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Navigating the WTF Risks: War, Tariffs, and the Fed's Impact on Emerging Markets in 2025

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> Emerging markets debt outperformed developed markets yet again in 2024. In 2025, war, tariffs, and Fed risks are top of mind to start the year.

The **VanEck Emerging Markets Bond Fund** declined 1.62% in December, compared to -1.66% for its benchmark, the 50% J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM) and 50% J.P. Morgan Emerging Markets Bond Index (EMBI). For the year, the fund gained 3.09%, compared to 2.01% for its benchmark (and compared to -2.08% and -1.67% for the Global Agg and 10-year Treasuries, respectively). For the trailing 5-year period, the Fund's cumulative return is 13.4%, compared to -4.1% for its benchmark (and -11.3% and -9.6% for the Agg and Treasuries, respectively). The decades-old story of emerging markets (EM) bonds outperforming developed markets (DM) continues.

During December, the winners were Sri Lanka and Brazil (an underweight during a big selloff). Ecuador, a long-held position for the fund, way by far the biggest loser. December's markets were very thin and volatile, and this hit Ecuador excessively to our eye. We are poised to increase some exposure to high-beta EM currencies (EMFX) such as the Mexican peso and Brazilian real, both of which had devastating losses last year (down around 20%). Many market participants got beaten up in the peso and real, and our assessment is that both markets might have exhausted selling.

We have covered our underweight in duration into the selloff in bonds and are looking to increase duration further. High yield sovereigns remain our hunting ground in USD, but we added some investment grade sovereigns on the selloff in yields as well. Carry is 7.8%, yield to worst is 9.8%, duration is 5.8, and local makes up around 56% of exposure.

Average Annual Total Returns* (%) (In USD)

As of December 31, 2024	1 Month	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Class A: NAV (Inception 07/09/12)	-1.83	-5.05	2.52	2.52	1.61	2.21	1.87
Class A: Maximum 5.75% load	-7.48	-10.51	-3.38	-3.38	-0.37	1.00	1.27
Class I: NAV (Inception 07/09/12)	-1.62	-4.93	3.09	3.09	2.01	2.54	2.20
Class Y: NAV (Inception 07/09/12)	-1.81	-5.14	2.84	2.84	1.86	2.44	2.11
50% GBI-EM/50% EMBI	-1.66	-4.48	2.01	2.01	-0.88	-0.83	1.84

* Returns less than one year are not annualized.

Expenses: Class A: Gross 2.08%, Net 1.21%; Class I: Gross 1.34%, Net 0.86%; Class Y: Gross 1.35%, Net 0.96%. Expenses are capped contractually until 05/01/25 at 1.20% for Class A, 0.85% for Class I, 0.95% for Class Y. Caps excluding acquired fund fees and expenses, interest, trading, dividends, and interest payments of securities sold short, taxes, and extraordinary expenses.

