

Virtus Seix Investment Grade Tax-Exempt Bond

A: SISIX (92837F615) | I: STTBX (92837F599)

MARKET REVIEW

As in the first half of the year, issuance declined and institutional investors pulled back. For the quarter, the Bloomberg Barclays Municipal Bond Index slipped -0.15%. Year-to-date, the index is down -0.40%. While the short end of the curve has outperformed, the long end has largely lagged.

Year-to-date, new issuance came to \$235 billion, down about 16% from the same period last year. Supply was constrained in the first three quarters of 2018 and is expected to remain so for the rest of the year. Total issuance is anticipated to decline 15-20% from more than \$400 billion in 2017.

The drop in new issuance is a result of issuer frugality and the elimination of advance refundings by the 2017 tax law. The new law has impacted supply as advance refundings accounted for about 20% of issuance in 2017.

While demand started out strong in the third quarter, fed by reinvested cash from coupon payments and maturing bonds, it waned later on. Flows into municipal bond mutual funds totaled \$5 billion for the quarter, bringing the year-to-date total to \$16 billion, according to the Investment Company Institute, down from about \$24 billion in 2017.

For more on our Municipal Market Review, read our third quarter [Market Review and Outlook](#).

PERFORMANCE

The Bloomberg Barclays 10-year Municipal Bond Index produced a positive return (0.06%) during the third quarter while all other maturity indices, as well as the broad market, were negative. The slope of the municipal yield curve (30-year yield minus 2-year yield) flattened from 130 to 122 basis points (bps) as 2-year yields moved higher, increasing by 33 bps during the quarter, while the yield on the 30-year increased only 25 bps.

Stable flows into municipal mutual funds and ongoing limited supply continues to facilitate tight credit spreads.

The Bloomberg Barclays Baa Municipal Index returned 0.21% for the quarter, more than 50 bps higher than the AAA Index (-0.30%).

The Fund (I Shares) underperformed the Bloomberg Barclays 1-15 Year Blend Index by 35 bps, largely a result of the Fund's overweight to high quality bonds and to the 15- and 20-year maturity buckets. The Fund's underweight to the 10-year maturity bucket was a detriment to performance as the 10-year was the best performing maturity bucket for the quarter. The Fund's underweight to lower quality bonds also detracted from performance.

CURRENT STRATEGY

At the end of the quarter, the Fund's effective duration was slightly lower at 4.82 versus 5.15 years. 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. The Fund continues to be overweight the electric, water/sewer, and special tax sectors, and maintains an active underweight to state and local general obligation (GO), leasing, and education sectors.

OUTLOOK

Our outlook continues to advocate owning high quality issues. Although low quality bonds have been outperforming, we believe that if the market turns, the lack of liquidity will take a heavy toll on these issues.

We also anticipate an increase in demand from the retail sector, especially from higher-earning households in states with high income tax rates. With the new cap on the deductibility of state income taxes, these taxpayers might be surprised by how much their federal income taxes are going to rise. That may prompt them to seek tax-exempt income in the municipal bond market. We've already seen evidence of this in California and New Jersey.

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PORTFOLIO MANAGER



Ronald H. Schwartz CFA
Industry start date: 1982
Start date with Fund: 1992



Dusty Self
Industry start date: 1992
Start date with Fund: 2018

SECTOR ALLOCATIONS

% Fund

Pre-Refunded	25.17
Special Tax	19.26
State General Obligation	14.42
Water & Sewer	9.49
Cash & Equivalents	8.43
Local General Obligation	7.07
Transportation	6.01
Power	5.82
Education	2.71
Lease	1.33
IDR/PCR	0.30

Sector weights 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 10/21/1993
Fund Class I	-0.41	-1.01	-0.60	1.41	2.53	4.19	4.80
Index	-0.06	-0.13	0.02	1.76	2.72	4.00	n/a

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 0.82%. The net expense ratio is 0.66%, 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 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 Municipal 1-15 Yr Blend (1-17) Index** is a market capitalization-weighted index of investment grade tax-exempt bonds with maturities of 1-17 years. The index includes investment grade bonds, general obligations, revenue bonds, insured bonds, and pre-refunded bonds. 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. **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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