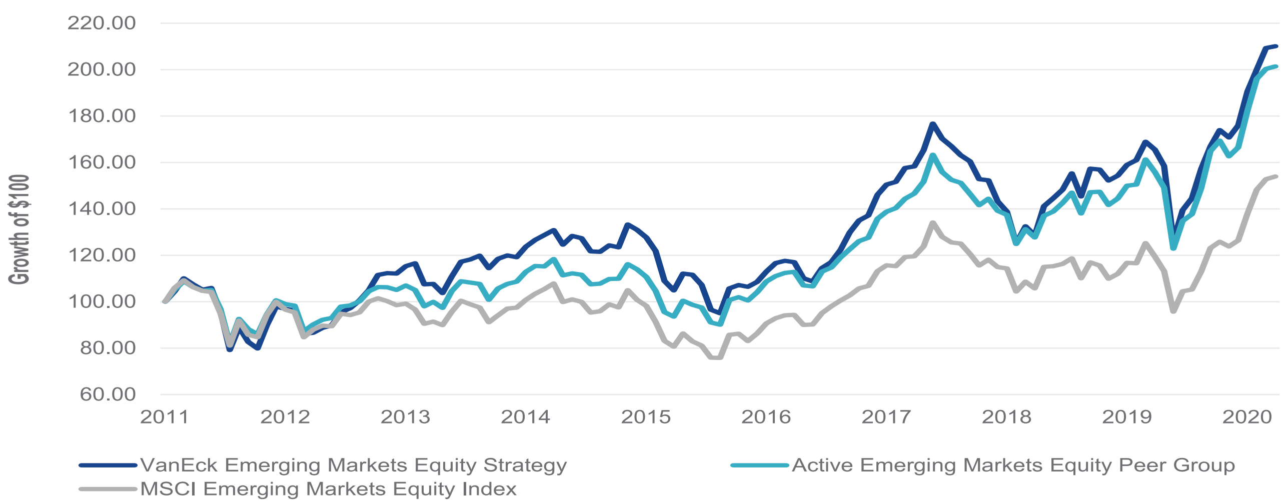
Our Active EM Solution vs. Passive Investing

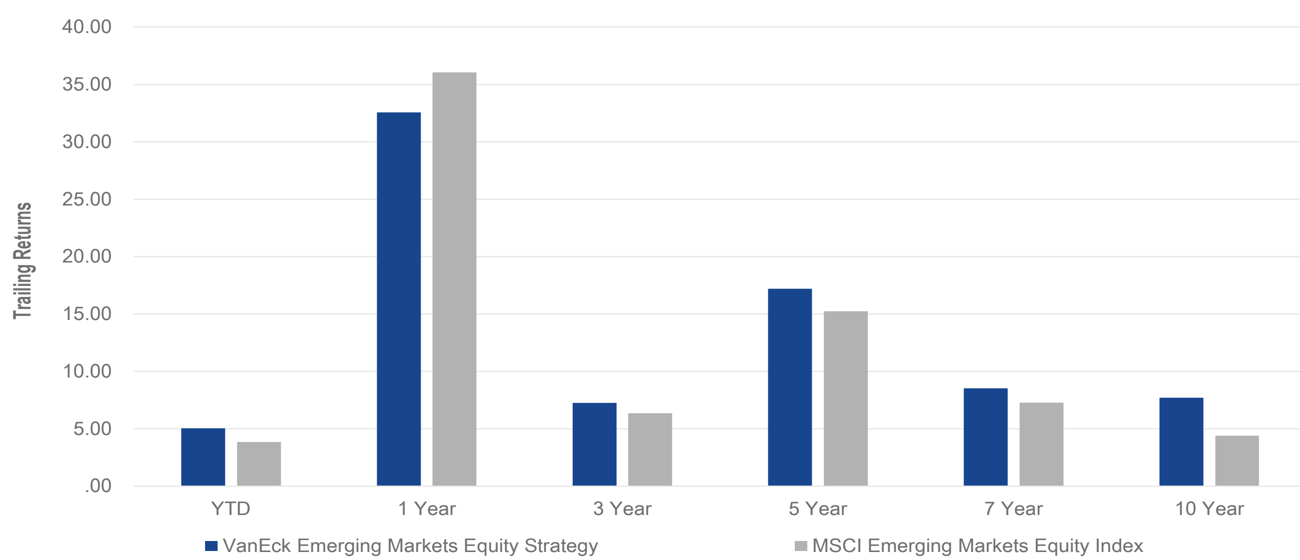
The rise of passive investing in emerging markets ("EM") shows no signs of abating. Very many indices have been created and new ETFs are being proposed to further carve up the asset class. And yet, the **VanEck Emerging Markets Equity Strategy** continues to outperform a broad emerging markets index ("MSCI EM Index") over multiple periods. The Strategy has also outperformed the Active Emerging Markets Equity Peer Group,[1] as outlined below. This has led us to reflect again on the relative role, advantages and disadvantages of active and passive investing in emerging markets. This white paper aims to explain emerging markets index limitations and inefficiencies, and discuss the VanEck Emerging Markets Equity Strategy as an active solution and its fit within an investor's total portfolio allocation framework.

