

Virtus Emerging Markets Opportunities Fund

Fund News

Over the full year, the Virtus Emerging Markets Opportunities Fund (Class A shares at NAV) outperformed its benchmark index, the MSCI Emerging Markets Index (net). Strong stock selection helped performance over the quarter and full year.

While we are pleased with the Fund's strong relative performance during 2011, we caution investors to remember that increased market volatility often results in periods of strong overperformance and, unfortunately, underperformance for our Fund. Uncertainty still reigns supreme, and we would not be surprised if the Fund lagged significantly during the first stage of a strong market rally. We do not want investors to be surprised either. Our investment process is designed to protect assets during periods of market weakness and, hopefully, to capture a significant portion of the upside when markets perform well. Our objective is to outperform over full market cycles.

Market News

Looking back, 2011 will likely be remembered for policy gridlock and economic half-measures that failed to restore health in developed countries. The U.S. economy has shown marginal improvement, but eurozone leaders continue to apply band-aids when more serious treatment appears to be required. Economic weakness in the developed world has the potential to continue to affect emerging markets. Many of these markets experienced slower growth this past year because of rising interest rates. Rates rose in response to high inflation, currency volatility, and end-demand weakness from the developing world. We continue to believe that countries with strong domestic demand drivers, such as Brazil and India, will prove to be more resilient to global issues than countries that depend on external demand from the United States, Europe, and Japan.

While we are cognizant of macroeconomic issues, we try to minimize their impact on the Fund by investing in companies that have the potential to perform in a variety of market conditions. The Fund is concentrated in companies with idiosyncratic earnings-drivers and few ties to the global economy.

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Stock Selection and Avoiding Big Declines

At Vontobel, we think of ourselves, first and foremost, as stock pickers in search of quality companies. We define these types of companies, qualitatively, as having structural barriers and growth drivers that are likely to persist, and, quantitatively, as having high and stable returns on equity and invested capital; stable, yet growing margins and earnings; an ability to generate cash; and low leverage.

A benefit of this approach is that the Fund tends to have fewer “blow-ups” — large declines in stock share prices — than the market. This is extremely important. When a stock's share price declines by 50%, investors must earn a 100% return just to break even. Over a full market cycle, avoiding stock blow-ups tends to lead to outperformance.

Bottom-Up Stock Selection Determines Allocation

The Fund's country and sector allocations are largely determined through bottom-up stock selection. Historically, our allocation tends not to mirror that of the Index. While some believe this increases risk, as the Fund often is significantly over- or underweight in a given sector or country, we believe that careful stock selection lowers absolute risk. There may be times when

continued

SYMBOL (CUSIP)

A: HEMZX (92828T707)

C: PICEX (92828T806)

I: HIEMX (92828T889)

INVESTMENT PROFESSIONAL

Rajiv Jain

Senior Vice President and

Senior Portfolio Manager

Industry start date: 1989

Start date with the fund: 2006

The Virtus Emerging Markets Opportunities Fund offers exposure to the growing demographic of the emerging markets consumer through a benchmark agnostic approach that emphasizes well-established companies positioned to benefit from increased consumer spending.

TOP TEN HOLDINGS % Fund

| | |
|--|--------------|
| British American Tobacco PLC | 4.35 |
| Companhia de Bebidas das Americas ADR | 2.94%, 0.04% |
| ITC Ltd. | 3.23 |
| Souza Cruz S.A. | 2.93 |
| Housing Development Finance Corp. Ltd. | 2.80 |
| Baidu Inc. ADS | 2.65 |
| SABMiller PLC | 2.40 |
| HDFC Bank Ltd. | 2.31 |
| Companhia Energetica de Minas Gerais, 0% | 2.26 |
| Redecard S/A | 1.83 |

Holdings are subject to change.

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performance lags on a relative basis because the Fund's allocation does not match the benchmark index; however, we believe our approach can deliver stronger performance than the Index, on both an absolute and relative basis, with lower volatility over full market cycles.

During 2011, bottom-up stock picking led us to invest in India, one of the worst-performing world markets. About 23% of the Fund was invested in India during the year, compared to 7% of the Index. The Indian market performed poorly, finishing the year down 37%, yet the Fund's Indian holdings outperformed and were down 20% for the year. We view neither country allocation nor sector allocation as the reason for the Fund's strong performance. Rather, it was a function of stock selection; the Fund was invested in the right stocks.

Our Investment Process Helps Protect in Down Markets

To demonstrate the strength of our selection process, we sorted stocks held by the Fund and those held by its benchmark index based on their 2011 performance. Negative-performing stocks were sorted into three groups based on a value loss of 50% or more, 25% to 50%, and 0% to 25%. Positive-performing stocks were sorted into three groups based on a value gain of 0% to 25%, 25% to 50%, and 50% or more.

