September 2022

Are We There Yet?

Eric Fine

Portfolio Manager

VanEck Emerging Markets Bond Fund

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

Overview

The Fund went down -6.31% based on its net asset value in September, compared to down -5.62% of its benchmark, the J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified and 50% J.P. Morgan Emerging Markets Bond Index (EMBI). The Fund's underperformance brings year-to-date ("YTD") outperformance to 491bps. YTD, owning no Russia, navigating Ukraine, being long Brazil in local currency, while not keeping our duration or EMFX views on "autopilot" in a roller-coaster year drove outperformance.

Emerging Market's ("EM") September performance was driven by weaker global markets, most importantly accompanied by a still-hawkish Fed and commensurate rises in U.S. market interest rates that math dictates hit all bonds. But, we are getting increasingly bullish on both "risk" (EM local currency and at some point spread duration), and think that we are closer to a moment during which the Fed is less of a global risk driver, and maybe even risk-supportive. We'll list the reasons.

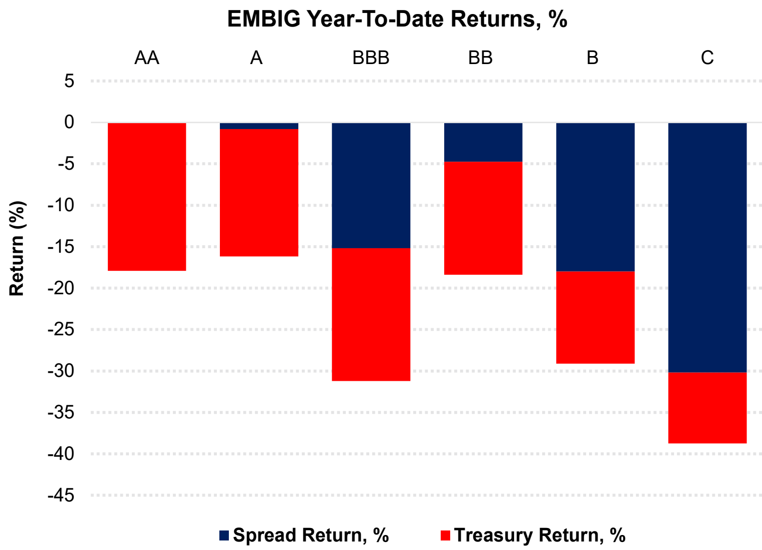
The underperformance in September was due primarily to China, just as it was the primary cause of (greater) outperformance in August. What's different now was that this involved one bond that we bought later in our purchasing cycle, which was hit with the bad news that we think was not factual. We are sticking with our view that property-sector (and other) bonds are majorly oversold and underpriced. And recall that all 5 of the bonds we purchased in the property sector turned out to be on the list of 7 companies that the Chinese government subsequently said were off-limits/had strong government support. We've heard "face" is important in Chinese culture (the bond that hiccupped is one of the 7).

As of end-September, local currency exposure was much lower at around 34% of exposure. Duration was down further to 4.6, back near the lows of the year for the fund. And carry remained very high at 6.86%. Risks are that our duration and local currency rise, we think.

We are becoming increasingly bullish on both "risk" (emerging markets (EM) local currency and at some point spread duration), and think that we are closer to a moment during which the U.S. Federal Reserve (Fed) is less of a global risk driver, and maybe even risk-supportive. EM's September performance was driven by weaker global markets, most importantly accompanied by a still-hawkish Fed and commensurate rises in U.S. market interest rates that math dictates hits all bonds. Later in this Commentary, we'll list the reasons behind our view that the risk to our positioning is that we increase risk and duration. But, just as an appetizer, we'll start you off with a September 30, 2022 YTD comparison of some key bond market returns versus ratings. Ratings didn't matter. There is nowhere to hide, other than low duration. Our second appetizer makes the duration point. And, our view is that duration is on the verge of mattering a lot less.

