Manager Commentary  June 2018

Compelling Value in Hard Currency Bonds
By Eric Fine, Portfolio Manager

VanEck Unconstrained Emerging Markets Bond Fund
EMBAX / EMBCX / EMBUX / EMBYX

Market Review
Emerging markets (“EM”) remained under pressure in June, driven pretty much by the same factors as in previous months – with global developments being among the key ones. First, multiple data points suggest that the period of synchronized global growth recovery might be coming to an end. While the U.S. economy appears to be going well, the growth momentum in many key emerging markets is faltering, with the ratio of PMIs (Purchasing Managers’ Indices) still in the expansion territory falling to 75% (versus 100% in February). Additional headwinds to growth come from the fact that some EMs are tightening or will have to tighten soon in response to market pressures or policy moves in developed markets (“DM”).

The U.S. Federal Reserve (“Fed”) went ahead with the expected 25bps target rate hike in June and the relative strength of the U.S. economy seems to point to more hikes over the rest of the year. This leads us to the U.S. dollar: a generalized U.S. dollar rally caused EM local currency debt to follow hard currency debt lower in June. We think that the changing global narrative has room to play out further, with EM local debt looking particularly vulnerable.

A number of important EM economies faced their own idiosyncratic challenges, in addition to the pressures noted above. In particular, Turkey, Brazil, and Mexico were/are in the midst of potentially transformative presidential elections, which means the market cannot really know what the policy response will be to the challenging global environment.

Other countries, such as Argentina, have large financing requirements that simply could not be met in the more challenging global environment. One of our favorite metrics is Current Account/Fiscal Balance/Foreign Direct Investment (“FDI”), where Argentina currently ranks the worst among major EM countries. However, Turkey, Brazil, South Africa, and India also look quite weak in this space. Regarding EM country exposure, it is important to make a distinction between EM debt (with its heavy concentration in EMEA and LATAM) and EM equities which are more “Asia-based”, and where things had been relatively calm until now – in part because China was “doing fine”. Recent developments, however, indicate that China might be back on the list of potential risks – and not just for Asia, but for EMs as a whole. The reappearance of negative growth surprises and uncertainty surrounding trade tariffs caused a fairly sharp weakening of the yuan in the second half of June. Even though the People’s Bank of China has policy instruments to slow down the depreciation if deemed necessary, another round of large-scale interventions is likely to be frowned upon by the market. China’s international reserves are still large in absolute terms, but their adequacy has eroded to the point where they are no longer sufficient on one of the four metrics used by the IMF (International Monetary Fund).

So, how do we look at our asset class against this background? Overall, we think there is significant value in hard currency debt – in part, because the adjustment started earlier and spreads now look about 120bps wider (on average), presenting a compelling entry point. However, we see multiple risks as regards local currency debt and duration. One reason is that global growth still face headwinds and more EM central banks have started to hike interest rates. Another reason is that EM local risk premia (measured, for example, by the local rates’ spread over U.S. Treasuries minus EM credit spreads) are still extremely low compared to the post-taper tantrum highs. Going into specifics, we maintain a preference for individual names with high idiosyncrasy
and low correlation. In particular, credit/U.S. dollar-denominated bonds in Argentina, Ecuador, and Angola are very uncorrelated and have substantial value. These countries are either in, or moving towards, official financing programs (i.e., do not require market borrowing) and yield 9% in U.S. dollar terms! There are also many major EMs that have negative idiosyncrasy (Turkey, Mexico, Brazil, and Hungary). Avoiding these names in the EM local currency space and having only limited corporate exposure helped to minimize our losses, despite large exposure to Argentina in June. Our current positioning can be summarized as follows:

- The Fund has 90% in hard currency debt, carry of 7.6%, and duration of 4.2.
- The exposure is low beta, very idiosyncratic, and diversified (carry of local debt is 7, duration of local debt is over 6).
- The Fund has no Turkey, no Mexico, and no Brazil local currency exposure.

What do we think right now about the fundamental environment in EM, and how are we positioned for it? We believe that growth weakness in the emerging markets still needs to play itself out. In addition, Asian asset prices have barely moved so far, despite stronger China risks. We also see big policy risks in Mexico, Brazil, and Turkey. In Mexico, newly-elected President Obrador has ideological (leftist) biases which might affect fiscal performance, energy reform, and the NAFTA negotiations. In Brazil, the far left and far right are set to clash in the run up to the presidential elections, with none of the top candidates willing to pass pension reform in a format that will likely set fiscal performance on a sustainable path. In Turkey, the central bank appears to be under the total control of President Erdogan appears to be interested in pro-growth policies than in fighting inflation and eliminating other macro imbalances. As regards Argentina, we remain hopeful. Local assets are reacting positively (finally) to policy adjustments. The “bazooka” deal with the IMF covers the country’s financing needs for the next two years, isolating it from market risk. Generally speaking, we think that countries in IMF programs (especially of this size) should not trade at 9% in U.S. dollar terms for too long. You may recall the same point we made about Mongolia just slightly over a year ago.

Exposure Types and Significant Changes
The changes to our top positions are summarized below. Our largest positions are currently: Argentina, Poland, Brazil, China, and South Korea.