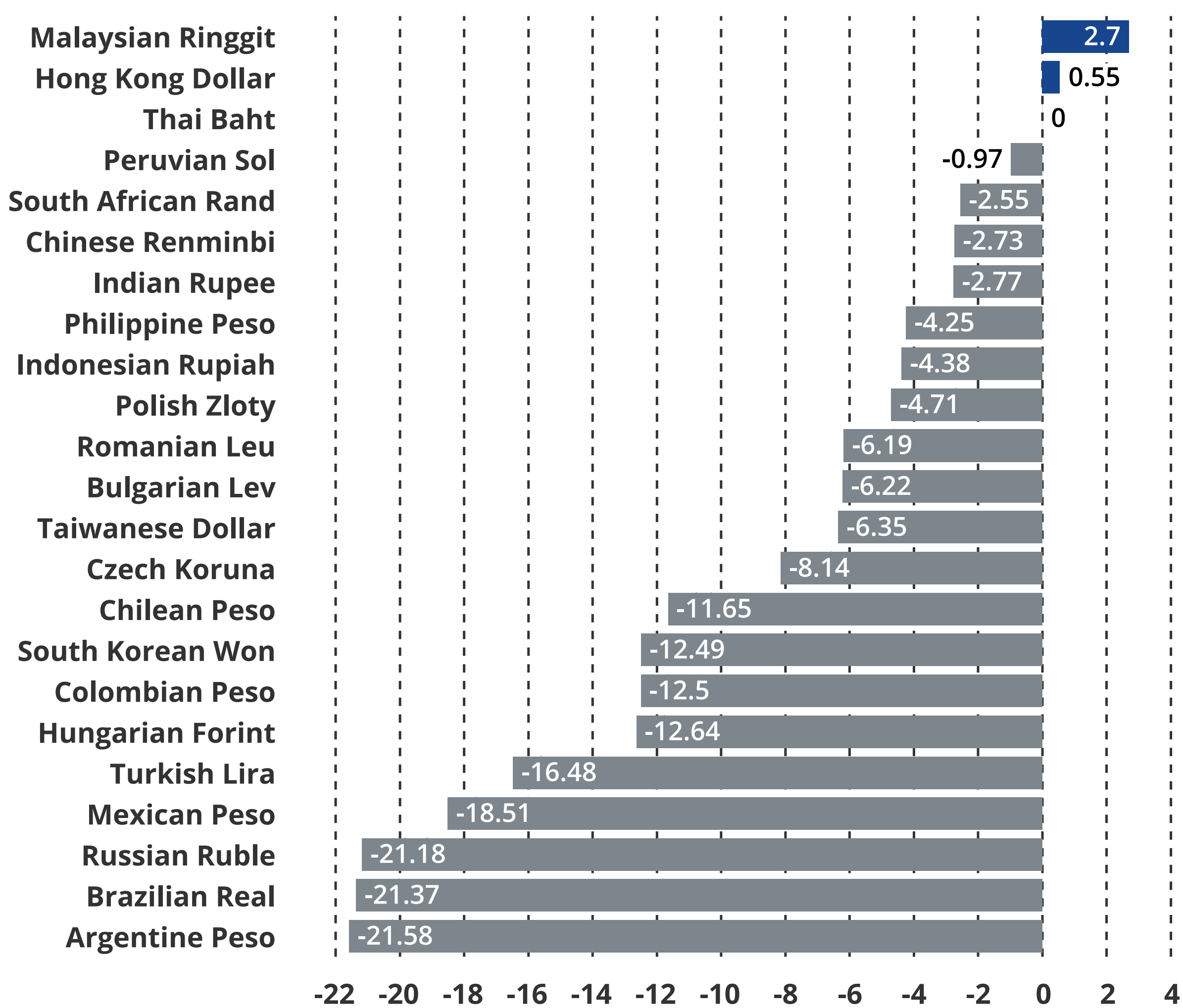
The performance data quoted represents past performance. Past performance is not a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance may be lower 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.

Markets spent December trying to price eventual Trump administration policy, and markets are still at it in January. Tariff policy is obviously the proximate concern, but war and the Fed also loom uncertainly. War, tariffs, and the Fed -- we'll call these the "WTF" risks. These issues, by themselves, are obviously determinant. War is inflationary, boosts commodities prices, and places a layer of geopolitical risks onto markets. Tariffs are generally viewed by economists as a risky distortion, though we must note that this seems to be misreading Ricardo who was opining about trade with a *closed* capital account…open capital accounts are a challenge to the frameworks many economists seem to be using (money doesn't need to cross borders just for goods trade, it can invest to balance trade flows). We should reiterate that the Fed staff have consistently viewed tariffs as hits to demand which should be met with appropriately responsive (i.e., loose) monetary policy. So if our spin on tariff theories is correct, it's really about the magnitude and targeting – are they so big they cover "everything" or so punishing to China they create CNY devaluation risks? *That* would be important and nice to know, but we don't yet. Our point is that the theorizing isn't that productive, the details would be. On to the F in WTF, there is great uncertainty – will cuts return, is a long pause in store, is growth enough that hikes are coming? And, if you knew the direction of rates for the year, would that even be helpful? 2024 saw many seasons in Treasuries and catching those seasons were *way* more important than the year trend, practically speaking. Therefore, our strongly preferred stance remains to focus on economic data (is the market pricing Fed policy with too much expected strength or weakness?) or moments when markets seem to deviate significantly from policy moves. This latter case may hold now. Treasuries yields pushed over 90 basis points (bps) higher following the Fed's latest cutting cycle. This is one of the most perverse reactions in the history of modern Fed cutting cycles. Anyway, our point is that seems to be an observable fact, which has now pushed us to higher duration.