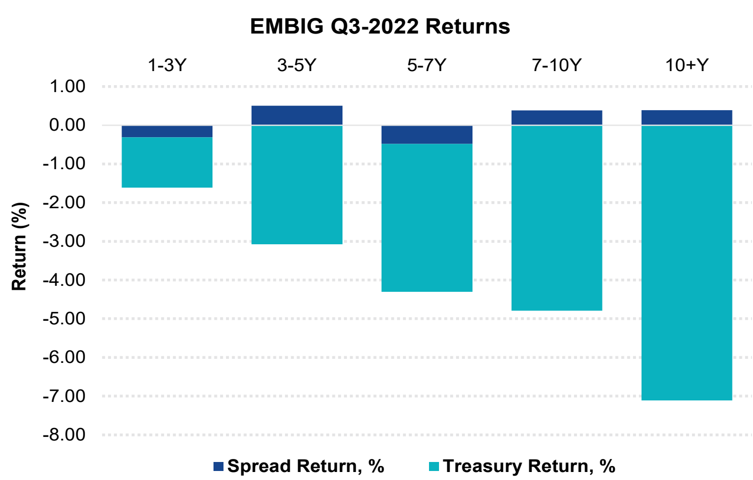
[1] Carry is defined as Current Yield. 30-Day SEC Yield for Class A was 7.80% as of 9/30/2022. 30-Day SEC Yield is a standard calculation developed by the Securities and Exchange Commission that allows for fairer comparisons among bond funds. It is based on the most recent 30-day period. This yield figure reflects the interest earned during the period after deducting the Fund's expenses for the period. In the absence of temporary fee waivers, the 30-Day SEC Yield for EMBAX would have been 6.74% as of 9/30/22.

Exhibit 1 – Ratings Didn't Matter



Source: Bloomberg. Data as of September 30, 2022.

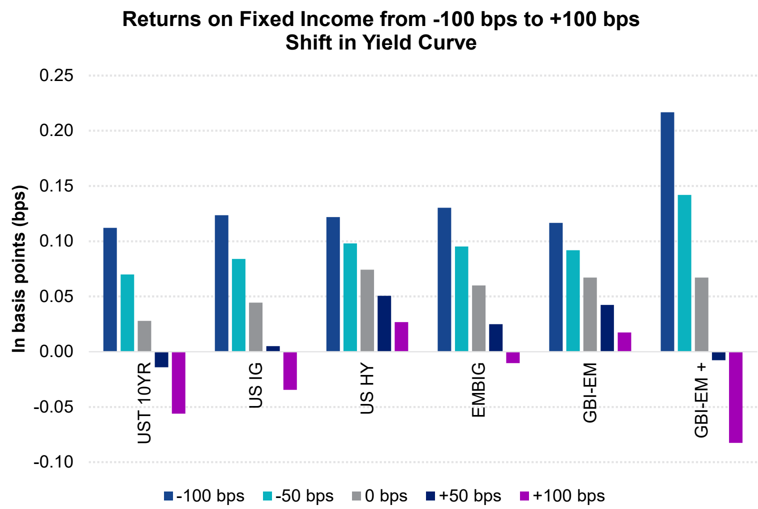
Exhibit 2 – Duration Mattered



Source: Bloomberg. Data as of September 30, 2022.

First, carry is increasingly the return driver. This, by definition, makes global rates less of a driver (see charts). Our current mantra, "if you think rates are rising then lower your duration and don't extrapolate any more than that", is still true. We have had a low duration all year except for a couple of months beginning in June. But, we don't think we're confusing low duration with "risk" and we have had big local Brazil exposure most of this year (the currency is up year-to-date!), though we reduced many months ago due to election and market risks. Just look at Exhibit 3, below, where we chart the return implications of 100bp higher rates, to 100bp lower rates across major bond categories. Treasuries and investment grade bonds (IG) have the worst upside/downside. EM and high-carry have the best. Maybe don't own bonds at all, but if you're still worried about rates rising at this stage, don't own Treasuries or IG, either. But don't avoid EM! And, of course, maintain low duration; once again, we repeat our mantra "higher rates mean have lower duration, period", do not extrapolate beyond that. (The exhibit below's output assumes a 12-month holding period to capture the importance of carry).

