Virtus International Series Commentary

VIRTUS
VARIABLE INSURANCE TRUST

PERFORMANCE OVERVIEW

The Virtus International Series slightly lagged its benchmark, the MSCI EAFE® Index, for the quarter ended March 31, 2012. From a geographic perspective, asset allocation was positive over the period, however this was offset by negative stock selection.

MARKET OVERVIEW

The sustainable level of economic growth in China was called into question in the first quarter. The Chinese government reduced its expectations for economic growth from 8% to 7.5%. In addition, there are growing fears about the housing market as lending levels in the first quarter appear to be undershooting expectations.

Despite the best efforts of the so-called "Troika" (the European Commission, the European Central Bank, and the International Monetary Fund), the second rescue package that was agreed upon for Greece would appear to be far short of what will ultimately be required. Moreover, private bond holders were coerced into taking heavy haircuts, while the ECB and European governments did not. Despite this, it was not sufficient to be classified a formal default.

Equity markets, particularly in the Western world, replayed the enthusiasm which began in 2011. Relative confidence has been aided by fourth quarter earnings results having generally been perceived as being not as bad as had been feared, as well as economic data, especially in the U.S., appearing to show some stabilization and a second Long-term Refinancing Operation (LTRO) in Europe providing some much needed liquidity.

There would appear to be almost no lengths that Western governments have not been prepared to take to save their economies from falling back into recession. In many cases, conventional monetary policy is no longer a viable option and, as a result, some countries have gone further, using non-conventional monetary measures such as quantitative easing. The ECB significantly bolstered its own non-conventional measures by announcing another large LTRO. While this liquidity appears to have specifically bought more time for the European banking system to try to repair its balance sheets, it risks us travelling further down the road of moral bankruptcy. The hoped for "green shoots" that many commentators believe they are seeing in the U.S. contrasts with slightly different conditions in a number of the larger emerging economies. India has actually been one of the few central banks that has not reduced interest rates in the past twelve months, as the undoubted slowdown in their economy has yet to be sufficient to quell inflationary pressures. In China, the authorities seem to be treading a fine line between purging the system of the excesses in the housing market that have built up over the past few years and not tipping the economy over the edge.

The radical shift in ECB policy direction from Trichet to Draghi has continued at pace through the first quarter of the year. Even though the ECB has shown itself to be more dynamic under its new leadership and has injected around one trillion euros into the European banking system in less than six months, countries continue to run hard to keep up with events. Greece still professes its undying love for its European Union membership, but it continues to test the extent to which this is reciprocated. The second rescue package that was eventually agreed upon this quarter was not quite the rubber stamp the first rescue package had been. Lots of noise has been made by other members surrounding Greece's inability to live up to its end of the bargain, but ultimately the fear of an uncontrolled exit of the euro continues to allow remaining eurozone members to defer that difficult decision for another day. The other hope may well be that Greece makes the decision for itself, as the populous eventually revolts against the ever-increasing levels of austerity the rest of the eurozone requires of them. This outcome, however, could well spark the very contagion the eurozone members wish to avoid.

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CUSIP 92829L505

INVESTMENT PROFESSIONALS

Bruce Stout
Senior Investment Manager
Industry start date: 1987
Start date with Series: 2000

Andrew McMennigall
Senior Investment Manager
Industry start date: 1987
Start date with Series: 2003

Stephen Docherty
Head of Global Equities
Industry start date: 1991
Start date with Series: 2000

Jamie Cumming, CFA
Senior Investment Manager
Industry start date: 2001
Start date with Series: 2003

Stewart Methven, CFA
Senior Investment Manager
Industry start date: 1987
Start date with Series: 2010

The Virtus International Series offers access to international equity markets built around a high conviction, best ideas approach capitalizing on the expertise of the manager's regional equity teams.

TOP TEN HOLDINGS	% Series
Taiwan Semiconductor Manufacturing Co. Ltd. ADS	4.83
Vodafone Group PLC	4.71
Samsung Electronics Co., Ltd. 1.470%, 5%	4.41
British American Tobacco PLC	4.31
Roche Holding AG	4.21
Novartis AG	3.91
Nestlé S.A.	3.66
Standard Chartered PLC	3.37
Zurich Insurance Group AG	3.16
QBE Insurance Group Ltd.	2.92

Holdings are subject to change.

