Manager Commentary

Hard Currency Outperforms Local, Argentina Continues Decline

By: Eric Fine, Portfolio Manager

Summary

In November, the J.P. Morgan Emerging Markets Bond Global Diversified Index (EMBI), representing hard currency (HC) debt*, returned 1.18%. The J.P. Morgan Government Bond-Emerging Markets Global Diversified Index (GBI-EM), representing local currency (LC) debt*, returned 1.41%.

In hard currency, Venezuela was the big winner, generating just over a 6% monthly return for November, but Russia and Turkey were not far behind. Argentina was the biggest loser this month, again dropping over 2%.

In the local currency index, Nigeria, Turkey, Poland and Russia were top gainers, while Brazil and South Africa were top losers.

Our basic views are unchanged from last month. For emerging market debt asset prices, we prefer the simpler race to the bottom for the dollar and interest rates that we expect under Obama to the bumpier race to the bottom that we would have expected under Romney. On the other hand, we think that geopolitical concerns could potentially escalate under an Obama presidency, in our opinion. This makes us less comfortable with significant exposure to the possible affected countries, such as Turkey and potentially Nigeria.

We still think there will be a period of nominal rises in growth and asset prices that are confused with real rises, and we will have to navigate that if it occurs.

In our view, Europe remains fraught with risk as the ECB appears to have over-promised and under-delivered.

Performance Review

The Unconstrained Emerging Market Bond Fund completed its fifth month with a 1.72% return. The biggest contributor was Venezuela, where our exposure is in hard currency debt. Venezuela's attribution was due, in our opinion, to President Chavez's health issues as well as our large exposure. We have been near our maximum 15% country limit in Venezuela since the fund's launch. Russia and Nigeria, where our exposure is in local currency debt, also added to our performance. Russia appeared to benefit from stable-to-stronger oil prices, as well as the announced Euro-clearability of its longer-dated bond market (OFZs), set for late December.

There was no specific catalyst in Nigeria, other than continued inflows into that market as participants, in our opinion, appreciate what we consider to be the country's strong fundamentals and attractive yields and currency.

Average Annual Total Returns (%) as of November 30, 2012

	1 Mo*	1 Yr	Life
Class A: NAV (Inception 7/9/12)	1.72	--	8.70
Class A: Maximum 5.75% load	-4.11	--	2.47

*Monthly returns are not annualized.

Expenses: Class A: Gross 1.91%; Net 1.25%. Expenses are capped contractually until 05/01/14 at 1.25% for Class A. Caps exclude certain expenses, such as interest. The table presents 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 investor's 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 NAV.

The Fund's outperformance relative to the hard and local currency indices was also largely the result, in our opinion, of having no Brazilian exposure in local currency, no South African exposure in local currency and no Argentine exposure in hard currency.

The fund's losses came mostly from our exposure to the Indian rupee (INR). The "SNAT" and "KR" descriptors in the graph on the next page identify two INR issuers – a supranational, the Inter-American Development Bank, and a quasi-sovereign, the Export-Import Bank of Korea. However, domestic developments in India may have driven most of the poor performance, as investors seem to be continuing to doubt the government's commitment to new reform initiatives, and its ability to implement them.

*See definitions on last page.

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.
[1]Beta is a measure of sensitivity to market (benchmark) movement.

