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MONTHLY COMMENTARY AUGUST 2020

# 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 31 August 2020

| | 1 month | 3 months | 6 months | 1 year | 3 years (p.a.) | 5 years (p.a.) | Since EBND inception (p.a.) |
|---|---|---|---|---|---|---|---|
| Price Return | 0.63% | 6.37% | -4.88% | - | - | - | -5.34% |
| Income Return | 0.45% | 1.43% | 2.72% | - | - | - | 2.91% |
| **Total Return** | **1.08%** | **7.80%** | **-2.16%** | - | - | - | **-2.43%** |
| Benchmark | -1.42% | -0.07% | -6.57% | -3.24% | 3.24% | - | -7.00% |
| **Value Add** | **+2.50%** | **+7.87%** | **+4.41%** | - | - | - | **+4.57%** |

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 | 62 |
| Number of issuers | 39 |
| Modified Duration (yrs) | 4.86 |
| Yield to Maturity | 7.18% |
| Running Yield | 6.76% |
| Weight of top 10 issuers | 52.4% |
| Credit Rating Profile | B+ |
| Time to Maturity (yrs) | 7.95 |
| Top Holding Weight (%) | 4.94% |
| Investment Grade (%) | 25.44% |

As at 31 August 2020

## Summary

- VanEck Emerging Income Opportunities Active ETF (Managed Fund) (EBND) outperformed the benchmark in August by 2.50%.
- Top five country exposures are currently in Argentina, Indonesia, Mexico, Uruguay and China.
- There is still plenty of good opportunities within emerging markets. Fundamentals remain, on the whole, characterised by low debts relative to developed markets. Global stimulus is also still likely to find its way into emerging markets bonds, just as it did post-GFC. It all points to having a bottom-up, country-by-country attitude, rather than being confined to owning only local, or corporate, or sovereign debt.

## Market and portfolio commentary

The fund outperformed its benchmark in August. We did not have any exposure to Brazil and this aided the fund on a relative bases as the country's well-publicised ongoing weakness weighed on its market.

We see three interesting themes characterising emerging markets (EM) bonds now:

1. greater opportunities in hard-currency EM bonds over local-currency EM bonds;
2. there is a low margin for error in many EM fixed income markets, and
3. the need to be selective as many markets approaching pre-COVID highs.

Local currency yields are low in real terms, so are policy rates, with only three countries – Russia, Mexico, and Indonesia – having positive real policy rates. This suggests that many EM countries want their currencies stronger. As we have noted before, monetary experimentation in developed markets has not benefited EM local currency performance. EM currencies have tended to act as shock absorbers protecting the economic health of the EMs, therefore investing in local currency bonds requires greater selectivity.

EM hard currency, on the other hand, appear to be better supported. The US Fed is now buying US corporate investment grade and high yield bonds. That leaves EM bonds as the only market-priced sovereign or corporate debt. Hard currency debt has done very well in this era of developed market monetary experimentation, compared to local-currency. This is because the key dynamic remains – low interest rates. This anchors hard currency bonds, depending on credit quality, while having intermittent effects on local currency debt whose interest rates are already low and whose currencies have underperformed in the QE era.

There is a low margin for error in the many EMs with low interest rates (local or hard), particularly with many markets at pre-COVID highs. In a risk-on scenario, you would expect the US yield curve to steepen. Low-spread, high-duration hard currency bonds would suffer in that scenario. Low-yield, high-duration bonds in local currency would suffer in that scenario. In a risk-off scenario, credit spreads, especially long-duration, would suffer. EM local currency markets would also sell off in that scenario. The point is that depending on your duration, a 50 basis point rise in spreads or yields would result in very few exposures have the running yields to make it back in under a few years. Thus, we are positioned with low duration, combined with carefully selected positions with re-rating and defensive characteristics.

## Portfolio changes

The changes to our top positions are summarised below.

- Our largest positions are currently: Argentina, Indonesia, Mexico, Uruguay and China.
- We increased our hard currency sovereign exposure in South Africa. Despite the numerous macroeconomic concerns, the central bank's policy – especially its commitment not to waste the international reserves on FX interventions – is not one of them. South Africa's external debt is extremely well managed, and there is no risk of default. In terms of our investment process, this improved the country's technical and policy test scores.
- We also increased our hard currency sovereign exposure in Sri Lanka and Argentina. These increases reflected positive price changes. In Argentina, the main driver was the government's finalising the sovereign debt restructuring deal with foreign creditors near the end of the month. In Sri Lanka, the market continues to internalise the overwhelmingly positive outcome of the recent presidential elections, which improves the country's chances of getting an IMF deal.
- Conversely, we reduced our hard currency sovereign exposure in Angola and Romania. There were two main reasons for trimming Angola's exposure. First, the country's bonds staged a rally after the initial COVID-related selloff, so valuations were high. Second, the market was concerned about a delay in the IMF deal. We do not think that these concerns were justified, because the country wanted to expand its IMF program, but these concerns affected market sentiment. In terms of our investment process, these developments worsened Angola's technical test score. In regards to Romania, the reduction was technically a switch from the sovereign bond to higher-yielding and better-valued local bonds, which should get extra support from the European Union's COVID emergency funds which have the potential to improve the country's growth outlook. We continue to monitor the situation regarding pension hikes, but for now this risk seems contained. In terms of our investment process, the European Union support improved the country's technical test score.
- We also exited from our hard currency sovereign and corporate exposure in Belarus. We had started to pare the position in July in the run up to the presidential elections. We thought the market was underestimating the risk of protracted political impasse and were betting on the "business as usual" scenario instead. The elections did turn out more troubled than expected and there is still no solution in sight, each day brings new reports about massive demonstrations and police brutality. The incumbent switched from anti-Russia provocations to pleas for help and this path might lead to sanctions. In terms of our investment process, this significantly worsened the country's policy/politics test score.

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EBND invests in emerging markets which have specific and heightened risks that are in addition to the typical risks associated with investing in the Australian bond market. The PDS contains details of the key risks.

No member of the VanEck group guarantees the repayment of capital, the payment of income, performance, or any particular rate of return from EBND.

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