August 2022

# Partly Cloudy With a High Chance of Carry

**Eric Fine**

Portfolio Manager

## VanEck Emerging Markets Bond Fund

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

### Overview

The Fund went up +1.47% based on its net asset value in August, compared to down -0.54% 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). August's 201 bps of outperformance brought year-to-date ("YTD") outperformance to 585 bps. YTD, owning no Russia, navigating Ukraine, and not keeping our duration or emerging market foreign currencies ("EMFX") views on "autopilot" in a roller-coaster year drove outperformance.

Outperformance in August was primarily due to China, where sticking with our view that property-sector (and other) bonds were majorly oversold and under-priced finally gave joy. During the month, we made relatively minor adjustments, increasing EMFX in Asia at the expense of some higher-beta EMFX in Latam, while nudging China exposure slightly higher.

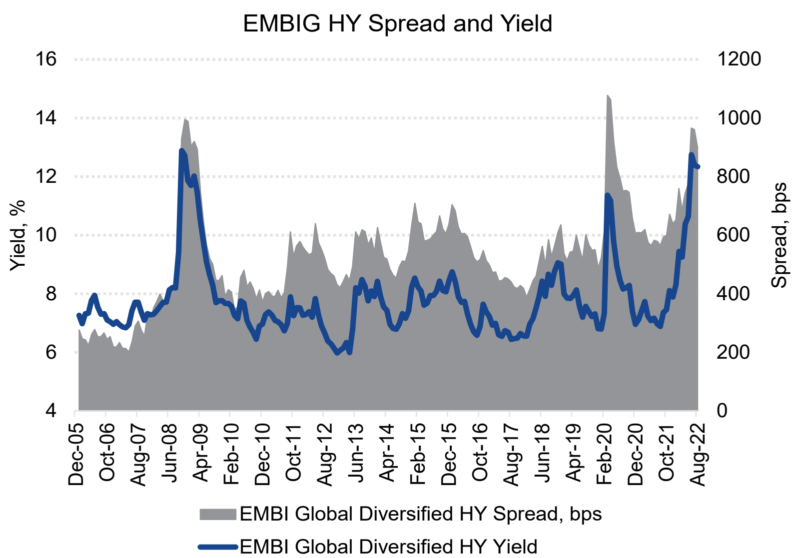
At the end of August, local currency exposure was a little lower at around 37.6% of exposure. The Fund's duration was down further to 4.83, back near the lows of the year for the fund. And the Fund's carry[1] remains very high at 7.96%.

**September's outlook looks partly cloudy, relative to our very positive outlooks for July and August ("EM Debt's Time to Shine"), because of the U.S. Federal Reserve ("Fed") and the European Central Bank ("ECB").** The Fed looks set to keep rates higher for longer than the market was thinking, and the ECB is only now jumping on the anti-inflationary bandwagon with a new hawkish tilt. That was the clear message from Jackson Hole. Fed officials are explicitly, in our opinion, saying that they remain solely focused on inflation, even if a recession is a consequence. As we noted in one of our monthlies earlier in the year, all of the experimental tools the Fed innovated during the Global Financial Crisis ("GFC") were premised on its ability to tackle inflation with certainty. Everything depends on this, as far as the Fed is concerned, we think. And, it has political support given the cost inflation and declining real incomes are having on U.S. voters. We think the ECB's recent hike of 75 bps means it's jumping on the bandwagon. The market is pricing in another 75 bps hike (81 bps as of this writing). And Europe has a more durable inflation problem than the U.S. This is just beginning to be priced in, in our view. Do you know anyone bullish on Europe or the euro? Moi no plus. This creates significant upside risks for the euro, in our view. If the Fed is rolling out its "we're hiking until it's over" show, the ECB is just starting.

[1] Carry is defined as Current Yield. 30-Day SEC Yield for Class A was 7.26% as of 8/31/2022. 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 6.33% as of 08/31/22.

