

**VanEck** FUNDS

# Markets Stop Panicking When Central Banks Panic

Q&A with David Semple, Portfolio Manager

## VanEck Emerging Markets Fund

GBFAX / EMRCX / EMRIX / EMRYX

### Performance Review

The VanEck Emerging Markets Fund (the “Fund”) lost 9.45% during the third quarter 2018, underperforming the Fund’s market index benchmark, the Morgan Stanley Capital International Emerging Markets Investable Market Index (MSCI EM IMI), which lost 1.45% for the same period.

#### Average Annual Total Returns (%) as of September 30, 2018

	3Q18†	1 Yr	3 Yr	5 Yr	10 Yr
Class A: NAV (Inception 12/20/93)	-9.45	-9.94	7.84	2.94	7.08
Class A: Maximum 5.75% load	-14.64	-15.12	5.73	1.72	6.45
MSCI EM IMI	-1.45	-1.18	11.72	3.51	5.65
MSCI EM Index	-1.09	-0.81	12.36	3.61	5.40

### David, a general note on 2018?

It has certainly been a disappointing year. We entered 2018 with much optimism about the strength of the fundamentals of emerging markets companies, which we believe is still the case. However starting February, macro events and political disputes took center stage and became the main market drivers.

**Expenses: Class A: Gross 1.47%; Net 1.47%.** Expenses are capped contractually until 05/01/19 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.

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](http://vaneck.com).

Please refer to index descriptions on the last page. One cannot invest in an index.

Please note that the information herein represents the opinion of the portfolio manager and these opinions may change at any time and from time to time. Information herein should not be construed as investment advice.

At this point in time, it is very important to put our investment process and philosophy into context. As part of our philosophy, we focus on investing in structural growth trends in emerging markets and at a reasonable price. As a result, we have consistent, persistent factor risk to growth, size, quality, and momentum and, typically, a high active share in pursuing the strategy. As we are always careful to explain to investors, when volatility rises often there is a panic out of size and growth risks and active managers reduce active share and tracking error risk. If we try to follow the herd into more “defensive” parts of the emerging markets, we may risk missing whatever the trigger is for recovery. We would, in addition, be failing to execute the strategy as we have described it to our investors over the years.

We would like to reaffirm the robustness of our philosophy and process as it remains very much intact. This process is designed to deliver competitive returns over time, however, in times of high stress, the strategy may underperform. Just as in prior periods of market turmoil, we remain in constant contact with the management teams of our portfolio companies and continue regularly to stress test our structural growth theses. As of now, we are seeing very little in terms of actual business stress.

We continue to believe that the real story in emerging markets remains the long march of secular growth. Valuation is cheap and positioning is light. We are pleased with the resilience of earnings in emerging markets despite some revisions in the past quarter. This period may well be regarded in the future as one of the best buying opportunities into much discounted structural themes.

### **Can you give us a market review of the year so far?**

The U.S. dollar and dollar liquidity, escalation of the trade war between U.S. and China, and a perceived slowdown in the Chinese economy were among the factors impacting the markets negatively.

The combination of macro events has resulted in a tough year for both size and growth factors in emerging markets as investors have reduced risk either by raising cash or fleeing to safer spots in emerging markets. Based on MSCI Indices<sup>1</sup>, large caps and value companies outperformed their small caps and growth counterparts by 4.67% and 6.88% respectively. The rise in oil prices, especially during the third quarter, helped the energy sector top the list of best performing sectors in 2018, by a wide margin, returning a positive 15.79% for the year, versus losses of 21.00% and 16.07% respectively for the worst performing sectors during the same period: consumer discretionary and financials. The Fund's focus on structural growth means that we tend to have low/no weighting in the energy sector, and persistent overweights in the consumer discretionary and healthcare sectors and a sizable allocation to financials and information technology especially internet stocks. While this has helped the Fund's performance over the medium and long term, clearly this was a particular headwind this year.

On a country level, Russia and Colombia, also energy driven economies, performed best in 2018. Conversely, the accumulation of bad policies over the years caught up with Argentina and Turkey, leading to steep equity and currency losses. China and India were also down in 2018, each for different reasons, returning -8.98% and -9.60%, respectively.