- We increased hard currency sovereign exposure in Nigeria. Nigeria’s bonds sold off a great deal relative to the underlying fundamentals – many of which look stronger now (such as international reserves). In terms of our investment process, this translates into the improved vulnerability score for the country.
- We increased hard currency sovereign exposure in Costa Rica and El Salvador. We are mindful of the political risks in El Salvador associated with the forthcoming presidential elections. Still, the country’s 2018 financing needs seem to be covered and there are stronger signs of reaching an agreement between major political parties about financing the 2019-2024 maturities. In terms of our investment process, this improves the country’s vulnerability and policy/politics scores. In Costa Rica, there is a higher probability that fiscal reform will be approved in the fall, which should improve the policy/politics score for the country (and also pave the way for additional financing from IFOs (international financing organizations).
- We also increased hard currency corporate exposure in Chile (Enel – Chile’s largest energy group) and China (real estate). One of the reasons we invested in Enel’s new issue was the company’s strong rating – it was recently upgraded to Baa1 by Moody’s – which suggested it would prove less volatile in today’s market. Equally important, however, was a spread to our model of some 50bps, making it cheap as well, especially for such a highly-rated, stable credit. The increase in our investments in China properties was based on their status as being inexpensive per our calculations and their lower likelihood of being affected by price fluctuations in general. These bonds have little correlation with the rest of the market, more dependent as they are on internal policies in China.
- We reduced hard currency sovereign and quasi-sovereign exposure in Venezuela. The odds of a regime change are now significantly reduced (following the recent changes in the military command). This worsened the country’s policy/politics score. The only Venezuelan security that we decided to keep is the PDVSA 2020 bond due to its Citgo collateral.
- We reduced local currency exposure in Brazil, South Africa, Colombia, and the Dominican Republic where we see limited room for policy easing. In addition, Brazil’s reform outlook remains extremely convoluted in the run up to the presidential election. The central bank’s response function is very unclear as well. In South Africa, the post-election euphoria is over, but
we are yet to see a coherent reform plan. In terms of our investment process, this reduces the policy/politics scores for both countries. In Colombia, the local currency outperformed many of its peers (in part, due to higher oil prices) – so the risk of correction looks higher now and this negatively affects the vulnerability score.

- We also reduced hard currency corporate exposure in Brazil (Vrio – digital entertainment) and South Africa (Sibanye-Stillwater – gold and precious metals’ mining). Vrio, an AT&T subsidiary, called its bonds. Per the covenants in the new issue, placed in April 2018, the bonds would have to be repurchased by the company, should parent AT&T be unable to spin it off within a relatively short time frame. As it became more obvious that such an IPO was not going to happen, AT&T exercised that call. Sibanye bonds have been under pressure as safety concerns and its pursuit of an acquisition weigh on prices. We decided that these pressures could remain in place for a while and decided to exit the position.

**Fund Performance**

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) lost 2.78% in June compared to a loss of 2.02% 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 Chile, Zambia and Peru. The Fund’s losers included Argentina, South Africa, and Venezuela. Turning to the market’s performance, the GBI-EM’s biggest winners were Mexico, Peru and Dominican Republic. The biggest losers were Indonesia, South Africa and Argentina. The EMBI’s biggest winners were Costa Rica, Belize and Colombia. The biggest losers were Egypt, Argentina and Gabon.

### Average Annual Total Returns (%) as of June 30, 2018

<table>
<thead>
<tr>
<th></th>
<th>1 Mo†</th>
<th>3 Mo†</th>
<th>YTD</th>
<th>1 Yr</th>
<th>5 Yr</th>
<th>Life</th>
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<tr>
<td>Class A: NAV (Inception 7/9/12)</td>
<td>-2.78</td>
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<td>-6.05</td>
<td>-2.25</td>
<td>0.39</td>
<td>0.60</td>
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<td>Class A: Maximum 5.75% Load</td>
<td>-8.33</td>
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<td>-11.49</td>
<td>-7.88</td>
<td>-0.79</td>
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<tr>
<td>50 GBI-EM GD / 50% EMBI GD</td>
<td>-2.02</td>
<td>-7.02</td>
<td>-5.78</td>
<td>-1.89</td>
<td>1.89</td>
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### Average Annual Total Returns (%) as of March 31, 2018

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<th></th>
<th>1 Mo†</th>
<th>3 Mo†</th>
<th>YTD</th>
<th>1 Yr</th>
<th>5 Yr</th>
<th>Life</th>
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</thead>
<tbody>
<tr>
<td>Class A: NAV (Inception 7/9/12)</td>
<td>1.72</td>
<td>2.66</td>
<td>2.66</td>
<td>8.77</td>
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<td>Class A: Maximum 5.75% Load</td>
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<td>-3.28</td>
<td>2.51</td>
<td>-1.36</td>
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<tr>
<td>50 GBI-EM GD / 50% EMBI GD</td>
<td>0.66</td>
<td>1.33</td>
<td>1.33</td>
<td>8.61</td>
<td>2.04</td>
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†Monthly returns are not annualized.

**Expenses:** Class A: Gross 1.71%; Net 1.26%. Expenses are capped contractually until 05/01/19 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. Certain indices may take into account withholding taxes. 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. The Blended 50/50 Emerging Markets Debt Index is an appropriate benchmark because it represents the various components of the emerging markets Fixed income universe.

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 over time. 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. Certain indices may take into account withholding taxes. 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.

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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 below investment grade securities, credit, currency management strategies, debt securities, derivatives, emerging market securities, foreign currency transactions, foreign securities, hedging, other investment companies, Latin American issuers, management, market, non-diversification, operational, portfolio turnover, sectors and sovereign bond risks. 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, and the risk that a position could not be closed when most advantageous. The Fund may also be subject to risks associated with non-investment grade securities.

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 vanec.com for performance information current to the most recent month end and for a free prospectus and summary prospectus.