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.

The eurozone is more than just Greece. The initial measures undertaken by the Draghi-led ECB have worked well to bring down the cost of funding for some of the other peripheral members. In addition, the LTRO has provided some much-needed liquidity for many banks, which have yet to improve their relatively weak capital positions. The fact that Spanish and Italian interest rates have come down to more comfortable levels does not mean these economies are less vulnerable. The Spanish economy appears to be struggling to find any kind of traction, and with youth unemployment at around 50% (the same as Greece), there must be a real risk that the structural issues in these peripheral economies are not being accurately reflected and appreciated.

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The press in the United States has been largely devoted to covering the political posturing of the Republican primaries rather than the economy. That does not mean the economy has achieved some vibrant green shoots; instead, there has been sufficient data to suggest that some form of stabilization may be occurring. The fact that the tax holiday on capital equipment expired at the end of 2011 may have had some positive effect on the economic data in the first quarter. What is clear, however, is that the housing market continues to show few signs of recovery, getting on the same for seven years after it peaked in the middle of 2005. Unlike their European counterparts, U.S. banks have done a better job of recapitalizing their balance sheets, yet despite this, there is either still a clear reluctance to lend and/or a lack of demand for loans. It appears that no interest rate is sufficient to convince an already overleveraged consumer to take on more incremental debt. The last thing the U.S. wants is for its citizens to become thrifty, which would potentially risk the paradox of thrift and be deflationary.

The United Kingdom's playbook continues to have a similar storyline as its trans-Atlantic cousin. However, if anything, the plight of the U.K. economy would seem to be in a less advantageous position. House prices have not seen much in the way of a correction, compared to the steep falls experienced across the Atlantic. The U.K., right or wrong, continues to take a more austere path for its economic policy compared to the U.S. The stamp duty holiday for first-time home buyers has just lapsed towards the end of the year, and the budget announced in March was, in classic Shakespearian language, "much ado about nothing." Any "giveaways" to a specific section of society needed to be carefully balanced by taking from another section of society. As always, the arithmetic and assumptions embedded in the decisions are subject to some degree of skepticism.

This quarter, we commemorate the tragic events that unfolded at Fukushima one year ago. The extent to which corporate Japan has managed to bounce back has been a credit to the nation. The tsunami rightly deflected attention from the structural economic plight of its deflationary economy. What has been hurting Japan recently has been the ongoing appreciation of its currency. At a time when domestic demand remains weak, it has been important that its exporters were not put at a disadvantage. Japan has conducted currency intervention a number of times over the past few years, but each time the effects have worn off in a relatively short period. The yen appreciated by 20% through 2011, and the pressure was clearly starting to tell. Authorities' recent efforts to weaken the currency by monetizing its debt to the tune of 10 trillion yen would appear, so far, to have been more successful than most of its previous attempts given that the yen has depreciated by around 7% over the course of the quarter. In an environment where no country wants a strong currency, such gains might well be difficult to sustain.

The plight of some of the larger Asian economies has been brought into focus this quarter. In China, where the level of disclosure is relatively low with regard to the economy, it would appear that growth is slowing. At the same time, there will be a much anticipated change in leadership in the fourth quarter of this year. The Chinese authorities downgraded their 2012 growth outlook from 8% to 7.5%. One should remember, however, that China does not have a particularly strong history of being able to accurately predict its economic growth rate. Given the foreign exchange reserves that China has available, one would think that they have sufficient ammunition to stimulate the economy, but they are also intensely aware of the potential for the reemergence of inflation. In India, where interest rates remain high, policymakers also struggle to determine what their non-inflationary growth rate limit actually is. The irony is that since the country is reliant on imported oil, there is a risk that India falls into a downward spiral where higher energy costs will mean that interest rates will stay higher for longer, further weakening the economy.

Latin America has not been immune to the generally slower growth in the larger emerging markets. The Brazilians have not felt as restricted in pushing the monetary policy pedal as some of their Asian counterparts. The benchmark SELIC rate has fallen from a high of 12.5% as recently as August 2011 to 9.75%. Rates were reduced twice throughout the quarter, including the recent higher-than-expected 75 basis points. It seems clear that Dilma Rousseff and her administration are keen for rates to come down further. As we have cited in previous commentaries, there would certainly seem to be room for further reductions given the relatively high nature of real interest rates. With inflation levels just under 6%, this is the top end of the comfort zone for the administration. The SELIC rate's historic low is 8.75%, which occurred in 2009 and into 2010. Should Chinese growth continue to weaken, it is likely the SELIC will drop to new historical lows.

