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SEPTEMBER 2021

VanEck Emerging Income Opportunities Active ETF (Managed Fund)

ASX Code: EBND

Investment objective

EBND aims to provide investors with a globally diversified portfolio of bonds and currencies in emerging markets. The fund aims to provide total investment returns, measured over the medium to long term in excess of the Benchmark.

Benchmark

A blended index consisting of 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified.

Performance as at 30 September 2021

	1 month	3 months	6 months	1 year	3 years (p.a.)	5 years (p.a.)	Since EBND inception (p.a.)
Price Return	-2.81%	-1.78%	1.82%	-0.67%	-	-	-4.22%
Income Return	0.39%	1.17%	2.45%	5.04%	-	-	5.07%
Total Return	**-2.42%**	**-0.61%**	**+4.27%**	**+4.37%**	**-**	**-**	**+0.85%**
Benchmark	-2.21%	-0.04%	4.49%	2.88%	4.21%	3.35%	-2.91%
Value Add	**-0.21%**	**-0.57%**	**-0.22%**	**+1.49%**	**-**	**-**	**+3.76%**

Benchmark is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond Emerging Market Index Global Diversified. The table above shows past performance of the Fund from its Inception Date and of the Benchmark from 31 December 2015. Results are calculated to the last business day of the month and assume immediate reinvestment of distributions. Fund results are net of management fees and costs, but before brokerage fees or bid/ask spreads incurred when investors buy/sell on the ASX. Returns for periods longer than one year are annualised. Past performance is not a reliable indicator of current or future performance which may be lower or higher.

Key benefits

Emerging market income opportunities: Emerging markets bonds generally pay higher interest than developed markets bonds offering investors an opportunity to broaden their income horizon with elevated risk.

Active management: An actively managed benchmark-unaware approach that makes high conviction investments.

Target yield of 5% per annum: Income from investing in emerging markets government, semi-government and corporate bonds that provides an attractive addition for investors' growing income needs.

Key risks

An investment in the Fund carries risks associated with: emerging markets bonds and currencies, bond markets generally, interest rate movements, issuer default, currency hedging, credit ratings, country and issuer concentration, liquidity and fund manager and fund operations. See the PDS for details.

Fundamentals[1]

Number of constituents	134
Number of issuers	83
Modified Duration (yrs)	6.35
Yield to Maturity (%)	5.12
Running Yield (%)	4.99
Weight of top 10 issuers (%)	32.7
Credit Rating Profile	BBB-
Time to Maturity (yrs)	9.37
Top Holding Weight (%)	4.11
Investment Grade (%)	54.09

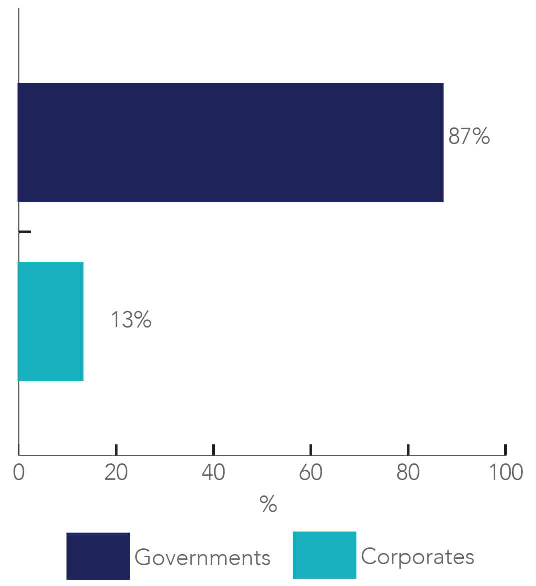
1. As at 30 September 2021.

Monthly Dividends History (CPU)

Financial Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	YTD
2022	4.5	4.5	4.5	-	-	-	-	-	-	-	-	-	13.5
2021	5	5	5	5	5	5	5	4.5	4.5	4.5	4.5	4.5	57.5
2020	-	-	-	-	-	-	-	2.5	5	5	5	5	22.5

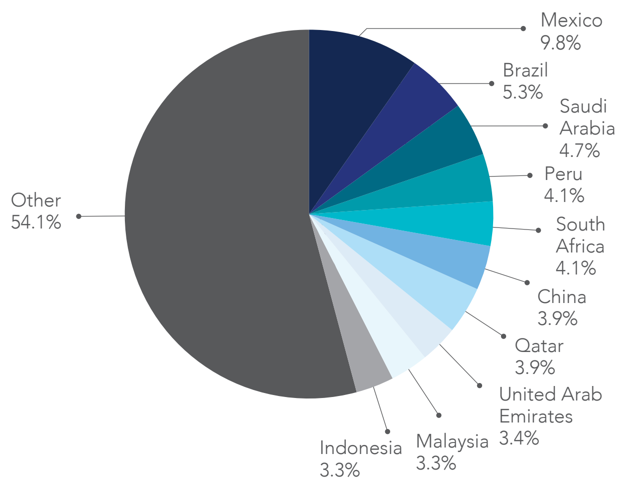
Source: VanEck. Past dividends are no indicators of future dividends. CPU is Cents per Unit. Since EBND inception, 11th February 2020.