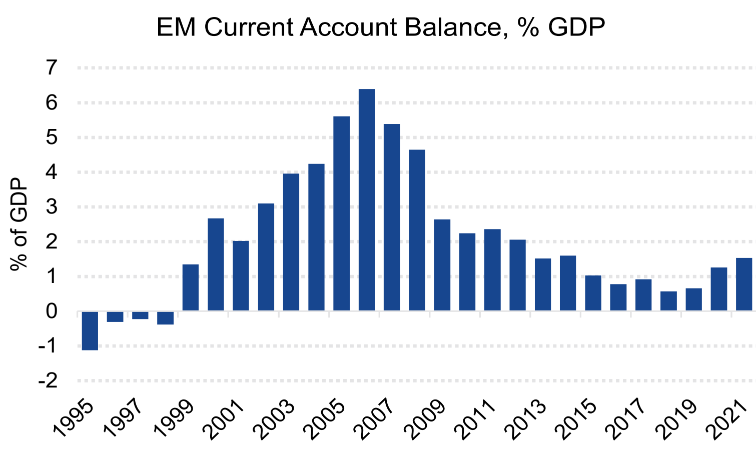
**Still, we see mostly sunny emerging markets ("EM") skies around those developed markets ("DM") clouds.** EM sovereign high yield ("HY") spreads are at crisis highs (i.e., GFC, Covid crises), with fundamentals fine. EM hiked earlier and larger than any of the DMs, as we've been emphasizing. We get that U.S. stocks seem to like the need to price in a Fed that will be hawkish for longer. But worrying about a stock correction strikes us as a pretty common affliction. We certainly have it. But, we are lucky to be bond investors (yes, seriously). There's a reason most credit folks say carry is King. And, it's very kingly right now, as you can see in chart 1, below. This is keeping us a little more risk-accepting as markets digest the many (obvious, unfortunately) risks. Remember these are U.S. dollar obligations, so we thought we would show the history of EM current account surpluses for the second chart. No commentary is needed there – surpluses as far as the eye can see, despite the many global crises we've faced. 99 problems, but dollars aren't one.

### Exhibit 1 – Near-Crisis Yields for HY EM Sovereigns




Source: Bloomberg. Data as of August 31, 2022.

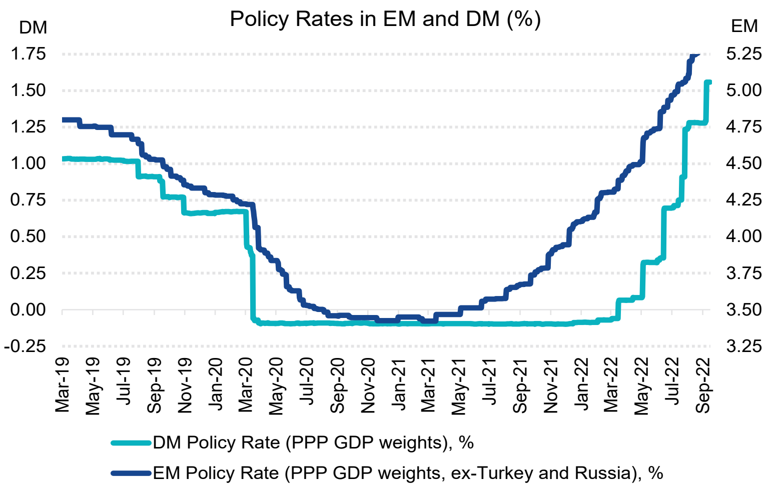
### Exhibit 2 – EM Still Generating Current Account Surpluses in Good Times and Bad




Source: Bloomberg. Data as of December 31, 2021.

