

# Rebalancing Markets Fuel Positive Sentiment

By Shawn Reynolds, Portfolio Manager

## VanEck Global Hard Assets Fund

GHAAX / GHACX / GHAIX / GHAYX

### Performance Review

The Global Hard Assets Fund (the “Fund”) maintained momentum built during the second quarter of 2016 with Class A shares providing a total return of 7.61% (excluding sales charge) for the third quarter as of the end of September. The Fund outperformed its commodity equities-based benchmark index, the Standard & Poor’s® (S&P) North American Natural Resources Sector Index (SPGINRTR), which returned 4.23% over the same period. For comparative purposes, we continue to include total return figures for two additional commodity equity indices: the MSCI ACWI Commodity Producers Index (M2WDCOMP) and the Standard & Poor’s (S&P) Global Natural Resources Index (SPGNRUN).

#### Average Annual Total Returns (%) as of September 30, 2016

	3Q16 <sup>†</sup>	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 11/2/94)	7.61	28.91	-1.76	1.94
Class A: Maximum 5.75% load	1.42	21.48	-2.91	1.33
SPGINRTR Index <sup>1</sup>	4.23	22.36	2.98	3.08
M2WDCOMP Index <sup>2</sup>	3.19	23.79	-1.29	0.87
SPGNRUN Index <sup>3</sup>	6.03	24.71	-0.03	1.66
SPGSCITR Index <sup>4</sup>	-4.15	-12.21	-12.61	-9.04

<sup>†</sup>Quarterly returns are not annualized. Please note that commodity prices may swing sharply in response to cyclical economic conditions. Investing involves risk, including possible loss of principal. The performance shown represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance information shown.

Expenses: Class A: Gross 1.36%; Net 1.36%. Expenses are capped contractually until 05/01/17 at 1.38% for Class A. Caps exclude certain expenses, such as interest.

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 from index constituents have been reinvested.

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The Fund’s positions in Energy (approximately 59% of Fund assets on average during the third quarter) and Diversified Metals & Mining (approximately 10% of Fund assets on average during the third quarter) sectors were, in particular, significant contributors to positive performance. Within the Energy sector, positive performance stemmed mainly from the Oil & Gas Exploration & Production (E&P) sub-industry, which continued to account for approximately 42% of Fund net assets on average during the third quarter. The Oil & Gas Drilling sub-industry (approximately 4% of Fund assets on average during the third quarter) also made a useful contribution to Fund performance during the quarter. Within the Energy sector, Oil & Gas Equipment & Services (approximately 9% of Fund assets on average during the third quarter) was the only sub-industry to detract from the Fund’s performance and its impact was relatively minimal. Other sub-industries that made positive contributions of note to performance were Copper (approximately 4% of Fund assets on average during the third quarter) and Coal & Consumable Fuels (approximately 2% of Fund assets on average during the third quarter). During the quarter, the Fund continued to hold no position in Integrated Oil & Gas.

The top performing company was major diversified mining company Glencore (4.05% of Fund net assets at period end\*), which continued to benefit from debt reduction and overall restructuring initiatives that began in 2015. In the face of persistent skepticism from the market, the company has proved demonstrably that it has been able to provide a workable blueprint and subsequently execute this plan to deleverage its balance sheet and improve its cost structure. Not only has the company delivered (as we expected) thus far on what it said it would do, it continues to implement its debt reduction program. This has, in some instances, been in contrast with other major metal mining companies who, despite rhetoric to the contrary, have been slow to recognize the need for, or have been unsuccessful in, executing similar restructuring measures and have largely found themselves playing “catch up” with Glencore in the eyes of the market.

Rounding out the top 5 performing positions were E&P companies, Pioneer Natural Resources (3.98% of Fund net assets at period end\*), Parsley Energy (3.92% of Fund net assets at period end\*), and SM Energy (2.42% of Fund net assets at period end\*). These companies benefited from the high quality of their assets and acreages, in particular those in the Permian Basin. The final contributing company for the quarter was metal mining company Teck Resources (3.20% of Fund net assets at period end\*) which benefited from strengthening zinc and coal prices.

In a reversal from the second quarter when it was the strongest performing sub-industry, in the third quarter, Gold (approximately 18% of Fund assets on average during the third quarter) was the largest detractor from Fund performance. Gold mining companies Barrick Gold (1.48% of Fund net assets at period end\*), Goldcorp (2.29% of Fund net assets at period end\*), and Randgold Resources (2.25% of Fund net assets at period end\*) all suffered from a consolidation in the gold price during the quarter and, by the end of the quarter, we had reduced our exposure to each. The two other poor performers during the quarter were E&P companies Hess (2.04% of Fund net assets at period end\*), which had to contend with a dry hole in Guyana, and Gulfport Energy (2.05% of Fund net assets at period end\*).