VanEck EM Active Solution vs. Passive Investing – Growth of $100 over 10 Years (2011-2021)



Source: eVestment. Historical data from February 28, 2011 through February 28, 2021.

VanEck EM Active Solution vs. Passive Investing – Historical Trailing Returns over 10 Years (2011-2021)



Source: eVestment. Historical data from February 28, 2011 through February 28, 2021.

[1] The Active Emerging Markets Equity Peer Group is defined as the Global Emerging Markets All Cap Growth Equity Category in eVestment.

Inside the MSCI Emerging Markets Index – Its Limitations and Inefficiencies

Through many years of investment research, deep expertise and local knowledge of emerging markets around the world, our Investment Team[2] have identified the following limitations and inefficiencies of the broad emerging markets index, which we will address individually. We believe that the MSCI EM Index is:

- Backward looking vs. forward looking
- Not fully representative of emerging markets as an asset class due to
  - – Natural bias and significant overweight in large cap, often cyclical issuers
  - – Corporate governance issues
  - – Sector dispersion
  - – Under-researched opportunities in small-mid capitalization companies ("SMID") as future business model disruptors
  - – Index's liquidity constraints

Backward-Looking vs. Forward-Looking Approach

Most widely used indices tend to poorly capture current EM trends, leading investors to potentially miss out on forward-looking, sustainable, structural growth[3] opportunities, as emerging markets continue to evolve.

Market-cap weighted indices tracking emerging markets tend to be backward looking, influenced by the movement of companies that have succeeded in the past, without regard for future growth potential or risks. While this approach could work in mature and diverse economies with indices that tend to be more balanced and stable (i.e., the U.S. economy and the S&P 500 Index), it may not be appropriate for emerging markets. Because emerging markets are diverse and evolve at a much faster pace, passive vehicles may be at a structural disadvantage compared to active managers who have the flexibility to continuously evaluate and shift exposures to sectors and countries with the optimal risk-adjusted growth potential in mind.

To further illustrate how emerging markets equities have evolved, let's examine the top ten holdings of the MSCI EM Index in December 1997 (as the Asian currency crisis unfolded and before Russia's 1998 debt default), in August 2008 (prior to the global financial crisis) and more recently, in March 2021, as highlighted in the table below.

#	**Top Ten** 12/31/1997	**Top Ten** 8/31/2008	**Top Ten** 3/31/2021
1.	Centrais Electricas Brasileiras S.A.	Gazprom	TSMC
2.	Telecomucacoes Brasileiras S.A.	China Mobile Limited	Tencent Holdings Ltd.
3.	Telefonos de Mexico SAB de C.V.	Petroleo Brasileiro S.A.	Alibaba Group Holding
4.	Oil Company LUKOIL PJSC	Samsung Electronics Co., Ltd.	Samsung Electronics Co., Ltd.
5.	Unified Energy System of Russia	Vale S.A.	Meituan
6.	YPF S.A.	America Movil SAB de CV	Naspers Ltd.
7.	Petreleo Brasileiro S.A.	TSMC	China Construction Bank
8.	Tenaga National Bhd	Teva Pharmaceutical	Reliance Industries Ltd.
9.	Wal-Mart de Mexico SAB de CV	Oil Company LUKOIL PJSC	Ping An Insurance Group
10.	Genting Malaysia Bhd.	Sasol Limited	JD.com Inc.

Source: Bloomberg. Data as of 12/31/1997, 8/31/2008 and 3/31/2021 (Estimates).

[2] The VanEck Emerging Markets Equity Strategy is led by Portfolio Manager David Semple who has over 30 years of dedicated emerging markets investment experience. David has been at VanEck since 1998 and has run the Strategy since its inception in 2002. The Portfolio Manager is supported by a deeply experienced team of career emerging markets analysts, who are dedicated solely to this Strategy. The Investment Team also benefits from access to research resources available across VanEck's broader organizational platform. This includes rigorous on-the-ground research and due diligence, including firsthand interaction with company managements, which takes our investment teams around the globe.

