

# Virtus Market Neutral Fund

## Market Overview

In a difficult quarter marked by extreme volatility, global stock markets were rocked by an ever-growing list of negative economic data points. The eurozone debt crisis, well into its second year, was the biggest drag on global markets, followed by growing fears of a double-dip in the U.S. These problems were truly worldwide, also hitting the most important markets in Asia and Latin America, specifically China and Brazil. Markets began pricing in a global recession, with commodities and any other cyclical areas taking a big hit. While the overall trend was clearly lower, it was not unusual to experience days with multi-percentage point gains as global markets traded in tandem, locked in a pattern of lower highs and lower lows.

## Portfolio Performance

The Virtus Market Neutral Fund (Class A shares at NAV) underperformed its benchmark, the Citigroup 3-Month T-Bill Index, for the quarter ended September 30, 2011.

The Fund had an unusually disappointing quarter, which we believe was indicative of the challenging investment environment. Changing sentiment brought down all investment styles, but equity investors continued to favor a narrow range of stocks that have been working, at least on a relative basis. Stocks that maintained consistency of earnings and did not report any bad news continued to attract buyers, while those that missed on earnings or brought down guidance were harshly punished. This backward-looking “certainty trade” presents a challenge for investors who focus on investment fundamentals in making equity decisions – whether long-only or long and short.

In terms of sectors, we had positive results in financials and consumer staples. Our most challenged sectors were consumer discretionary, healthcare, industrials, and information technology. Overall, our short positions held up fairly well, but our forward-looking long positions significantly detracted.

From the standpoint of stock selection, the Fund’s best individual performers were Limited Brands Inc. (long), Sanderson Farms Inc. (long), Unilever N.V. (long), Hewlett Packard Co. (short), and Jeffries Group Inc. (short). Limited Brands, a long-time holding, did well by surpassing reduced expectations as the higher-end consumer kept spending. We moved into Sanderson Farms when we thought chicken prices had hit a trough and were showing signs of improving. Unilever continues to be a strong performer in consumer staples with global exposure. Hewlett Packard announced yet another CEO change along with indications that it would exit the PC business. Jeffries Group fell on expected weakness that we had anticipated in underwriting and trading.

Our five worst performers were all long positions in the portfolio. Melco Crown Entertainment, owner of a casino in Macau, was our biggest detractor as investors worried about luxury spending in China. The latest earnings and gaming receipts data from Macau point to an overdone sell-off. Dendreon encountered a number of setbacks, including trouble with the launch of its prostate cancer drug Provenge. We exited this position. Focus Media fell because of fears that slowing in China could lead to falling Internet advertising spending. NetApp reported a sales shortfall, which we expect is the result of a sales shift into the current quarter, while Velti PLC reported a margin disappointment, but this mobile marketing and advertising company remains a long because we think they are wisely investing for the future.

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## SYMBOL (CUSIP)

A: EMNAX (92828R727)

C: EMNCX (92828R693)

I: VIMNX (92828R297)

## INVESTMENT PROFESSIONALS

Sean P. Fitzgibbon, CFA  
*Senior Vice President*  
Industry start date: 1992  
Start date with the fund: 2008

Robert J. Eastman, CFA  
*Senior Vice President*  
Industry start date: 1989  
Start date with the fund: 2008

Jeffrey D. McGrew, CFA  
*Vice President*  
Industry start date: 1992  
Start date with the fund: 2008

*The Virtus Market Neutral Fund employs a unique market neutral style through investments in undervalued companies with strong and improving business prospects while shorting companies with deteriorating business momentum and excessive valuations.*

## TOP TEN HOLDINGS

	Long % Fund
Electronic Arts Inc.	1.83
Sanderson Farms Inc.	1.80
Cabot Oil & Gas Corp.	1.65
NetApp Inc.	1.58
Melco Crown Entertainment Ltd ADR	1.50
Fomento Economico Mexicano S.A.B. de C.V. ADS	1.48
Viacom Inc. (CI B)	1.44
Comerica Inc.	1.42
Unilever N.V.	1.18
QUALCOMM Inc.	1.06
	Short % Fund
J.C. Penney Co. Inc.	1.93
Wynn Resorts Ltd.	1.89
Rolls-Royce Holdings PLC	1.69
Research In Motion Ltd.	1.49
Thomson Reuters Corporation	1.45
LKQ Corp.	1.44
Huntington Bancshares Inc.	1.42
Novo Nordisk A/S ADS	1.42
Microsoft Corp.	1.41
Lockheed Martin Corp.	1.38

