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VanEck FUNDS

Bullish on Emerging Markets Bonds

By Eric Fine, Portfolio Manager

VanEck Unconstrained Emerging Markets Bond Fund

EMBAX / EMBCX / EMBUX / EMBYX

Market Review

We have continued to shift our portfolio towards local currency and away from the defensive stance (i.e., low duration and low local currency) that characterized it during most of 2016. Roughly one half of the portfolio is now in local currency. The current yield of the portfolio is in the high 7% range, and the duration is in the high five year range. In particular, we increased local currency exposure in South Africa, Russia, Colombia, Brazil, and Uruguay, and reduced our hard currency exposure in Mongolia, Argentina, and Belarus.

There are bottom-up/country-specific reasons, as well as top-down/global macro reasons, why we have continued this shift towards local currency. Starting with the bottom-up/country-specific reasons: all of the local currency investments we own are in high real yield bonds, consistent with the core of our process (in which we compare countries' fundamentals to their bonds' premia – Z-spread[1] for hard currency and real yield for local currency). In South Africa, yields became sharply higher on the back of President Zuma's firing of market-friendly Finance Minister Gordhan. We believe that the central bank will maintain high policy rates relative to inflation, and would note that the country's external accounts are turning around (the current account deficit is now close to the post-crisis lows) and will remain that way. We should note, though, that unlike our other exposures, we have lower confidence in our South African investment due to the potential for a sea change in economic policy now that Gordhan has left. As a result, we will be watching policy signals closely, essentially to determine whether the good policy "frog" will be boiled to death slowly (in which case we will be more comfortable), or quickly (in which case we will not).

Russia also has high real yields, very strong external accounts, and strong and improving fiscal policy. Our economist, Natalia Gurushina, has returned from a country visit and has written a report entitled "Russia: Best. Policy. Ever". You will understand our confidence in this view. This is not a new view, and there is not much more one can say when a central bank has a policy rate nearly double that of likely inflation; fiscal policy is very constrained and aiming at a balance (0%) by 2020; and the current account is in surplus. No new view, just a continuation of our increased exposure that has characterized the first quarter of 2017. We should note that the central bank has started cutting interest rates at a 25 basis points clip. We are not over emphasizing this, as we were largely expecting it. Moreover, our view is, if the cuts continue, duration will be boosted, and if they do not, the currency will be boosted. It is really whether the ice cream will be chocolate or vanilla, but we do expect ice cream to be served.

Brazil is an old story for us. Even when our portfolio was more defensively positioned last year, we maintained significant exposure due to the idiosyncratic improvements we saw – very high real interest rates maintained by an orthodox central bank, collapsing inflation and inflation expectations, and sharply improved external accounts. (We should note that, at that time, we invested in hard currency bonds which we saw as less risky than local currency bonds, and performance was not hurt as they did roughly as well as the local currency bonds without the risk). The fiscal situation is more problematic, as the country faces a deteriorating debt dynamic. However, the current government is focused on this issue, and is, in particular, pursuing a social security reform (following its implementation of spending caps)

that will likely improve the debt dynamic. In our opinion, there were setbacks and concerns over that during the month, and the higher yields and weaker currency made it a buying opportunity. (If you recall from our last commentary, we were slowly increasing exposures in order to take advantage of such developments.) Our view is that even if social security reform gets watered down, as long as the policy drift is positive and the economic situation (particularly the high real interest rates) remains, we are getting compensated for the risk.

Colombia, too, has high real yields and improved external accounts. The fiscal situation is more questionable, but is generally conservative as is economic policy overall. The disinflation trend looks well established, the economy is hardly overheating, and this should allow the central bank to continue policy easing in the coming months, supporting duration exposure there.

Uruguay's underlying macro story finally started to look more attractive. Inflation is set to ease further in the second quarter. A low base effect will be a headwind later in the year, but CPI[2] should stay in single digits (i.e., within the target range). The central bank is unlikely to make abrupt shifts in its monetary policy. This would risk increasing depreciation expectations – something that the Banco Central del Uruguay wants to avoid given that inflation expectations are still above the target. The government is implementing some fiscal consolidation (we are unlikely to see a 4% deficit again this year), but stronger consumer confidence will prop up the real GDP growth in the coming months.