The best argument addressing these WTF risks is *not* that they are immaterial, but that they may *already* be priced. Some EMFX, particularly the Mexican peso, sold off already in 2024 on tariff risks. Look at the chart below to get a sense. It's fairly amazing to us that we had an overweight in local currency throughout 2024 and still outperformed the benchmark. The fund's biggest winner for the year was not owning the Mexican peso (and there's always a bottom-answer with us), but it perhaps gives you a sense of how comfortable we are with some of these risks at the start of 2025. Putting aside the WTF risks, the facts we are left with are a U.S. that is stimulating and a China that is stimulating, which are very supportive of EM.

Exhibit 1 – EMFX Sold Off in 2024



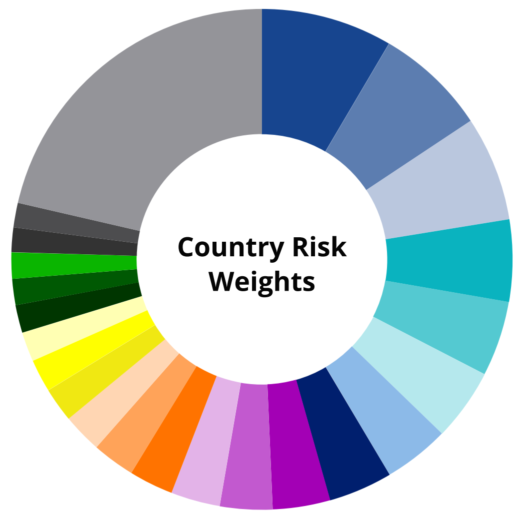
Source: Bloomberg LP, Data as of December 2024

While we await U.S. policy clarity, China appears to be steadily moving toward increased spending, perhaps aggressively in the event of harsher U.S. tariffs. Importantly, the Chinese currency has been stable in the face of WTF risks, and this is despite a record-low yield differential with the U.S.. This stability has been an anchor for many EMs, underlining the idea that tariffs remain a serious risk until clarified, the only pushback is how anticipated they are. So, what's up with CNY now? Well, to our eye, it remains stable. One trigger for concern recently was that a basket of currencies managed against CNY is saw a small reduction of USD and EUR in the basket. But, this basket is changed regularly based on trailing trade data, so we think the regular change in the basket in December says most about the market reaction and little about the basket change itself; the market speculated that a devaluation was likelier and we disagree that this was the intention. Moreover, and most important, the daily fixes of the currency have remained remarkably stable around 6.2, it's market pricing of concern after the fixes that remains an issue. And, the market will take its cues from actual developments. China stimulus should be bullish for CNY, for example. U.S. tariffs may be a more negotiated compromise or even be harsh, and we could still see CNY fixes remain stable. We should note that China's reserves and continued external surpluses make this a sustainable and defensible stance. We should further note that with domestic government bond rates around 1%, this does not strike us as a capital flight situation. Now, pressure still exists on the currency (as measured between the difference between the onshore and offshore exchange rates, CNY and CNH), and the currency could weaken. Perhaps currency weakness would be in reaction to policy moves by the U.S. But, our point is that any currency weakness is likely to be smooth and managed, and could even mark a catharsis of the tariff concern. We have a view, but are watching.