### **What are the primary catalysts that should get the markets back on track?**

Resolution of the same issues that are holding the markets back: A decrease in global risk, especially the trade dispute between the U.S. and China, a waning in the relative strength of both the U.S. dollar and the U.S. economy, anticipation of the peak of the interest rate cycle in the U.S., and better sentiment towards China with an appreciation of the impact of its stimulus measures.

### **What about trade?**

While we can't foresee where this mad dash to protectionism will eventually lead, we hope that saner heads prevail over time. But maybe that will come only when pain is apparent on both sides of the table. Tariffs are not "the greatest", they are like sand in the wheels of the global economy. None of our holdings are directly exposed to the tariffs measures implemented or discussed. There is a secondary effect in terms of drag on investments, and ultimately growth, as exports get hit. However, in the past few years, emerging markets have been more dependent on domestic demand and exports as a percentage of gross domestic product (GDP) has been declining. Also, China's regional exports have been on the rise. Our discipline is to focus on companies with robust operational outlook, and not be overly influenced by the fickle changes of short-term market sentiment.

### **Will the contraction in U.S. dollar liquidity lead to an emerging markets contagion?**

As the tide has gone out due to Federal Reserve (Fed) tightening, some countries have been exposed without their bathing suits. Turkey and Argentina have been the starkest examples. Other countries such as Brazil, the Philippines, and Indonesia may also be facing difficulties. Furthermore, the relative strength of the U.S. economy has led to a repatriation of U.S. dollars from both developed and emerging economies.

A contagion scenario similar to 1998 seems unlikely to us. The main reasons that the crisis in 1998 was as deep were external debt and pegged currencies. Both factors are much less of an issue today. Most debt is in local currencies and almost all major emerging markets countries now have floating currencies, which they can use in addition to monetary policy to absorb shocks. Belatedly, Argentina and Turkey have made policy moves that give them more credibility, but the after-effects of the foreign currency moves will be with them for some time.

### **What does the worst case scenario look like for Chinese markets this year?**

China has imbalances. Given the scale and the speed of its economic development, there are significant issues that need to be addressed. But China also has many more, and more effective, levers to influence its economic outcome in the shorter term. Tariffs alone, at the levels that have been postulated, will have a modest impact on the economy, almost completely negated by the fiscal, monetary, and currency measures that have been effected. The Chinese government has proven on multiple occasions to be

competent with the will, expertise, and tools to control its quasi-command economy effectively. We don't anticipate anything dramatic, but we wouldn't be surprised to see some modest currency weakness, if the current trade dispute with the U.S. is extended and deepened.

### China is a large overweight, what is your base case?

Actually, I prefer the expression "less underweight than rest of our peers" when discussing our weighting in China, given the true market capitalization of China within emerging markets especially after you factor in the A Share market. Economic data have pointed to a slowdown in the Chinese economy in recent months. I predicted the slowdown in our first quarterly commentary this year. I also stated that I expect China to reverse its monetary policy from tightening to easing, which it did. The effects of easing have not been reflected in hard economic data yet. But they will be. The government's aim is to stabilize growth despite tariff related issues. It has engaged in monetary, fiscal, regulatory, and tariff measures to achieve that goal. Don't fight Beijing... As the saying goes, "markets stop panicking when central banks start panicking".

### What is your outlook for the U.S. dollar?

The U.S. dollar has been relatively robust. So far this year, despite all the negative headlines, the USD is up only approximately 4%. On a Real Effective Exchange Rate (REER) basis, a measure used to compare currency valuation relative to other currency/currencies, the USD valuation is currently at multi-year highs compared to emerging markets local currencies. The U.S. is also facing the largest twin deficit on record, which, combined with likely political paralysis post mid-term elections, will make it hard for the dollar to perform, we believe. U.S. growth has been exceptionally high versus the rest of the world—we expect that advantage to diminish. Exacerbating the situation has been a repatriation rush from U.S. corporates, which is now diminishing, and the flows from an increasing number of momentum-driven strategies. The USD (as well as the U.S. equity market) is very much a consensus long.

### How do emerging markets perform during interest rate hiking cycles?

In the past such an environment has been positive for emerging markets, since it is a response to higher growth. However, we are also seeing signs of global central banks becoming more dovish in the face of market downturns. A slowdown in rate hikes from the Fed can be also very positive for emerging markets. The negative impact of U.S. rate hikes may be more negatively felt in countries

with large funding requirements. Using the same image again, it is like when the tide goes out, we see who's lacking a swimming suit. So far, Argentina and Turkey have been the first two countries to be impacted.

