

EM Debt's Time to Shine



Eric Fine

Portfolio Manager

VanEck Emerging Markets Bond Fund

EMBAX

EMBUS

EMBYX

Overview

The Fund went up by 2.87% in July, compared to 1.59% increase of its benchmark, the J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified and 50% J.P. Morgan Emerging Markets Bond Index (EMBI). The Fund's 128 bps of outperformance last month brought year-to-date ("YTD") outperformance to 411 bps. YTD, owning no Russia, navigating Ukraine, and not keeping our duration view on "autopilot" drove performance. The outperformance in July was due to our exposure to high-beta EMFX, particularly in Mexico, South Africa, Brazil, Colombia and Poland.

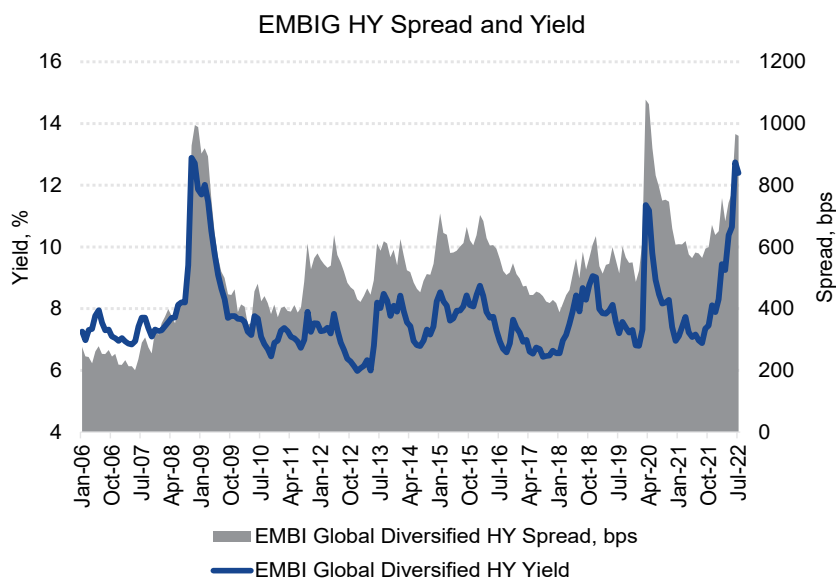
We increased exposure in EMFX, funded by reductions in low-beta duration in USD. As of end-July, the local currency was around 45% of exposure, a big increase. Duration is down to 6.3, after being around 8.0 at the end of June. Carry¹ is now very high at 6.5% (This is not a year to be on autopilot, we think.) To generalize, we have fairly concentrated exposures in EMFX (high beta, commodity exporters, index stalwarts) and fairly diversified/smaller exposures in USD/credit (high beta, commodity exporters).

Dollar down and EMFX up...we finally love (selected) EMFX! A rare view for us. Emerging markets ("EM") central banks hiked early and large. Maybe more important, we believe U.S. sanctions on Russia are backfiring and undermining domestic markets ("DM") currencies in favor of EM commodity-based currencies. Do you want currencies backed by oil, food, and manufactured exports, or a currency that is backed by treasuries? I'll bet you would want these commodity-based currencies even more if they expand into a commodities-currency bloc excluding DM. Those we've met with have heard our story. Perhaps the biggest event in economic history since Bretton Woods is the establishment of U.S. sanctions on Russia's central bank. Though sanctioning Russia is creating an inflationary and geopolitical nightmare for DM, it's going to do much more. The day sanctions on Russia's central bank were announced, China saw that its \$3tn² in reserves had practically disappeared. Do we really need to continue this story? We'll add that this follows U.S. strategy that has (unintentionally, we're assuming and hoping) married Russia to China. Will they just sit there? With massive current account surpluses (and virtually no debt in Russia's case), should we believe they are in some kind of trouble? China is already selling treasuries, we believe. Moves to unify Russia and China's version of the SWIFT payments system, and expand it are afoot, we think (SWIFT was the technical infrastructure, the control of which made US/Japanese/EC sanctions possible).