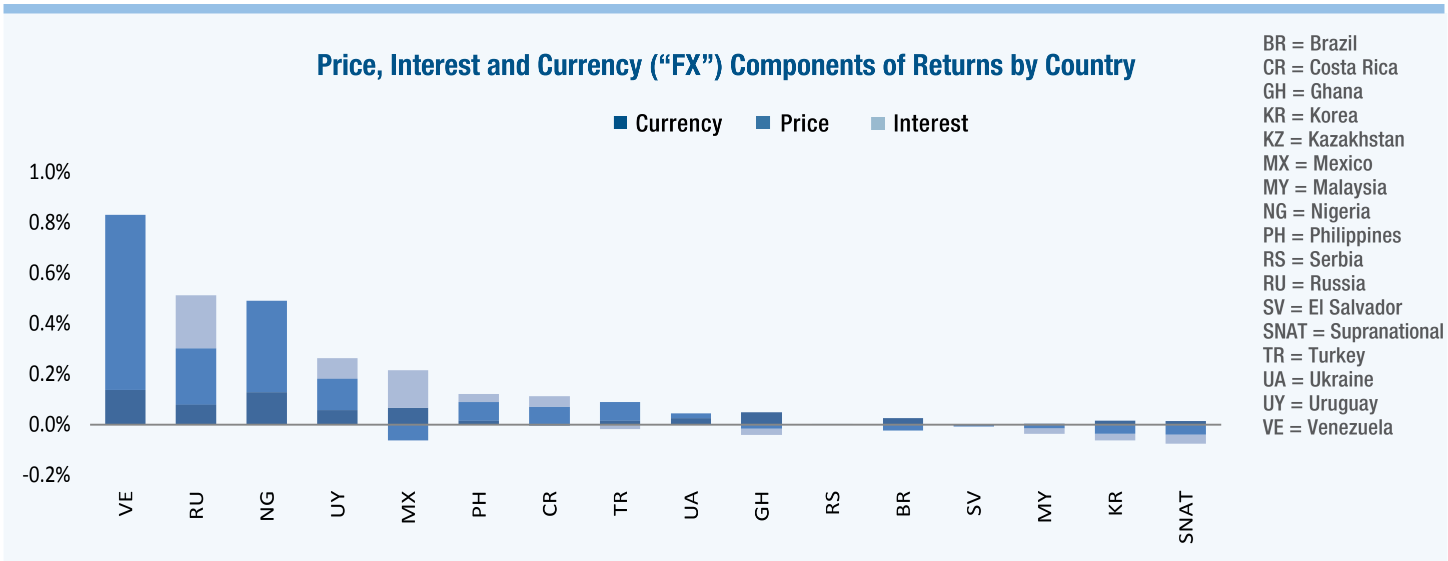
Current Views

Our basic views are unchanged from last month. To summarize, we believe the U.S. elections generated the best possible outcome for the status-quo, in particular ongoing support for large banks, ongoing monetary forbearance, and capital outflows from the U.S. into emerging market hard and local currency debt. We believe that the fact that the election was not close and/or subject to legal challenges was an additional positive. Most importantly, the re-election of President Obama was ideal for emerging market debt, in our opinion, because it means that the Fed may continue its balance sheet expansion for the foreseeable future. At the end of Mr. Bernanke's term, an even looser framework is likely, in our opinion, with Janet Yellen his likely successor. Dollar debasement and "don't worry, be happy" approaches to fiscal and monetary policy generally have been key push-factors for money out of the U.S. and into emerging markets. Emerging markets have benefited, by-and-large, by having the opposite policy mix – tight fiscal policy combined with independent central banks.

For EM debt asset prices, we prefer the simpler, straightforward race to the bottom for the dollar and interest rates that we expect under Obama to the bumpier race to the bottom that we would have expected under Romney. We think the policy mix likely to be offered under an Obama presidency will end badly for the U.S. In our experience, not recognizing fiscal constraints and the co-option of the central bank by the fiscal authority have always ended badly. In addition, we believe a Romney presidency would have been more complicated and confusing as there could have been the pretense of addressing these issues, which might have falsely boosted confidence for several months, only to ultimately disappoint if these issues were not adequately addressed.

On the other hand, we think that geopolitical concerns could potentially escalate under an Obama presidency. This makes us less comfortable with significant exposure to possible affected countries such as Turkey and potentially Nigeria. The U.K. appears to be taking a lead role in Syria, as it did along with France and Italy in Libya. In our opinion, a policy of toppling the current regime is a proxy war with Iran, which will be different (i.e., much more destabilizing) from previous conflicts in the region. We believe that this is because of Russian and Chinese opposition, Iran's size, and the destabilizing effects on domestic politics in countries such as Egypt, Saudi Arabia, and Pakistan, when it becomes more obvious to their populations that their governments are Israeli allies.