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ASSET ALLOCATION

There were no major changes to asset allocation within the Series during the quarter.

Japan remains the most significant underweight relative to the benchmark. This was increased slightly as the position in Takeda Pharmaceuticals was sold. The Series also remains significantly underweight to Europe ex-U.K. and marginally underweight to the U.K.

Asia Pacific ex-Japan and Other International remain significant overweight positions in the portfolio. Both increased marginally over the quarter with the introduction of the insurance group, AIA, in Asia Pacific ex-Japan and Vale, the Brazilian mining company, in Other International.

LARGEST COUNTRY POSITIONS VERSUS BENCHMARK

Overweight

> **Switzerland** – remains one of the largest overweight positions within the Series, and includes holdings in insurance group Zurich Financial Services, food producer Nestlé, pharmaceutical companies Roche and Novartis, and elevator manufacturer Schindler.

> **Brazil** – the Series remains overweight in Brazil with holdings in Banco Bradesco, Petrobras, and Vale. Vale was added during the quarter for its attractive assets and valuation.

> **Taiwan** – the Series holds Taiwan Semiconductor Manufacturing, while the benchmark has no exposure to Taiwan.

Underweight

> **Japan** – the Series' underweight position in Japan expanded over the quarter as Takeda Pharmaceutical was sold, but the portfolio continues to maintain positions in Fanuc, Shin-Etsu Chemical, Daito Trust, and Canon.

> **Germany** – Linde, a gases and engineering company, is the only German-listed company in the Series at present. This stake was initiated in the quarter on an attractive valuation.

> **Australia** – the Series remains underweight this country though maintains a position in international insurance group QBE, which was reduced over the quarter.

LARGEST MSCI SECTOR POSITIONS VERSUS BENCHMARK

Overweight

> **Information Technology** – the Series' overweight position remains in this sector with holdings in Sweden's Ericsson, Japanese imaging solutions company Canon, Korea's Samsung Electronics, and Taiwan Semiconductor. Taiwan Semiconductor and Samsung Electronics were among the largest positive stock contributors during the quarter.

> **Telecommunication Services** – holdings in China Mobile, Singapore Telecom, Vodafone, and Telus maintain the overweight position in this sector relative to the benchmark.

> **Energy** – the Series holds Eni, Petrochina, Petrobras, Royal Dutch Shell, and Tenaris. The position in Royal Dutch Shell was increased on the back of relative pricing weakness.

Underweight

> **Consumer Discretionary** – the Series has avoided a number of the Western hemisphere retail companies that dominate the benchmark index due to the overleveraged positions consumers find themselves in. We have no current exposure to this sector.

> **Industrials** – despite maintaining an underweight position relative to the benchmark, the Series invests in a variety of industrial groups, including Canadian National Railway, Fanuc, Schneider Electric, Atlas Copco, and Schindler.

> **Materials** – the Series continues to hold Shin-Etsu Chemical, BHP Billiton, and Rio Tinto in this sector, as well as Linde, Potash, and Vale, all of which were initiated during the quarter.

LARGEST STOCK POSITIONS VERSUS BENCHMARK

Overweight

> **Taiwan Semiconductor** – is the world's largest semiconductor foundry, holds a significant technological lead over its competitors, and was one of the best-performing stocks over the quarter.

> **Samsung Electronics** – the Series holds an overweight position in Korea's Samsung Electronics, which proved to be one of the best-performing stocks during the period.

> **Vodafone Group** – this global mobile telecommunications company has generated strong cash flows and raised returns to shareholders through a growing dividend yield.

Underweight

> **BP** – we prefer other energy stocks such as Petrobras and Petrochina.

> **Toyota Motor Corp** – we prefer other industrial groups such as Fanuc, which supplies automation and robotics technology to a wide variety of businesses, including the auto industry.

> **GlaxoSmithKline** – we do not hold this stock as we prefer other pharmaceutical companies, such as Roche and Novartis.

