February 2022

Invasion Starts the Global Recession Clock

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VanEck Emerging Markets Bond Fund

EMBAX | **EMBUX** | **EMBYX**

Overview

The Fund outperformed its benchmark, 50% J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified and 50% J.P. Morgan Emerging Markets Bond Index (EMBI), by 377 bps in February. The Fund was down -1.99%, while its benchmark was down -5.76%. Year-to-date ("YTD"), the Fund was down -3.35%, compared to -7.11% for its benchmark, translating into 376 bps of outperformance for the Fund.

Our Russia stance was responsible for the outperformance. Those who have followed us know that we have not owned any Russian asset prices for many years. Our view was (and remains) that sanctions probabilities were much higher than market thinking and that their price impact would be much more significant than market thinking.

As of the end of February, we had local currency exposure with 44.5%, a low duration of 4.7, and generated approximately 5.9% carry.[1]. We are becoming more constructive on emerging markets ("EM") local currency for commodity exporters, Ukraine, and high-quality/long-duration credit spreads. Brazil, South Africa, Malaysia, Mexico and Colombia were the Fund's largest country exposures.

Russia's invasion of Ukraine is the global asset price and economic driver and it means risk-off on a global macro level. In particular, the global recession clock has started. The spike in energy prices combined with just-starting import and export bans will have a global adverse impact. Import and export bans were growing simply due to de-globalization, but have now been accelerated. Inter-connections are hard to predict. Brazil is very dependent on "at-risk-of-export-ban" Russian fertilizer, as just one random example.

No help from the fiscal authority. The collapse of the Democrats' power in Washington, DC is a significant risk factor now, as it means no chance of fiscal support when markets will be demanding it. We've been harping on this risk for many months now. But, it's been irrelevant with an easy U.S. Federal Reserve ("Fed") and no need for fiscal stimulus. We think there's virtually no chance of serious fiscal stimulus out of Washington until there is a president of the same party as the Congress, which isn't possible (assuming mid-terms see a Republican wave) until 2024. No fiscal stimulus until 2024, with a big fiscal cliff already happening this year before the Ukraine invasion. Let that settle in. Markets have to discount that at some point.

Much higher gold prices. Central banks were just told their dollars aren't there if you fall on the wrong side of the U.S.: what would you do if you were China? We wrote a long-term 'think-piece' many years ago where we speculated on what could happen to gold prices if the dollar was no longer trusted. And the answer was on multiples of current levels. What do you think the price impact would be of the Chinese buying $3 trillion of gold? Much higher commodity prices, too. There's been no capital expenditures ("CapEx") for years and we think all Russian oil will be taken off of major markets. Enough said.

[1] Carry is defined as Current Yield. 30-Day SEC Yield for Class A was 5.88% as of 02/28/2022.

Euro in play. The Eurozone is the most affected by the Ukraine invasion. This keeps a dovish ECB against a hiking Fed, likely very bullish for USD. If they materialize, European fiscal plans may change this. But, a Europe that can never grow now gets an energy price shock. And, they can't even decide their future. Have you read anywhere that the German Chancellor has said Nordstream 2 is closed? We haven't. He's been telling everyone Ukraine will never join NATO. But it seems irrelevant. He and Germany are being rolled into this and seemingly have no say over their future. That's an important element of the political-economy dynamic if our description is correct.

Russia will be devastated. Without access to its reserves, and combined with existing and likely sanctions, Russia's hard and local currency debt should be worth around 0 (it is still not marked there). The sanctions on the central bank itself made its normal foreign exchange ("FX") intervention, and its role as a provider of dollars to domestic debtors including the government, questionable at best. Everything else—corporate bonds, even oil exports—paled in comparison to that. And, it isn't priced yet (the ruble is harder to quantify, but it is not a deep asset price now).