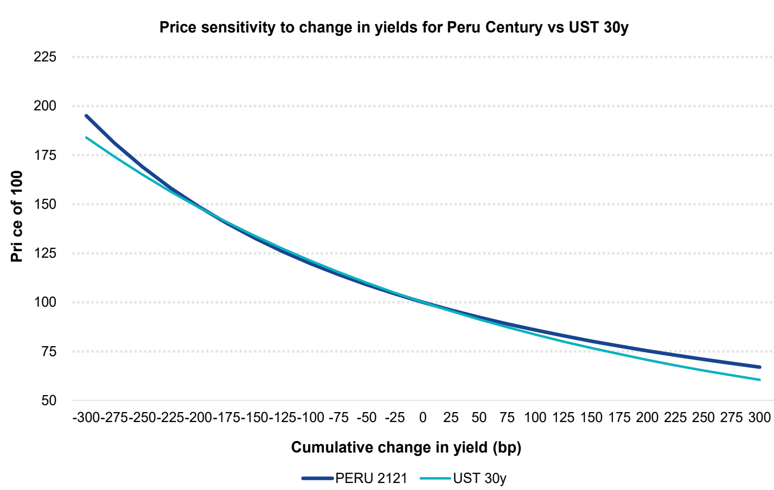
Exhibit 3 – If You're Still Worried About Rising Rates, Treasuries and IG are the Problem Areas



Source: VanEck and Bloomberg. Data as of September 30, 2022.

Second, details matter, and EM has tons of them. Tradable details matter, most importantly. Low duration and high carry in credit and local currency matter, as do long duration, low price, high carry and asymmetric convexity in credit, which allows us to benefit from any pause in rate rises without as much downside. Overall, EM central banks that hiked earlier and larger than the Fed, e.g., Brazil and Mexico, have resulted in currencies that are stronger against the U.S. dollar YTD, and with rates potentially poised to rally as well and which are generating very high carry. We are very excited about potential local currency exposures at the right moment. We'll only use one exhibit here (major geek alert) that shows lower price sensitivity to rates of one of our favorite of the long duration, low price, high carry and asymmetric convexity and thus duration – the Peru century (100 year) bond.

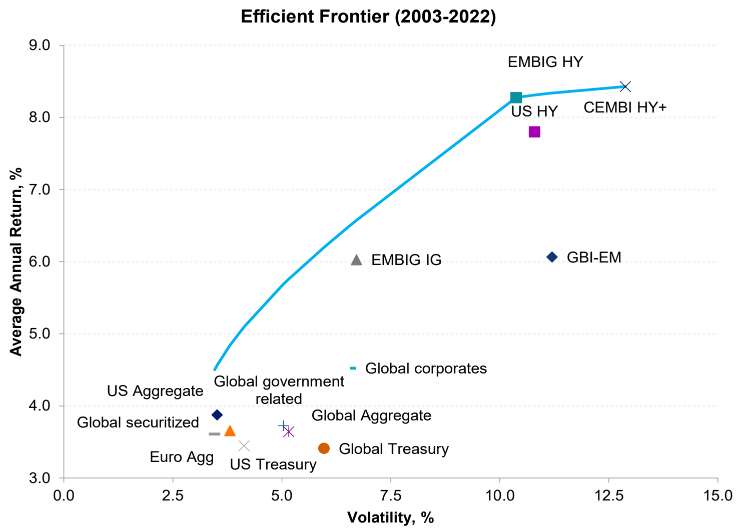
Exhibit 4 – There's a Unique Category of Long Duration Bonds with High Carry, Low Price, and Lower Sensitivity to Rate Rises (Geek Alert)



Source: VanEck and Bloomberg. Data as of September 30, 2022.

Third, and this is a repeat – the 60/40 model will get its revenge. It starts when 2-year yields peak, with perhaps a high-4 or low 5 handle, which is looking to be this year's business. When cash moves into 2-year bonds, the discussion of bond inflows begins. Once the discussion turns to bonds, the answers will inevitably involve much more EM debt exposure than most investors have. All we'll say is that only two bond categories are even ON the frontier – EM High Yield Sovereigns (love 'em) and EM High Yield corporates (love 'em, but very selective and liquid (or crushed)). U.S. High Yield ("HY") isn't even on the frontier, after 19 years of data through August of this year, and EVERYONE has U.S. HY. The implied allocations to EM debt (50% of your bond portfolio should be EM debt for a target volume of 6, there are no typos here) are massively higher than anyone has, particularly in the U.S. So, I'll leave it there. Outflows would be a key risk, of course, given the usual mass cyclical pattern of selling after losses as buying more after gains, but to us, stocks strike us as more overbought in the big picture than bonds overbought.

Exhibit 5 – The Efficient Frontier for Bonds



Source: VanEck and Bloomberg. Data as of September 30, 2022.