PERFORMANCE ATTRIBUTION BY COUNTRY

Looking at the major geographic regions, Europe ex-U.K. was the most significant drag on relative performance. The underweight position to Germany detracted from returns as the German market rebounded over the quarter. This was exacerbated by the relative underperformance of Swiss holdings Roche, Novartis and Nestlé, which lagged the sharp rebound.

The U.K. also contributed negatively, following weakness from Vodafone, Royal Dutch Shell, and Weir Group.

In contrast, Asia ex-Japan made a positive contribution to performance, with the primary drivers being technology leaders Samsung Electronics and Taiwan Semiconductor, both of which reported strong financial results.

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From a sector perspective, the underweight position to consumer discretionary was the most significant detractor from relative performance. Weakness across industrial holdings Weir and Schindler also weighed on performance, offsetting positive returns from the consumer staples and information technology sectors.

OUTLOOK

The picture many have had of slower growth in most developed markets balanced by continued strong growth in emerging markets appears to be in question. It is likely that the eurozone will fall into recession through 2012. The U.K. will do well to avoid recession, but any growth achieved is likely to be anemic. The U.S. should also see weaker-than-expected growth through 2012, despite the best efforts of the Federal Reserve Chairman, who seems to be on a mission to stimulate the economy, almost regardless of the consequences. The lack of any real traction is worrying, given the sheer weight of stimulus pumped into the system over the past few years. At the same time, growth rates are coming down and can be expected to continue to weaken in many emerging markets as the year unfolds. The general belief that China's Communist party cannot only accurately predict, but also manage, growth will be fully tested this year, while the likelihood is for India to keep rates higher for longer, given the more disciplined approach of its central bank with regard to inflationary pressures.

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At the risk of overstating our approach, we are cognizant of the macroeconomic environment, but it is but one element of the Aberdeen investment approach. We, as ever, remain focused on where we see the value on a company by company basis, regardless of the label that is attached, be that either the geography or sector that a company belongs to. The strength registered in the first quarter was primarily driven by a rebound in what we would regard as more cyclical and, in many cases, lower-quality companies. As a result, we believe that, at the margin, this has meant that the relative underperformers have in general become a slightly better value. Regardless of this better valuation, if liquidity continues to be pumped into the system, and "talking heads" continue to talk up the markets, then it is likely that we will continue to underperform. We are fully aware of the risks present in the system and make no apology for focusing on protecting the downside rather than chasing the upside.

Annualized Performance as of 3/31/12 in percent

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 5/1/1990
Series	9.58	9.58	2.71	24.06	2.60	8.84	7.50
Index	10.98	10.98	-5.31	17.68	-3.04	6.16	5.38

QTD, YTD and 1 Year performance is not annualized. Benchmark since inception performance is reported from 4/30/1990.
Operating expenses are 1.03% and gross operating expenses are 1.21%. Operating expenses reflect a contractual expense reimbursement in effect through 11/30/2012.

Average annual total returns reflect the change in share price and the reinvestment of all dividends and capital gains.

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 EAFE® Index** is a free float-adjusted market capitalization-weighted index that measures developed foreign market equity performance, excluding the U.S. and Canada. The index is calculated on a total return basis with gross 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.

The investments for the Series are managed by the same portfolio manager(s) who manage one or more of the other funds that have similar names, investment objectives and investment styles as the Series. You should be aware that the Series is likely to differ from the other mutual funds in size, cash flow pattern and tax matters. Accordingly, the holdings and performance of the Series can be expected to vary from those of the other mutual funds.

Shares of the separate Series of Virtus Variable Insurance Trust are sold only through the currently effective prospectuses and are not available to the general public. Shares of the VIT Series may be purchased only by life insurance companies to be used with their separate accounts which fund variable annuity and variable life insurance policies or qualified retirement plans and are also available as an underlying investment fund for certain qualified retirement plans. The performance information for the Series does not reflect fees and expenses of the insurance companies. If such fees and expenses were deducted, performance would be lower.

Please carefully consider the investment objectives, risks, charges, and expenses of the Series before investing. For this and other information about any Virtus Variable Insurance Trust Series, call 1-800-367-5877 or visit Virtus.com for a prospectus. Read it carefully before you invest or send money.