

Virtus Ceredex Small-Cap Value Equity Fund

A: SASVX (92837F433) | C: STCEX (92837F425) | I: SCETX (92837F417)

MARKET REVIEW

Strong fundamentals and positive earnings momentum helped to lift stock markets higher during the quarter, with large caps generally outperforming small caps and growth leading value. The Russell 2000® Value Index rose 1.60% on impressive gains in the telecommunication services (+31.07%), healthcare (+7.51%), and industrials (+5.07%) sectors, while the consumer staples (-6.95%), energy (-1.68%), and real estate (-0.96%) segments weighed on returns.

Although stocks broadly remained attractive from a bottom-up perspective, investors began to face a conundrum of what may lie ahead for equity markets. The U.S. economy remained solid but continued to show growing signs of late-stage expansion. Additionally, concerns around price-to-earnings contraction, higher bond yields, and the negative impact of a strengthening U.S. dollar on emerging markets added to increased levels of general market anxiety.

PERFORMANCE

For the quarter, the Fund (Class I) returned 1.37% while its benchmark, the Russell 2000 Value Index, returned 1.60%. Consumer staples, real estate, and consumer discretionary stock selection and an overweight industrials position and underweight energy position contributed positively to returns. Information technology and healthcare stock selection and an overweight consumer staples position detracted from returns.

AMC Entertainment Holdings and Tetra Tech were among the strongest stock contributors.

- > Movie theater chain AMC Entertainment's stock climbed on a strong box office and a \$600 million investment from private equity firm Silver Lake. The cash enabled AMC to distribute a special dividend and repurchase shares from its top investor, Chinese real estate conglomerate Dalian Wanda Group, which had come under pressure by Chinese authorities to reduce its foreign holdings given strained U.S.-China trade relations. AMC's Stubs A-List subscription service was also more popular than expected, benefiting from the demise of MoviePass.
- > Water and infrastructure consulting firm Tetra Tech's stock rose on strong earnings and upbeat guidance. The company has seen attractive economic activity and new contract wins from higher infrastructure demand and increased municipal tax revenues. It also has profited from business acquisitions and operational efficiency gains.

Plantronics and Energizer Holdings were among the largest stock detractors.

- > Despite strong financials, headset manufacturer Plantronics saw a reversal of its impressive gains from the first half of the year on profit-taking and concerns its market capitalization had grown too big from overenthusiasm around its acquisition

of audio equipment company Polycom. We reduced our stake as we expect further pressures due to a natural slowdown from the rapid acceleration in gaming that has been a prime driver of headset sales.

- > Battery manufacturer Energizer Holdings reported strong earnings but the stock still fell on concerns about forward-looking guidance. Concerns about the EU not approving the company's acquisition of Spectrum's global battery and lighting business, plus rising interest rates, are headwinds for consumer staples in general. We maintained our position given the firm's solid overall fundamentals and our optimism about the Spectrum acquisition.

PORTFOLIO CHANGES

The Fund initiated positions in Power Integrations and Nutrisystem and exited a number of positions.

- > Semiconductor manufacturer Power Integrations was a new holding purchased after the stock appeared oversold on general sector softness. The firm focuses on high-voltage power management in items such as washers and dryers, electric vehicles, and larger battery-powered goods. We believe the segment's growth prospects are significant, and the company enjoys an attractive degree of pricing power, with much lower competition than the low-voltage space.
- > We bought weight loss firm Nutrisystem on attractive valuation disparity from the stock's historical norms as well as relative to competitors such as Weight Watchers and Medifast. The company has a range of popular products, as well as plans for new offerings, that should benefit from the strong post-year-end holiday seasonal nature of the business.
- > We exited avocado distributor Calavo Growers, footwear retailer DSW, fragrance manufacturer Inter Parfums, and drive-in fast-food chain Sonic as they reached valuation targets.
- > We sold a small position in pizza chain Papa John's International given the high-profile challenges the firm continued to face surrounding its former chairman.

OUTLOOK

In our view, it is stock fundamentals that matter most in the current market. While we remain bullish on the overall economy and see further upside potential in stocks, particularly in the companies we own, mounting signs of late-cycle pressures and the general increase in investor anxiety warrant a degree of caution—especially at today's higher valuations. Investors should also expect that stocks will continue to be more severely punished for results that miss market expectations than rewarded for beating them. In this type of environment, we believe it is imperative to keep risk exposure tightly controlled.

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INVESTMENT ADVISER

Virtus Fund Advisers, LLC

INVESTMENT SUBADVISER

Ceredex Value Advisors LLC

PORTFOLIO MANAGER



Brett Barner, CFA

Industry start date: 1985

Start date with the Fund: 1995

TOP TEN HOLDINGS

% Fund

Energizer Holdings Inc.	4.43
Meredith Corp.	4.16
Kemper Corp.	4.03
Power Integrations, Inc.	4.01
Hill-Rom Holdings, Inc.	3.99
Tetra Tech, Inc.	3.70
B&G Foods, Inc.	3.68
Evercore Inc Class A	2.93
Physicians Realty Trust	2.91
Tanger Factory Outlet Centers, Inc.	2.65

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 9/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 1/31/1997
Fund Class I	1.37	5.67	13.24	14.31	9.67	10.95	10.78
Index	1.60	7.14	9.33	16.12	9.91	9.52	9.58

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.

The fund class gross expense ratio is 1.18%.

Average annual total return is the annual compound return for the indicated period and reflects the change in share price and the reinvestment of all dividends and capital gains. Returns for periods of one year or less are cumulative returns. Class I shares have no sales charges or distribution or service fees, therefore their returns do not reflect these expenses. Fees and expenses vary, and other share classes are subject to sales charges and fees. Class I shares are offered primarily to eligible institutional investors who purchase the minimum amounts required as described in the prospectus and may not be available to all investors. For fund performance on other share classes, please visit www.virtus.com.

Index: The **Russell 2000® Value Index** is a market capitalization-weighted index of value-oriented stocks of the smallest 2,000 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, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

Notes on Risk: Equity Securities: The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Value Stocks:** Value stocks are subject to the risk that the broad market may not recognize their intrinsic value. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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.

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