VanEck®

Access the opportunities.

EBND

How we manage your money

Active high conviction emerging markets income strategy

VanEck Emerging Income Opportunities Active ETF (Managed Fund) (ASX: EBND) enables investors to access a diversified portfolio of emerging markets bonds via a single trade on ASX.

We believe an optimal portfolio of emerging markets bonds is unconstrained by benchmarks, and invests in bonds that offer the best value relative to their fundamentals while managing risk.

Our unconstrained approach offers a number of benefits including:

- A plethora of investment opportunities;
- Greater diversification; and
- Potentially high income.

We focus on the entire emerging markets bonds universe to maximise the return potential of our fund. We conduct comprehensive country research, set in the context of global economic developments, which forms the foundation of our investment process. We look at factors such as key macroeconomic variables, the political environment, fiscal and monetary policy developments and major risk. This is coupled with analysis of technical market indicators such as the nature of instruments, relative value, liquidity and demand and supply imbalances.

Our expertise

- The depth and breadth of VanEck's experienced and stable emerging markets bond team is unparalleled. The team has an average of over 20 years* of investing experience across a variety of market conditions and stages of the economic cycle.
- VanEck manages in excess of US$5.4 billion* in emerging markets fixed income.
- VanEck has been investing in emerging markets since 1993.

*As at 31 December 2019

Summary of investment process

Step 1: Valuation

Normalise fundamentals and compare to risk premia, highlighting bonds that pay excessive premia relative to fundamentals, across the three classes of EM debt (i) local currency sovereigns, (ii) hard currency sovereigns, and (iii) hard currency corporates.

Step 2: Testing

Conduct tests designed to capture important information and risks, which cannot be systematized in a model as in Step 1.

Step 3: Portfolio construction

Allocate to bonds that are cheap according to Step 1 and pass the tests in Step 2. Incorporate duration and currency considerations into the portfolio. Use Black-Litterman model to formalise and optimise asset allocation.

Step 4: Monitor risk

Measure and track a range of risk metrics.

Portfolio

10 to 30 markets | 30 to 100 issuers | 50 to 100 bonds

Step 1. Valuation: Fundamental analysis and value

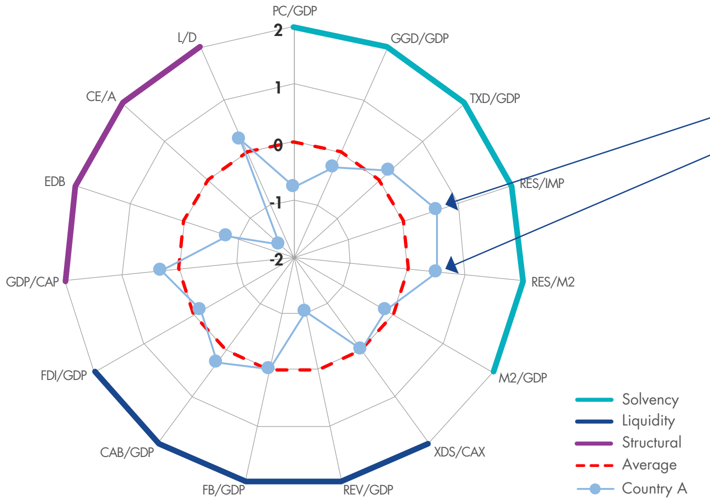
First, we normalise country and corporate fundamentals by turning economic variables from percentages and nominal units into units of standard deviation from the mean, of the global peer group for countries, and industry peer group for corporates. More specifically, this step entails looking at 20 different variables for each country and 10 variables for each potentially investible corporate, ranking those variables in units of standard deviation, and assessing how they compare to the rest of their peers. The goal of the normalisation is to create a level playing field and put country and corporate variables into a form that allows for comparison.

We then compare these countries and corporates with normalised fundamentals to the risk premia that exist in the fixed income instruments by comparing the z-score to what investors are getting paid on the issuer's bonds. For hard-currency bonds we examine the credit spreads, for local-currency bonds the focus is on real yields. Other comparisons and valuation metrics are also conducted, such as a country score against real effective exchange rate richness/cheapness. However, the main valuation metrics are hard currency credit spreads and local currency real yields.

If a particular expected value has tail risks that are too fat, we take that into consideration, usually adjusting sizing downward, or sometimes eliminating the investment altogether if the tail risk's probability or price downside is significant. In addition, we sometimes assign low confidence intervals to certain expected values. We believe that some countries are too opaque to analyse based on their history of unpredictability (in an area that affects bond prices, not simply unpredictable on other issues). We might reduce or eliminate positions based on this assessment.

Below is an example of how the 20 variables apply to a Country and how the 10 variables are applied to a Corporate. The red circle represents the global average. The concentric circles are standard deviations from the mean. Where the fundamental result is outside the red circle, the country is worse than the global average.

Country A

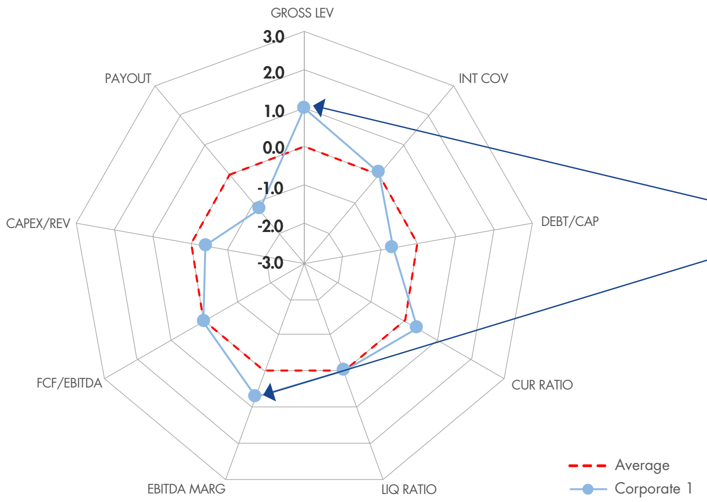


In this example, Country A is "worse than average" on metrics such as:

- International Reserves/Months of imports; and
- International Reserves/M2 by about 0.5 standard deviations.