Portfolio Allocation



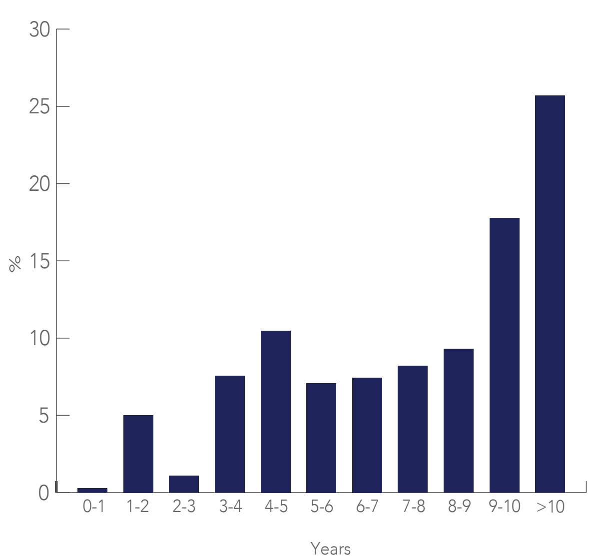
Source: VanEck, as at 30 September 2021.

Top 10 Country Breakdown



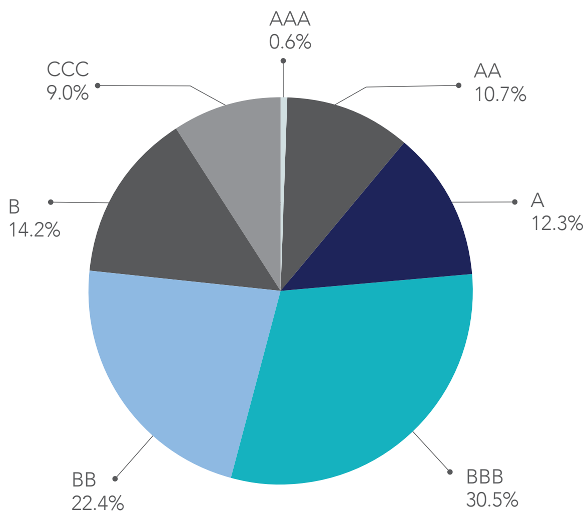
Source: VanEck, as at 30 September 2021.

Time to Maturity Profile



Source: VanEck, as at 30 September 2021.

Credit rating breakdown



Source: VanEck, as at 30 September 2021.

Summary

- The VanEck Emerging Income Opportunities Active ETF (Managed Fund) (EBND) fell 2.42% in September underperforming the 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified Index which fell 2.21%.
- Top five country exposures are currently in Mexico, Brazil, Saudi Arabia, Peru and South Africa.
- We are positioned more defensively on emerging markets debt, with roughly 70% of the fund in hard currency.
- One of our longstanding points is that many emerging market countries have plenty of dollar assets relative to dollar liabilities, so the dollar bonds of a number of countries that might have other problems, remain defensive in our opinion. Brazil, Chile, Colombia, South Africa, and others are among these.

Market and Portfolio commentary

EBND fell 2.42% in September, underperforming its benchmark by 0.21%. The fund has outpaced the benchmark for the past twelve months, returning 4.37% whereas the benchmark has returned just 2.88%. During the month we have become more defensive on emerging market debt. We are positioned more defensively on emerging markets debt, with roughly 70% of the fund in hard currency.

China remains the source of risks that could affect emerging markets, especially those with higher volatility. There are four reasons we have supporting this view:

1. Contagion within China's offshore bond market remains an under-appreciated risk;
2. China's growth trajectory is hiccupping, not helped by its real estate sector;
3. There is more evidence for a "stagflation" scenario in the US and global economy, with key implications, many adverse, for the markets that we focus on; and
4. We see all this ending with pressure on China's currency, which would directly affect EM currencies.

It took a long time for the Evergrande saga to spread to other low-rated bonds. Nevertheless, our view remains that the entire sector has not yet priced new risks uncovered by Evergrande's downfall. The government seems uninterested in supporting offshore bondholders. The Evergrande episode should result in lower property prices, as developers lower prices, but more importantly as consumers completely change their attitudes. Property development and real estate account for around 28% of Chinese GDP and roughly half of household wealth, so the contagion is that this has to hit growth. Government support is problematic because everyone expects it. So far the government's interventions have not prevented Evergrande risks from spreading, which have impacted the attractiveness of holding the bonds.