### Market Review

Despite the continuing uncertainties in the market surrounding the U.S. presidential elections, and in the face of moderating global GDP growth, sentiment remained on the positive side and demand for commodities remained remarkably resilient. As in the second quarter of the year, the most significant macroeconomic factor influencing

the Fund was the extraordinary accommodation extended by central banks around the world which continues to add support for economic growth and demand for commodities.

After an explosive first half of the year, the gold market experienced significant consolidation during the third quarter and gold mining companies suffered. On a positive note, the gold mining firms have been bolstered by restructuring and strategic improvements and appear well positioned to withstand a short-term decline in the gold price.

In the U.S., the rig count continued to rebound slightly and increase at a modest pace from previous trough levels. However, we continue to note and emphasize that any rebound remains very much incremental when compared with the nearly 1,300 rigs throughout the U.S. that were taken out of commission between 2014 and 2016.

Global demand for crude oil and, in particular, gasoline increased once again during the quarter. U.S. gasoline demand remains at record highs and the country is now consuming around 10 million barrels a day. The country's gasoline demand continues to exceed the unrefined crude oil demand of every country in the world except China.

Supply disruptions with the potential to impact future production continued during the quarter including the lingering effects of attacks instigated by militant groups in Nigeria, an uncertain and confusing political situation in Libya, and a deteriorating economic and social environment in Venezuela, where production had fallen some 6% from around 2.35 million barrels a day (bbl/d) at the beginning of the year to around 2.2 million bbl/d by the end of the quarter. On a positive note, oil sands production in Canada was no longer affected by the wild fires which impeded second quarter production.

In the base metals space, zinc experienced further rebalancing of supply and demand. Fundamentals continued to tighten with a reduction in overall supply accompanied by solid demand. Nickel markets erased losses from early in the quarter following the results of environmental mine audits in the Philippines in which three quarters of mines fell short, with 20 mines facing suspension, and an announcement by Indonesia that the ban on exports was being reconsidered. At the company-level, restructuring continues. Balance sheet strengthening appears to be the primary objective with reducing operating costs a secondary focus. Additionally, we are just now starting to hear chatter from some companies about re-engaging growth projects.

In the agriculture sector, the quarter was marked by a couple of major deals and the potential for further consolidation in the potash market amid oversupply. U.S. agriculture giant, Monsanto, agreed to be bought by German giant Bayer (the Fund had no exposure to either company during the quarter) while Canada's Agrium (1.84% of Fund net assets at period end\*) and Potash Corp of Saskatchewan (the Fund had no exposure during the quarter) agreed to merge. In grains, an ideal growing season in the U.S. led to record, or close to record, production in both corn and soybean.

By the end of the quarter, the prices of metallurgical coal (an essential steel-making raw material used to produce coke which, in turn, is used in the production of steel) had climbed more than 100% since the beginning of the year. The overwhelming driver behind this price recovery has been supply. In addition to both lower seaborne and domestic supply, global inventories are also at multi-year lows.

## Outlook

In the fourth quarter, we see the macro drivers continuing to be central bank policy and the ramifications of the forthcoming presidential election in the U.S. Broadly speaking, commodity demand has proven to be remarkably resilient. Despite concerns about global growth there is still firm demand and healthy consumption. On the supply side, we continue to see the effects from the lack of investment and capital expenditure reductions over the past several years.

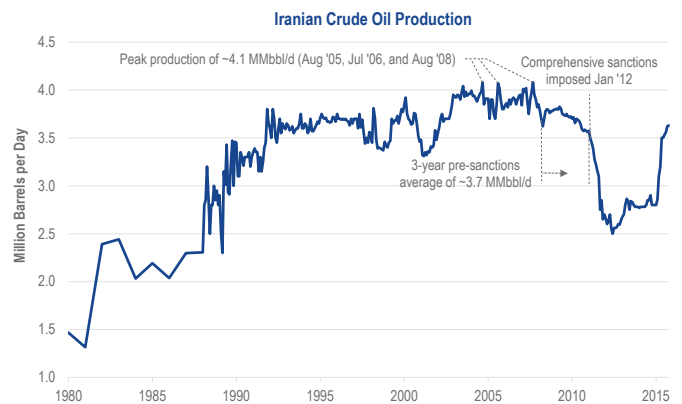
At the very end of the quarter, OPEC (Organization of the Petroleum Exporting Countries) came to an agreement to cap production. This move appears to us to indicate that Saudi Arabia and other OPEC members have reached their threshold of pain, which appears to be roughly in the \$40 to \$45 range. Anything below that would probably only serve to consolidate and accelerate any decisions they might make as a group which indicates that, surprisingly, there may actually be a price floor.