¹ Carry is defined as Current Yield. 30-Day SEC Yield for Class A was 6.85% as of 7/31/2022. 30-Day SEC Yield is a standard calculation developed by the Securities and Exchange Commission that allows for fairer comparisons among bond funds. It is based on the most recent 30-day period. This yield figure reflects the interest earned during the period after deducting the Fund's expenses for the period. In the absence of temporary fee waivers, the 30-Day SEC Yield for EMBAX would have been 5.81% as of 07/31/22.

² Source: IMF.org

Exhibit 1 – EM Central Banks Led Global Interest Rate Cycle!



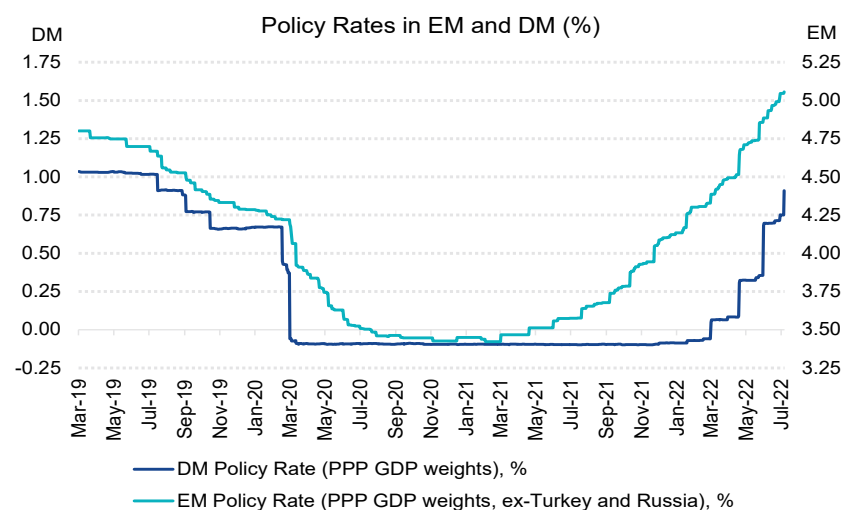
Source: Bloomberg. Data as of July 31, 2022.

Beta up...high-beta EM credit spreads in USD look to be at fire-sale levels. We've been accumulating here in July. Together with our EMFX view, this makes us very bullish, following the devastation of the first half of 2022. It feels a bit like when we recommended "Buy of the Century" in hard-currency bonds in April of 2020. July saw outflows from bond funds, as was more dramatically the case in March of 2020. This led to forced selling, not selling based on fundamental developments. Investors sold what they could, not what they wanted to. We're buyers of what they sold. This includes a lot in sub-Saharan Africa (SSA), as was the case in April 2020. SSA is often orphaned during outflow-based selloffs, and we are buyers of a number of names here. Angola and Gabon are standout examples, as both are under IMF programs. As are other similar names (outside the region) such as Ecuador and Argentina to which we added exposure during the outflow-driven phase of the selloff. It is hard to imagine a funding problem for a country under an IMF program.

The revenge of the 60/40 model will kick-start inflows into EM debt. High global cash levels with 2-year yields around 3% are not sustainable. Once money flows into bonds, we believe the final answer is inevitably EM debt. Look at the data we showed last month; in a sentence: "for a target volatility level of around 6, the optimal allocation to EMBIG HY debt, based on the efficient frontier using 19 years of data is around 50%". Yes, you're supposed to allocate 50% of your fixed income portfolio to EM HY sovereign bonds. The rest is supposed to go into treasuries. Sound high for EM bonds? It is, way too high, and it's a kind of corner-solution, we get it. But 0%-5% is too low given that result, and that's the typical allocation in the U.S. Europe and Asia have much higher allocations, but they've been allocating too much to EMFX, and have been suffering as a result for years. They were a big part of the outflow story in July (outflows from Asia and from EMFX in Asia). We're buying what they are selling, and are likely to increase our EMFX exposure in Asia in August.

Since you asked us about duration, we think the next move in treasuries is to price out cuts in 2023, leaving us bearish on low-beta duration. Don't fret, it's not the driver it's been so far this year. There is not much more to say here. We've tried to be super nimble on duration. We started the year with 4-handle duration, but took it to 8-handle in June. Now it's down to 6-handle. It's been a great performance-stabilizer for the fund all year. This is not the time for autopilot, is all we'll say. Look at the chart below. Spreads and yields are at crisis-highs (meaning around levels seen in the GFC and COVID crises).