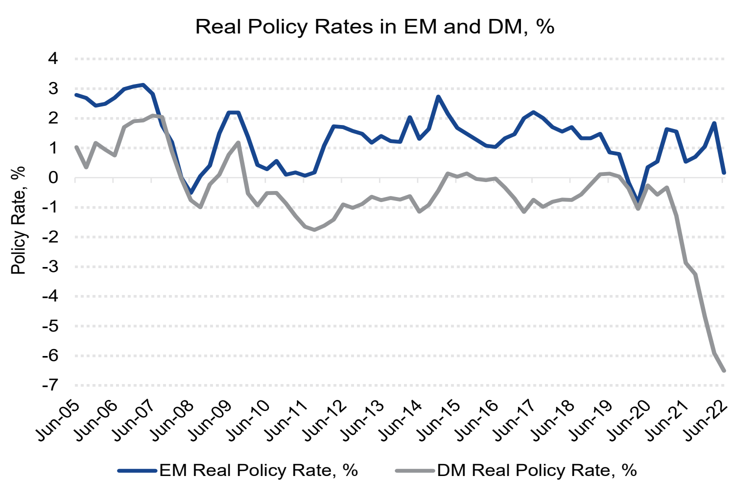
**And, there're some great supportive tailwinds for EM debt.** The 60/40 model will get its revenge starting when 2-year yields peak, probably with a 4% handle, which is looking to be this year's business. When cash moves into 2-year bonds, the discussion of bond inflows begins. Once the discussion turns to bonds, the answers will inevitably involve much more EM debt exposure than most investors have. We've stressed this before. But, based on 19 years of data through August of this year (including all the recent bad times), the efficient frontier's implied allocation is roughly 50% of all fixed income to EM debt (EM High Yield sovereigns in particular). We're not recommending an allocation of 50% of fixed income assets to EM debt, nor are we asset allocators. We are saying that EM debt's low allocations will not survive bond stability, and if bonds recover, they will begin a major re-pricing, in our opinion. ***We've talked about USD debt so far, so we'll add chart 3, showing EM local's early and large hiking cycle, compared to DM's late and light hiking cycle. You're there for the carry…but you stay for the turnaround. And to pound the point into the ground, we add chart 4 to illustrate – it shows EM and DM policy rates in "real" terms.***

### Exhibit 3 – EM Central Banks Led, and Strongly; DM Central Banks Following




Source: Bloomberg. Data as of August 31, 2022.

### Exhibit 4 – EM Central Banks are "Real", DM Central Banks Not Really




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

**What to do? - Our main reaction to this setup is to keep duration low but not to fear risk.** We still like EMFX (a rare view for us) for all the reasons we've mentioned, and now a hiking ECB could add support to the euro, which almost nobody expects. We also still like High Yield sovereigns and some corporates. Selectivity and remaining vigilant in a roller-coaster year remain central, though. Our portfolio is largely the same. What we love about EM right now, other than what we've already written, is the plethora of uncorrelated asset prices. China property was the key reason for our outperformance in August, for example. One still needs to be very selective (of the five names we owned, all were on the list of seven companies the Chinese government slated for special support). And China is arguably counter-cyclical, with an easing monetary policy bias. Brazil was the first to seriously hike and is about to embark on a possible cutting cycle. Our point: how great it is to have asset prices that are not correlated with all the high-level risks buffeting asset prices right now.

