VIRTUS MUTUAL FUNDS

Virtus KAR Mid-Cap Core Fund

A: VMACX (92828N114) | C: VMCCX (92828N122) | I: VIMCX (92828N130) | R6: VRMCX (92828N262)

MARKET REVIEW

Stocks got off to a very strong start in the quarter but shifted into correction mode in early February and stayed there on concerns over inflation, trade, and large technology stocks. The S&P 500® Index closed the quarter down 0.76%. Growth stocks outperformed value stocks, and small stocks slightly outperformed their larger counterparts. Developed foreign markets, represented by the MSCI EAFE® Index, were down 1.53%, and emerging markets, as measured by the MSCI Emerging Markets Index, were up 1.42%. Equity volatility, represented by the CBOE Volatility Index (VIX®), staged a pickup, which was expected coming off of 2017's exceptionally low levels. On the fixed-income front, the Bloomberg Barclays U.S. Aggregate Bond Index fell 1.46%. The 10-year U.S. Treasury yield rose during the quarter from 2.40% to 2.74%, which pressured many fixed-income issues and bond proxies in the equity market.

PERFORMANCE

The Fund (Class I) outperformed the Russell Midcap® Index during the first quarter, with a return of 2.01% versus -0.46% for the Index. The outperformance was driven largely by strong stock selection in the healthcare and financial services sectors. Weak stock selection in the consumer discretionary and technology sectors offset some of the gains.

Globus Medical and Broadridge Financial Solutions were the biggest contributors to performance.

> Globus Medical shares rose in the quarter after a surge in organic growth in the fourth quarter of 2017. Gains in market share in the medical device company's core spine market were driven by the ramping up of new sales associates and operational improvements in its Alphatec business.

> Shares of electronic data processing services company Broadridge performed strongly following the company's reports of better-than-anticipated operating results and a further improved near- to medium-term outlook driven by organic revenue growth acceleration.

Tractor Supply Company and Manhattan Associates were the biggest detractors from performance.

> Tractor Supply reported a solid end to the year, growing same-store sales and reporting the first quarter of neutral deflation in 17 consecutive quarters. The company is facing challenges from tight trucking markets, which is challenging profitability. The company plans to reinvest proceeds from a lower tax rate into higher store payroll, increased spending on IT, and a new point-of-sale system. While the lower profitability expected in 2018 is disappointing, we view the company's investments in solidifying moats around its business as crucial to protecting its competitive advantages.

> Software company Manhattan continues to be challenged by a weak retail environment. Its customers are balking at making large and expensive investments in their supply chains. The company is also transitioning to a cloud model, which should help lower upfront costs for customers, but this will also negatively impact Manhattan's financial statements. We believe the company still has the strongest offering in the market but that customers under duress may not be willing to pay for that. We will continue to monitor this position closely.

PORTFOLIO CHANGES

We purchased AMN Healthcare Services, Lamb Weston Holdings, and Verisk Analytics. We sold our positions in Axalta Coating Systems and Intuit.

> AMN Healthcare is an established leader in the $16 billion healthcare staffing services market and provides clients with access to a vast network of nurses and other professionals. We believe the company's evolution from a traditional staffing business to a healthcare workforce solutions leader should drive long-term value creation for its clients and shareholders.

> Lamb Weston, the biggest U.S. producer of frozen potato products and second-largest globally, benefits from scale advantages in its purchasing and processing of potatoes, and enjoys a certain level of barrier to entry the industry affords.

> Verisk provides data analytics to help customers manage risk and increase revenue. Its core insurance business is excellent as its proprietary data set, voluntarily provided by customers, allows the company to provide a product that is required for successful underwriting.

> We sold our position in Axalta as our confidence in management diminished after the company engaged in two different merger talks that it terminated in the end. Given our smaller-than-normal weight, combined with the lack of conviction in adding to our holdings, we sold our position.

> Intuit generated double-digit annual returns over the past 13 years that we've held the stock. However, with this success comes a price, in terms of market-cap size, and we sold our position based upon the large market cap of the company.

OUTLOOK

We want to underscore that market corrections, while unpredictable, sharp, and painful, are necessary to remove excessive speculation and to shake out weak stockholders. We still believe that businesses will be growing their earnings over the next couple of years and that the market will ultimately reward this growth with positive returns in the mid-to-high, single-digit range. The shape of the yield curve is certainly worth monitoring over the next year or two, and we would like to see it steepen. As always, we remain focused on investing in high-quality businesses that we believe offer a sustainable competitive edge.

Virtus KAR Mid-Cap Core Fund

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS

Jon Christensen, CFA
Industry start date: 1995
Start date with Fund: 2009

Craig Stone
Industry start date: 1989
Start date with Fund: 2009

TOP TEN HOLDINGS

TOP TEN HOLDINGS	% Fund
Globus Medical, Inc. Class A	5.48
AMETEK, Inc.	5.16
Zoetis, Inc. Class A	5.09
Monster Beverage Corp.	4.99
Aspen Technology, Inc.	4.70
Broadridge Financial Solutions, Inc.	4.23
Amphenol Corp. Class A	4.10
Tractor Supply Co.	4.07
Cooper Companies, Inc.	3.99
WABCO Holdings Inc.	3.98

Holdings 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 06/22/2009
Fund Class I	2.01	2.01	20.73	11.04	14.24	n/a	15.76
Index	-0.46	-0.46	12.20	8.01	12.09	n/a	16.62

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 1.23%. The net expense ratio is 0.96%, which reflects a contractual expense reimbursement in effect through 1/31/2019. 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 0.95%.

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 **Russell Midcap® Index** is a market capitalization-weighted index of medium capitalization stocks of U.S. companies. The index is calculated on a total return basis with dividends reinvested. 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: Equity Securities: The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Limited Number of Investments:** Because the fund has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a less concentrated fund. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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