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# EM Debt: January Pause Refreshes

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## VanEck Emerging Markets Bond Fund

EMBAX / EMBUX / EMBYX

### Market Review

The Fund (Class A Share) was down 0.75% in January, 32 bps of outperformance relative to its benchmark, which was down 1.07%. Winners in January for the Fund were China, where we were overweight a strong local currency, in our view, and USD corporate bond market, and Brazil, where we were underweight a weak overall market. Paraguay, Suriname and Ecuador also contributed to relative performance.

What are our key asset price views for 2021 after our first month? They are pretty much unchanged. 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 should add is that if the authorities challenge currency weakness, the bonds themselves should potentially 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 generally disliked and has an improving current account and the prospect of near-term growth. We have even added Turkey in local currency, as hinted at in our last monthly, to our Turkish 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 there, too, to our sense.

There are numerous fundamental drivers underlying our views and positioning. First, U.S. fiscal stimulus looks likelier following Democrat control of the Senate. Related, stimulus should continue to generate even bigger current account deficits, which may help EM economies. Too many market participants, in our view, are translating their aversion to President Joe Biden's new policies to negativity about markets, whereas we simply see likelier stimulus that puts greater upward pressure on U.S. fiscal and current accounts which are potentially bullish for EM. Second, Chinese currency strength historically translates into global inflation. Third, we believe higher oil and other commodity prices should further boost inflation and EM fundamentals. It does not 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 will 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 "risk-free" bond markets*. If so, this means that we will not 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 tend 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 historically 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 of the DM).

So far in the first weeks of 2021, we have 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 and then overdone concerns about "GameStop", in our view. In fact, one could argue that the market's brief obsession with GameStop told us how "themeless" the market was and that the market was looking for an excuse to hiccup. Anyway, the trifecta of higher rates, higher commodity prices and a lower USD may maintain in the first quarter of the year, we believe. EMFX remains below its pre-Covid highs, we should add. Fed Vice Chair Richard 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 February with about 60% of the Fund in local currency, carry of 5.8% and duration of 5.0. 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 reflation. 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 January were: China, Mexico, Indonesia, South Africa and Russia.

- We increased our local currency exposure in Turkey. We continue to have multiple concerns about the country's institutional strength—in particular the fact that so much depends on the whim of just one person, President Recep Tayyip Erdogan (and he is known to have some highly unorthodox views)—but the recent policy U-turn appears to have legs. The policy rate is very positive, following the recent sizable rate hikes and the central bank's governor reiterated his higher-for-longer promise in the first quarterly report of the year. Higher interest rates should help to curb credit expansion, promote external adjustment and reduce pressure on the international reserves. In terms of our investment process, this improved the economic and policy test scores for the country.
- We also increased our hard currency quasi-sovereign exposures in Argentina and Saudi Arabia, and hard currency corporate exposure in Saudi Arabia. Bonds in Saudi Arabia were cheap relative to fundamentals. Rapprochement with Israel created a much better geopolitical backdrop to be invested in this part of the word. In terms of our investment process, this improved the country's policy and technical test scores. As regards Argentina, state-owned YPF improved its voluntary debt-restructuring offer, which made the existing recovery value assumptions look too low. In terms of our investment process, this improved the technical and policy test scores for the country.
- Finally, we further increased our hard currency sovereign exposures in Angola and Oman. In Angola, correlations with rising oil prices were an important consideration, which improved the technical test score for the country. The government is also making progress with the IMF—this last does not anticipate that Angola will require debt restructuring this year due to savings achieved with the debt relief for poorer counties and agreement with China. This improved the policy test score for the country. Oman's bond was a new issue that was well priced (the top initial allocation bucket), giving a boost to the country's technical test score.
- We reduced our local currency exposures in Brazil and Peru. The reason we continued to take profits in Peru is that the previous story (lower political risks and FX inflows after the second round of pension fund withdrawals) played out and the market started to focus on less "appetizing" developments, such as the pension system overhaul, which worsened the policy test score for the country. Brazil's fiscal issues are creating too much noise and this might force the central bank to raise its policy rate earlier than previously thought. In terms of our investment process, this worsened the policy test score for the country.
- We also reduced local currency exposures in Hungary and Romania. We had a good run in Romania, as the election outcome significantly reduced policy and political risks. As a result, local yields dropped a lot, making valuations less attractive. In terms of our investment process, this worsened the technical test score for the country. As regards Hungary, we exited out position due to deteriorating valuations and a clear hawkish shift in the central bank's communications (especially

when compared to regional peers). These developments worsened the policy and technical test scores for the country.

- Finally, we reduced our hard currency sovereign exposure in Jordan. The bond's valuation became less attractive, moving to a lower initial allocation bucket in our process. We used it to fund more attractive opportunities.

## Fund Performance

The VanEck Emerging Markets Bond Fund (Class A shares excluding sales charge) lost 0.75% in January compared to a loss of 1.07% 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 China, Turkey, and Romania.Its biggest losers were Brazil, Colombia, and Indonesia. The EMBI's biggest winners were Sri Lanka, Angola, and Costa Rica. Its losers were Ecuador, Mexico, and Brazil.

### Average Annual Total Returns (%) as of January 31, 2021

| | 1 Mo† | 3 Mo† | YTD | 1 Yr | 5 Yr | Life |
|---|---|---|---|---|---|---|
| Class A: NAV (Inception 7/9/12) | -0.75 | 7.47 | -0.75 | 9.86 | 6.79 | 2.98 |
| Class A: Maximum 5.75% Load | -6.45 | 1.29 | -6.45 | 3.55 | 5.53 | 2.27 |
| 50 GBI-EM GD / 50% EMBI GD | -1.07 | 6.33 | -1.07 | 2.80 | 6.73 | 3.23 |

### 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 |

† 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.**

*Risk free bond markets refers to financially stable countries that offer government bonds which are often treated as risk-free bonds.

**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 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.

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.



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 and portfolio managers of other investment strategies may take an opposite opinion than those stated herein. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Non-VanEck proprietary information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission of Van Eck Securities Corporation

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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