“Our investment process is designed to protect investors in declining markets while capturing significant upside in strong markets. As a result, the Fund's performance during the 2011 down market met our expectations.”

Our Fund held fewer stocks with extreme value declines than our benchmark. The average return for stocks held by our Fund was -2.8%, far better than the -19.6% average return of stocks held by the benchmark.

We also evaluated Fund holdings and those of the Index in terms of performance of countries and sectors. In each case, the pattern remained constant. The Fund held fewer stocks that experienced large value declines, leading to the Fund's outperformance.

Our investment process is designed to protect investors in declining markets while capturing significant upside in strong markets. As a result, the Fund's performance during the 2011 down market met our expectations.

Stock Selection Drives Fund Performance

Some think that our strong weighting of the consumer staples sector was responsible for the Fund's outperformance during 2011. In fact, our consumer staples investments performed better than the consumer staples sector. However, our allocation decisions were not top-down driven; rather, country and sector allocations were determined by our search for

quality companies. We believe that careful stock selection was the primary driver behind the Fund's strong performance during the year.

India: Structural or Cyclical Issues?

As mentioned earlier, India was one of the worst-performing markets in the world last year. The stock market performed poorly in local terms, and the weak rupee made performance in dollar terms even worse. There were many reasons for India's poor performance:

- >> Multiple corruption probes of government officials
- >> Lack of agreement on regulatory affairs
- >> Continuing budget deficits
- >> Ongoing infrastructure bottlenecks
- >> Stubbornly high inflation despite tightening measures by India's central bank
- >> Weakening rupee

While these issues are real and material, we believe India's slower economic growth has already been largely discounted in the stock market. The country's structural issues – including heavy bureaucracy, corruption, poor infrastructure, and high inflation – have existed for years. In our opinion, they simply tend to be given more weight by investors during cyclical downturns. Once India is out of its cyclical malaise, we believe investors will, once again, recognize that businesses have operated and thrived in this environment for many years.

Our Fund primarily holds Indian companies that rely on domestic demand to drive growth. On the consumer side, this includes companies such as **ITC**, **Nestle India**, and **Hindustan Unilever**. Generally, these companies have well-established procurement and distribution systems, so they are less affected by a lack of infrastructure. In fact, in some cases, issues related to infrastructure help keep competitors at bay. Over the long term, the structural growth of these companies is huge. As the country continues to grow its middle class, disposable income will rise and these companies stand to profit for a very long time.

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Indian Banks Under Pressure

Indian bank stocks came under particular pressure in 2011 on asset quality concerns. We believe this resulted from two main issues. First, the level of non-performing loans in the system is expected to increase as the Indian economy softens. While the banks we own are not immune, their underwriting

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standards are higher than those of the industry. They have sufficient loan loss reserves on their balance sheets to offset their expected losses as this should be a normal cyclical downturn. Second, concerns about the financial health of the power sector in India affected bank shares. The power sector issues are concentrated in the State Electricity Boards (SEBs), and the private-sector banks in the Fund do not lend to them; therefore, this should have little effect on the Fund.

In fact, the competitive situation may become more favorable for private-sector banks if their state-owned peers with exposure to SEBs are forced to take impairments on those assets. Over the longer term, we believe India's banking industry will absorb losses related to the power sector and continue to grow profitably. The financial services penetration rate remains low in India, despite strong growth in recent years. We expect that the well-tested banks in the Fund will continue to deliver strong earnings growth for the foreseeable future.

Countries

BRAZIL

Brazil was one of the Fund's top-performing countries during the fourth quarter. The Fund had more exposure to Brazilian companies than its benchmark, and the companies held outperformed those in the Index. Consumer staples names, such as **Ambev** and **Souza Cruz**, helped relative and absolute performance.

TAIWAN

The Fund had limited exposure to Taiwanese companies during the quarter, which helped relative performance. Our only position was in **Taiwan Secom**, and it outperformed the benchmark.

UNITED KINGDOM

We continue to invest in **British American Tobacco**, which generates around 60% of its profits from emerging market countries. The company made a strong contribution to relative and absolute performance during the fourth quarter.

INDIA

India was one of the worst-performing countries in the Index and the Fund during the fourth quarter. **HDFC Bank** and **Housing Development Finance Corp.** detracted from performance.

Sectors

CONSUMER STAPLES

The Fund had significantly more exposure to consumer staples companies than the benchmark during the fourth quarter, and these companies contributed to our strong performance. **Ambev**, **Souza Cruz**, and **British American Tobacco** helped relative and absolute performance.

UTILITIES

The Fund also had more exposure to utilities companies than the benchmark during the fourth quarter, which helped relative and absolute performance. **CEMIG** and **CPFL Energia** made positive performance contributions.