Exposure Types and Significant Changes

The changes to our top positions are summarized below. Our largest positions in September were China, Mexico, Indonesia, Brazil and South Africa:

- We increased local currency exposure in Indonesia, Poland and the Czech Republic. Indonesia's central bank chose to frontload more rate hike in response to rising inflation pressures – just as the government decided to increase subsidized retail fuel prices – a fiscally responsible move. In terms of our investment process, this improved the policy and technical test scores for the country. Disinflation in Poland and the Czech Republic might be progressing faster than expected, opening room for staying on hold "safely". In terms of our investment process, this improved the economic test scores for these countries.

- We also increased our hard currency sovereign exposure in Chile and Mexico, and hard currency corporate exposure in Nigeria. Global duration might start outperforming again; as global growth slows, inflation is peaking, and key central banks are getting closer to their terminal rates. This creates space for selective duration exposure in EM, especially in countries with stronger fundamentals and institutions. In the case of Chile and Mexico, these developments improved the technical test scores for these countries. The corporate bond in Nigeria is attractively valued and defensive. The company is operationally a good performer under almost any market conditions and diversified beyond Nigeria. In terms of our investment process, this resulted in the improved technical test score.

- Finally, we increased local currency exposure in Uruguay, South Korea and Israel. In Uruguay, we liked good valuations, signs of inflation plateauing and a solid growth outlook. At the same time, the central bank maintained its hawkish policy stance, making sure that inflation expectations remain anchored. In terms of our investment process, this gives a boost to the country's policy and economic test scores. In South Korea, the currency can benefit from a strong correlation with the Japanese yen (and the central bank made it quite clear that further "speedy" depreciation is not welcome). Further, the central bank remains credible, tightening as inflation pressures are persistent. Israel's central bank is equally hawkish and credible, and the currency was attractively valued at the time when we added the position. These factors improved the countries' policy and technical test scores.

- We reduced our local currency exposure in China, South Africa and Brazil. The Brazilian central bank almost certainly ended its tightening cycle, but we preferred to scale down the position before the first round of the hotly-contested presidential elections with a view of possibly re-entering back, if the results turn out to be more market-friendly than suggested by recent polls. Our decision reflected the worsening policy test score for the country. In China, we were motivated by stronger depreciation pressures on the currency, as authorities were forced to continued easing in order to prop up growth. These developments worsened the policy and economic test scores for the country. In South Africa, the current account unexpectedly flipped into a deficit in Q2-2022, undermining the fundamental support for the currency. There were also concerns about the central bank being a latecomer to the global tightening cycle, as well as about the impact of the global slowdown on the South African economy. An additional consideration is that the South African rand is often traded as the EEMEA's regional proxy, and the region is subject to high inflation pressures, downward growth revisions and geopolitical instability. In this particular case, all three test scores for the country – economic, technical and policy – started to look worse.

- We also reduced our local currency exposure in Romania, Hungary and Thailand. Thailand's central bank is widely perceived to be lagging behind the global policy curve – in addition to concerns about the widening current account deficit. These factors worsened the economic and policy test scores for the country. Hungary and Romania are too close to the Russia/Ukraine war, which seems to be escalating, and Hungary's position in the conflict often looks at odds with the rest of the European Union. The Hungarian government has also yet to resolve its latest spat with the EU related to domestic political issues, which can cost the country billion of euros of financial transfers. In terms of our investment process, this worsened the technical test scores for both countries, as well as the policy test score for Hungary.
- Finally, we reduced hard currency sovereign exposure in El Salvador and Turkey, and hard currency sovereign and corporate, as well as local currency exposure in Georgia. Our decision to take profit on our positions in Georgia was motivated by the escalation of the Russia/Ukraine war, which could have meaningful implications for all the neighboring states, pulling down their policy test scores. El Salvador's reduction was a more optimistic story – we tendered the entire position during the bond buyback. As regards Turkey, this was one of the countries where we reduced the remaining duration exposure in the portfolio as U.S. inflation proved more persistent than expected. In terms of our investment process, this worsened the technical test score for the country.

Note: we are currently attending Fall IMF Meetings – look out for daily commentary from Natalia Gurushina in our VanEck Emerging Markets Daily, and an IMF: Key Takeaways publication from the team soon after the meetings end. Also, we have a high charts/prose ratio in this month's monthly – should be an especially copasetic read.

