

## Virtus Small-Cap Core Fund

### Portfolio Overview

The Virtus Small-Cap Core Fund (Class A at NAV) outperformed the Russell 2000® Index during the quarter. Our strategy of owning businesses with secure competitive positions produced good relative results in a difficult market.

The ability to resist declines during times of stress is a cornerstone of our investment approach and the third quarter certainly tested this objective. The source of this trait lies in the nature of the businesses in which we invest. These businesses have created competitive protections that, in our view, provide them with more resilient earning power and greater discretionary cash flow.

Companies contributing the most to performance during the quarter included Advisory Board and Computer Programs & Systems. Advisory Board's stock performed strongly following the company's reports of excellent fiscal first quarter 2012 results with improved member renewal and the new client acquisition environment providing the foundation for the calendar 2011 guidance increase. Importantly, the company's balance sheet remains pristine with \$35 million in cash and no debt. With the nation's health care industry facing an environment of unprecedented complexity and uncertainty, further exacerbated by recently adopted health care reform provisions, the company's value proposition to both existing and prospective clients is becoming more evident than ever. Advisory Board is in an excellent position to maintain its profitable growth by continuing to win market share and execute on numerous product development and tuck-in acquisition opportunities, leveraging the company's dominant positioning and expertise in the health care segment. Computer Programs & Systems' shares have advanced in 2011 as the company experienced healthy earnings growth due to higher demand from its hospital clients as part of the federal government's efforts to spur electronic medical record adoption in the health care industry through government subsidies.

Companies contributing the least to performance during the quarter included Tempur-Pedic International and Brown & Brown. Tempur-Pedic saw its shares fall in the quarter despite posting financial results that showed the company hitting all-time highs in earnings and operating margins as it takes share in the premium mattress category. The company was one of our top-performing stocks in the first two quarters of the year. Tempur-Pedic continues to generate strong free cash flow that has been used to pay down its debt levels. Brown & Brown's stock lagged following the company's reports of weaker-than-expected second quarter 2011 results driven by the ongoing softness in the P&C insurance market, difficult economic conditions in the company's core middle market segment, and a slow acquisition environment. Despite this challenging operating environment, the company continues to maintain its industry-leading profitability. Despite being one of the nation's largest P&C insurance brokers, Brown & Brown holds a modest single-digit share of its highly fragmented market. The company is in an excellent position to maintain its profitable growth by continuing to win market share and execute on numerous consolidation opportunities leveraging the company's unique business culture and M&A expertise.

### Purchases and Sales

There were no new purchases or complete sales in the Fund during the quarter.

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### SYMBOL (CUSIP)

A: PKSAX (92828N551)

C: PKSCX (92828N536)

I: PKAFX (92828N528)

### INVESTMENT PROFESSIONALS

Robert A. Schwarzkopf, CFA  
*Chief Investment Officer*  
 Industry start date: 1980  
 Start date with the fund: 1996

Jon Christensen, CFA  
*Portfolio Manager &  
 Senior Research Analyst*  
 Industry start date: 1989  
 Start date with the fund: 2008

Todd Beiley, CFA  
*Portfolio Manager &  
 Senior Research Analyst*  
 Industry start date: 1999  
 Start date with the fund: 2009

*The Virtus Small-Cap Core Fund invests in a select group of small-cap companies that exhibit a competitive advantage, have strong management and low financial risk, and that are able to grow over market cycles.*

### TOP TEN HOLDINGS % Fund

Tempur-Pedic International Inc.	6.00
Cohen & Steers Inc.	5.40
Copart Inc.	5.10
Techne Corp.	5.04
Pool Corp.	4.88
Jack Henry & Associates Inc.	4.86
Ansys Inc.	4.74
Owens & Minor Inc.	4.41
Hittite Microwave Corp.	4.30
Computer Programs & Systems Inc.	4.24

*Holdings are subject to change.*

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## Outlook

Small-capitalization equity valuations are certainly lower now compared to just three months ago, but remain elevated. However, high-quality small companies are more reasonably priced and should therefore provide superior investment results over the next several years, relative to the Russell 2000® Index. The Fund's strategy is centered on investing in high-quality small capitalization stocks, and we therefore expect our relative results to compare favorably to the Index over the intermediate and long term.

The best times to invest can often be those times when circumstances appear the worst. We do not know precisely how the current challenges will turn out, but we will continue to invest in businesses that have the greatest control over their markets with excellent business-level economics. We focus on purchasing these businesses at good prices with the expectation to own them for many years. This approach has historically produced healthy excess returns with less risk and we expect that to continue in the future.

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

	QTD	YTD	1 Year	3 Year	5 Year	Since Inception 8/30/2002
NAV	-13.62	-1.12	13.09	8.62	2.42	5.74
POP	-18.59	-6.81	6.58	6.50	1.21	5.05
Index	-21.87	-17.02	-3.53	-0.37	-1.02	7.03

QTD, YTD and 1 Year performance is not annualized.  
Class A operating expenses are 1.41%.

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](http://Virtus.com) for performance data current to the most recent month-end.**

**Notes on Risk:** A portfolio that holds a limited number of securities will be impacted by each security's performance more than a portfolio with a larger number of holdings. Investing in the securities of small and mid-sized companies involves greater risks and price volatility than larger, more established companies. 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.

Index: The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The index is unmanaged and not available for direct investment.

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](http://Virtus.com) for a prospectus. Read it carefully before you invest or send money.**

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