China Headlines Overshadow EM Potential



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VanEck Emerging Markets Fund

GBFAX | EMRCX | EMRIX | EMRYX | EMRZX

Performance Review

The VanEck Emerging Markets Fund (the "Fund") returned -8.33% during the third quarter of 2021, underperforming its market index benchmark, the MSCI Emerging Markets Investable Market Index ("MSCI EM IMI"), which returned -7.39% for the same period.

Average Annual Total Returns (%) as of September 30, 2021

	3Q21†	1 Yr	3 Yr	5 Yr	10 Yr
Class A: NAV (Inception 12/20/93)	-8.33	10.95	9.94	8.67	7.66
Class A: Maximum 5.75% load	-13.60	4.58	7.79	7.39	7.02
MSCI EM IMI	-7.39	20.80	9.10	9.28	6.21
MSCI EM Index	-8.09	18.20	8.58	9.23	6.09

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 net asset value (NAV). Index returns assume that dividends of the Index constituents in the Index have been reinvested. Performance information current to the most recent month end is available by calling 800.826.2333 or by visiting vaneck.com.

Expenses: Class A: Gross 1.53%; Net 1.53%. Expenses are capped contractually until 05/01/22 at 1.60% for Class A. Caps exclude acquired fund fees and expenses, interest, trading, dividends, interest payments of securities sold short, taxes and extraordinary expenses.

Market Review

The economic healing from the effect of Covid continues. The economic recovery in emerging markets (EM) countries remained strong throughout September 2021. Going forward, we believe that the easing of lockdown measures, coupled with strong developed markets (DM) growth, should support EM recoveries over the remainder of this year.

The shifting landscape of regulatory action and property angst in China were widely discussed, but not always understood. China's economic "miracle" of lifting the vast majority of its population out of poverty has come at a breathless pace relative to the similar development paths of more mature economies. That pace has left gaps where commercial enterprise has been allowed to thrive relatively unfettered by regulation. In part, the flurry of new rules can be seen to be a "catch up" to create a better long-term environment for many industries.

In a sense, the impetus has shifted from just growth to both sustainability and growth. Left unchecked, some companies have taken full advantage of grey space, but now find some of their activities to be on the wrong side of the increasingly clear hard lines of regulation.

One frustrating aspect of new regulation in China is the method by which changes to industry rules happen. There is very little in the way of iterative, public hearing-type processes and analysts are often restricted to the parsing of political signs to anticipate changes. Often, we know that an industry is in the spotlight, but putative changes are not bounced off the walls of popular and market opinion and, frankly, they are not subject to a very transparent political process. In addition, many new regulations have lacked specific implementation detail, prolonging uncertainty. And as we know, global financial markets do not respond well to uncertainty.

Taking a step back, whilst criticism for implementation may be valid, the goals are not too dissimilar from much that is happening in the developed world:

- Providing decent, affordable and quality education and healthcare;
- Making the housing market more stable with more affordable options;
- Tightening up on the (mis)use of personal and potentially sensitive data;
- Providing occupational insurance for "gig" workers;
- Preventing monopolistic behavior and enhancing competition; and
- Opening up the financial system to wider foreign participation.

A widely known, and incredibly predictable challenge for China, is demographics. The population is rapidly aging. The fertility rate is low. The cost of raising a larger family can be daunting, particularly as it relates to the "three mountains" of costs associated with childcare—***education, healthcare and housing***. In part, some recent changes are designed to address those challenges, and attempt to create a more equitable society.

China's Property Development—The Evergrande Case. It is important to note that the VanEck Emerging Markets Fund does not have any direct exposure to Evergrande. In China, our only real estate position is **A-Living Smart City Services Co., Ltd.** (2.06% of Fund net assets*), which is a property management company, not a developer. We expect government action to ensure orderly liquidation of Evergrande. No explicit bail out, but support for the most important stakeholders, the property buyers. Given the importance of property activity and prices in GDP and consumers' net worth and psyche, the longer the uncertainty persists, the more effect it will have on general consumption. This exacerbates an economy slowing domestically for a combination of reasons, including Covid outbreaks, decarbonization efforts and the well-known micro tightening (regulations). All the above argues for caution in the shorter term, whilst being alive to very stock-specific opportunities, where prices are already discounting very bad outcomes.

As a result, the opportunity set is even more company-specific in China and in the rest of emerging markets. It is true that many regulations may ultimately create a better end point of fairer, more sustainable industries, but the journey can be arduous and uncertain. Investors don't like uncertainty. In addition, for a number of the more recent China related listings in the Internet space, we question the moats[1] of their business models.

In summary, we believe the macro environment, with subdued inflation and low rates, even as global activity normalizes, may be rewarding for forward-looking, sustainable and structural growth investors in emerging markets. But the focus has to adjust to a landscape of changing regulatory and industry dynamics, potentially creating a compelling, alpha generation opportunity for active investors in the space.