Funding our purchases, we focused on reducing hard currency positions in Mongolia, Argentina, and Belarus and positions in local debt exposure in Argentina. We still like Mongolia's story – the government's emphasis on reforms that is supported by the IMF[3] and other international financial organizations. The country's new policies got a nod of approval from Moody's, which revised its rating outlook from negative to stable at the end of March. However, Mongolia's bonds rallied a deal in the past few months and our process shows that sovereign Z-spreads now look tight relative to the underlying fundamentals. Belarus' policy/political score worsened in the wake of large-scale street protests. In Argentina, higher than expected inflation increases the likelihood of a tighter monetary policy stance, denting the fundamental support for local currency debt. There is also some risk that soft activity indicators will increase political/policy/headline risk in the run up to mid-term elections.

Moving to top-down reasons, the following support our shift towards local currency debt. First, the real interest rate differential between emerging markets and developed markets (mainly the U.S.) is the highest in four years. The spread is likely to remain high going forward, since higher inflation in developing markets will be pushing real yields lower. Second, there's been noticeable improvement in both the political environment and policy making in several key emerging economies (Argentina, Russia, Brazil, India, and Indonesia, for example) which should improve market sentiment towards them and reduce the risk of further rating downgrades (together with risk premia). Third, bad news and fears related to changes in U.S. trade policy under President Trump are largely priced in. Meanwhile, the global leading trade indicator is rising sharply and the growth outlook in emerging markets should be the main beneficiary (which means more fundamental support for emerging markets local currencies). Finally, additional U.S. Federal Reserve hikes are now largely in the price – the two-year U.S. Treasury yield is now hovering around 1.3%.

Exposure Types and Significant Changes

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

- We increased local currency exposure in South Africa, Russia, and Colombia. Disinflation processes in Russia and Colombia should support further gradual easing (which translates into improved correlation and policy scores for these countries). South Africa's macro story appears to be turning around while many political risks are already priced in. We believe this may result in the improved vulnerability score for the country.

- We also increased local currency exposure in Brazil and Mexico. Mexico's central bank surprised with the hawkish attitude which should help to curb inflation pressures down the road. Mexico's foreign exchange commission introduced a sizeable swap scheme that does not affect international reserves. In Brazil, the disinflation trend looks established, while inflation expectations continue to decline and the reform process looks on track, paving the way for monetary policy frontloading. In terms of our investment process, this resulted in improved policy and vulnerability scores for Mexico and Brazil.

- We reduced sovereign hard currency exposure in Turkey and Belarus. The proximity of the constitutional referendum in Turkey and the uncertainty about its policy implications worsen the policy/politics score for the country. The politics/policy score in Belarus has also deteriorated in the wake of large-scale street protests.

- We reduced local currency exposure in Argentina due to concerns about higher inflation, tighter monetary policy stance, and mid-term election risks stemming from soft activity indicators. In terms of our investment process, this worsened the policy/politics score for the country.

- Hard currency sovereign exposure in Mongolia and Armenia was reduced on valuation concerns (and ensuing higher correlation risks). We used these bonds as funding for our duration/local debt exposure.

Fund Performance

The VanEck Unconstrained Emerging Markets Bond Fund (Class A shares excluding sales charge) gained 0.58% in March, compared to 1.35% 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 Brazil, Russia and Mongolia. The Fund's losers included South Africa, Kurdistan and Turkey. Turning to the market's performance, the GBI-EM's biggest winners were Mexico, Russia and Poland. The biggest losers were South Africa, Argentina and Chile. The EMBI's biggest winners were Belize, Mozambique and Paraguay. The biggest losers were Venezuela, Ecuador and Bolivia.

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

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	0.58	5.40	5.40	7.33	-1.79	0.85
Class A: Maximum 5.75% Load	-5.21	-0.61	-0.61	1.14	-3.70	-0.40
50 GBI-EM GD / 50% EMBI GD	1.35	5.18	5.18	7.26	1.76	–

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

	1 Mo†	3 Mo†	YTD	1 Yr	3 Yr	Life
Class A: NAV (Inception 7/9/12)	1.22	-1.43	6.06	6.06	-2.28	-0.28
Class A: Maximum 5.75% Load	-4.61	-7.07	-0.11	-0.11	-4.18	-1.58
50 GBI-EM GD / 50% EMBI GD	1.60	-5.05	10.16	10.16	1.00	–

†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 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.

[1]The Zero-volatility spread (Z-spread) is the constant spread that makes the price of a security equal to the present value of its cash flows when added to the yield at each point on the spot rate Treasury curve where a cash flow is received. [2]Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services. [3]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.

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 compromises 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.

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 ©2017 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, 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.

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