Virtus Seix Total Return Bond Fund

A: CBPSX (92837F805) | I: SAMFX (92837F870) | R: SCBLX (92837F888) | R6: SAMZX (92837F862)

MARKET REVIEW

The volatility and risk-off plunge of the fourth quarter is but a distant memory; all it took for a dramatic reversal was the "Powell Fed pivot," and the rally persists today, with high yield now up over 8.5% year-to-date through April 16. We saw the Powell-led Federal Reserve (Fed) put a greater emphasis on normalization through the end of 2018. The stock market sell-off of Q4 clearly became too much for Powell and the Federal Open Market Committee to stomach, thereby spurring the January 4 pivot toward "patience" and heightened concern for downside risks globally.

Clearly, the declining liquidity that accompanied a declining global central bank balance sheet became too much for risk markets in the final quarter of 2018. This was a dynamic we anticipated, but mistakenly believed that markets would begin discounting this inflection point earlier in 2018. Surprisingly, it wasn't until the final quarter of the year that the impact was finally felt, which attests to the difference in today's markets where machine/algorithmic-driven trading strategies are behind much of the daily volume.

Corporate credit led the way in the investment grade space with a +5.14% total return and +273 basis points (bps) of excess return. Commercial mortgage backed securities (CMBS) had a good quarter within the securitized space with a +3.24% total return and +118 bps of excess return. Residential mortgage backed securities was the laggard with a +2.17% total return and only +28 bps of excess. Asset backed securities (ABS), the smallest and shortest securitized sector, was subdued with a +1.48% total return and +40 bps of excess.

The Treasury market also responded favorably to the Fed pivot, driving yields lower and offering the investment grade market such attractive nominal returns. Although obviously in conflict with the risk-on move, the Treasury market was offering a more sobering interpretation of the Fed's pivot to patience amid concerns about continued sluggish growth. And the Treasury market rally was not limited to just US sovereign debt; the sovereign debt market rally was a global phenomenon. Global bond markets now have more than $10 trillion in negative yielding debt at the end of Q1—a tally that was as low as $5.8 trillion back in early October 2018, according to Bloomberg.

Easily outdoing the investment grade credit space were the PLUS sectors. High yield delivered a +7.26% total return and a massive +573 bps of excess return; even the high quality high yield sleeve (Ba/B) delivered +7.21% total return/+566 of excess. Emerging markets were also impressive with a +5.43% total return and +334 bps of excess.

PERFORMANCE

The Virtus Seix Total Return Bond Fund (I Shares) returned +2.47% in the first quarter of 2019, underperforming the Bloomberg Barclays Aggregate Index return of +2.94%, during a period of strong fixed income returns.

The corporate bond underweight (asset allocation) was the primary drag on relative performance for the quarter. Security selection within the corporate allocation was a small positive contributor. Within the securitized sleeve, security selection was a positive contributor, as the use of agency CMBS as a proxy for lower coupon RMBS was additive to relative performance. The continued void in government-related assets was a modest detractor, while yield curve positioning had no material impact on relative performance.

On a net basis, the Plus allocation in the Fund was an additional detractor from relative performance during a quarter that experienced an exceptionally strong "risk-on" trade. Detractors came from the high yield short, as well as a credit default swap position. Partially offsetting these detractors was a positive contribution from the foreign-exchange overlays.

During the first quarter of 2019, the Fund's corporate weighting was modestly reduced to 0.5x the benchmark weighting on a duration contribution (DC) basis from last quarter's weighting of 0.6x. The RMBS allocation increased 0.2 to 0.6x the Index (DC).

The CMBS weighting decreased to 6.0x (DC) versus 6.8x at the end of last quarter. The ABS weighting increased to 5.2% on a market value basis, up +0.4%.

Due to offsetting spread sector allocation changes, the Treasury weighting remained at 1.5x the Index on a DC basis. The Fund had no exposure to the emerging market sector.

OUTLOOK

Growth, inflation, and interest rates have all likely peaked in this economic cycle. In terms of investment exposure, we remain underweight the primary spread sectors, as we have been for quite some time, given an overarching aversion to inordinate risk. Generically speaking, the weighting to the corporate credit sector and RMBS is roughly half that of the benchmark. An overweight in commercial mortgages, largely through the agency CMBS market, represents "safe income at a reasonable price," in our view, while we wait for more attractive valuations in the primary spread sectors. In other words, we will add risk to portfolios when we believe we're being compensated for it.

Virtus Seix Total Return 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 as Fund Portfolio Manager: 2008

Perry Troisi
Industry start date: 1986
Start date as Fund Portfolio Manager: 2002

Michael Rieger
Industry start date: 1986
Start date as Fund Portfolio Manager: 2007

Seth Antiles, Ph.D.
Industry start date: 1994
Start date as Fund Portfolio Manager: 2007

Carlos Catoya
Industry start date: 1987
Start date as Fund Portfolio Manager: 2015

Jonathan Yozzo
Industry start date: 1991
Start date as Fund Portfolio Manager: 2015

SECTOR ALLOCATIONS

	% Fund
U.S. Treasury	52.75
Mortgage Backed	27.68
Corporate	11.74
Asset Backed	5.15
Cash & Equivalents	2.68

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/19

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 12/30/1997
Fund Class I	2.47	2.47	3.81	1.74	2.38	3.82	4.73
Index	2.94	2.94	4.48	2.03	2.74	3.77	4.84

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 0.57%. The net expense ratio is 0.46%, 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. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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