VanEck®

VanEck FUNDS

Navigating QE and Market Uncertainties

By Eric Fine, Portfolio Manager

VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

Our overall stance remains – we are in the process of shifting gears to lower local currency exposure, while keeping duration low, and emphasizing idiosyncrasy. For now, we are thinking of this as a shift in gears, not a slam down on the brakes, as there are enough idiosyncratic opportunities to keep us invested in "local currency" for the coming month or so. We believe we are shifting gears to achieve what would be a more defensive stance as we move into the last quarter of 2017.

Since central banks are now looking more frequently at the quantitative easing (QE) "exit" signs so are we. We believe economies and markets are entering an endgame as the Federal Reserve (Fed), and then European Central Bank (ECB), look likely to formally announce tapers to their programs. In the past, these exit attempts triggered the taper tantrum of May 2013, a mini-tantrum in February 2015, and the reflation tantrum of July 2016 (started by the Bank of Japan and accelerated by the election of Mr. Trump as U.S. president). We do not want to be caught up in tantrums such as these. We have probably all read the incessant lamentations about low volatility, the 35-year rally in bonds, and the unprecedented nature of the exit from QE. We would like to reiterate that the game theory of a QE exit is not straightforward. For one it could be viewed as a "game of chicken", through which the Fed needs to convince the market that the famous "put" is removed, especially because market expectations are well below what the Fed is attempting to communicate through its dots. Alternatively, the Fed's attempt to end QE might be less aggressive then currently thought - especially if the market's reaction proves to be too adverse. This sounds like "multiple equilibria", and that is exactly what it is. Finally, we would note that the Fed's language appears focused on tightening financial conditions, not on dealing with runaway final demand. We believe that is an important distinction, because Fed tightening – associated with strong demand – should be credit positive, whereas Fed tightening to remove the "put" is inherently "risk-off".

We do not believe that an accident is approaching, but rather that uncertainty is likely to increase. Other contextual points that may add to the uncertainty include the growth of passive investing (some argue that is leading to mispriced assets) and the fact that, while credit ratings in emerging markets have deteriorated, spreads have rallied. G4[1] interest rate correlations have been extremely high during QE exit fears in the past, and this is another "transmission mechanism" from central bank policy to bonds. We think this results in asymmetric asset price outcomes: if this is a sequel to the moments of uncertainty witnessed in the past, the downside, in our opinion, seems to be a lot larger than the upside, in the event it is not another moment of high uncertainty.

We are maintaining some of our higher beta positions, particularly in local currency, for the time being. The reason is bottom-up idiosyncrasy – we are now less negative on Brazil following its turmoil, and on Poland following some turmoil of its own. After several quarters of profitable exposure to Brazil, we started reducing our exposure in April of this year. This was due primarily to our view that social security reform was fully priced into the market. Soon after we started reducing our Brazil exposure, President Temer became embroiled in a corruption scandal that ended up weakening the currency significantly. The currency has returned to where it was when we exited, allowing us to avoid the volatility. Now that this has died down, and more importantly, that the government is showing signs of strength, we think the opposite of what we

did in April. Namely, we believe that social security reform is viewed by the market as very unlikely, whereas we see a government that may surprise us on that front. Essentially, our argument is that the Brazilian government has done a good job responding to the scandal. Most importantly, impeachment was avoided. This would have created at least a delay or distraction from reform efforts. Moreover, the government was able to get legislative approval for labor reform, despite these political challenges. And, following the avoidance of impeachment, the government is refocusing on its reform agenda, with social security reform as the vehicle.

In Poland we have a similar view – that uncertainty surrounding tension between the Polish government and Brussels (which claims that Poland is violating European law in exerting more control over the justice system) looks to be on the back burner for now. The country's president has vetoed the controversial moves of the prime minister, both of whom are in the same ruling party, showing the strength of Polish institutions that are in the midst of this spat with Brussels. Growth is solid, with low inflation, creating the appearance of a "goldilocks"[2] scenario. The government has been outperforming its fiscal targets, too, further strengthening the supply/demand argument. In addition, we see very limited bond supply risk in the tenors we like (under five years). In both of these cases, we feel there is enough idiosyncrasy as we approach a possibly riskier environment in the coming months. Our bottom line is that we are enjoying the "warm weather" where we are highly confident it will continue a bit longer, but keeping our woolen caps close by as the risk of a QE exit winter approaches.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: Argentina, Mexico, Poland, Israel, and Ukraine.