**Exposure Types and Significant Changes**

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

- We increased local currency exposure in Brazil, Indonesia and Thailand. Brazil is a policy trailblazer in the current EM tightening cycle. The central bank was among the first to launch aggressive frontloading of rate hikes in response to rising inflation pressures, and with the inflation risks seemingly subsiding (there are finally signs of disinflation) it might now be in a position to pause, and possibly start easing at some point in the future – especially if Brazil's fiscal outperformance continues (we are mindful of the pre-election fiscal risks). Brazil's real policy rates are among the highest in EM, and this provides a supportive backdrop for local bonds. In terms of our investment process, this improved the policy test score for the country. Thailand and Indonesia were among the latecomers to the EM tightening cycle, but we finally had liftoffs in both countries – an indication of the improved policy test scores – which should provide fundamental support for the respective currencies and longer local rates.
- We also increased our local currency and hard currency corporate exposure in China, and hard currency sovereign exposure in Israel. Chinese authorities finally started to react more proactively to the near-term growth headwinds, including disruptions in the real estate sector. The central bank unexpectedly cut interest rates, and there was also a pledge to provide liquidity support to select developers. Finally, the central bank signaled that it finds additional currency weakness undesirable. All these developments improved the policy test score for China. Israel's macroeconomic framework remains solid, and the economy continues to generate large current account surpluses. The experience also shows that Israel's rates do not always sell off in synch with the rest of EM due to its "safer haven" status – a desirable trait when global risks remain elevated. This particular factor improved the technical test score for the country.
- Finally, we increased hard currency sovereign exposure in El Salvador, Tunisia and Senegal, and hard currency quasi-sovereign exposure in the United Arab Emirates (UAE). El Salvador's buyback announcement (2023-2025 sovereign bonds) at the end of July showed a greater willingness to pay and improved the country's policy test score. The results of Tunisia's July referendum showed that the president has a policy mandate for an IMF deal, despite the relatively low turnout. Subsequent reports about Japan providing additional financial support once the agreement with the IMF is reached further improved the policy test score for the country. A combination of stable and high oil prices and our general comfort with the UAE's macroeconomic backdrop explains our decision to add lower-duration exposure there. In terms of our investment process, this improves the technical test score for the country (due to our concerns about longer duration).
- We reduced our local currency exposure and hard currency sovereign exposure in Mexico and Colombia. Our decision to reduce exposure to longer-dated sovereign bonds was motivated by concerns about global duration as major DM central banks show no signs of pivoting to the dovish side. In terms of our investment process, this worsened the technical test scores for both countries. As regards local debt, the reasons were more idiosyncratic. In Mexico, inflation shows no signs of abating, and this means that the central banks will have to continue tightening at a brisk pace. In Colombia, we are concerned about the political dynamics, as well as the widening current account deficit. In addition, annual headline inflation accelerated past 10% in July. All these factors point to the deteriorating economic test scores for both countries.
- We also reduced our local currency exposure in Poland, Hungary and Chile. Chile's constitutional referendum was rejected, and the post-referendum political/policy roadmap looks uncertain, taking a toll on the country's policy test score. The Central European economies cannot catch a break from inflation pressures. The fact that Poland's central bank tends to lean dovish does not add confidence, whereas Hungary's outlook is also marred by multiple domestic political and geopolitical complications. In terms of our investment process, this worsens the policy test scores for both countries.
- Finally, we reduced hard currency sovereign exposure in Oman, Gabon and Ghana, and hard currency corporate exposure in Taiwan. Ghana was downgraded by S&P, while the outlook for an IMF deal remains uncertain, worsening the policy test score for the country. Gabon's outlook was raised to "positive", but the country's sovereign bond valuations worsened after a rally (the lowest initial valuation bucket #4) – a reason why the technical test score for the country declined. As regards Oman and Taiwan, the main reasons were our concerns about the impact of global duration on longer-dated bonds, and the ensuing deterioration in the technical test scores.

### Average Annual Total Returns (%)

| As of August 31, 2022 | 1 Month† | 3 Month† | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|
| Class A: NAV (Inception 7/9/12) | 1.47 | -2.47 | -10.73 | -14.85 | 0.45 | 0.27 | 0.77 |
| Class A: Maximum 5.75% Load | -4.36 | -8.08 | -15.86 | -19.74 | -1.52 | -0.91 | 0.18 |
| Class I: NAV (Inception 7/9/12) | 1.34 | -2.42 | -10.63 | -14.69 | 0.68 | 0.53 | 1.05 |
| 50 GBI-EM GD / 50% EMBI GD | -0.54 | -4.34 | -16.58 | -20.08 | -5.17 | -2.12 | 0.16 |

| 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 | - |

† 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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**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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