

Virtus Seix Investment Grade Tax-Exempt Bond

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

MARKET REVIEW

The tax-exempt municipal bond market defied expectations in the first quarter of 2018. Amid uncertainty of pending tax reform, the last two months of 2017 saw record levels of supply as issuers rushed to the market for fear of losing access to the tax-exempt market. Entering 2018, investors thus expected light municipal bond issuance alongside strong demand from higher-tax-bracket individuals still attracted to tax-free investment income, especially given the elimination or limitation of the deduction of the state income tax. Anticipated outperformance by the municipal market in this scenario, however, did not materialize. Indeed, the first quarter saw just \$62 billion in issuance, which was down 32% versus the year before and demand by retail investors for bonds in high tax states was consistent; but dealers, heavy with inventory overhang, were met with selling pressure from banks and insurance companies. Rising rates and moderate demand were not enough to overcome a favorable technical position.

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

PERFORMANCE

Yields rose on all maturities with the 10-year increasing the most at 44 basis points; the 2-year increased 9 basis points and the 30-year increased 41 basis points. As a result of the steepening municipal yield curve, only the 1-year and 3-year Bond Indices returned positive performance while the 10-year Bond Index posted the worst performance (-1.61%) across the maturity spectrum. As a measure of the broader municipal market, the Bloomberg Barclays Municipal Bond Index returned -1.11% for the first quarter of 2018, the worst first quarter since 1996. The Revenue Index (-1.19%) and the General Obligations Index (-1.20%) posted similar negative returns as

the education, transportation, and special tax sectors posted negative returns in excess of 1.00%. The Baa Index returned -1.00% and the AAA Index was slightly lower at -1.19%.

The Fund underperformed the Bloomberg Barclays 1-15 Yr. Blend Index by 23 basis points, largely a result of the Fund's overweight to the 15- and 20-year maturity buckets and exposure to A-rated Transportation Bonds. The Fund's underweight to the 5-, 7-, and 10-year maturity buckets was additive, as was security selection in the General Obligation (GO) sector (specifically the avoidance of Illinois GO), and above market 5% coupon structures within the GO sector. Exposure to 15-year A-rated transportation and special tax bonds was a detractor. The Fund's overweight to AAA and AA-rated credits was a slight detriment.

CURRENT STRATEGY

At the end of the quarter, the Fund's effective duration remained nearly unchanged at 5.24 from 5.28 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. In line with our investment thesis, the Fund continues to be overweight versus the Index to the Transportation, Water/Sewer, and Special Tax sectors, and underweight State and Local GOs and Leasing sectors.

OUTLOOK

As we enter the second quarter, we are optimistic on the tax-exempt asset class. Demand is still positive for tax-free bonds. The demand/supply dynamic may change in the second quarter as seasonal factors boost demand as more money comes due to investors. The absence of institutional buyers may increase volatility and credit spreads may widen, both of which play to our strength of identifying and taking advantage of inefficiencies.

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INVESTMENT ADVISER

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PORTFOLIO MANAGER



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

SECTOR ALLOCATIONS

% Fund

Pre-Refunded	24.77
Special Tax	21.83
Transportation	18.98
Water & Sewer	0.37
State General Obligation	8.30
Local General Obligation	6.24
Power	3.63
Cash & Equivalents	3.12
Education	2.23
Industrial Development Revenue/ Pollution Control Revenue	0.28
Hospital	0.26

Sector weights 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 10/21/1993
Fund Class I	-1.14	-1.14	1.62	1.44	1.99	3.96	4.89
Index	-0.91	-0.91	1.81	1.78	2.20	3.80	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 0.85%. The net expense ratio is 0.67%, 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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