Average Annual Total Returns (%)

As of September 30, 2022	1 Month†	3 Month†	YTD	1 Year	3 Year	5 Year	10 Year
Class A: NAV (Inception 7/9/12)	-6.31	-2.20	-16.36	-17.99	-2.45	-1.34	-0.12
Class A: Maximum 5.75% Load	-11.70	-7.82	-21.17	-22.70	-4.35	-2.50	-0.71
Class I: NAV (Inception 7/9/12)	-5.98	-1.95	-15.98	-17.60	-2.09	-1.00	0.19
50 GBI-EM GD / 50% EMBI GD	-5.62	-4.63	-21.27	-22.44	-7.06	-3.21	-0.63

As of June 30, 2022	1 Month†	3 Month†	YTD	1 Year	3 Year	5 Year	10 Year
Class A: NAV (Inception 7/9/12)	-6.57	-10.86	-14.48	-18.50	-2.27	-0.06	-
Class A: Maximum 5.75% Load	-11.94	-15.98	-19.40	-23.19	-4.18	-1.23	-
Class I: NAV (Inception 7/9/12)	-6.43	-10.73	-14.31	-18.23	-2.00	0.25	-
50 GBI-EM GD / 50% EMBI GD	-5.33	-10.03	-17.44	-20.22	-5.46	-1.69	0.40

† Returns less than one year are not annualized.

Expenses: Class A: Gross 2.33%; Net 1.28%. Van Eck Associates Corporation (the "Adviser") has agreed to waive fees and/or pay Fund expenses to the extent necessary to prevent the operating expenses of the Fund (excluding acquired fund fees and expenses, interest expense, trading expenses, dividends and interest payments on securities sold short, taxes and extraordinary expenses) from exceeding 1.25% for Class A and 0.95% for Class I of the Fund's average daily net assets per year until May 1, 2023. During such time, the expense limitation is expected to continue until the Board of Trustees acts to discontinue all or a portion of such expense limitation. 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. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance may be lower or higher than performance data quoted. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.

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. The NAV is not necessarily the same as the ETF's intraday trading value. Investors should not expect to buy or sell shares at NAV.

Index Definitions

GBI-EM: The J.P. Morgan GBI-EM Global Diversified tracks local currency bonds issued by Emerging Markets governments.

EMBIG HY: The J.P. Morgan EMBI Global Diversified High Yield index tracks returns for actively traded external high yield debt instruments in emerging markets, and is also J.P. Morgan's most liquid U.S dollar emerging markets high yield debt benchmark.

CEMBI HY+: The J.P. Morgan Corporate Emerging Markets High Yield Bond index tracks U.S. dollar high yield bonds issued by emerging markets corporates.

Global Aggregate: Bloomberg Global-Aggregate Total Return Index Value Unhedged USD is a sub-index of the Bloomberg Global Aggregate Index, which is a flagship measure of global investment grade debt from twenty-four local-currency markets.

Global Treasury: The Bloomberg Global Treasury Index tracks fixed-rate, local currency government debt of investment grade countries, including both developed and emerging markets.

Global government related: Bloomberg Global Aggregate Government Related Total Return Index Value Unhedged USD tracks global government debt issues.

Global corporates: The Bloomberg Global Aggregate Corporate Index is a flagship measure of global investment grade, fixed-rate corporate debt.

Global securitized: The Bloomberg Global Aggregate - Securitized Index tracks Securitized (Class 1= Securitized) bonds from the flagship Global Aggregate Index.

US Aggregate: The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

US HY: The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market.

Euro Agg: The Bloomberg Euro-Aggregate Index is a benchmark that measures the investment grade, euro-denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues. Inclusion is based on currency denomination of a bond and not country of risk of the issuer.

US Treasury: The Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury.

CEMBI IG+: The J.P. Morgan Corporate Emerging Markets High Yield Bond index tracks U.S. dollar investment grade bonds issued by emerging markets corporates.

EMBIG IG: The J.P. Morgan EMBI Global Diversified Investment Grade index tracks returns for actively traded external investment grade debt instruments in emerging markets, and is also J.P. Morgan's most liquid U.S dollar emerging markets investment grade debt benchmark.

Source: Bloomberg LP and JP Morgan Index Research

Disclosures

International Monetary Fund (IMF) is an international U.S.-based organization of 190 countries focused on international trade, financial stability, and economic growth.

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 mea- sure 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 promote 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.

A **handle** is the whole number part of a price quote, that is, the portion of the quote to the left of the decimal point.

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. The S&P 500® Index consists of 500 widely held common stocks covering the leading industries of the U.S. economy.

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