Exposure Types And Significant Changes

The changes to our top positions are summarized below. Our largest positions in December were Mexico, South Africa, China, Thailand and Indonesia, with the overall country allocations looking as they do below:

Country Risk	Weight
Mexico	8.0
South Africa	6.8
China	6.4
Thailand	5.0
Indonesia	4.6
Malaysia	4.4
Chile	4.0
Brazil	3.9
Colombia	3.5
Czech Republic	3.2
Poland	3.0
Hungary	2.7
Sri Lanka	2.6
Turkey	2.4
Zambia	2.1
Philippines	2.0
Congo	1.8
Ecuador	1.7
Nigeria	1.6
Luxembourg	1.6
Saudi Arabia	1.5
United Arab Emirates	1.5
Other (<1.5%)	20.2



Source: VanEck Research, as of December 2024.

- We increased our local currency exposure in Poland and Chile. Poland can benefit from potential changes in the regional geopolitical landscape (a ceasefire in Ukraine). The currency can also track the euro if the U.S. Fed ends up cutting more than currently expected (only 1 full rate cut in H1-25). These factors improve the policy and technical test scores for Poland. Chile is at the end of the easing cycle, and the economy can potentially benefit from China's eventual response to policy stimulus, which should improve Chile's technical and economic test scores.

- We also increased our local currency exposure in Thailand and Malaysia. Thailand's tax reform proposals look encouraging, while solid tourism inflows should support the currency. In terms of our investment process, this improves the policy and economic test scores for the country. Malaysia's local currency bonds are considered a higher-yielding proxy for China's government bonds, and China's rates are expected to continue rallying on the back of additional policy easing (including rate cuts). This strengthens Malaysia's technical test score.

- Finally, we increased our hard currency sovereign exposure in Qatar. The decision was motivated by more dovish comments from the U.S. Fed and lower prices paid pressures in some surveys/indices for the U.S. The outlook for the Fed is highly uncertain, but the market prices in a very shallow easing cycle in the U.S. this time around.

- We reduced our local currency exposure in Brazil, Uruguay, Mexico, and Indonesia. The Brazilian government and the central bank to do not see eye to eye, reinforcing the negative feedback loop and sending local rates higher and the currency weaker. Despite the recent progress on spending cuts, the mechanism of how these risks can be communicated to the authorities is not always working, which worsens the country's policy test score. Concerns about fiscal slippages under Uruguay's new administration had a similar (negative) impact on the country's policy test score. Some EM local curves are getting flatter after the 5-year segment – Mexico and Indonesia including – not justifying taking duration risks in turbulent markets with thin liquidity. In terms of our investment process, this worsened the technical test scores for both countries.

- We also reduced our hard currency sovereign exposure in Israel and Ecuador. We took partial profits in Ecuador in order manage potential risks associated with the pre-election political noise, which worsened the country's policy test score. Israel's geopolitical and domestic political pressures limit improvements in the policy test score, even though we are likely to see more initiatives to come under Trump 2.0 administration.

- Finally, we reduced our hard currency corporate exposure in China and hard currency sovereign exposure in Ghana and Benin. China's "glacial" stimulus pace keeps disappointing investors, with the year-end liquidity issues amplifying price moves and worsening the technical test score. Benin's valuations are getting very expensive (the lowest initial valuation bucket), worsening the technical test score, while the opposition's victory in Ghana's presidential elections raised questions about fiscal slippages and the IMF program's renegotiations. These factors worsened the country's policy test score.

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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 Bloomberg Global Aggregate Index measures the performance of global investment grade fixed income securities.

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ICE BofA Global Broad Market Index tracks the performance of investment grade debt publicly issued in the major domestic and eurobond markets, including sovereign, quasi-government, corporate, securitized and collateralized securities.

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