VIRTUS FUNDS

Virtus Seix U.S. Government Securities Ultra-Short Bond Fund

A: SSAGX (92837X681) | I: SIGVX (92837F821) | R6: SIGZX (92837F813)

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 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.

Commercial mortgage backed securities (CMBS) had a good quarter within the securitized space with a +3.24% total return and +118 basis points (bps) of excess return. RMBS 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 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 U.S. 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.

PERFORMANCE

The Virtus Seix U.S. Government Securities Ultra-Short Bond Fund (I Shares) return of 0.60% slightly trailed the Bloomberg Barclays 3-6 month T-Bill Index return of 0.63% during the first quarter of 2019. While floating rate securities slightly underperformed fixed rate during the quarter, the excess carry of the Fund allowed for gross performance to generate a +6 bps relative return advantage (0.69% total return versus 0.63% for the benchmark).

The Fund's floating rate exposure increased 1% to 82%. The three largest sector exposures remained Agency CMBS floaters (37.9%), Agency CMO floaters (24.5%), and Post Reset ARMs (10.1%). The overall duration remained near the lower end of the band at approximately 0.3 year. The first quarter saw one- and three-month LIBOR rates decrease by 1 and 21 bps, respectively, as the Fed indicated it was "pausing" the hiking cycle.

As for the main allocation changes, we added about 4% to our agency CMBS floater exposure while reducing other exposures slightly. CMBS fixed, CMO floaters, ABS floaters, and post-Reset ARMS decreased about 1% each.

OUTLOOK

Given that the Fed is on hold emphasizing patience and data dependence, we will continue to seek "safe income at a reasonable price" as we traverse this inflection point. The fluid nature of future Fed policy will likely offer potential opportunities in both fixed or floating assets, as markets are prone to over-extrapolate every last data point and conclude some Fed policy directive as a result. This environment will likely lead to more tactical shifts versus longer-term strategic shifts.

Virtus Seix U.S. Government Securities Ultra-Short 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: 2014

Michael Rieger
Industry start date: 1986
Start date as Fund Portfolio Manager: 2014

Perry Troisi
Industry start date: 1986
Start date as Fund Portfolio Manager: 2014

SECTOR ALLOCATIONS

SECTOR ALLOCATIONS	% Fund
Mortgage Backed	81.60
U.S. Treasury	8.05
Asset Backed	5.30
Government Related	3.96
Cash & Equivalents	1.10

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 4/11/2002
Fund Class I	0.60	0.60	2.02	1.41	0.98	1.31	2.16
Index	0.63	0.63	2.22	1.24	0.81	0.50	1.47

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 0.50%. The net expense ratio is 0.42%, 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 0.41%.

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. Treasury Bill 3-6 Month Index** measures performance of U.S. Treasury bills with a remaining maturity from one up to (but not including) 12 months. The index excludes zero coupon strips. 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. **U.S. Government Securities:** U.S. government securities may be subject to price fluctuations. An agency may default on an obligation not backed by the United States. Any guarantee on U.S. government securities does not apply to the value of the fund's shares. **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. **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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