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Mania Clouds Risk Despite Gold Merger Bright Spot

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INIVX | IIGCX | INIIX | INIYX

Fed spooks early on talk of taper, rate hikes

Gold prices have now been consolidating for over a year since hitting an all-time high of $2,075 per ounce in August 2020. During September, the U.S. Dollar Index (DXY)[1] broke out to a one-year high and pressured gold, which finished the month with a $56.67 loss at $1,756.95. Gold was also pressured by a spike in U.S. interest rates following the September Federal Open Market Committee (FOMC) meeting in which the U.S. Federal Reserve Bank (Fed) suggested it could begin tapering its $120 billion per month purchases of U.S. Treasuries and mortgage-backed securities in November. The Fed also indicated it might begin raising key interest rates as soon as late 2022.

Market mania overshadows potential risks

We believe that myriad risks may come with a Fed tightening cycle, including:

- A grinding halt to stimulus-fueled economic growth
- Problematic debt service costs with higher interest rates
- A collapse of bubbles in stocks, bonds, crypto assets and housing

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

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception (2/10/56)	-8.85	-25.47	2.21	-3.94
Class A: Maximum 5.75% load	-14.09	-29.75	1.01	-4.51
GDMNTR Index[2]	-9.78	-24.18	17.74	-5.07

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

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception (2/10/56)	-13.09	-7.23	4.67	-3.30
Class A: Maximum 5.75% load	-18.09	-12.57	3.43	-3.87
GDMNTR Index[2]	-13.59	-6.29	5.13	-3.62

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 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. Index returns assume that dividends from index constituents have been reinvested. Investing involves risk, including loss of principal; please see disclaimers on last page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month end.

† Monthly returns are not annualized. Please note that precious metals prices may swing sharply in response to cyclical economic conditions, political events or the monetary policies of various countries.

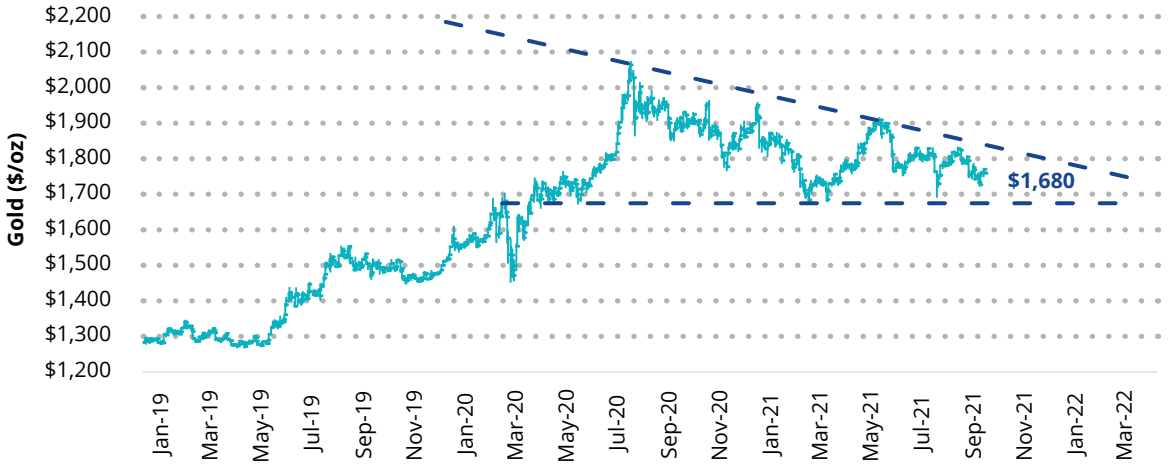
Expenses: Class A: Gross 1.34%; Net 1.34%. Expenses are capped contractually until 05/01/22 at 1.45% for Class A. Caps exclude acquired fund fees and expenses, interest, trading, dividends, and interest payments of securities sold short, taxes and extraordinary expenses.

While we believe that this risks will eventually drive gold higher, markets are currently in a euphoria where complacency reigns and risks are ignored.