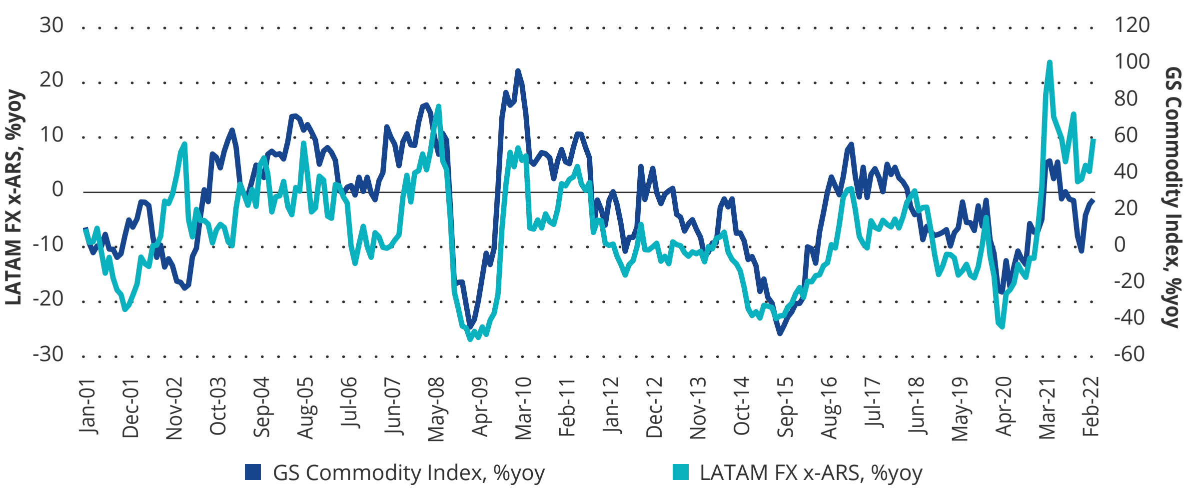
We also think that sanctions will expand. All Russian asset prices will ultimately be sanctioned. Loopholes will be plugged, it will be risky to provide them, and institutions will err on the side of caution, meaning sell first. As we write, it looks like oil import bans are coming to the U.S. This means the U.S. will find it easier to sanction banks involved in that trade (sanctions on them were avoided only and precisely due to their role in energy trade). Note that we are neither necessarily saying sanctions plans already exist, nor that they are even intended. We are predicting that it is going that way. Many times in the multi-year Ukraine/Russia standoff have U.S. policymakers done things they never planned on doing initially. This is why the "storylines" are so important to follow (and not for whether the stories are true, that is a fool's errand in our opinion … they need to be followed instead to see how policy is being influenced).

Odds have risen that the clock on Putin's rule has started. We think the western strategy will become to condition sanctions removal on Putin's removal. On the other hand, he has to make military gains as his only leverage, and that could be the case in the near term. Also, he's already successfully engineered the exact kind of economic transition he will need to exit this crisis. The story is still unfolding, in our view, but the clock may still be ticking.

If Ukraine survives in almost any form, its bonds are very cheap. Please see our recent piece ("The Case for Ukraine"). The gist of it is that Ukraine is getting the worldwide financial support that dwarfs its external financing requirements. This includes funding for future defense spending increases. The regions that are disputed were never assumed to be sending revenue to the central government. The latest "storyline" that seems to be winning is one in which Russia will make military gains, but will sue for peace quickly to avoid a quagmire, in our view. This would be very constructive for Ukraine bond prices (where restructuring is already priced-in), we believe.

We are more constructive on the EM local currency debt of commodity exporters and on high quality/long duration spread. In local currency, we simply think that commodity prices have run away from a lot of EM currencies. We put up with it in 2021 because many of those countries were going through big political crises (Chile, Peru and, to some extent, Colombia). Those crises are either priced or modulating now, though. Also, the price upside in commodities could be dramatic and doesn't seem over to us. You read in our earlier monthlies the "blah-blah" on how so many EM countries had pre-emptively hiked rates? What if they have to cut? On high-quality/long-duration risk, our thinking is simple. Because we think the global recession clock has started, we see long-end yields as anchored. But, we also see a lot of high-rated bonds that will benefit from that anchoring, and some are oil exporters who could see an improved credit profile however tight their spreads already are. Look for more of those names in the portfolio as well. You've read this far, so here's a chart. Exhibit 1 shows how EM FX, especially LATAM FX, has been lagging behind commodity prices.

Exhibit 1 – LATAM FX vs Commodity Prices



Source: Bloomberg. Data as of February 10, 2022.

Exposure Types and Significant Changes

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

- We increased our local currency exposure in Colombia and Chile. Geographically, both countries are far from the Russia/Ukraine military conflict, their policy responses to higher inflation are already engaged and they can benefit from higher commodity prices. In terms of our investment process, this improved the technical test scores for the countries. However, we are cognizant of risks associated with local political cycles—the work of the constitutional assembly in Chile and the presidential election in Colombia. We are also aware that higher commodity prices—especially food and energy—can slow the process of fiscal consolidation. We are keeping a very close eye on these developments.

