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Key to Rising Rates: Low Duration

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VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

Most elements of our views at the end of the year remain intact. In the broadest terms, we see a global synchronized economic recovery that is supportive of emerging markets fundamentals. Fundamental risks do exist – inflation is the paramount risk, and rising interest rates, following a global leverage binge, encapsulate them all. We are also keeping an eye on the abnormally low (in reality still negative) term premium in the developed markets that is likely to drift higher as major central banks withdraw accommodation and net bond issuance increases. Another consideration is the very real prospect of a wider fiscal gap in the U.S. that should also push yields higher (if the long-term historic relation between the two holds). The challenge remains that asset prices are largely stretched in the face of this supportive, yet risky, backdrop.

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. and Germany. 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, we maintain low duration.

We also continue to favor idiosyncrasy. We want bonds and credits whose outcomes are not mostly driven by the global macro crosswinds buffeting asset prices. In hard currency, where there is a large risk-free interest rate component, we continue to have exposure to shorter duration with high idiosyncrasy. Our exposures here continue to include names such as Belarus, Ukraine, Ecuador, Armenia, and Mongolia. These names are higher-spread, and we see fundamentals as strong or improving due to good policy, not because the global tide has lifted them. Having International Monetary Fund programs are important policy (and sentiment) anchors in Ukraine and Mongolia. In Ecuador, President Moreno continues to strengthen institutional controls and his recent referendum victory should put this process on an even firmer footing. Belarus has managed to find the geopolitical "Golden Mean" in its relations with both Russia and Europe, while fostering growth, maintaining fiscal discipline, and rebuilding international reserves. The Armenian economy is in turnaround mode growth-wise and this should help to reduce macroeconomic imbalances (current account and fiscal gaps).

One conclusion that has evolved for us, though, concerns local currency, where we have been increasing exposure (currently about 42%). Basically, in local currency we see a number of situations in which the risks of rising rates are significantly addressed. In particular, in South Africa, Poland, Mexico, and Chile we see early economic and reform cycles that deviate significantly from the more mature cycle of the rest of the world. Moreover, in each country, policy makers are maintaining high real interest rates to cushion the risk of higher global interest rates. The "idiosyncrasy theme" benefits a lot from the fact that fundamental factors affecting U.S. dollar currently point in the opposite directions. In particular, while the differential between short-term rates in the U.S. and Europe should be pulling the U.S. dollar higher, the widening twin deficits in the U.S. (a sum of the current account and fiscal gaps) should continue to push the U.S. dollar down.

While we have discussed more country-specific factors before, the gist of the narrative remains that we are finding opportunities in local currency. Poland is a growth juggernaut with contained inflation pressures and impressive fiscal discipline (despite the government's populist reputation). In South Africa, the election of Cyril Ramaphosa as the African National Congress' (ANC) president has already started to improve the policy landscape (changing Eskom's board is just one example). If these trends continue in the coming months many imbalances of the Zuma era might be reduced. In Chile, the recent presidential election eliminated an important negative tail risk (fiscal populism), paving the way for the local bonds' rally. Finally, even though the political uncertainty in Mexico is likely to persist in the run up to the presidential election, the central bank is firmly focused on bringing inflation back to the target range and its promise to keep the real policy rate at 3.5% means that valuations should remain attractive in the foreseeable future. One important consideration that "unites" many of our local currency positions is that the respective countries are early in the business cycle, while the central banks have enough policy room to ease in the not-so-distant future irrespective of the U.S. Federal Reserve's moves.

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Exposure Types and Significant Changes

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

- We increased local currency sovereign exposure in South Africa and Poland. In South Africa, the results of the ANC leadership contest in December and the election of market-friendly Cyril Ramaphosa as the ANC's next president signal a likely departure from the defective policy-making of the past several years with its negative impact on growth, fiscal performance, and debt ratios. In Poland, the "goldilocks" scenario remains unchallenged, and the benign inflation outlook gives the central bank an opportunity to stay on hold for most of 2018. In terms of our investment process, this improved the countries' policy/politics scores.

- We also increased local currency sovereign exposure in Chile and Singapore. In Chile, Sebastián Piñera's victory in the presidential elections substaintially reduced the negative tail risks – especially as regards growth and the fiscal outlook. In terms of our investment process, this translates into the improved policy/politics scores for the country. In Singapore, valuations remain compelling, while broadening economic recovery provides an extra "safety net" for the budget. It is also encouraging that the 2018 fiscal plan puts extra emphasis on structural issues and competitiveness. In terms of our investment process, this improves the country's correlation and policy/politics scores.

- We also increased hard currency corporate and quasi-sovereign exposure in Brazil – including Brazil's largest television company, a protein company, and a freight company. The television company should prove relatively resistant to market gyrations given a cash position that hovers between 2-3x total debt. After three years of slower economic growth, the top line should perform better, leading to greater cash flow generation. The protein company is the highest yielding corporate in this space in Brazil. Our expectation is that there will be a refinancing agreement between the company and its banks over short-term maturities, which should push spreads tighter. The freight company's new seven-year deal came at a slight discount to the already extant issues. The recent capital increase also meant an investment in a stronger company with an improved balance sheet.

- We reduced low-duration local currency exposure in Mexico switching into higher-duration bonds instead. The move reflected sharp disinflation which should become more entrenched as the central bank remains focused on bringing inflation back to the target range. This policy, however, is less favorable for the short end of the curve, worsening the policy/politics score for these tenors.

- We reduced hard currency sovereign exposure in Ecuador and Mongolia. 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 local currency sovereign and hard currency quasi-sovereign exposure in Argentina, and hard currency corporate exposure in Indonesia. In Argentina, authorities made a badly-timed decision to revise the inflation target – which might affect the results of the wage negotiations and the overall price trajectory for the next two years. In terms of our investment process, this lowered the country's policy/politics score. In addition, the political infighting between the central government and provinces which are not loyal to President Macri resulted in a situation where one of them (Chubut) threatened to default on its bonds. Both local and quasi-sovereign trades were extremely popular with investors in the past, and the aforementioned developments worsened the vulnerability score for these kinds of exposure.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) gained 1.60% in December compared to a gain of 2.22% 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, Brazil and Poland. The Fund's losers included Argentina, Ecuador, and Venezuela. Turning to the market's performance, the GBI-EM's biggest winners were Peru, Argentina and South Africa. The biggest losers were Czech Republic, Uruguay and Hungary. The EMBI's biggest winners were Venezuela, Mozambique and Belarus. The biggest losers were Argentina, Uruguay and Chile.

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

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	1.60	0.97	1.60	11.65	0.82	2.07
Class A: Maximum 5.75% Load	-4.28	-4.89	-4.28	5.21	-1.17	0.99
50 GBI-EM GD / 50% EMBI GD	2.22	4.53	2.22	13.15	5.42	–

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

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life	Life
Class A: NAV (Inception 7/9/12)	1.16	-0.24	11.68	11.68	0.78	1.81	1.94
Class A: Maximum 5.75% Load	-4.71	-5.99	5.30	5.30	-1.20	0.71	0.80
50 GBI-EM GD / 50% EMBI GD	1.38	1.01	12.74	12.74	4.87	–	–

†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 1.68%; 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.