

VanEck FUNDS

Brexit - A Major Test for Europe

By Eric Fine, Portfolio Manager

VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Our basic framework remains – the headwinds are serious, binary, albeit perhaps not immediate, while the tailwinds appear temporary, unsustainable, albeit perhaps immediate. Policy and political uncertainty in Europe after the Brexit vote, China’s inability to dispel concerns about growth and currency, doubts about the number of policy bullets at the U.S. Federal Reserve’s (the Fed’s) – or other developed markets central banks’ – disposal, the U.S. elections, and the inability of Japan’s central bank and the government to get the country out of the deflation/low growth vicious circle are among the most serious headwinds that markets are facing right now. Tailwinds still exist and can be felt occasionally, with powerful short-term effects...but they seem to fade and require ever more repetition. Markets are increasingly pricing out Fed rate hikes – especially after the Brexit vote – and pricing in more quantitative easing (QE)/rate cuts/stimulus in Europe. What is very important is that this pushes down the entire U.S. Treasury curve, including both long-term expectations for short rates and term premium (which is already at historic lows). Our most durable view is that short-dated, high-quality U.S. dollar yields in emerging markets should decline in a world where a large portion of debt now trades at negative interest rates. Tailwinds – basically monetary forbearance – only seem to generate sharp, but short-lived, boosts to the risk assets we focus on (in particular, to emerging markets local currency).

As regards to headwinds, the outcome of the Brexit vote in the U.K. highlights Europe’s fragility, which stems from its inconsistent “one currency and many fiscals/financials” setup, with a democracy deficit on top of it. Even though any resolution is

probably far away, the authorities’ resolve will likely be tested again very soon. Hits can come from many places: the October constitutional referendum in Italy, the continuing conflict between Poland and the European Commission (EC) regarding the country’s constitutional tribunal, a possible European Union (EU) membership vote in the Netherlands, to name just a few. Recent events point to additional issues that might come in the wake of the EC’s harsh reaction to the fiscal strain in Spain/Portugal and problems in the Italian banking sector.

One obvious macro implication of the Brexit vote is its negative impact on growth – first and foremost in the U.K. and Europe, but also in other countries that can be affected through investment and trade channels, as well as through potentially tighter financial conditions. A decline in global trade due to Brexit’s shock to globalization should be negative for emerging markets foreign currencies with very open economies. Despite these uncertainties, asset price implications might be positive for good credit U.S. dollar bonds which stand to benefit from prolonged global monetary easing.

A great deal will also depend on the reaction of Japan and China especially in the currency space. If subsequent developments in Europe result in more risk aversion and a flight to safety down the road, the Bank of Japan might consider intervening in the spot market, initiating another round of currency wars. The Peoples’ Bank of China (PBOC) might use the situation to weaken CNY more going forward. We think that this warrants caution in some local markets.

Finally, we would like to draw attention to specific risks associated with the financial sector. Banks (especially European ones) stand more exposed to potential rollover risks and lower global interest rates in the aftermath of the Brexit vote. These types of risks warrant exposure to high-quality, high-rated U.S. dollar bonds that behave well in risk-off periods.

As regards to implications for our portfolio, our key view is that USD rates in high-quality emerging markets debt will likely be coming down in the foreseeable future, so we want to have core positions in high-quality and/or high-spread U.S. dollar paper such as Brazil (Petrobras), Mexican corporates with defensive characteristics and in countries such as Korea, Argentina, Ukraine, Indonesia, and Peru.

As we mentioned, the near-term tailwind of pricing out the Fed hikes could boost some emerging markets foreign currencies, but not all. We are viewing emerging markets foreign currencies more tactically and balancing near-term tailwinds against long-term headwinds. For this reason, we are focusing our local currency debt exposure on names with the highest real rates and high nominal rates that can benefit most from a re-pricing of the Fed. We also prefer names with positive idiosyncratic fundamental drivers such as Brazil, Russia, Indonesia, Malaysia, and Argentina (though maybe that's weakening), and we are looking at Peru local as in that camp.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions are currently: Brazil, Argentina, Mexico, South Korea, and Indonesia.

- We added local currency sovereign exposure in Russia and Brazil, where we expect to benefit from the improving inflation dynamics which should encourage the central banks to ease down the road.
- We also added corporate hard currency exposure in Mexico, Peru, and Brazil. In Mexico and Brazil, we see opportunities in high-quality and/or high-spread U.S. dollar paper with defensive characteristics.

- We also added quasi-sovereign hard currency exposure in China to benefit from the stabilization of capital flows and lower hard landing risks. In terms of the process, these bonds score well on the vulnerability test, as China's serious problems are focused on local currency, whereas their serious resources are focused on hard currency.
- We reduced hard currency sovereign exposure in Israel and Pakistan, using the proceeds to add to other positions in the portfolio.
- We also reduced hard currency sovereign exposure in Guatemala, Paraguay and the Dominican Republic for similar reasons.

Fund Performance

The Fund (EMBAX) gained 1.99% in June, compared to a gain of 4.63% for the blended benchmark 50/50 GBI-EM GD local-currency index and EMBI GD hard-currency index.

The Fund's biggest winners were Brazil, South Korea and Russia. The Fund's biggest losers were Malaysia, Honduras and Belarus.

Turning to the market's performance, the GBI-EM GD's biggest winners were Brazil, South Africa and Colombia, while its biggest losers were Nigeria, China and Romania.

The EMBI GD's biggest winners were Venezuela, Zambia and Colombia, while its biggest losers were Belize, Lebanon and Ecuador.

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

	1 Mo [†]	3 Mo [†]	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	1.99	2.63	6.90	-3.46	-0.69	-0.12
Class A: Maximum 5.75% Load	-3.90	-3.29	0.68	-9.05	-2.63	-1.59
50 GBI-EM GD / 50% EMBI GD	4.63	3.90	12.24	5.96	1.75	-

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

	1 Mo [†]	3 Mo [†]	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	3.27	4.16	4.16	-8.88	-5.32	-0.82
Class A: Maximum 5.75% Load	-2.71	-1.90	-1.90	-14.13	-7.17	-2.38
50 GBI-EM GD / 50% EMBI GD	6.16	8.03	8.03	1.33	-1.70	-

[†]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 comprises 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.

Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The index may not be copied, used or distributed without J.P. Morgan's written approval. Copyright 2014, J.P. Morgan Chase & Co. All rights reserved.

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 and portfolio managers of other investment strategies may take an opposite opinion than those stated herein. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Non-VanEck proprietary information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission of Van Eck Securities Corporation ©2016 VanEck.

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, and 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.



Van Eck Securities Corporation, Distributor
666 Third Avenue | New York, NY 10017
vaneck.com | 800.826.2333