- We also increased our local currency exposure in Indonesia and Brazil. There is a good chance that Indonesia's fiscal outperformance will continue in 2022 (albeit there are risks associated with the impact of the Russia/Ukraine war on commodity prices). If this scenario materializes, net debt issuance is likely to be smaller than in 2021, while high-interest rates and low inflation will support valuations. Further, Indonesia's central bank is set to continue government bond purchases under the burden-sharing deal. In terms of our investment process, this improved the policy and technical test scores for the country. In Brazil, we sold the least interesting corporate bonds to make room for local debt, which should benefit from disinflation (expected in the second half of the year) and a slower pace of rate hikes. Brazil's local debt valuations continue to look attractive across the yield curve. In terms of our investment process, this improved the policy and technical test scores for the country.

- We also reduced our hard currency sovereign exposure in Ukraine, albeit the decision was a bit more nuanced. We decided to take profits on our Ukrainian position and close it completely one week before the start of Russia's military operation because we saw limited upside in a situation when the geopolitical situation was getting more worrisome. As would be expected, Ukrainian bonds were hit very hard once the war started. However, Ukraine's Ministry of Finance communicated a strong willingness to continue servicing the external debt (it actually made the interest payment that was due), while governments across the world and international financial organizations pledged sizable support for Ukrainian authorities. We, therefore, decided to add a small sliver of Ukraine's sovereign debt, as these developments improved (under the circumstances) the policy test score for the country.

- We reduced our hard currency sovereign exposure in the United Arab Emirates and hard currency quasi-sovereign exposure in Saudi Arabia. The securities in question had very low spread-to-yield ratios, which made them proxies of U.S. Treasuries in the run-up to the Fed's rate-setting meeting in March. In terms of our investment process, this worsened the technical test score for both countries.

- Finally, we reduced hard currency sovereign exposure in the Dominican Republic and hard currency corporate exposure in China. China's changes reflected a decline in bond prices. As regards the Dominican Republic, our decision was driven by the low spread-to-yield ratio (similar considerations as in the United Arab Emirates and Saudi Arabia) and the fact that sovereign valuations were no longer compelling (initial valuation bucket #3). In terms of our investment process, this worsened the technical test score for the country.

Average Annual Total Returns (%)

As of February 28, 2022	1 Month†	3 Month†	YTD	1 Year	3 Year	5 Year	Life
Class A: NAV (Inception 7/9/12)	-1.99	-3.23	-3.35	-6.33	3.17	2.91	1.86
Class A: Maximum 5.75% Load	-7.62	-8.79	-8.91	-11.72	1.15	1.70	1.24
Class I: NAV (Inception 7/9/12)	-1.91	-3.18	-3.20	-5.98	3.48	3.21	2.16
50 GBI-EM GD / 50% EMBI GD	-5.76	-5.74	-7.11	-8.70	-0.09	1.51	1.61

As of December 31, 2021	1 Month†	3 Month†	YTD	1 Year	3 Year	5 Year	Life
Class A: NAV (Inception 7/9/12)	0.12	-1.94	-4.57	-4.57	6.18	4.59	2.26
Class A: Maximum 5.75% Load	-5.63	-7.58	-10.06	-10.06	4.10	3.36	1.62
Class I: NAV (Inception 7/9/12)	0.02	-1.93	-4.30	-4.30	6.50	4.87	2.55
50 GBI-EM GD / 50% EMBI GD	1.48	-1.49	-5.30	-5.30	4.04	3.79	2.44

† Monthly returns are not annualized.

Expenses: Class A: Gross 2.30%; Net 1.25%. Expenses are capped contractually until 05/01/22 at 1.25% for Class A and 0.95% for Class I. Caps exclude acquired fund fees and expenses, interest expense, trading expenses, dividends and interest payments on securities sold short, taxes and extraordinary expenses. 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. Performance may be lower or higher than performance data quoted.

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. Investors should not expect to buy or sell shares at NAV.

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

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.

Broad based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index. Past performance is no guarantee of future results. 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 2020, J.P. Morgan Chase & Co. All rights reserved.

Goldman Sachs Commodity Index (GSCI) is a world production-weighted commodity index comprised of 24 liquid exchange-traded futures contracts. LATAM FX x-ARS Index is a custom-created equal-weight currency index comprising the nominal exchange rates of the following LATAM currencies against the U.S. Dollar – Brazilian real, Mexican peso, Chilean peso, Colombian peso, and Peruvian sol. The values are normalized with 31 December 2017 =100.

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 vaneck.com for performance information current to the most recent month end and for a free prospectus and summary prospectus. Past performance is no guarantee of future results.

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