

EM Debt: 2020 is Now 20-20, Whither 2021?

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VanEck Emerging Markets Bond Fund

EMBAX / EMBUX / EMBYX

Market Review

The Fund was up 3.32% in December, 63 bps of outperformance relative to its benchmark, which was up 2.69%. Year-to-date, for 2020, the Fund was up 11.41%, 737 bps of outperformance relative to its benchmark, which was up 4.04%. Winners for the month were Mexico, Suriname, China and Russia. Losers included Brazil and Indonesia, which were up less for us than for our benchmark, and Sri Lanka. Winners for 2020 were Mexico, Gabon, Uruguay, China, Angola and Jamaica; losers were El Salvador and Belize.

2020 is now in the rear-view mirror. What worked initially was viewing the March/April selloff as a buying opportunity. What worked later in 2020 was taking profits on the dramatically oversold bonds we found in April and shifting into EM local currency bonds. This remains a key part of our view for now, at the start of 2021—we now have roughly 60% of the Fund in local currency, which is about the highest we get, historically. We took our accumulation of EMFX slowly, and have remained at this peak for a few months. We have a combination of safer Asian stalwarts, such as China and Indonesia, as well as high-beta EMFX such as South Africa, Russia, Mexico and, now, Turkey. It is hard to predict, of course, but historically EMFX moves quickly, meaning that traditionally the value may be realized quickly. It is somewhat semantic, but we'd also say that EMFX itself can be viewed as zero-duration "risk" (we, of course, have duration with our bonds), so it fits nicely with our views.

What are our key asset price views as 2021 gets started? EMFX-attraction and duration-aversion, to put it simply. U.S. rates look set to rise, making duration a big risk, especially for "safe" investment-grade bonds. EMFX looks set to benefit from global reflation, as rising yields are being generated by "risk-on" economic conditions, not "taper tantrum" conditions, in our view. Commodity prices look set to continue their rise, consistent with our positioning. We like

China for reasons explained in previous monthlies. What we'd add is that, if the authorities challenge currency weakness, the bonds themselves should rally—they offer among the highest real yields in EM. Indonesia is a reform stalwart with high real yields in a neighborhood with none. Russia has never had better fundamentals and we see sanctions risks as priced. South Africa is hated and has an improving current account and the prospect of near-term growth. Brazil benefits from strong external accounts, no real inflation pressures and leverage to global reflation. We're even considering adding Turkey in local currency and added its U.S. dollar-denominated bonds. Its real policy rate is the highest in the EM world and it looks as if policy has been made orthodox for a short period of time. The market seems very underweight, to our sense.

There are numerous fundamental drivers underlying our views and positioning. First, U.S. fiscal stimulus looks likelier with Democrats in control of the Senate. Related, stimulus should continue to generate even bigger current account deficits, which generally help EM economies. Second, Chinese currency strength translates into global inflation. Third, higher oil and other commodity prices should further boost inflation and EM fundamentals. It doesn't look like U.S. rate rises will be viewed as a challenge to the Fed, which seems willing to accept them for now. If we do get to the point of yield curve control (YCC, as implemented in Japan), that will be a big moment in history. It may be the moment the Fed truly realizes it is simply an organ of the government and cannot bankrupt it with high interest payments. That could be a very U.S. dollar negative moment, in our view, and perhaps very positive for "risk" assets. However, we lay that out to be chewed on as we watch the current more straightforward rise in yields play out.

G-10 rates have been highly correlated, and the rise in U.S. rates should be mirrored in other potential "risk-free" bond markets. If so, this means that we won't simply see higher U.S. rates, which by themselves could be bullish for the U.S. dollar. Also, our

longstanding view remains that, if rates are rising due to greater final demand, this tends to be positive for risky assets such as equities and EMFX. It is difficult to find serious inflation pressures in EM and we tend to own bonds with high real interest rates. Also, EM tends to export the things that are creating inflation (food and energy), which means their external accounts (and currencies) should be strongly supported. Inflation should ultimately be the result of policy, not these one-off price rises, in EM economies, as EM central banks tend to be orthodox. Unlike developed markets (DM) central banks, their modus operandi is not to gin up asset prices, but to focus on general price stability and leave the other work to the fiscal/political authority, which has responded with steady structural reform (also unlike the never-ending stimulus attitude of the DMs).

So far in the first week of 2021, we've seen higher U.S. rates, higher commodity prices, higher equities, but not yet higher EMFX. We think that EMFX is simply taking a breather, significantly due to overdone concerns about an early taper from the Fed, in our view. The trifecta of higher rates, higher commodity prices, and a lower USD should maintain in the first quarter of 2021, we believe. EMFX remains below its pre-Covid highs, we should add. Fed Vice-Chair Clarida clarified a nascent market concern over tapering at the end of the first week in January, putting that discussion firmly into late 2022, in our view.

We start 2021 with about 60% of the Fund in local currency, carry of 5.3% and duration of 5.3. Note that our duration is very curated, with special culling of long duration bonds whose spreads are low as a percentage of their yields. In other words, the duration we have should do well in a deflation. It is "safe" low-yielding bonds that are at great risk, in our opinion.

Exposure Types and Significant Changes

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

- We increased our local currency exposure in Indonesia, Colombia and Chile. Indonesia's valuations still look very attractive and there were no negative changes in the macro story in the past month. So, the country's technical test score keeps improving and we felt comfortable getting closer

to our sovereign limit. Colombia continues to benefit from the oil price dynamics and falling inflation. These factors improved the country's technical and economic test scores. Chilean assets should be expected to get a boost from strong correlations with China's economic rebound and the ensuing support to copper prices. In terms of our investment process, this improves the technical test score for the country.