According to the Wall Street Journal, initial public offering (IPO) activity has already surpassed that of every full-year on record. Sales of junk-rated bonds and loans have also topped previous annual highs. In 2021, the average daily notional value of stock options traded is set to surpass the value of underlying stock trades for the first time. Non-fungible tokens (NFTs) of digital art are selling for millions in a bubble reminiscent of the seventeenth century tulip mania, when a single tulip sold for more than some houses.

Frothy markets do not worry about risks and do not see a need for safe havens. As a result, gold has fallen below its bull market trend base, shifting to a sideways consolidation in a wedge pattern with a new base around $1,680.

Gold's sideways consolidation establishes a new $1,680/oz base



Source: Bloomberg, VanEck Estimates. Data as August 2021.

Shifting positions on a more muted outlook

Gold's consolidation has gone on longer and the price has dropped lower than we had anticipated. As a result, after gold fell below critical support in August, we took several defensive measures in the portfolio. We reduced exposure to gold producers and added both gold bullion and cash to our top ten positions. We also trimmed our exposure to junior gold miners.[3] We believe that gold bullion and cash should outperform the miners if there is further weakness in the gold price.

By the end of first quarter of 2022, we believe, gold will break out of the wedge pattern on the chart, either to the upside with strength, or to the downside with weakness. Once we see the bull market regaining traction, we anticipate that we will reverse the defensive measures taken in August.

Miners remaining firm on commitments

We attended the Gold Forum Americas conference in Colorado where gold companies gather to meet with investors each year. This year was a hybrid event and we were happy to meet face-to-face with many of our companies. The key takeaway from the conference is that the transformation we have witnessed over the past five years is lasting and fully engrained in the culture of the industry. Many companies demonstrated their commitment to strong cash flow, capital returns, organic development to extend mine lives, technological advances and sustainability.

Having underperformed gold heavily in yet another month this year (with a -9.78% loss in the NYSE Arca Gold Miners Index and -11.19% drop in the MVIS Global Junior Gold Miners Index[4] compared with a -3.12% loss in gold), we continue to see gold stocks as vastly undervalued.

Now, if the gold price would just cooperate…

Major deal (of majors)[5]

A major deal was announced on September 28 that, once approved by shareholders, will combine Kirkland Lake (3.70% of fund net assets) with Agnico-Eagle (3.87% of fund net assets) to create the world's third largest gold company.

We like the deal for two reasons:

- **It was structured as a friendly merger of equals (MOE) where no premium was offered** — This is another aspect of the industry's transformation that we have talked about before at length where, in the past, we have seen many premium deals end in tears. Unlike premium deals, a MOE minimizes speculation and arbitrage activity, leaving most of the stock in the hands of shareholders who judge a deal on its fundamentals. It also avoids selling pressure in the acquirer's stock and the churning of stock that often occurs following a premium deal.

- **We like the creation of a third industry leader** — Barrick (4.88% of fund net assets) and Newmont (6.20% of fund net assets) are already recognized as "super-majors" and industry leaders. At 3.5 million ounces per year, the new Agnico does not rise to the level of a super-major (typically producing five to six million ounces per year). However, other attributes enable Agnico to enter the big leagues. The merger sets it apart from other majors in terms of production, its costs are expected to be lower than the super-majors', and it has the lowest geopolitical risk with 75% of production coming from Canada and the remainder from Finland, Australia and Mexico.

Divergent views on inflation "from the top"

Over the past year, U.S inflation (as measured by the headline Consumer Price Index[6], or CPI) rose 5.3%, U.S. Producer Price Index[7] (PPI) gained 8.3%, and EU CPI (as measured by the Harmonized Index of Consumer Prices[8]) reached a 13-year high of 3.4%. Central bank and business leaders seem to have divergent views on this inflation:

- "The current bout of elevated inflation in the U.S. is tied to the reopening of the economy as it recovers from the pandemic and won't lead to a new regime of higher inflation going forward"
  – Fed Chairman Jerome Powell, Bloomberg, Sept. 29, 2021
- "There are no signs that this increase in inflation is becoming broad-based across the economy"
  – EU Central Bank President Christine Lagarde, Bloomberg, Sept. 28, 2021
- "Our prices are going up for the remainder of the year as we see inflation going up"
  – General Mills CEO Jeff Harmening, WSJ, Sept. 22, 2021
- "We're not expecting supply chain pressures to ease"
  – Bed, Bath, & Beyond CEO Mark J. Tritton, New York Times, Oct. 1, 2021
- "The impact of constrained labor markets remains the biggest issue facing our business"
  – FedEx COO Raj Subramaniam, WSJ, Sept 22, 2021

Bureaucrats in Washington and Brussels do not seem too worried, whereas the folks on the ground are quite concerned.