KEY:
PC/GDP: Private credit/GDP
GGD/GDP: General government debt/GDP
TXD/GDP: Total external debt/GDP
RES/IMP: International reserves, months of imports
RES/M2: International reserves, % M2
M2/GDP: M2/GDP
XDS/CAX: External debt service (public and private), % CA receipts
REV/GDP: Government revenue, % GDP
FB/GDP: Headline fiscal balance, % GDP
CAB/GDP: Current account balance, % GDP
FDI/GDP: Net FDI, % GDP
GDP/CAP: US$ GDP per capita, PPP
EDB: Ease of doing business
CE/A: Common equity, % assets
L/D: Loans to deposits ratio

Corporate 1



In this example, Corporate 1 is "worse than average" on metrics such as:

- Gross Leverage; and
- EBITDA margin by about 1 standard deviation.

KEY:
GROSS LEV: Gross Leverage
INT COV: Interest Coverage
DEBT/CAP: Debt/Capitalization
CUR RATIO: Current Assets/Current Liabilities
LIQ RATIO: (EBITDA+Cash)/(ST Debt+Interest)
EBITDA MARG: EBITDA Margins
FCF/EBITDA: Free Cash Flow % Revenues
CAPEX/REV: Capex as % Revenue
PAYOUT: Dividends/EBITDA

Step 2. Testing

After bonds are ranked according to their premium relative to fundamentals, country-specific, bottom-up tests are conducted to adjust or eliminate certain issuers. The tests include policy, economic and technical assessments, and are designed to evaluate risks that cannot be captured in the first step of the investment process, such as vulnerabilities, correlations, liquidity, momentum and central bank policy, among others. For corporates, additional country and management tests are conducted. The country test involves assessing whether there are country-related risks to the corporate and the management test involves assessing management quality and ability to execute.

- A **policy test** may include an assessment of capital controls. For example, Ghana's government imposed capital controls, with no "official" announcement. Holders of local bonds could sell their bonds and receive Cedi, the local currency, but could not buy US dollars with the cedi. Prices were marked in portfolios as if one could purchase US dollars. Capital controls are often invisible and an "exchange rate" is sometimes just a number on a screen.
- **Economic tests**, on the other hand, can capture risks such as to sudden-stops in capital flows, as measured by an "External Vulnerability Ranking." Economic tests can capture risks, such as adverse or positive shocks to terms of trade.
- A **technical test** may include an assessment of the relationship between a currency and a commodity price. For example, the relationship between the Colombian peso and oil can be beneficial in determining the sensitivity of the currency to the commodity price and comparing it to the current behaviour. Any deviation can mean either a rich/cheap status given the absence of a catalyst.

These tests allow us to revisit and adjust country and corporate economic rankings determined in Step 1 based on current conditions. All sovereigns and corporates are then re-ranked based on the final score.

Step 3. Portfolio construction

Investments are prioritised based on the expected values of the range of possible investments. First, we establish which country's bond market pricing deviates the most from its fundamentals. Scenario analyses are then conducted, generating a central case for asset price behaviour, as well as tail risks around that central case. This establishes an expected value for a position and consequently guides sizing, as long as we are comfortable with liquidity.

We then adjust the duration exposure of each allocation based a multitude of factors such as economic growth rate, ratio of spread to yield, global central bank policy, treasury yield path and curve shape analysis, in addition to other factors. The goal is to increase exposures to bonds that benefit from duration tailwinds while reducing those that face duration headwinds. Finally, we adjust the currency exposure based on emerging markets foreign exchange considerations in an effort to tilt the portfolio towards bonds that are expected to benefit from current conditions. Some of the considerations for currency include local central bank policy, country reserves and foreign exchange regime, positioning and short- and long-term valuations.

Step 4. Monitor risk

Risk management is directly incorporated into investment decisions through each step of the investment process. It begins with normalised economic data and by comparing a country's collection of normalised data to its risk premium (real interest rates for local currency, and credit spreads for hard currency). The process rewards countries whose risk premium is too high compared to other countries with the same fundamentals.

As described in Step 2, we perform three tests related to policy, economy, and technical, to evaluate additional risks.

Normally, a foreign exchange risk, an interest rate risk, or a credit risk is determined by bottom-up factors. Therefore reducing risk elements (FX risk, interest rate risk, country credit risk) is deemed unnecessary as the investment process is designed to choose the right risks. However, when a particular type of risk in the portfolio is high, for example, duration risk, the Team engages in a deeper analysis of the likely direction of such a risk, and may choose to reduce that risk via hedging, in this example interest rate risk.

We also conduct regular visits to key countries, meeting with the official sector, e.g. central bank, ministry of finance, private sector, e.g. key banks, important companies, and independent bodies, e.g. media, official international organizations, opposition parties.

After investment decisions are made, we constantly monitor portfolio risks. This includes, but is not limited to stress testing, monitoring risk limits, assessing correlations and scrutinising daily news and data announcements.

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 its benchmark. EBND's benchmark is a blended index consisting of 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD Index and 50% J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Index.

ASX code: EBND

Commencement Date: 13 February 2020

Management costs: 0.95%

Frequency of dividends: monthly

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