[3] Structural growth investment opportunities are defined as forward-looking and sustainable growth ideas that survive and thrive in a rapidly changing asset class such as emerging markets.

In 1997, transportation and utility companies from Latin America and Russia dominated the top ten. Some of the countries included in the list (e.g., Argentina) have since been recategorized to a frontier market status and some of the companies have been delisted.

By the turn of the century, many emerging nations progressed into a new phase of the financial reform, technological advancement and massive infrastructure building, which, naturally, changed the Index's composition. By 2008, the top ten list included companies such as China Mobile, Petrobras, Samsung, Vale and Taiwan Semiconductor.

Since the financial crisis of 2008, the top drivers of economic growth have shifted from infrastructure development that favored fixed asset companies to domestic consumption, which favors Internet and Internet-related technology companies, consumer electronics manufacturers and banks, among others – which are primarily dominated by China and India. Thus, the top ten list composition has changed again.

Not Fully Representative of Emerging Markets as an Asset Class

Natural Bias and Significant Overweight in Large Cap, Often Cyclical Issuers

The MSCI EM Index does not fully represent the universe of opportunity in emerging markets. As of today, it is dominated by large-cap companies, many of which are state-owned enterprises ("SOEs")[4] that happen to be highly cyclical in nature, such as energy and materials; or low growth companies that comprise the utilities and telecommunications sectors. Many of these issuers grew not due to their superior competence and/or competitive advantage, but rather due to being systematically favored by their own governments through cheap capital, access to raw materials and preferential treatment.

Corporate Governance Issues

Two issues specific to the MSCI EM Index construction are:

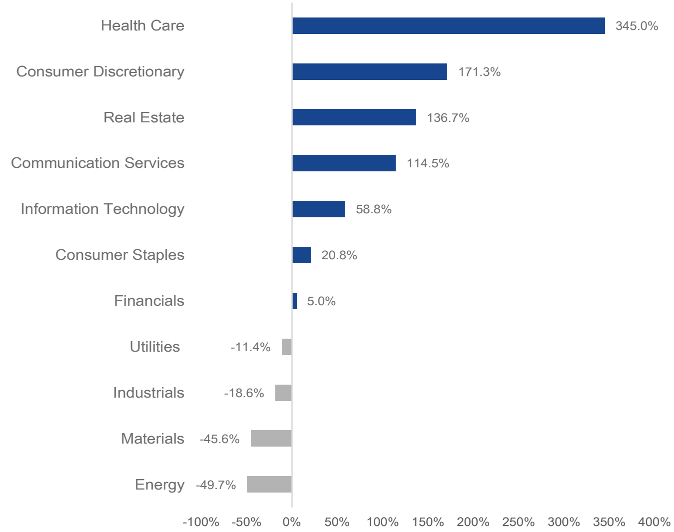
1. Corporate Governance: A significant number of companies, more often than not SOEs, included in the MSCI EM Index have significant corporate governance and ESG issues.
2. Areas of structurally lower growth: The current Index is heavily weighted towards structurally lower growth economies such as Korea and Taiwan Region. These countries are heavily exposed to global growth factors, as well as structurally low growth sectors, e.g., Utilities and Telecoms.

Sector Dispersion

The Index's inability to implement a forward-looking perspective leads to investor concentration in continuously shrinking, mainly cyclical sectors. For example, 2010 marked another inflection point in the evolution of emerging markets following the financial crisis of 2008. As the economic stimulus from monetary and fiscal easing slowed globally, emerging economies had to look for other ways to maintain their robust economic growth trends. For many governments, focus on domestic growth and consumer-led sectors and away from highly cyclical, fixed-asset infrastructure driven sectors was the answer. As a result, policymakers and investors turned their attention to the emerging markets domestic consumer, favoring sectors and industries influenced by local consumption and services. These sectors not only outperformed in the past few years but they also expanded substantially, especially when compared to some cyclical sectors that experienced a significant decline during the same period (as illustrated in the graph on the next page).

[4] A state-owned enterprise ("SOE") is a legal entity that is created by a government in order to partake in commercial activities on the government's behalf. It can be either wholly or partially owned by a government and is typically earmarked to participate in specific commercial activities.