For most, inflation is already here

Increased overtime, higher wages to attract new workers and extra spending on transportation added $450 million to costs in FedEx's quarter ending August 31. Help wanted signs are common here in the New York tristate area. We spent some time traveling in the Inter-Mountain West recently, where labor is even tighter. One restaurant billboard simply posted "Name your Wage".

The Federal Reserve Bank of New York's August survey found consumers expect inflation of 5.2% in a year and 4.0% in three years. Expectations might be conservative, as the S&P CoreLogic Case-Shiller National Home Price Index[9] had an annual rise of 19.7% in July, an all-time record.

"Greenflation" too

The nascent transition to a green economy is already creating inflationary pressures. Energy prices have skyrocketed in Europe and China. In Europe an overreliance on unreliable wind energy is forcing grid operators to turn to natural gas and coal for backup. In a chain of unintended consequences, a lack of wind is creating high gas prices, which, in turn, are causing fertilizer producers to cut back and a subsequent shortage of carbon dioxide byproducts used in soft drinks. In China, blackouts are becoming increasingly common, ostensibly due to efforts to meet emissions targets.

The UBS Bloomberg CMCI commodities index made new seven-year highs in early October, driven by fossil fuels, metals and agricultural commodities. Metals needed to build the green economy may see increasing demand, while most mining companies are reluctant to commit the large capital outlays needed to build new mines, in our view.

Supply woes adding fuel to the fire

Supply chains are being realigned and businesses are relocating sources of production, creating bottlenecks that limit supply. Record numbers of container ships are parked off the coasts of California and Georgia, waiting for warehouse space and trucks to ship the goods inland. Factories in China are being forced to close intermittently to conserve power as the U.S. trade deficit surged to a record in June. Meanwhile, a recent Wall Street Journal article is titled: Car Chip Crisis to Extend for Years.

While some inflation drivers are surely related to the reopening of the economy, it seems the majority are long-term post-pandemic structural changes in consumer behavior, the workforce, raw materials dynamics and production and transport of goods that all point to a sustained period of rising prices. Perhaps the most compelling argument is the fact that for years, easy monetary policies, and more recently fiscal policies, have been stoking inflation.

If this assessment is correct, we would expect gold to react in 2022 if inflation metrics remain elevated in the longer-term.

All company, sector, and sub-industry weightings as of September 30, 2021 unless otherwise noted.

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[1]The U.S. Dollar Index (DXY) measures the value of the U.S. dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. [2]NYSE Arca Gold Miners Index (GDMNTR) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold. [3]"Junior" gold mining companies typically produce, on average, approximately less than 0.3 million ounces of gold per year. [4]MVIS Global Junior Gold Miners Index (MVGDXJTR) is a rules-based, modified market capitalization-weighted, float-adjusted index comprised of a global universe of publicly traded small- and medium-capitalization companies that generate at least 50% of their revenues from gold and/or silver mining, hold real property that has the potential to produce at least 50% of the company's revenue from gold or silver mining when developed, or primarily invest in gold or silver. [5]"Senior"or "Major" gold mining companies produce, on average, approximately 1.5-6.0 million ounces of gold per year. [6]The U.S. Headline Consumer Price Index (CPI) is a measure of the average change in the price for goods and services paid by urban consumers between any two time periods. It can also represent the buying habits of urban consumers. [7]The producer price index (PPI) represents the average movement in selling prices from U.S. domestic production over time and is typical utilized as a measure of inflation based on input costs to producers. [8]The Harmonized Index of Consumer Prices (HICP) is a list of the final costs paid by consumers for items in a basket of common goods and is a composite measure of inflation in the European Union. [9]The S&P CoreLogic Case-Shiller National Home Price Index tracks changes in home prices throughout the United States, covering nine major census divisions and calculated on a monthly basis.

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