Exhibit 2 – EMBIG HY Spreads and Yields at Crisis Levels



Source: Bloomberg. Data as of July 31, 2022.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions in July are Mexico, South Africa, Brazil, Colombia and Poland:

- We increased hard currency sovereign exposure in Angola, Kenya and Gabon. Angola's outlook was revised to positive by Fitch, and the economy continues to benefit from higher oil prices, which help to generate fiscal surpluses and a major drop in government debt. In terms of our investment process, this improved the policy and economic test scores for the country. In Kenya, the IMF's board approved the 3rd program review, sending a signal that it stays on track. Better revenue collection helps to offset the impact of fuel subsidies on overall budget balance. The IMF factor – the extension of the EFF facility – was also important for our position in Gabon. Our process showed the improved policy test scores for both countries.
- We also increased our local currency exposure in Poland and South Africa. We are getting more comfortable with having EMFX exposure, due to a combination of stretched net long U.S. Dollar positioning and the market pricing in the end of the tightening cycle in the U.S. by the end of the year (December). In addition, South Africa's central bank surprised with a larger than expected rate hike, responding to persistent inflation pressures and improving the policy test score for the country.
- Finally, we increase local currency exposure in Chile and Colombia, and hard currency corporate exposure in Indonesia. In Chile, the central bank's decision to re-deploy FX intervention did wonders for the currency, and improved the policy test score for the country. In Colombia, the central bank continues to sound very hawkish, raising the policy rate by another 150bps in July. There are legitimate concerns about the policy direction under the newly-elected president, but the first moves of the new administration were not market unfriendly, including the appointment of Jose Antonio Ocampo as Minister of Finance.
- We reduced our hard currency sovereign exposure in Brazil, China and Mexico. We swapped part of Brazil's hard currency exposure into local bonds, as BRL looked cheap relative to short-term driver, and its net long positioning was significantly reduced. The market was also expecting an extra 25bps of rate hikes in 2022, which should be beneficial for BRL and inflation expectations. In terms of our investment process, this improved the policy and technical test scores for the country. In China, used proceeds from low-yielding hard currency sovereign bonds to add some beaten-up real estate developers' bonds after reports that authorities decided to create a CNY1trln fund to channel lower-interest loans to selected companies. This worsened the technical test score for the country, but improved the policy test score for real estate developers' bonds. Reduction in Mexico mostly affected bonds with very long duration due to the deterioration in the technical test score for the country.
- We also reduced our hard currency sovereign exposure in United Arab Emirates, Qatar and Saudi Arabia. The reduction affected longer-dated bonds and it look place well into duration's rally. We also had concerns about the impact of lower global growth on commodity prices, including oil. In terms of our investment process, this worsened the technical test score for the countries in question.

- Finally, we reduced hard currency sovereign exposure in Honduras and Malaysia, local currency exposure in Kazakhstan, and hard currency corporate exposure in India. The main concerns in Honduras were unorthodox policies (such as monetary financing) that created headwinds for an IMF deal. This worsened the policy test score for the country. Our main concern in India was the impact of a likely recession on demand for steel. Similar concerns affected our decision in Malaysia – namely the fact that a greater risk of global recession can affect commodity-producing state-owned enterprises. In both cases, the countries' technical test scores were negatively affected. In Kazakhstan, we were concerned by higher geopolitical risks due to standoff with Russia on oil transportation, and other issues (CIS FX committee participation, refusal to recognize breakaway republics in Ukraine). This significantly worsened the policy test score for the country.

Average Annual Total Returns (%)

As of July 31, 2022	1 Month [†]	3 Month [†]	YTD	1 Year	3 Year	5 Year	Life
Class A: NAV (Inception 7/9/12)	2.87	-3.45	-12.02	-15.30	-2.03	0.28	0.84
Class A: Maximum 5.75% Load	-3.04	-9.00	-17.08	-20.17	-3.94	-0.90	0.24
Class I: NAV (Inception 7/9/12)	2.91	-3.41	-11.81	-15.03	-1.71	0.59	1.13
50 GBI-EM GD / 50% EMBI GD	1.59	-2.96	-16.13	-18.94	-5.30	-1.66	0.52