- We also increased our hard currency exposure in Turkey. Turkey made its traditional orthodox policy U-turn after being cornered by the market, which was getting quite nervous about numerous policy slippages. President Tayyip Erdogan replaced top economic officials (including the governor of the Central bank and minister of finance), who were given "carte blanche" to fix things. The central bank immediately delivered two sizable and above-consensus rate hikes and pledged to maintain tight policies, while the new minister of finance presented a decent "to do" list. These changes led to a big improvement in technical and policy test scores for the country.
- Finally, we further increased our hard currency corporate and sovereign exposures in United Arab Emirates. Correlations with rising oil prices were an important consideration, which improved the technical test score for the country. The corporate bond has been in our peripheral vision for some time, so oil also helped here. In addition, the bond was screening cheap for a while and we've been watching it intently (including meetings with the managements, etc.).
- We reduced our local currency exposures in South Africa and Peru. We took partial profits in South Africa after the currency and rates rallied to incorporate a more realistic 2021 budget and a stronger global risk-on sentiment. In terms of our investment process, this worsened the technical test score for the country. The reason for taking partial profits in Peru was very similar: local rates and the currency rallied in lower political risks and the expectation of FX inflows after the second round of pension fund withdrawals, weakening the technical test score for the country.
- We also reduced local currency exposures in Thailand and Romania. We had good runs in both countries, benefitting from Thailand's incredibly strong current account position and the dissipation of Romania's domestic political risks. We think

that both narratives have legs, but we felt it would be prudent to take partial profits and re-deploy the money to fund more attractive opportunities.

- Finally, we reduced our local currency exposure in Russia. We continue to like Russia's macroeconomic and policy stories—this last has been the best in years. However, a major U.S. government agencies' hack strengthened a sanctions drumbeat. So, we are not sure that the post-election geopolitical "thaw" will be longer-lasting. In terms of our investment process, this worsened the policy test score for the country.

Fund Performance

The VanEck Emerging Markets Bond Fund (Class A shares excluding sales charge) gained 3.32% in December compared to a gain of 2.69 % for the 50/50 J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) local currency and the J.P. Morgan Emerging Markets Bond Index (EMBI) hard-currency index.

Turning to the market's performance, GBI-EM's biggest winners were South Africa, Brazil, and Chile. The EMBI's biggest winners were Mexico, Turkey, and Dominican Republic. Its losers were Sri Lanka, Qatar and Indonesia.

Average Annual Total Returns (%) as of December 31, 2020

	1 Mo [†]	3 Mo [†]	YTD	1 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	3.32	8.22	11.41	11.41	6.82	3.10
Class A: Maximum 5.75% Load	-2.62	2.00	5.00	5.00	5.57	2.38
50 GBI-EM GD / 50% EMBI GD	2.69	7.70	4.04	4.04	6.97	3.39

Average Annual Total Returns (%) as of September 30, 2020

	1 Mo [†]	3 Mo [†]	YTD	1 Yr	5 Yr	Life
Class A: NAV (Inception 7/9/12)	-1.94	5.42	2.94	7.48	5.36	2.21
Class A: Maximum 5.75% Load	-7.57	-0.64	-2.98	1.30	4.12	1.47
50 GBI-EM GD / 50% EMBI GD	-1.93	1.47	-3.41	-0.02	5.53	2.57

† Monthly returns are not annualized.

Expenses: Class A: Gross 2.69%; Net 1.26%. Expenses are capped contractually until 05/01/21 at 1.25% for Class A. Caps exclude acquired fund fees and expenses, interest expense, trading expenses, dividends and interest payments on securities sold short, taxes and extraordinary expenses. Please note that, generally, unconstrained bond funds may have higher fees than core bond funds due to the specialized nature of their strategies.

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 temporary contractual 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 investors' 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). An index's performance is not illustrative of the Fund's performance. Certain indices may take into account withholding taxes. Index returns assume that dividends of the index constituents in the index have been reinvested. Investing involves risk, including loss of principal; please see disclaimers on next page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.

Source: VanEck, Bloomberg.

Prior to May 1, 2020, the fund was known as the VanEck Unconstrained Emerging Markets Bond Fund.

Value at risk (VaR) is a statistic that measures and quantifies the level of financial risk within a firm, portfolio or position over a specific time frame. Beta is a measure of the volatility—or systematic risk—of a security or portfolio compared to the market as a whole. Correlation is a statistic that measures the degree to which two securities move in relation to each other.

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 measure 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.

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Investing involves risk, including loss of principal. 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 risks associated with its investments in below investment grade securities, credit, currency management strategies, debt securities, derivatives, emerging market securities, foreign currency transactions, foreign securities, hedging, other investment companies, Latin American issuers, management, market, non-diversification, operational, portfolio turnover, sectors and sovereign bond risks. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. As the Fund may invest in securities denominated in foreign currencies and some of the income received by the Fund will be in foreign currencies, changes in currency exchange rates may negatively impact the Fund's return. Derivatives may involve certain costs and risks such as liquidity, interest rate, and the risk that a position could not be closed when most advantageous. The Fund may also be subject to risks associated with non-investment grade securities.

Investors should consider the Fund's investment objective, risks, charges, and expenses of the investment company carefully before investing. Bond and bond funds will decrease in value as interest rates rise. The prospectus and summary prospectus contain this and other information. Please read them carefully before investing. 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.

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