VIRTUS MUTUAL FUNDS

Virtus Seix Core Bond Fund

A: STGIX (92837F102) | I: STIGX (92837F300) | R: SCIGX (92837F201) | R6: STGZX (92837F409)

MARKET REVIEW

The rolling volatility witnessed in some of the weaker sectors of the capital markets earlier in 2018 (such as emerging markets) finally infected the investment grade sectors in the fourth quarter of 2018, generating a dramatic turn relative to the 'risk on' backdrop that was prevalent in Q3 (and earlier). Credit, both investment grade (IG) and high yield (HY), greatly underperformed, and in a mirror image to past periods when lower quality outperformed, Q4 saw the lower quality sectors underperform their higher quality counterparts by a large amount. IG corporate bonds suffered -310 basis points (bps) of excess return over the quarter while HY bonds endured -675 bps of excess return. Valuation measures for IG corporate bonds over a one-year time frame snapped back again to 'extremely cheap' levels (over two standard deviations cheap to their one-year mean) at the end of the fourth quarter after ending Q3 at a 'fair' valuation (within one standard deviation to the one-year mean); the intermediate three-year metric slipped to 'cheap' (between one and two standard deviations cheap to the three-year mean) and the ten-year time frames still show corporate credit valuations unchanged at 'fair.' Securitized assets (residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), asset-backed securities (ABS)) also suffered some degree of underperformance over the quarter in excess return terms, but it was pretty muted relative to the credit underperformance. Valuations in the securitized space are now 'cheap'-to-'fair' versus the 'fair'-to-'rich' range that prevailed at the end of Q3. There has been no change in our overarching valuation assessment; while levels have obviously cheapened, in the context of where we are in the cycle, in tandem with both the declining global central bank balance sheet (read: declining liquidity), and the ever-expanding macro/political uncertainty, we remain disenchanted with the risk/reward profile of the primary spread sectors (corporates/ RMBS). As a result, our corporate bond and RMBS sector weightings remained underweight through the fourth quarter of 2018.

For more on our market commentary, read Seix's fourth quarter Investment Grade Market Review and Outlook.

PERFORMANCE

The Virtus Seix Core Bond Fund (Class I) returned +1.84% in the quarter, outperforming the Bloomberg Barclays Aggregate Bond Index return of +1.64%.

The corporate bond and securitized sector underweights were positive contributors to relative performance for the quarter. Partially offsetting those contributors were modest detractors attributable to security selection within each of those respective sleeves. The void in government-related assets as well as yield curve positioning had no material impact on relative performance.

CURRENT STRATEGY

During the final quarter of 2018, the Fund's corporate and RMBS allocations were further reduced to weightings of 0.6x the Index and 0.4x the Index on a duration contribution (DC) basis. (This compares to weightings of 0.8x and 0.6x, respectively, at the end of 3Q.) The Fund's CMBS weighting increased to 6.5x from 5.2x (DC), while the Fund's ABS sector weighting was trimmed to 4.9% from 5.7% on a market value basis. As a result of the overall reduction in spread sector assets, the Fund's allocation to the U.S. Treasury sector increased to 1.5x (DC) the Index at the end of the year.

OUTLOOK

For the quarter, there were no real changes in our view regarding spread asset exposure, as we remained more likely to further lighten our weightings to the primary spread sectors at current valuations. We maintained our modest CMBS/ABS overweight, as it represented a continuation of our safe income at a reasonable price theme, with exposure predominately in high quality, top-of-the-capital-structure type risk.

Virtus Seix Core Bond Fund

INVESTMENT ADVISER

Virtus Fund Advisers, LLC

INVESTMENT SUBADVISER

Seix Investment Advisors LLC

PORTFOLIO MANAGERS

James F. Keegan
Industry start date: 1982
Start date with Fund: 2008

Perry Troisi
Industry start date: 1986
Start date with Fund: 2004

Michael Rieger
Industry start date: 1986
Start date with Fund: 2007

Carlos Catoya
Industry start date: 1987
Start date with Fund: 2015

Jonathan Yozzo
Industry start date: 1991
Start date with Fund: 2015

SECTOR ALLOCATIONS

	% Fund
U.S. Treasury	56.08
Mortgage Backed	24.76
Corporate	12.05
Asset Backed	4.86
Cash & Equivalents	2.25

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 7/16/1992
Fund Class I	1.84	-0.14	-0.14	1.97	2.47	3.44	5.02
Index	1.64	0.01	0.01	2.06	2.52	3.48	5.28

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 0.62%. The net expense ratio is 0.50%, which reflects a contractual expense reimbursement in effect through 7/31/2019.

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 **Bloomberg Barclays U.S. Aggregate Bond Index** measures the U.S. investment grade fixed rate 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: Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **ABS/MBS:** Changes in interest rates can cause both extension and prepayment risks for asset- and mortgage-backed securities. These securities are also subject to risks associated with the repayment of underlying collateral. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **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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