As of June 30, 2022	1 Month [†]	3 Month [†]	YTD	1 Year	3 Year	5 Year	Life
Class A: NAV (Inception 7/9/12)	-6.57	-10.86	-14.48	-18.50	-2.27	-0.06	0.56
Class A: Maximum 5.75% Load	-11.94	-15.98	-19.40	-23.19	-4.18	-1.23	-0.04
Class I: NAV (Inception 7/9/12)	-6.43	-10.73	-14.31	-18.23	-2.00	0.25	0.85
50 GBI-EM GD / 50% EMBI GD	-5.33	-10.03	-17.44	-20.22	-5.46	-1.69	0.77

[†] Returns less than one year are not annualized.

Expenses: Class A: Gross 2.33%; Net 1.28%. Van Eck Associates Corporation (the "Adviser") has agreed to waive fees and/or pay Fund expenses to the extent necessary to prevent the operating expenses of the Fund (excluding acquired fund fees and expenses, interest expense, trading expenses, dividends and interest payments on securities sold short, taxes and extraordinary expenses) from exceeding 1.25% for Class A and 0.95% for Class I of the Fund's average daily net assets per year until May 1, 2023. During such time, the expense limitation is expected to continue until the Board of Trustees acts to discontinue all or a portion of such expense limitation. Please note that, generally, unconstrained bond funds may have higher fees than core bond funds due to the specialized nature of their strategies.

The performance data quoted represents past performance. Past performance is not a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance may be lower or higher than performance data quoted. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.

The "Net Asset Value" (NAV) of a Fund is determined at the close of each business day, and represents the dollar value of one share of the fund; it is calculated by taking the total assets of the fund, subtracting total liabilities, and dividing by the total number of shares outstanding. The NAV is not necessarily the same as the ETF's intraday trading value. Investors should not expect to buy or sell shares at NAV.

Index Definitions

GBI-EM: The J.P. Morgan GBI-EM Global Diversified tracks local currency bonds issued by Emerging Markets governments.

EMBIG HY: The J.P. Morgan EMBI Global Diversified High Yield index tracks returns for actively traded external high yield debt instruments in emerging markets, and is also J.P. Morgan's most liquid U.S. dollar emerging markets high yield debt benchmark.

CEMBI HY+: The J.P. Morgan Corporate Emerging Markets High Yield Bond index tracks U.S. dollar high yield bonds issued by emerging markets corporates.

Global Aggregate: Bloomberg Global-Aggregate Total Return Index Value Unhedged USD is a sub-index of the Bloomberg Global Aggregate Index, which is a flagship measure of global investment grade debt from twenty-four local-currency markets.

Global Treasury: The Bloomberg Global Treasury Index tracks fixed-rate, local currency government debt of investment grade countries, including both developed and emerging markets.

Global government related: Bloomberg Global Aggregate Government Related Total Return Index Value Unhedged USD tracks global government debt issues.

Global corporates: The Bloomberg Global Aggregate Corporate Index is a flagship measure of global investment grade, fixed-rate corporate debt.

Global securitized: The Bloomberg Global Aggregate - Securitized Index tracks Securitized (Class 1= Securitized) bonds from the flagship Global Aggregate Index.

US Aggregate: The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

US HY: The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market.

Euro Agg: The Bloomberg Euro-Aggregate Index is a benchmark that measures the investment grade, euro-denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues. Inclusion is based on currency denomination of a bond and not country of risk of the issuer.

US Treasury: The Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury.

CEMBI IG+: The J.P. Morgan Corporate Emerging Markets High Yield Bond index tracks U.S. dollar investment grade bonds issued by emerging markets corporates.

EMBIG IG: The J.P. Morgan EMBI Global Diversified Investment Grade index tracks returns for actively traded external investment grade debt instruments in emerging markets, and is also J.P. Morgan's most liquid U.S. dollar emerging markets investment grade debt benchmark.

Source: Bloomberg LP and JP Morgan Index Research

Disclosures

International Monetary Fund (IMF) is an international U.S.-based organization of 190 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.

A **handle** is the whole number part of a price quote, that is, the portion of the quote to the left of the decimal point.

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. The S&P 500® Index consists of 500 widely held common stocks covering the leading industries of the U.S. economy.

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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.

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