Mainstream interpretation seems to be that the OPEC announcement is a reaction to forty dollar oil. Maybe it is, but we believe it could also be the excuse that Saudi Arabia has needed to allow it to force through some serious, and absolutely essential, economic restructuring. It now has the low price of oil to blame publicly.

We believe that the move by Saudi Arabia is a longer-term one and that, in particular, it demonstrates the country is also worried about a spike in oil prices in the next 18 to 24 months. Any such

spike may: a) help Iran the most (something Saudi is obviously not too keen on doing); b) eventually cause the price to plummet back down; and c) accelerate alternative energy use. Evidence of this can be seen in the press release put out by OPEC following its meeting, in which it said that its objective was "to stabilize the oil market and avoid the adverse impacts in the short- and medium-term."

We also see this move as a way for Saudi Arabia to indicate to Iran that it is happy for the country to try and ramp up production from 3.6 million to 4 million barrels a day (something Iran is struggling to do) over the next four to five years. The Saudis are fully aware that this is extremely unlikely to happen any time soon as Iran has only hit the 4 million barrels per day figure three times since 1978.



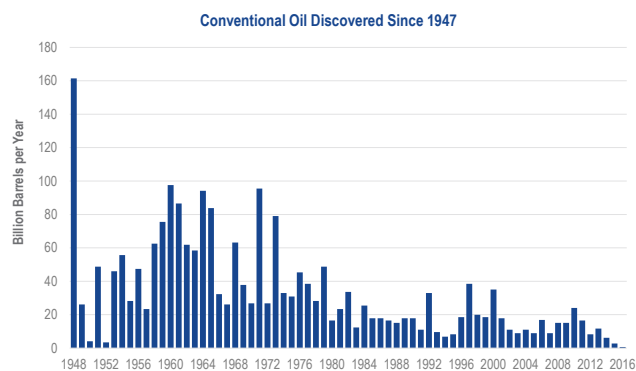
Source: Bloomberg. Data as of September 30, 2016

While the focus is squarely on Saudi Arabia and Iran, among other OPEC nations, despite the political uncertainty in Libya mentioned earlier, there do appear to be some moves toward establishing some sort of unified government and we have seen the beginning of some flows of oil in the country.

As usual, during the quarter we made a number of trips outside the U.S. and met with many prospective and existing clients. During our visits we noted a recurrent theme of strong skepticism around the rebalancing of commodity markets and, in particular, oil. We believe that much of this has been fueled by headlines that trumpet Saudi and Russian oil production reaching all-time highs, and talk of the strength of the rebound in the oil rig count in the U.S. People seem to truly believe that shale oil is a spigot that can just be turned on and off at will, and there continues to be a misplaced belief that higher oil prices will reinvigorate shale drilling to the point where it starts to raise production and "unbalance" the fundamentals. We do not believe this to be the case and, in our view, any increase in U.S. production must be preceded by a dramatic increase in the rig count which will require significantly higher crude prices.

As we continue to point out it remains, perhaps, too easy to fall into the trap of thinking that a 10%, or even a 50%, increase in a U.S. onshore oil rig count of around 400 can restore the balance, and to forget that, to plumb its current depths, the rig count has actually dropped from its highs by a total of some 1,300 rigs. It is going to take an increase of considerably more than 150-200 rigs to bring back any growth in production.

In addition, people continue to miss the fact that conventional exploration has been abysmal (discoveries in 2015 were the lowest since 1947), a point that was also hinted at in OPEC's press release when it was stated that the "Conference ... noted that world oil demand remains robust, while the prospects of future supplies are being negatively impacted by deep cuts in investments and massive layoffs."



Source: Wood Mackenzie; Bloomberg. Data as of August 31, 2016

One of the main pillars of our investment philosophy continues to be to look for long-term growth and the structural enhancement in intrinsic value in the companies in which we invest. Even in today's market conditions this continues to be one of our guiding tenets. Since we remain convinced that positioning our portfolio for the future, and not just reacting to current circumstance, is of paramount importance, our focus across the sectors in which we invest remains on companies that can navigate commodity price volatility and help grow sustainable net asset value.

\*All company, sector, and sub-industry weightings as of September 30, 2016 unless otherwise noted.

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