

Virtus Ceredex Small-Cap Value Equity Fund

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

MARKET REVIEW

Value stocks again delivered positive returns for the quarter but continued to lag growth peers, with large-caps outperforming small-caps in both segments. The Russell 2000® Value Index rose 2.05%, led by consumer discretionary (+6.89%), energy (+6.36%) and consumer staples (+5.94%). Telecommunication services (-8.07%) and real estate (-1.14%) posted the largest negative returns.

Economic growth in the U.S. and overseas remained upbeat, and strong earnings, employment gains, increased business investment, and corporate tax reform all offered an extremely constructive investment environment for U.S. stocks, which capped off an impressive year that saw the Dow Jones Industrial Average and S&P 500® Index reaching all-time highs. Volatility also remained low as investors continued to shrug off geopolitical concerns and continued chaos and intense partisan fighting from Washington, DC.

PERFORMANCE

The Fund's return in the quarter of 7.17% (Class I) significantly outperformed the 2.05% return of the Russell 2000® Value Index. Stock selection was additive across all sectors, except materials, with the strongest positive contribution coming from financials, industrials, real estate, and healthcare. Overweight positions in consumer discretionary and industrials also lifted returns.

Regal Entertainment Group and American Eagle Outfitters were the strongest stock contributors.

- > Movie theater chain Regal Entertainment Group came off a weak summer with a cyclical rebound from strong film receipts, driven by blockbuster releases including "It" and "The Last Jedi." Shares also surged after the announcement of discussions for a potential buyout by U.K.-based Cineworld Group.
- > Clothing brand American Eagle Outfitters rose on positive holiday consumer spending expectations and strong same-store sales growth that indicated the retailer is able to compete with e-commerce rivals. An overall rebound in mall traffic, along with the company's effective omni-channel capabilities and online business, helped drive sales momentum with stronger-than-expected Black Friday and Cyber Monday results.

Hecla Mining Company and Papa John's International were the largest stock detractors.

- > Precious and base metal producer Hecla Mining fell on an ongoing labor dispute, which shut down one of its largest-producing silver mines earlier in the year, and operating income declines in its other three mines. Shares were further

pressured by concerns around the potential impact of digital currencies on gold and silver. We selectively added to our position based on steady metal demand expectations and anticipation of an eventual labor resolution.

- > Pizza delivery chain Papa John's fell on weaker-than-expected same-store sales due in part to declining NFL viewership, in which it is a major advertiser. Shares were further pressured by consumer pushback when the firm's CEO blamed poor performance on NFL player protests, ultimately resulting in the quarter-end announcement of his resignation. We have lightened our position as fundamentals have deteriorated but still see upside at current valuations.

PORTFOLIO CHANGES

The Fund bought Taubman Centers, Cheesecake Factory, and Ritchie Bros. Auctioneers. There were no notable exits from the portfolio.

- > We initiated a position in luxury mall operator Taubman Centers, which benefited from improving investor sentiment toward the retail store segment and the announcement of a second activist investor acquiring a stake in the real estate investment trust and joining the push for changes.
- > Restaurant company Cheesecake Factory is a new holding that we purchased based on its attractive valuations and improving fundamentals that also benefited from the rebound in mall traffic.
- > We established a position in Ritchie Bros. Auctioneers, the world's largest auctioneer of heavy equipment, at what we felt was an attractive entry point on investor concerns that the strengthening energy sector would prompt lower used-equipment volumes coming to market, which we found unwarranted from a historical perspective. The company also showed improvements in integration difficulties with its IronPlanet acquisition.

OUTLOOK

We remain optimistic in our outlook. Markets tend to follow earnings, which have been very robust and are set to benefit from tax reform-driven gains in 2018. Economic growth continues to strengthen, and business confidence is finally translating into capital expenditures. While equity valuations may appear expensive on an absolute basis, from a relative perspective they still are generally attractive, albeit certain segments are somewhat pricey. Geopolitical risks give some reason for pause, but overall it remains a favorable investment backdrop. Extended stock prices do offer some challenges for value investors, but we continue to find compelling opportunities and remain fully invested.

Virtus Ceredex Small-Cap Value Equity Fund

INVESTMENT ADVISER

Virtus Fund Advisers, LLC

INVESTMENT SUBADVISER

Ceredex Value Advisors LLC

INVESTMENT PROFESSIONAL



Brett Barner, CFA
Industry start date: 1985
Start date with the Fund: 1994

TOP TEN HOLDINGS

% Fund

| | |
|-------------------------------------|------|
| Energizer Holdings Inc. | 4.24 |
| Hill-Rom Holdings, Inc. | 3.98 |
| Evercore Inc. | 3.16 |
| Tanger Factory Outlet Centers, Inc. | 3.13 |
| Tetra Tech, Inc. | 2.77 |
| Herman Miller, Inc. | 2.76 |
| Covanta Holding Corp. | 2.74 |
| B&G Foods, Inc. | 2.66 |
| Lithia Motors, Inc. | 2.47 |
| American Eagle Outfitters, Inc. | 2.38 |

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS as of 12/31/17 in percent

| I Share | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception 1/31/1997 |
|---------|------|-------|-----------|-----------|-----------|------------|------------------------------|
| NAV | 7.17 | 10.29 | 10.29 | 10.28 | 13.09 | 9.50 | 10.89 |
| Index | 2.05 | 7.84 | 7.84 | 9.55 | 13.01 | 8.17 | 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 1.23%.

Average annual total returns reflect the change in share price and the reinvestment of all dividends and capital gains. Class I shares have no sales charge and therefore their returns do not reflect the deduction of a sales charge, which if applied, **would reduce the performance quoted**. Fees and expenses vary among share classes and other share classes do carry sales charges. Class I shares are offered primarily to eligible institutional investors who purchase the minimum amounts required 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: May be more volatile and carry more risk than other forms of investments, including investments in high grade fixed income securities. The net asset value per share of a fund will fluctuate as the value of the securities in the portfolio changes. **Value Stocks:** Are subject to the risk that the broad market may not recognize their intrinsic value. **Small-Capitalization Stocks:** Typically carry additional risks since smaller companies generally have a higher risk of failure. **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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