*Holdings are subject to change.*

*continued*

# Virtus Market Neutral Fund

In our management of the Fund, nine independent investment teams balance long and short positions within allocations determined by the lead portfolio manager to produce alpha for the portfolio. The International Core and Core Research teams turned in the best performances during the quarter. International Core's best sectors were consumer staples, information technology, and healthcare. Information technology, financials, and energy led the Core Research team's outperformance. The most challenged performance came from the Dynamic Value team, which was hurt by long positions in energy names, including Occidental Petroleum and Schlumberger. Emerging Core's performance was also weak, especially in consumer discretionary, healthcare, and utilities.

## Market Outlook

We expect the eurozone debt crisis to stay front and center, causing a whipsaw effect in the U.S. and around the world as efforts to agree on a solution dominate headlines. Every time the problem flares up, the European Central Bank and northern European countries come to the rescue, typically in words

but sometimes in deeds. We are cautious on the financials, generally taking long positions in institutions with little or no direct exposure to eurozone debt.

Global markets have fallen victim to a negative news loop, where every piece of data is interpreted to confirm the worst possible outcome, overwhelming any good news or positive data points.

As part of the negative news loop, there is increasing talk that we are experiencing a replay of 2008, with Greece and Europe taking on the roles of Lehman Brothers and the U.S. This overlooks the fact that weak recoveries in developed countries mean we have much less room to fall than in 2008. We do not see a global recession, although Europe's tightening credit

and wobbly banks could push individual European countries into recession. We expect the U.S. to bounce along with slow but positive growth. Emerging markets growth will be much higher than developed markets, but not at the sizzling levels we've seen. We do expect earnings to come down, ending the so-called certainty trade and focusing investors on individual company fundamentals. This should lead to a better environment for the Fund as we seek to fulfill our goal of positive total returns.

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## Annualized Performance Class A as of 9/30/11 in percent

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 5/1/1998
NAV	-6.00	-11.40	-11.59	-1.61	-2.94	-1.11	-0.54
POP	-11.40	-16.50	-16.67	-3.53	-4.08	-1.69	-0.98
Index	0.01	0.07	0.11	0.20	1.62	1.92	2.72

QTD, YTD and 1 Year performance is not annualized. Benchmark since inception performance is reported from 4/30/1998. Class A operating expenses are 1.91% and gross operating expenses are 4.18%. Operating expenses reflect a voluntary expense reimbursement, which may be discontinued at any time. Operating expenses do not include expenses related to dividends on short positions and prime brokerage interest expense.

Average annual total returns reflect the change in share price and the reinvestment of all dividends and capital gains. Net Asset Value (NAV) returns do not reflect the deduction of any sales charges. POP (Public Offering Price) performance reflects the deduction of the maximum sales charge of 5.75%. A contingent deferred sales charge of 1% may apply on certain redemptions made within 18 months following purchases on which a finder's fee has been paid.

**Performance data quoted represents past results. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate so your shares, when redeemed, may be worth more or less than their original cost. Please visit Virtus.com for performance data current to the most recent month-end.**

Index: The Citigroup 90-Day Treasury Bill Index measures monthly return equivalents of yield averages that are not marked to market. The 90-Day Treasury Bill Index is an average of the last three three-month Treasury bill issues. The index is unmanaged and not available for direct investment.

**Notes on Risk:** Investments in short positions have additional risk that long positions do not. In theory, the risk of loss on a short position is unlimited. Investing in the securities of small and mid-sized companies involves greater risks and price volatility than larger, more established companies. Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic and market risk. Lack of liquidity in an ETF could result in its value being more volatile than the underlying portfolio of securities. Sector ETFs are subject to sector risks and nondiversification risks, which may result in greater price fluctuations than the overall market. Because the fund invests in ETFs, it indirectly bears its proportionate share of the operating expenses of the underlying funds. Indirectly, the fund is subject to all risks associated with the underlying ETFs. The use of leverage, short selling, futures, options and/or derivatives may cause exposure to additional risks.

The commentary is the opinion of the subadviser. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

**Please carefully consider the Fund's investment objectives, risks, charges and expenses before investing. For this and other information about any Virtus mutual fund, call 1-800-243-4361 or visit Virtus.com for a prospectus. Read it carefully before you invest or send money.**

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