

Virtus Seix High Grade Municipal Bond Fund

A: SFLTIX (92837F631) | I: SCFTX (92837F623)

MARKET REVIEW

The tax-exempt municipal bond market experienced volatility in the fourth quarter driven by record issuance, consistent demand, and the underlying uncertainty over the potential impact of tax reform.

Supply was exceptionally strong for the quarter at more than \$130 billion, with a record \$62 billion in December alone. The year ended at roughly \$410 billion, which exceeded most predictions. Supply began to surge in November, when the Senate and House announced their respective tax reform proposals. There were key provisions in each proposal that could have restricted, and ultimately did restrict, some specific municipal issuances. As a result, many issuers entered the market early for fear of not being able to have access to the tax-exempt market once the final legislation passed.

In terms of the yield curve, the fourth quarter saw a significant flattening. The spread between the 2-year and 30-year bond went from 184 basis points (bps) at the end of the third quarter to 98 bps at year-end. This was driven largely by rates in the front-end adjusting higher and rates ten-years and longer moving lower. The 2-year yield increased by 56 bps, the 10-year moved lower by 2 bps, and the 30-year fell by 30 bps.

For more on our Municipal Market Review, [click here](#) to read Seix's fourth quarter Market Review and Outlook.

PERFORMANCE

As a result of the flattening yield curve, the Long Bond provided the best performance over the quarter, returning 2.23%, followed by the 20-year (1.78%) and 15-year (1.29%) maturity buckets. Yields rose on maturities less than 7 years, generating negative returns. The 3-year maturity bucket performed the worst at -0.77%. Driven by the threat of elimination, both the Hospital and Education sectors returned

more than 1.00% during the quarter as Revenue Bonds (0.96%) outperformed General Obligation (GO) bonds (0.56%). Despite the potential for lower tax rates, yield was still in demand resulting in the BBB Index (1.41%) returning more than twice the AAA Index (0.51%).

The Fund outperformed the Bloomberg Barclays Municipal Bond Index by 34 basis points, largely a result of the Fund's active overweight to 20-year and Long Bond maturities, and A-rated bonds. Additionally, an overweight in Transportation, Special Tax, and Hospital sectors were additive. The Fund's security selection in Transportation, Lease, Water/Sewer and Local School Bonds were also additive, while an overweight to PreRefunded sector was negative.

CURRENT STRATEGY

The Fund's effective duration was lowered from 6.45 to 6.26 years while maintaining a defensive profile. The Fund continues to be overweight cash, 1-year, 20-year and Long Bond maturity buckets while it is underweight all other maturity buckets. There were no significant changes to the credit profile, as the Fund maintains its overweight to higher quality assets, given the tightness of credit spreads. In line with our investment thesis, the Fund remains overweight Transportation and Special Tax while underweight State and Local GOs.

OUTLOOK

As we look to the year ahead, tax reform will continue to influence the municipal bond market. In summary, we believe that a net decrease in supply, a decrease in corporate demand, outperformance of lower-coupon bonds, and strong performance by debt from high tax states is likely to materialize over the next year. For more detail, please refer to [The Potential Impact of The Tax Cuts and Jobs Act on the Municipal Market 2018](#).

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INVESTMENT ADVISER

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INVESTMENT SUBADVISER

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Ronald F. Schwartz CFA
Industry start date: 1982
Start date with the Fund: 1994

SECTOR ALLOCATIONS

% Fund

Transportation	19.60
Pre-Refunded	13.18
Special Tax	12.47
Hospital	11.54
Education	11.40
State General Obligation	9.40
Water & Sewer	7.37
Lease	4.42
Local General Obligation	3.51
Power	2.73
Housing	2.29
Cash & Equivalents	2.08

Sector weights 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 1/25/1994
NAV	1.09	5.46	5.46	3.10	3.61	5.02	5.03
Index	0.75	5.45	5.45	2.98	3.02	4.46	5.01

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.

Benchmark since inception performance is reported from 1/31/1994.

The fund class gross expense ratio is 0.88%. The net expense ratio is 0.69%, which reflects a contractual expense reimbursement in effect through 7/31/2019. This ratio reflects the direct and indirect expenses paid by the Fund.

The net expense ratio minus the indirect expenses incurred by the underlying funds in which the Fund invests is 0.65%.

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 **Bloomberg Barclays Municipal Bond Index** is a market capitalization-weighted index that measures the long-term tax-exempt bond market. The index is calculated on a total return basis. 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: Bonds: Offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Intermediate-term, higher-quality bonds generally offer less risk than longer-term bonds and a lower rate of return. Generally, a fund's fixed income securities will decrease in value if interest rates rise and vice versa. **State & AMT Tax:** A portion of income may be subject to some state and/or local taxes and, for certain investors, a portion may be subject to the federal alternative minimum tax. **Municipal Market:** Events negatively impacting a municipal security, or the municipal bond market in general, may cause the fund to decrease in 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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