

Virtus Seix Short-Term Municipal Bond Fund

A: SMMAX (92837F565) | I: CMDTX (92837F557)

MARKET REVIEW

The tax-exempt municipal bond market continues to digest the effects of the tax law enacted in January 2018. Supply has declined, resulting in a smaller market; at the same time, banks and insurance companies have become active sellers. The Bloomberg Barclays Municipal Bond Index returned 0.87% for the quarter and -0.25% for the first half of the year.

Retail demand remained steady as year-to-date flows into municipal bond funds totaled \$7.1 billion, according to Lipper, but buying behavior shifted as major institutional buyers became active sellers. With the reduction in the corporate tax rate from 35% to 21%, the tax incentive for corporate investors to own municipal bonds was effectively reduced. This removed some support for the market as banks and property/casualty (P&C) insurance companies, which have historically been major buyers of muni bonds, scaled back their purchases. In addition, instead of opting for a buy and hold strategy, as many expected, these investors are now incented to be relative value investors and will consider their municipal bond allocation relative to other fixed income products.

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

PERFORMANCE

Returns across the maturity spectrum were positive at the end of the second quarter. The slope of the 2-year to 30-year municipal yield curve remained unchanged at 130 basis points (bps). There were, however, pockets of weakness, as yields on maturities from 7 to 12 years moved higher by 2 to 5 bps, while the anchor 2-year and 30-year were lower in yield by 1 bp.

As a measure of the broader municipal market, the Bloomberg Barclays Municipal Bond Index returned 0.87% for the second quarter, in line with the shorter Bloomberg Barclays 1-15 Year Municipal Bond Index return of 0.85%. Credit spreads remain tight, as demand for yield seems unabated. The Bloomberg Barclays Baa Municipal Index returned 1.41% for the quarter, nearly double the 0.72% return of the AAA Index.

The Fund underperformed the Bloomberg Barclays Short Municipal Bond Index by 17 bps, largely a result of the Fund's underweight to the 3- and 5-year maturity buckets.

CURRENT STRATEGY

The Fund's average maturity was basically unchanged from 2.2 years to 2.1 years. The Fund continues to be underweight the 3- and 5-year areas in comparison to the Bloomberg Barclays Short Municipal Bond Index, while overweight the less-than-1-year and 6- to 8-year areas. There were no significant changes to the credit profile as the Fund maintains a high-quality bias. The Fund remains overweight transportation, special tax, leasing, and electric, while maintaining an underweight in state and local general obligations (GOs).

OUTLOOK

We continue to upgrade the quality of our portfolios. If the market enters a rough patch, liquidity could dry up and spreads could widen quickly. But with the shift to higher quality, we should have a very liquid portfolio.

In the remainder of 2018, supply is likely to pick up in the third quarter, and the net increase in the market could be positive. We also will be watching banks and P&Cs to see if they continue to sell as they did in the first half of 2018.

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INVESTMENT ADVISER

Virtus Fund Advisers, LLC

INVESTMENT SUBADVISER

Seix Investment Advisors LLC

PORTFOLIO MANAGERS



Ronald H. Schwartz CFA
Industry start date: 1982
Start date with Fund: 2011



Dusty Self
Industry start date: 1992
Start date with Fund: 2011

SECTOR ALLOCATIONS

% Fund

Transportation	19.55
State General Obligation	14.05
Special Tax	13.23
Pre-Refunded	11.12
Education	10.33
Lease	9.42
Power	6.94
Local General Obligation	6.86
Hospital	3.30
Cash & Equivalents	2.82
Industrial Development Revenue/ Pollution Control Revenue	1.45
Housing	0.91

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 3/1/1996
Fund Class I	0.49	0.33	0.43	0.64	0.82	2.82	3.62
Index	0.66	0.77	0.60	1.09	1.23	2.22	2.53

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.

Benchmark since inception performance is reported from 3/31/2005.

The fund class gross expense ratio is 0.83%. The net expense ratio is 0.49%, 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 0.48%.

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 1-5 Yr Index** is a market capitalization-weighted index of investment grade tax-exempt municipal bonds with maturities of 1-6 years. 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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