Europe remains fraught with risk, as the ECB looks to have over-promised and under-delivered. Can it be contained? We are surprised to still be writing about Europe. After ECB head, Mario Draghi's, trumpeting of Outright Monetary Transactions (OMT), it appeared to us that the ECB was on the offensive. However, based on our interactions with ECB leaders and other officials, it now appears that OMT may only be used if spreads widen, which would make it a defensive tool. In our view, the problem with that is it means ongoing instability (at the least) and potentially rising debt-servicing costs in a worse case. In other words, time is not on the authorities' side. Given weak political support among populations, that is worrisome to us, if only from the perspective of growing social tension. However, for now, the threat of OMT and bans on shorting sovereign debt mean that, in our opinion, pressures from Europe might be contained or absorbed by the Euro (i.e., a weaker Euro, which is now basically the only short-able European asset).



Source: Van Eck Global. Data as of November 30, 2012.

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Current Positioning

The current portfolio is virtually identical to last month's. We are maintaining a cash allocation above 3%, seeking to take advantage of opportunities created by Europe, fears surrounding the "fiscal cliff" and a desire to participate in new issues. The market may need to digest hiccups, again, from the developed world, as discussed above. In the short-term, this could mitigate in favor of higher cash levels to take advantage of better buying opportunities. Also, 2012 has seen very little new issuance in the high-yield corporate sector, with the bulk of record corporate debt issuance being high-grade, where we have generally seen little value. As a result, we want the flexibility to participate in new issues, buying on the bid in a sense, for credits that appear cheap according to our models and in countries in which we are either neutral or positive. Another reason we want to participate in new issues is that we have low exposure to hard-currency emerging market debt, seeing little value in that sector generally, and want to be able to gain this exposure via new issues. The graph on the previous page shows our investment allocations by country.

Venezuela remains our largest allocation in hard currency debt. We like Venezuela simply because it has more hard currency reserves than external debt – i.e., it is a net external creditor – with credit spreads above 600 basis points. For credit spread data, we use five-year Credit Default Swap levels, even though that is not the precise asset price we are trading, because to us they represent the best apples-to-apples spread data for emerging market hard currency debt. In addition, most of Venezuela's debt is denominated in local currency, so devaluations should not, in our opinion, trigger a vicious cycle of rising debt service and greater devaluations. We mention this because we continue to expect a devaluation of the bolivar and official denials of such a scenario underline its likelihood, in our opinion.

Nigeria, Russia, Uruguay, and Mexico remain our largest allocations in local currency debt. We are loathe to generalize beyond any single country, but we view these as having strong balance sheets, and yields that are either consistent with inflation trends or supportive of stable currencies. We reviewed each country last month, so we won't repeat our views here, other than in Nigeria and Ghana. We recently returned from a trip to Nigeria, which strengthened what was already a positive outlook to us for the country's local debt. In particular, we believe good policy and populism actually coincide in some instances. For example, energy reform is now a priority for President Goodluck Jonathan, following protests earlier in the year. The risk, in our opinion, is that the country is in the process of rebuilding reserves, so upside to the currency will be limited by central bank reserve accumulation. Our trip to Ghana, on the other hand, has caused us to reduce our allocation to its local market. Upcoming elections, low reserves and a policymaking framework that appears to require near-crisis for a return of the IMF have pushed us toward waiting for a better entry point.

All weightings as of November 30, 2012.

*Hard Currency refers to currencies that are generally widely accepted around the world (such as the US 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.

A supranational is an international organization, or union, whose members transcend national boundaries and share in the decision-making. Examples of supranationals are: World Bank, IMF, World Trade Organization.

Any indices listed are unmanaged indices 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 J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) tracks local currency bonds issued by Emerging Markets governments. The index spans over 15 countries. The J.P. Morgan Emerging Markets Bond Index Global Diversified (EMBI) 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 Consumer Price Index (CPI) measures changes in the price level of consumer goods and services purchased by households.

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.

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. An investor 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.

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