MSCI Emerging Markets Equity Index
Historical Market Cap Expansion by Sector (2011-2021)



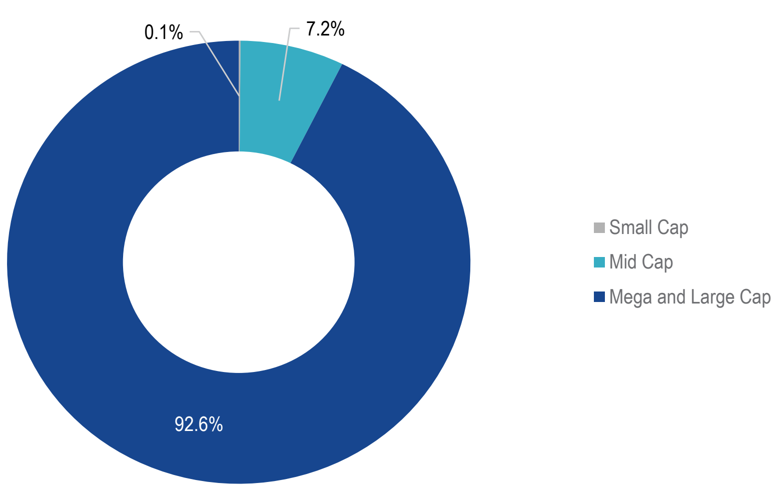
Source: FactSet. Historical data from December 31, 2010 through February 28, 2021.

Under-Researched Opportunities in SMID as Future Business Model Disruptors

Due to its methodology, the MSCI EM Index does not fully capture structural growth companies that started small and grew larger through effective management and favorable business conditions. There is no shortage of such inspiring companies in emerging markets. In many cases, some of carefully selected and properly researched small caps (i.e., companies with market capitalizations below $2 billion) can be the next generation's disruptive force, often powered by new technologies.

Nevertheless, small and mid-cap companies are underrepresented in traditional emerging markets indices (see the chart below). As of March 31, 2021 (estimated), small and mid-cap stocks comprised only 7.3% of the MSCI EM Index.

MSCI Emerging Markets Equity Index
Market Cap Breakdown by Number of Stocks



Source: Bloomberg. Data as of March 31, 2021 (Estimates).

Index's Liquidity Constraints

Given the number of passive funds, investing in companies that trade in smaller quantities and/or infrequently, can be a challenge. Therefore, passive funds that track broad EM indices may deprive investors of exposure to stocks that may prove not only potentially rewarding but also less vulnerable to the unpredictability of global flows in and out of such funds.

For smaller active strategies, this represents a good investment opportunity with a potential bonus: less volatility and lower valuations, given that the liquidity premium is typically priced into such companies. An active strategy with the ability to invest in small and mid-cap companies may be more nimble and flexible in finding structurally growth businesses at a reasonable price. Additionally, it can also provide investors with access to rising companies before they become liquid enough for inclusion in large active and passive strategies.

VanEck Emerging Markets Equity Strategy as an Actively Managed Solution

We believe an active approach to investing in emerging markets has significant advantages over purely passive investing.

The VanEck Emerging Markets Equity Strategy offers the following:

- Its perspective is **always forward looking**, whereas any index (for example, the MSCI EM Index) typically focuses on companies that have done well in the past
- The Strategy can invest in the most attractive **structural growth opportunities in emerging markets**, while avoiding inefficient large cap and highly cyclical names
- Its investment universe can include stocks of **all market capitalization sizes**, whereas a market-cap weighted index historically and inherently will be dominated by large-cap names that tend to be driven and more responsive to global events
- The portfolio's built-in flexibility enables the Investment Team to identify, access and invest in emerging markets companies that are otherwise **excluded from the MSCI EM Index** due to liquidity requirements and/or other considerations (i.e., market capitalization size)

Allocation to Growth within Total Portfolio Framework

As investors evaluate their growth exposure (i.e., emerging markets equity exposure) as part of total portfolio allocation, the question they should be asking themselves is: "Am I efficiently accessing the best opportunities in emerging markets?" By "best opportunities," we mean fundamentally sound companies with visible and persistent growth that survive and thrive in a rapidly changing asset class such as emerging markets. And by "efficiently," we mean investments that generate acceptable risk-adjusted returns at a reasonable price over time.

Conclusion

It is difficult to reconcile concepts of "passive" and "emerging markets," as the essence of the former is dependent on maintaining the status quo; whereas the latter is a symbol of a dynamic, onward and upward movement. This thesis certainly holds true for emerging markets equities that are more dynamic, constantly changing and evolving by nature. As a result, an actively managed strategy, like the VanEck Emerging Markets Equity Strategy, outperformed the broad emerging markets index (i.e., MSCI EM Index), as well as the Active Emerging Markets Equity Peer Group over multiple periods ending November 30, 2019. While we, as the firm, have long supported both active and index-based passive management styles, our EME Investment Team's research concludes that an active approach to investing is the way to go in the context of emerging markets equities.

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