- We increased hard currency sovereign exposure in Mongolia and Belarus. Both countries have an attractive combination of high spreads and idiosyncratic drivers, as well as good technical support. Mongolia's entry levels looked attractive on the back of misplaced (and short-lived) market concerns about the outcome of the presidential election. In terms of our investment process, this resulted in improved correlation scores for both countries.

- We increased local currency exposure in Brazil and Poland. In Brazil, the political noise is lower, the outlook for pension reform is somewhat better, and the central bank is willing to ease more – translating into improved policy/politics scores for the country. In Poland, disagreements with the European Union (EU) about some constitutional issues will have no impact on the EU funds' inflows. In terms of our investment process, this translates into improved correlation scores for the country.

- We also increased corporate hard currency exposure in Colombia and the United Arab Emirates (UAE). The Colombia investment is a well-run non-bank financial company that paid a significant premium to the market as a small, new issuer. The ownership group has provided capital in the past, with the most recent injection coming within the past year, further increasing our comfort with the credit. We saw the 10% yield for five years as particularly inexpensive. The UAE corporate exposure is a company that services the offshore needs of the oil and gas industry in the Caspian Sea. Careful cost management has resulted in high cash conversion, positive free cash flow, and a reduction in gross debt over the past year. In addition, the company has a backlog that continues to grow and that now stands at around five years. The new issue seemed inexpensive given the five years of backlog and operational improvements achieved.

- We reduced local currency exposure in South Africa due to concerns about the elevated headline risks and the impact of much weaker growth indicators on the country's ratings – all these factors worsen the country's policy/politics score. We also reduced hard currency corporate, sovereign, and quasi-sovereign exposure in Argentina due to concerns about the impact of the forthcoming mid-term elections on market sentiment. In terms of our investment process, this translates into the worsening policy/politics score.

- We reduced hard currency sovereign exposure in South Korea and Peru, as well as in Gabon and Chile. In Gabon, our main concern was that the lower oil price was not fully reflected in valuations (which worsened the correlation score for the country). In Peru, Chile, and South Korea, the main focus was on the impact of the Fed's tightening narrative on duration. In terms of our investment process, this translated into worsening correlation scores for these countries.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) gained 1.17% in July, compared to 1.46% 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 Poland, Belarus, and Uruguay. The Fund's losers included South Africa, Gabon and Russia. Turning to the market's performance, the GBI-EM's biggest winners were Brazil, Hungary, and Uruguay. The biggest losers were Indonesia, Russia, and Argentina. The EMBI's biggest winners were Iraq, Mozambique, and Mongolia. The biggest losers were Venezuela, Pakistan, and Argentina.

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

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	1.17	2.47	8.59	6.72	-2.63	1.18	1.39
Class A: Maximum 5.75% Load	-4.66	-3.44	2.39	0.54	-4.53	-0.01	0.22
50 GBI-EM GD / 50% EMBI GD	1.46	3.06	9.84	6.53	1.88	2.23	–

Average Annual Total Returns (%) as of June 30, 2017

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	0.81	1.83	7.34	6.49	-2.98	1.18
Class A: Maximum 5.75% Load	-5.02	-4.03	1.21	0.42	-4.87	-0.01
50 GBI-EM GD / 50% EMBI GD	0.16	2.93	8.26	6.26	1.28	–

†Monthly returns are not annualized.
[1]Brazil, Germany, India, and Japan.
[2]Investopedia: A goldilocks economy is an "economy that is not so hot that it causes inflation, and not so cold that it causes a recession."

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. current to the most recent month ended.

International Monetary Fund (IMF) is an international U.S.-based organization of 188 countries focused on international trade, financial stability, and economic growth.

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 Diversify 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.