On a more positive note, trends across non-China EM are mostly quite optimistic, as vaccines roll out and economies reemerge from lockdown. A combination of increased demand, lower rates, supply demand asymmetry and accelerated digital adoption have driven the earnings and share prices of many of our portfolio companies, from **Reliance Industries Limited**[2] (India's leading retail, communication and e-commerce business), to **Sea Ltd.**[3] (an e-commerce platform across ASEAN), to **Movida Participacoes SA**[4] and **Vamos Locacao de Caminhoes**[5] (Brazil's sustainable transportation companies). Many countries like the Philippines, Thailand, Indonesia, Brazil, etc. have not yet felt the full impact of decreased Covid risk and we expect continued strong performance from our investments in these countries, which were slower to throw off the very negative effects of the worst of this pandemic.

[1] A moat is a sustainable competitive advantage that is expected to allow a company to fend off competition and sustain profitability into the future.

[2] 3.98% of Fund net assets as of September 30, 2021.

[3] 2.20% of Fund net assets as of September 30, 2021.

[4] 0.93% of Fund net assets as of September 30, 2021.

[5] 1.22% of Fund net assets as of September 30, 2021.

Fund Review

On a sector level, consumer discretionary, communication services and financials contributed to the Fund's relative performance, while information technology, materials and utilities detracted. On a country level, South Korea, the Philippines and Argentina helped the Fund's performance on a relative basis, whereas China, Saudi Arabia and Brazil detracted.

Top Contributors

Top contributors to return during the quarter:

- **Reliance Industries Limited** (3.98% of Fund net assets*) is a Fortune 500 company and the largest private sector corporation in India. The company has evolved from being a refining and textiles business to an integrated player across innovation-led digital services, entertainment, retail, materials and energy, together with recently announced plans for material investments in renewable energy and storage. Reliance experienced a strong third quarter, as Covid-19 triggered transition to digital consumers, accelerated adoption of its online consumer businesses and brought forward expiations of profitability and scale.
- **Shanghai Baosight Software Co.** (1.75% of Fund net assets*) is a software company listed in the China A-Share market and its main business is digitizing the country's steel sector and making it more efficient through software and software-enabled processes, such as combustion control systems for tempering furnaces and hot blast furnaces. Baosight Software was born out of its parent group company Baosight Steel. Baosight Steel is the largest steel producer in China and is Baosight Software's biggest customer. During the quarter, Baosight benefitted from policy-driven downstream consolidation and equipment upgrades for lower carbon emissions—both of which are trends that promote the adoption of its software.
- **Tofas Turk Otomobil Fabrikasi A.S.** (0.85% of Fund net assets*) is a Turkish automotive company founded in 1968 that has been manufacturing seven different brands, with Fiat being one of them. The company also imports Alfa Romeo and Fiat for the domestic market and provides financing services. During the quarter, Tofas reported very strong numbers with its bottom line beating expectations and strong Year-over-Year (YoY) growth. The main reasons were effective price reflections and inventory optimization. There is a significant supply-demand imbalance in the Turkish market, currently driven by supply chain issues, whereas demand has been very strong throughout. The company has handled the situation really well and, as a result, has benefitted from strong domestic demand. Exports have been under pressure, given the Covid delta variant in Europe; however, Tofas has been able to divert the sales to the more profitable local market, supporting solid margins. The strong Lira has also helped the company apply better pricing in the domestic market, creating upside potential for profitability. Outlook remains very positive for Tofas in 2022, with expected normalization in export shipments and continued strong domestic markets.

Top Detractors

Top detractors to return during the quarter:

- **Tencent Holdings Ltd.** (3.12% of Fund net assets*), a long-time holding of the Fund, is a leading Internet company in China with the largest online community, focusing on social networking, chat and online gaming. In China, Internet is a structural growth theme with extensive untapped potential and it continues to increase in demand from current users. Based on its strong customer base, we believe Tencent is well positioned to monetize its enormous base of users through value-add advertising, cloud and payment management services. During the quarter, the company was negatively impacted by the ongoing regulatory upheaval in China.
- **Alibaba Group Holding** (1.63% of Fund net assets*), a long-time holding of the Fund, is one of the largest digital platform enterprises in China. The company was extremely well held and expectations were probably a little ahead of where they should have been, as we approached the aborted Ant Financial IPO. The overall confusion and lack of a clear regulatory framework led the stock to underperform sharply into the year-end. During the quarter, the company was negatively impacted by the ongoing regulatory uncertainty in China.
- **A-Living Smart City Services Co., Ltd.** (2.06% of Fund net assets*) is a top property manager in China, primarily (but not exclusively) focused on residential property management. The company's structural growth themes include the following: M&A, benefitting from increased urbanization and limited management contracts, deeper penetration of existing customers with value added services and expansion into nonresidential areas and government contracts. During the quarter, the company was negatively impacted by the ongoing regulatory upheaval in China, the stock price valuation has contracted, but we have not seen any reason to materially reduce earning power or growth trajectory.

