staff-level agreement on the third review of the Extended Fund Facility (EFF). Belarus has managed to find the geopolitical "Golden Middle" in its relations with both Russia and Europe while fostering growth, maintaining fiscal discipline, and rebuilding its international reserves. The Armenian economy is in turnaround mode growth-wise and this should help to reduce macroeconomic imbalances (current account and fiscal gaps).

As regards local currency, we continued to increase our exposure in February, bringing it to about 50% of our portfolio. There are several reasons for this. First, the risk of rising rates had been mostly addressed in a number of countries – and this includes policy adjustment. Second, many emerging economies are still relatively early in the business cycle with no need to tighten their policy stances (despite the impending stimulus withdrawal in developed markets). Third, we see quite a few countries where policy makers are maintaining high real interest rates which can cushion the risk of rising global interest rates. Finally, the outlook for the U.S. dollar remains uncertain despite the Fed's policy normalization. On the one hand, the differential between expected interest rates in the Eurozone and the U.S. is no longer widening and this should limit the dollar's downside – if the trend continues. On the other hand, the widening twin deficits in the U.S. are often associated with the dollar's weakness. We believe that this U.S. dollar backdrop leaves enough room for idiosyncratic plays in the emerging markets foreign exchange space. With all this in mind, we selected the following countries for our local debt exposure: South Africa, Poland, Russia, Mexico, Brazil, Chile, Argentina, Colombia, the Dominican Republic, and Indonesia.

South Africa is worth a special mention. This is our largest local currency position and we started to build the position early in the process of the political change. The last month confirmed that this was the correct decision. We were particularly impressed by the new cabinet's line up (which brought back the "holy trinity" of solid policy-making – Nhlanhla Nene was re-appointed Minister of Finance, Pravin Gordhan responsible for state owned enterprises, and Gwede Mantashe for mineral resources). Another impressive move was the gutsy decision to raise the value added tax in order to help improve fiscal performance. As a result, we now feel more confident that monetary policy will be easier at the margin, that the good policy noise will continue to prop up local assets, and that the risk of downgrade has receded. Our portfolio manager, Eric Fine, was recently in South Africa, and we came away reinforced in our bullish outlook for the South African politics, policy mix, economy, ratings, currency, and interest rates. We will, as usual, issue a more detailed report.

Finally, we now have about 30% of the portfolio in corporate bonds. Some of the names in Brazil, Indonesia, and Ukraine continue to show as cheap in our valuation framework and we believe that they have further appreciation potential. Several of the names we hold in Brazil and Ukraine pay very high coupons while having relatively short duration – which resonates well with the overall philosophy of the portfolio.

Exposure Types and Significant Changes

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

- We increased local sovereign exposure in Russia and Argentina. In Russia, the removal of the sanctions risk significantly improved the country's policy/politics score. At the same time, the macroeconomic background remains extremely beneficial for local rates – inflation is at the historic low (with no obvious meaningful upside risks), the external balance is very strong, the policy framework is stellar, and high real interest rates provide a "safety cushion" for ruble. In Argentina, the government and the central bank started to redeem themselves on the policy front – after a series of ill-timed mistakes in late-2017/early-2018 – including keeping the policy rate on hold and making some progress on the reform front. In terms of our investment process, this improved the country's policy/politics score.

- We also increased local currency sovereign exposure in Indonesia and the Dominican Republic. In Indonesia, the inflation outlook remains very benign and the central bank's policy is vigilant. We expect some negative impact from stronger investments on the current account balance – albeit the widening beyond 2.0%-2.5% of GDP is unlikely at this stage. Indonesia's inclusion in the Bloomberg Barclays Global Aggregate Index was a major boon – strengthening the country's policy score.

- We also increased local currency sovereign exposure in Colombia. The economy started the year with better than expected inflation indicators – signaling that the central bank is likely to maintain its dovish bias for a while. The current account looks much better as well – in part due to higher oil prices, and in part reflecting softer domestic activity. In terms of our investment process, this translates into the improved vulnerability score for the country.

- We reduced hard currency quasi-sovereign exposure in Israel

and hard currency sovereign exposure in Belarus. We continue to like fundamentals in both countries, however the valuations now look less compelling and this worsens their vulnerability scores. The deteriorating correlation score for Israel was an additional consideration.

- We reduced hard currency sovereign exposure in Mongolia and Angola. Even though both countries remain committed to structural changes, valuations now look less compelling and this translates into the worsening vulnerability score for these countries.

- We also reduced hard currency sovereign and corporate exposure in Ukraine, as well as hard currency corporate exposure in Colombia. The corporate bonds in Ukraine that we owned rallied a lot – they actually started to trade tighter than sovereign spreads – and this worsened their vulnerability score. We also wanted to trim our sovereign exposure until we get more certainty on the next tranche of the IMF loan (this translated into weaker policy/politics score for the country). The reduction in Colombia's corporate exposure reflected less compelling valuations (hence, weaker vulnerability scores) and we used these bonds as funders.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) was down 0.67% in February compared to a loss of 1.52% 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 South Africa, Indonesia and Argentina. The Fund's losers included Brazil, Dominican Republic, and Venezuela. Turning to the market's performance, the GBI-EM's biggest winners were South Africa, Russia and Chile. The biggest losers were Indonesia, Argentina and Hungary. The EMBI's biggest winners were Belize, Mozambique, and Trinidad and Tobago. The biggest losers were Ethiopia, Venezuela and Tunisia.

Average Annual Total Returns (%) as of February 28, 2018

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	-0.67	2.10	0.92	7.55	0.95	1.92
Class A: Maximum 5.75% Load	-6.35	-3.83	-4.92	1.36	-1.03	0.86
50 GBI-EM GD / 50% EMBI GD	-1.52	2.05	0.67	9.35	4.97	–

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

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	1.16	-0.24	11.68	11.68	0.78	1.81
Class A: Maximum 5.75% Load	-4.71	-5.99	5.30	5.30	-1.20	0.71
50 GBI-EM GD / 50% EMBI GD	1.38	1.01	12.74	12.74	4.87	–

†Monthly returns are not annualized.

The ACM (Tobias Adrian, Richard K. Crump, and Emanuel Moench) model prices "…the time series and cross-section of the term structure of interest rates using a three-step linear regression approach."

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 1.68%; Net 1.25%. Expenses are capped contractually until 05/01/18 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.

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 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.

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 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.