

Virtus Seix Total Return Bond Fund

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

MARKET REVIEW

The dominant theme of the fourth quarter, as well as the year, was the flattening of the yield curve. The Federal Reserve (Fed) raised its target rate 25 basis points (bps) in December for the third time in 2017 and for the fifth time since the Fed embarked (December 2015) on what we refer to as the “unloosening” cycle. During the quarter, the spread between the two-year and 10-year Treasury flattened by 33 bps (+85 bps to +52 bps). For the full year, the curve flattened by 74 bps (+126 bps to +52 bps).

As a result of the flatter curve in the fourth quarter, longer-duration assets outperformed shorter-duration assets and investment grade credit outperformed high yield and bank loans. 30-year Treasuries were the only segment of the yield curve that was lower in yield, over the quarter, compared with all of the other primary points of the curve. The U.S. dollar continued to sell off, though not as much as earlier in the year. Volatility for both stocks and bonds neared record lows. October, which historically is the most volatile month of the calendar year in the stock market, was the least volatile month in the stock market’s history, only to be overtaken by November. Economic data came in better than expected during the quarter, as measured by the economic surprise indices. Finally, commodities performed well with oil prices up over 16% and copper up over 11%.

For more on our investment grade market commentary, [click here](#) to read Seix’s 4Q17 Investment Grade Market Review and Outlook.

PERFORMANCE

The primary detractor from performance over the quarter was attributed to the Fund’s allocation to global strategies. Additional drags on relative performance were attributed to the Fund’s short position in High Yield CDX, security selection within the residential mortgage-backed security (RMBS) sector, and asset allocation to the corporate sector (minor drag). Positive contributors during the quarter were attributed to security selection within the corporate bond sector and asset allocation within the asset-backed security (ABS) sector.

CURRENT STRATEGY

During the fourth quarter of 2017, the Fund’s corporate allocation remained unchanged at a weighting of 0.8x the index on a duration contribution (DC) basis, while the RMBS allocation increased modestly to 0.8x the index versus 0.7x last quarter (DC). The commercial mortgage-backed security (CMBS) weighting also increased slightly to 1.9x from 1.7x (DC). The Fund’s allocation to the ABS sector was reduced to 5.2% on a market value basis, versus 5.5% at the end of last quarter. Exposure to the Emerging Market sector was reduced in market value terms to 5.1% of the Fund, from 7.2%.

We continue to believe valuation measures remain less than compelling (rich in short-term (1- to 3-year)/fair over longer term (10-year)) in the fixed income markets, thus there were no major allocation changes over the quarter. To the extent there were any movements in valuations, the moves were to the “richer side.” In the context of where we are in the cycle, in tandem with macro and political uncertainty, we remain disenchanted with the risk/reward profile of the primary spread sectors. As a result, our corporate bond and RMBS sector weightings were modestly underweight the index as we ended 2017. Complacency remains the watchword as risk markets remain resilient to any unsettling development, be it a broad geopolitical risk flare or an idiosyncratic sector/company risk development. As an early 2018 survey has confirmed, selling volatility is the most crowded trade; consensus for subdued to even lower volatility permeates the narrative and consequently feels wholly unsustainable. To the extent spreads continue to grind tighter, our weighting to the primary spread sectors will likely gravitate lower. Modest CMBS/ABS overweight represents a continuation of safe income at a reasonable price.

OUTLOOK

We enter 2018 with many of the same risks as 2017. Foremost among them is the threat the complacency bubble pops after another year of record-low volatility as the flow of global central bank liquidity abates. While risk continues to be well bid, volatility may pick up as we go through the course of the year and markets remain vulnerable to a sustained risk-off period. We will be watching the Fed closely as the new leadership navigates whatever challenges the markets may deliver.

Virtus Seix Total Return Bond Fund

INVESTMENT ADVISER

Virtus Fund Advisers, LLC

INVESTMENT SUBADVISER

Seix Investment Advisors LLC

INVESTMENT PROFESSIONALS



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



Perry Troisi
Industry start date: 1986
Start date with the Fund: 2002



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



Seth Antiles, Ph.D.
Industry start date: 1994
Start date with the Fund: 2007



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



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

SECTOR ALLOCATIONS

% Fund

U.S. Treasury	41.03
Mortgage Backed	28.28
Corporate	18.40
Asset Backed	5.17
Emerging Markets	5.14
Cash & Equivalents	1.93
Other	0.07

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 12/30/1997
NAV	-0.10	2.67	2.67	1.97	1.81	4.43	4.92
Index	0.39	3.54	3.54	2.24	2.10	4.01	5.00

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 0.61%. The net expense ratio is 0.47%, 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 0.46%.

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 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: 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. **Mortgage-Backed Investments:** Involve risk of loss due to prepayments and, like any bond, due to default. Because of the sensitivity of mortgage-related securities to changes in interest rates, a fund's performance may be more volatile than if it did not hold these securities. **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.

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.

Please carefully consider a Fund's investment objectives, risks, charges, and expenses before investing. For this and other information about any Virtus mutual fund, contact your financial representative, call 1-800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.

Distributed by **VP Distributors, LLC**, member FINRA and subsidiary of Virtus Investment Partners, Inc.

2187 01-18 © 2018 Virtus Mutual Funds