MATERIALS

The Fund had significantly less exposure to materials companies than the benchmark during the fourth quarter, which contributed to our strong relative performance. **Industrias Penoles** and **Semen Gresik** helped relative and absolute performance.

FINANCIALS

Financial companies detracted from relative Fund performance during the fourth quarter. The Fund had less exposure to the sector than the benchmark, which helped, but the companies held did not perform as well. **HDFC Bank** and **Housing Development Finance Corp.** detracted from performance.

Fund Changes

NEW/INCREASING POSITIONS

Hindustan Unilever (Consumer Staples – India): European Unilever owns this company, which is one of India's largest consumer goods companies. The company's personal care product line, which is experiencing top-line growth in the high teens, has emerged as a longer-term driver. The company also has stepped up its level of innovation materially in terms of new product variants and has better systems in place to react to competitive dynamics, such as pricing.

CLOSED OR TRIMMED POSITIONS

CNOOC (Energy – China): During the quarter, we sold our position in CNOOC, China's largest offshore oil exploration and production company, which is facing near-term challenges, including production growth.

Bharat Heavy Electricals (Industrials – India): This leading Indian power plant equipment manufacturer faces a slowdown in orders because of investors' concerns about the Indian power sector. Developers of power plants in India have postponed new projects because of weakness in the State Electricity Boards, which are the main off-take buyers of electricity in India. We allocated the capital to better relative opportunities.

STOCKS THAT HELPED PERFORMANCE

During the quarter, **Ambev**, **Itau Unibanco**, and **Souza Cruz** made some of the strongest contributions to absolute returns.

STOCKS THAT HURT PERFORMANCE

During the quarter, **HDFC Bank**, **Asian Paints**, and **ITC** detracted from absolute performance.

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Outlook

Uncertainty continues to underpin our outlook for the global economy. Confidence has diminished that governments of developed countries have the power or will to resolve pressing fiscal issues. If upcoming U.S. and European Union policy decisions help restore confidence, then the global growth outlook may improve. If they do not, then we may see continued economic weakness. The underlying structural issues driving global market volatility remain unchanged. As we have stated in the past, there is no quick or easy way to resolve these issues, and some may play out over several years. There are many possible outcomes, but the path to economic health is unlikely to be smooth.

While we like the way the Fund is positioned in these uncertain times, we caution investors to remember that volatility often results in periods of strong overperformance and underperformance. A great year may be followed by a weaker one. Macroeconomic concerns will heighten and diminish, causing the Fund to fluctuate as the market's mood changes. As bottom-up investors, we will continue to focus on underlying growth drivers, profitability, and earnings potential as we pursue our objective: outperformance over full market cycles.

Morningstar Ratings™ Class A as of 12/30/11

| | | Overall | 3 Year | 5 Year | 10 Year |
|--|---------------------------|-----------|-----------|-----------|-----------|
| Virtus Emerging Markets Opportunities Fund | Load Waived | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ |
| HEMZX | With Load | ★★★★★ | ★★★★★ | ★★★★★ | ★★★★★ |
| | Diversified Emerging Mkts | 352 funds | 352 funds | 237 funds | 144 funds |

Annualized Performance Class A as of 12/30/11 in percent

| | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception 8/11/1999 | |
|-------|------|--------|--------|--------|--------|---------|---------------------------|--|
| NAV | 6.54 | -3.13 | -3.13 | 22.41 | 6.30 | 15.04 | 11.10 | |
| POP | 0.42 | -8.70 | -8.70 | 20.02 | 5.05 | 14.36 | 10.57 | QTD, YTD and 1 Year performance is not annualized. |
| Index | 4.42 | -18.42 | -18.42 | 20.07 | 2.40 | 13.86 | 9.58 | Class A operating expenses are 1.67%. |

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 MSCI Emerging Markets Index (net) is a free float-adjusted market capitalization-weighted index designed to measure equity market performance in the global emerging markets. The index is calculated on a total return basis with net dividends reinvested. The index is unmanaged and not available for direct investment.

Notes on Risk: Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic and market risk. A portfolio that is heavily weighted in a single sector will be impacted by that sector's performance more than a portfolio with broader sector diversification. Investing in the securities of small and mid-sized companies involves greater risks and price volatility than larger, more established companies.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for a variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in an investment category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its 3-, 5-, and 10-year (if applicable) Morningstar Rating metrics. Ratings are for the A Shares as shown only; other share classes bear different fees and expenses, which affect performance.

Load-waived A share star ratings do not include any front-end sales load and are intended for those investors who have access to such purchase terms (e.g., plan participants of a defined contribution plan). Not all A share mutual funds for which Morningstar calculates a load-waived A share star rating may actually waive their front-end sales load. Therefore, Morningstar strongly encourages investors to contact their investment professional to determine whether they are eligible to purchase the A share without paying the front load.

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