Top Buys and Sells

During the quarter, we established two new positions—Wuxi Shangji Automation Co. Ltd. and Shandong Head Co. Ltd.

- **Wuxi Shangji Automation Co. Ltd.** (0.22% of Fund net assets*) develops and manufactures precision machine tools. The company is currently transitioning from a high end solar equipment maker to a major mono-wafer[6] supplier for 210mm and all other wafer standards. Its global market share could reach 20% with 60GW shipments in 2023 vs. 6.5GW in 2020—competitive production costs and recognized wafer quality will drive these gains and outsized earnings growth.
- **Shandong Head Co. Ltd.** (0.19% of Fund net assets*) is transitioning from a company primarily selling building materials to one that will eventually generate the majority of its earnings from the raw materials that make up alternative plant based products—specifically vegetarian capsules and plant-based meat. These two business lines should drive sustainable 25% CAGR revenue growth over the next 4-5 years, meaningfully improving profitability and driving a multiple re-rating of the stock.

During the period, we exited positions in Naspers Ltd., Ping An Insurance Group Co. and Hundsun Technologies Inc.

- **Naspers Limited Class N** (0.00% of Fund net assets*) is the largest shareholder in global Internet company Prosus with exposures to Tencent, Delivery Hero and large investments in key verticals including online classifieds, online food delivery and payments. Essentially, we replaced Naspers with Prosus, as we could access almost identical assets and growth potential through Prosus at a materially more attractive valuation.
- **Ping An Insurance (Group) of China** (0.00% of Fund net assets*) is one of the world's largest financial institutions and China's second largest insurance company, with businesses spanning life insurance, casualty business and banking. The company suffered from the combination of slower sales growth and, more importantly, risks associated with increasing its real estate exposures—which made us reassess our thesis and reduce our position based on a deteriorating risk/reward outlook.
- **Hundsun Technologies** (0.00% of Fund net assets*) is China's largest IT solution vendor for capital market participants, providing portfolio management and trading solutions. In recent years, it has expanded its product lines to include financial information and Internet finance. We decided to exit our position in the company due to concerns around management, guiding for large and unexpected increases in OPEX[7] that will likely outgrow revenue growth over the short to medium term.

Outlook

We believe the asset class is unloved, in particular because of the exceptional bounce in U.S. economic activity and improvement in the U.S. dollar's performance, coupled with a more optimistic outlook for the Eurozone as well. This sets up an interesting environment where U.S. economic exceptionalism fades, China "eases" (at the margin) its micro tightening and the rest of emerging markets catch up with vaccinations and economic mobility.

So far this year, the "toggle" between growth at any price and low quality value has not done any favors to our Fund, which is guided by the philosophy of forward-looking, sustainable and structural growth. However, after an active quarter, we feel very excited about our holdings and strongly believe that we are well positioned with compelling, stock-specific opportunities in a diversified portfolio that fits nicely into the evolving emerging markets investment landscape.

[6] Monocrystalline solar panels (or wafers) are generally considered a premium solar product. They are called "monocrystalline" to indicate that the silicon used is single-crystal silicon. Because the cell is composed of a single crystal, the electrons that generate a flow of electricity have more room to move.

[7] Operating expenses (OPEX) are defined as a company's day-to-day expenses.

† Quarterly returns are not annualized.

* All country and company weightings are as of September 30, 2021. Any mention of an individual security is not a recommendation to buy or to sell the security. Fund securities and holdings may vary.

All 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. 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 MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets countries. The MSCI Emerging Markets Investable Market Index (IMI) is a free float adjusted market capitalization index that is designed to capture large-, mid-and small-cap representation across emerging markets countries.

MSCI Emerging Markets Investable Market Index (IMI) captures large, mid and small cap representation across emerging markets (EM) countries. The index covers approximately 99% of the free float-adjusted market capitalization in each country.

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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 the risks associated with its investments in Chinese issuers, direct investments, emerging market securities which tends to be more volatile and less liquid than securities traded in developed countries, foreign currency transactions, foreign securities, other investment companies, Stock Connect, management, market, operational, sectors and small- and medium-capitalization companies risks. The Fund's investments in foreign securities involve risks related to adverse political and economic developments unique to a country or a region, currency fluctuations or controls, and the possibility of arbitrary action by foreign governments, or political, economic or social instability.

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. Investing involves risk, including possible loss of principal. An investor should consider the Fund's investment objective, risks, charges and expenses carefully before investing. The prospectus and summary prospectus contain this as well as other information. Please read them carefully before investing.

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