

Virtus Ceredex Small-Cap Value Equity Fund

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

MARKET REVIEW

Value stocks fell during the quarter and continued to lag growth counterparts. The Russell 2000® Value Index declined 2.64%, with the weakest performance coming from the energy (-10.54%), telecommunication services (-10.84%), and real estate (-8.41%) sectors.

Markets began the year strongly, continuing the positive momentum of the fourth quarter; however, stocks tumbled, as January came to a close, on investor anxiety around higher wage inflation fears and a sharp spike in 10-year U.S. Treasury note yields. Volatility was the norm for the rest of the quarter as enthusiasm for tax reform and deregulation gave way to concerns about potential global trade wars targeting China and NAFTA renegotiations. While overall stock fundamentals remain solid, the quarter served as a reminder that, at current multiples, there simply isn't much room for error in any sort of mispricing scenarios.

PERFORMANCE

For the quarter, the Fund's return of -3.93% (Class I) underperformed the -2.64% return of the Russell 2000® Value Index. Stock selection in industrials, real estate, consumer discretionary, and financials detracted from performance, as did a financials underweighting and consumer staples overweighting. An energy underweighting and stock selection in consumer staples and information technology were additive to returns.

Energizer Holdings and Plantronics were among the strongest stock contributors in the quarter.

- > Battery manufacturer Energizer's stock rallied on the company's acquisition announcement of Spectrum Brands' global battery and portable lighting business, but then quickly fell back to its previous levels on fears that government approval would face difficulty in the current political environment. Its stock price again jumped when the Department of Justice passed on asking for additional information, indicating they will allow the deal, though Europe and other regulatory approvals remain pending.
- > Shares of headset manufacturer Plantronics climbed on strong earnings and its announcement of a planned acquisition of privately held video and audio equipment company Polycom. The acquisition is expected to add immediately to the company's adjusted earnings, and effectively expands its product offerings.

B&G Foods and Herman Miller were among the largest stock detractors in the quarter.

- > The stock price of B&G Foods, which manufactures multiple food brands such as Green Giant and Spice Islands, fell on slightly lower-than-expected revenue and concerns about its leverage, rising costs, and increased competition from store brands. We added to our position on the price weakness. The stock offers an attractive dividend, product sales have held up

well, and the company continues to differentiate itself with new offerings. It also has potential for future beneficial acquisitions as larger consumer staples companies continue to rejigger their portfolios and sell off well-known brands.

- > Furniture manufacturer Herman Miller's shares tumbled on concerns around possible tariffs on steel, given the large impact this would have on the company's production costs. We continued to hold the position, as we believe the market overreacted. The overall office furniture segment remains strong, and the firm has continued to gain market share, introduce new products, and expand into new categories.

PORTFOLIO CHANGES

The Fund initiated positions in Kemper Corporation and Physicians Realty Trust. Notable exits included Guess? and California Water Service Group.

- > We bought insurance provider Kemper based on our positive outlook for the property and casualty segment and the company's relatively attractive valuation. In addition, Kemper announced a planned acquisition of Infinity Property and Casualty, which will expand its capabilities for nonstandard auto insurance with riskier drivers, a premium business with high entry barriers that we believe will capture solid earnings and cash flow upside.
- > We also bought Physicians Realty Trust, a REIT that primarily owns medical facility assets. The company offers an attractive dividend and appears undervalued relative to its net asset value, which could make its properties attractive acquisition targets at some point.
- > We sold clothing retailer Guess?, a long-time holding. While fundamentals remained strong, the company's chairman faced misconduct accusations, resulting in an unquantifiable risk that did not seem worth the potential upside.
- > We also sold California Water Service Group, in light of the state's increasingly difficult regulatory environment.

OUTLOOK

We continue to focus intensely on stock fundamentals, which have remained strong. As such, the contraction in the recent quarter did not overly concern us and instead offered a number of attractive buying opportunities. Still, there are several potential market overhangs to watch. Investors have enjoyed an extremely favorable backdrop, but wage growth, inflation, and higher interest rates could transmit into lower stock multiples moving forward. Although earnings are expected to remain strong, it remains to be seen whether they will be strong enough for investors' elevated expectations. And while tax reform and deregulation have been highly constructive for companies, the wild card of trade protectionism could get ugly, depending on how negotiations and any new policy ultimately play out.

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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: 1994

TOP TEN HOLDINGS

% Fund

Energizer Holdings Inc.	5.07
Meredith Corp.	4.63
Hill-Rom Holdings, Inc.	4.04
B&G Foods, Inc.	3.27
Tetra Tech, Inc.	3.04
Physicians Realty Trust	2.96
Evercore Inc Class A	2.86
Tanger Factory Outlet Centers, Inc.	2.80
American Eagle Outfitters, Inc.	2.71
Education Realty Trust, Inc.	2.63

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 1/31/1997
Fund Class I	-3.93	-3.93	4.57	7.97	9.71	10.01	10.55
Index	-2.64	-2.64	5.13	7.87	9.96	8.61	9.32

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 1.23%.

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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