### Fund Review

The underperformance of growth and size factors impacted the Fund's performance negatively during the quarter. In terms of country attribution, Spain (CIE Automotive, an emerging markets focused company) and South Korea added value most to the Fund's relative performance, while Taiwan and China detracted most. The Fund's exposures in the consumer staples and the utilities sectors helped relative performance, while stock selection in consumer discretionary and information technology detracted.

### Our Top Performing Companies in the Quarter, with Explanation

The top performers during the quarter included two companies from China and one from Thailand. Based on solid customer growth, Ping An Insurance (Group) Company of China (5.2% of the Fund Net Assets\*), the quarter's best performer, announced of its best six-monthly performance in 10 years. The company technology business, in particular, exhibited strong growth. Beijing Capital International Airport (1.1% of the Fund Net Assets\*) benefitted during the quarter from reporting a surge in concession income, in particular from duty free sales, in its first half. Srisawad Corporation (1.3% of the Fund Net Assets\*) benefitted from the reversal of a large non-performing loan which had hurt the stock when it was announced in the previous quarter.

### Our Bottom Performing Companies in the Quarter, with Explanation

The bottom performers included Tencent Holdings (6.7% of the Fund Net Assets\*), which suffered, we believe inordinately, from concerns about current regulatory issues in China and its performance was affected by short-term market myopia, fixated on discrete issues which cloud the fact that this is the most valuable internet community in the world. Indeed, the company has already taken steps to address some of the more popular concerns attached to the social issues around both gaming and health. In addition, we see the company's recent restructuring as pointing to a broadening of monetization efforts and a positive catalyst. Alibaba Group Holding (6.9% of the Fund Net Assets\*) was another Chinese company that suffered, we believe, unwantedly during the quarter, not least in light of a recent earnings report showing that, year-over-year, revenue growth was 61%.

Finally, China Maple Leaf Educational Systems (1.2% of the Fund Net Assets\*), along with other Chinese education shares, suffered during the quarter from uncertainty over government policy on regulatory oversight and fears that changes might negatively affect both growth and income.

### Any final words on emerging markets?

Let's not forget why we are invested in emerging markets. Despite all the noise, the real story in emerging markets remains the long march of secular growth. We have seen this happen over and over again in the past 15 years. Markets tend to mean revert and reach new highs. Our conviction in emerging markets is high for many reasons. Growth in emerging markets is expected to pick up in the coming years, especially compared to developed markets. According to the IMF, India is expected to grow 7-8% and China is expected to maintain 6-6.5% growth, mostly driven by domestic demand. According to McKinsey, consumption in emerging markets is expected to hit \$30 trillion by 2025, from \$12 trillion in 2010. Growth in industries such

as internet, e-commerce, payment, gaming, social media, healthcare, consumption, education, entertainment, furniture, and clean energy among others is still in nascent stages. Over the past 25 years, more than one billion people have been lifted from below poverty levels mostly in East and South Asia.

†Quarterly returns are not annualized.

\*All country and company weightings as of September 30, 2018. Any mention of an individual security is not a recommendation to buy or to sell the security. Fund securities and holdings may vary.

†Based on the MSCI EM sub-indices and the MSCI EM Small Cap Index such as the MSCI EM Growth Index, MSCI EM Value Index, MSCI EM Consumer Discretionary Index, MSCI EM China Index.

PEG ratio is the ratio of the forward price to earnings divided by growth in the following year. Return on equities is net income divided by total equity. Return on invested capital is the ratio of net income less dividend paid over the firm's total capital.

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 Morgan Stanley Capital International (MSCI) Emerging Markets Index captures large- and mid-cap representation across 24 Emerging Markets (EM) countries. With 836 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The MSCI Emerging Markets Investable Market Index (IMI) captures large, mid and small cap representation across 24 Emerging Markets (EM) countries. With 2,628 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in each country. MSCI All Country World Index (ACWI) captures large- and mid-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. With 2,483 constituents, the index covers approximately 85% of the global investable equity opportunity set.

Diversification does not assure a profit or prevent against a loss.

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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](http://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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