The Chinese growth rate is also under pressure elsewhere, with energy constraints being the latest challenge. Given China's leadership role in the global recovery, this is worth worrying about. The causes are manifold, but include the delta outbreak/movement restrictions, supply chain issues, high freight prices and now energy shortages. These, though, are likely temporary. The more worrisome cause would be the regulatory overhaul which state media has called a "profound revolution". That does not sound like something that is "transitory". The latest activity gauges show that tighter regulations, supply shocks and logistical bottlenecks continue to weigh on the industrial sector. The official manufacturing PMI (Purchasing Managers Index) slipped into the contraction zone (49.6) in September, for the first time since February 2020, and details show that deterioration was widespread. This month's small companies PMI moved deeper into contraction zone, reaching the lowest point since February 2020 (47.5). Recent reports indicate that some supply side constraints might be easing, but it is probably too late for this year. This will limit China's manufacturing rebound in Q4, especially in energy-intensive sectors. The ongoing weakness in new orders and new export orders also point to near-term demand-side growth headwinds. Against this backdrop, it is noteworthy that authorities are not in the mood to reopen credit spigots and continue to dispense policy support sparingly. There are also no signs of easing the regulatory crackdown or giving up on the environmental targets. The emphasis right now is on providing adequate liquidity via the central bank's almost daily injections and limiting Evergrande's spillovers into the real economy.

The "stagflation" scenario we noted in our commentary last month, the Federal Reserve (Fed) is now home to new and imminent risks that also seem unpriced. The trading scandal which has come to light undermines Fed credibility. At the same time, the prospect of four new voters, including a replacement for Fed Chair Jerome Powell, could mean an end to low rates and seemingly unlimited stimulus. This represents uncertainty. Uncertainty probably supports the risk-off trade. It also probably means a steeper curve, though the curve remains bounded by China and the absence of further fiscal stimulus developments in the US.

We continue to think China may be heading for an external adjustment, i.e., a weaker currency. If capital account flows are challenged by Chinese policy, and global "stagflation" challenges current account flows, China will need dollars. The only option in this scenario would be to reduce the value of the currency, perhaps with increased capital controls, though Chinese policy is already implicitly re-imposing them. This will take several quarters to play out, if it does, but bears consideration.

Chinese real estate prices strike us as central to China's future. Real estate sales and construction together account for around 28% of GDP and real estate stocks account for around half of household wealth. China's "common prosperity" policies would seem to point toward lower real estate prices, though some argue that this could be met by low-income housing construction. The point is, if China was experiencing problems in other sectors, we would not be as concerned but they are. Below is a chart, in which we show the relationship between Chinese relative interest rates and its currency. The point is that if China is going to use monetary policy to address growth concerns, which is expected, it would be reasonable to worry about related currency weakness.

Portfolio changes

The changes to our top positions are summarised below.

• We increased our hard currency sovereign and quasi-sovereign exposure in Saudi Arabia and Qatar, and hard currency quasi-sovereign exposure in United Arab Emirates. These countries' macroeconomic fundamentals benefit from higher oil prices and past cyclical support. Fiscal balances in the region are expected to be in surplus, and this means that issuance "overhang" is out of the way. International reserves are also on the mend. In addition, regional governments are delivering on structural reforms. Finally, quasi-sovereign credits have attractive valuations (top initial allocation buckets). In terms of our investment process, all three test scores for these countries – economic, technical, and policy – now look stronger.

• We also increased our local currency and hard currency quasi-sovereign exposure in Israel, and local currency exposure in the Philippines. In Israel, we were attracted by the solid recovery and a very credible central bank, as well as attractive valuations (initial allocation bucket #2). Israel's hard currency instruments also tend to outperform during market upheavals, acting as "safer haven" assets. These considerations improved the country's technical test score. In regards to the Philippines, we were comfortable covering an index underweight due to relatively cheap short-term currency valuations. However, we continue to pay attention to high inflation, President Rodrigo Duterte's succession saga, and the bumpy recovery.

• We reduced our hard currency corporate exposure in China and hard currency sovereign exposure in Egypt. China's property sector story took a turn for the worst, with one of the major real estate developers, Evergrande, failing to make an interest payment on its US dollar-denominated bond. The sector's role in the economy is very significant, and authorities are trying to reduce the spillovers, but there are no signs of easing the regulatory crackdown, which seems to be affecting other companies' bond prices. Given the big deterioration in the governance, company and technical test scores for Evergrande (and technical test scores for other real estate companies), we decided to close this position completely. The main reason for exiting our sovereign position in Egypt was a surprising additional bond issuance, despite an unfavourable market backdrop. The government's move worsened the technical test score for the country.

• We also reduced local currency exposure in Indonesia and Thailand. In Indonesia, we were driven by changes in the policy setup, including the renewed monetary policy concerns, as the central bank continues to finance fiscal expansion via bond purchases. We also think there may be additional risks associated with the Evergrande's impact on the Chinese renminbi and regional currencies. These factors worsened Indonesia's policy and technical test scores. China contagion concerns also featured prominently in our decision to reduce local exposure in Thailand, we swapped some of the proceeds into safer quasi-sovereign exposure.

Contact us

vaneck.com.au
info@vaneck.com.au
+61 2 8038 3300

VanEck-Australia
VanEck_Au
VanEckAus