

# A Different Way Home

The search for attractive long-term growth is an evergreen quest for all investors. Finding that growth while also trying to avoid sharp market losses is an even more challenging task.

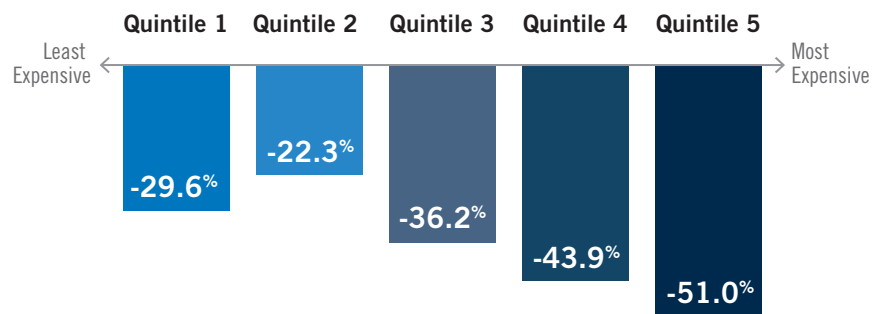


In the context of a decade-long bull market, investors seeking attractive risk-adjusted returns must face the reality that years of exceptional returns with below-average volatility are unlikely to continue. Historically, higher equity market valuations have tended to be followed by periods of muted returns and deeper drawdowns.

## 10-YEAR MAX DRAWDOWNS IN THE S&P 500® INDEX

By CAPE Valuation 1928-2018

**Current valuations—28.5x—are in the most expensive quintile.**



**Past performance is not indicative of future results.**

As of 12/31/18. Current valuation source: Robert J. Shiller, <http://www.econ.yale.edu/~shiller/data.htm>, accessed 2/5/2018. Maximum drawdowns source: © 2019 Ned Davis Research, Inc. See full disclosure on page 5. The S&P 500® Index is defined on page 5. Shiller P/E (CAPE) and Maximum Drawdown are defined on page 5.

What can investors do to achieve the growth their portfolios require?

**Consider the diversifying benefits of higher-yield credit as a way to manage equity risk without forgoing the pursuit of attractive longer-term returns.**

For an equity investor, credit can be best understood as a diversifying return stream which retains upside potential with lower volatility than equity alone.

Thinking of credit as an equity substitute requires a different mindset than that of a bond investor. For a bond investor, credit-based strategies are more attractive when credit spreads are relatively wide and less attractive when they narrow.

Over the past quarter-century, the high yield bond asset class has underperformed equities by less than two percentage points. At the same, it has earned those returns with roughly half the volatility, resulting in a higher return per unit of risk for high yield.

### RETURN PER UNIT OF RISK

January 1, 1992–December 31, 2018

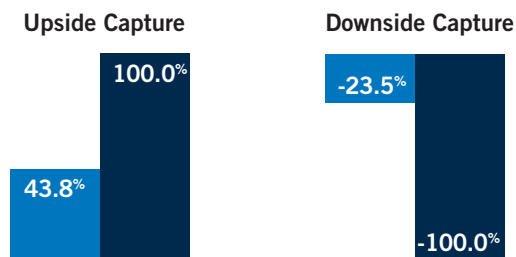
	Annualized return	Standard deviation	Return / unit of risk
High yield bonds	7.63%	8.15%	0.9
Large-cap equity	9.05%	14.01%	0.6
Small-cap equity	9.02%	18.48%	0.5

**Past performance is not indicative of future results.** The high yield, large-cap equity, and small-cap equity markets are represented by the Bloomberg Barclays U.S. Corporate High Yield Bond Index, S&P 500® Index, and Russell 2000® Index, respectively. Returns were calculated using monthly data and begin with the inception of the Credit Suisse Leveraged Loan Index on 1/1/92. Indexes are defined on page 5. Data sources: Credit Suisse, Standard & Poor's, FTSE Russell, Bloomberg Barclays.

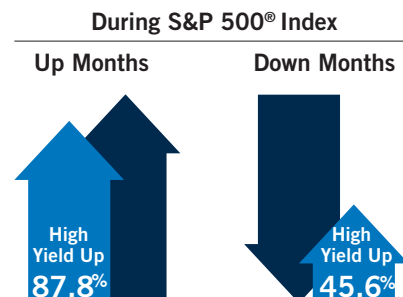
### HIGH YIELD PERFORMANCE

July 31, 1983–December 31, 2018

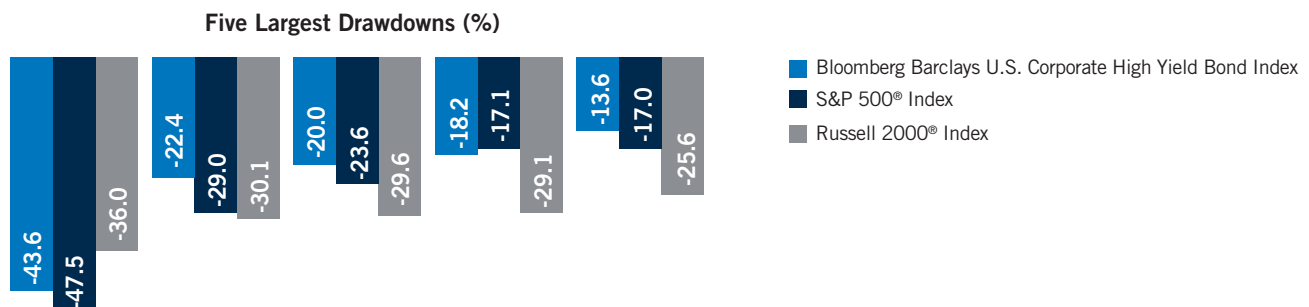
High yield has struck a relatively attractive balance between capturing the ups versus the downs of the U.S. equity market...



...and delivered a more consistently positive return pattern...



...while also averaging much smaller drawdowns. Steep losses are possible, but they have been overshadowed by those of more volatile equities.

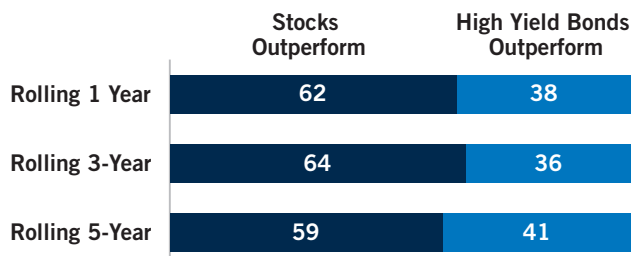


**Past performance is not indicative of future results.** Source: Ned Davis Research. © 2019 Ned Davis Research, Inc. See full disclosure on page 5. Up/Down Capture Ratio defined on page 5.

## STOCKS VS. BONDS

July 29, 1983–December 31, 2018

Stocks have outperformed high yield bonds less frequently than one might expect.



Past performance is not indicative of future results. Source: Ned Davis Research. © 2019 Ned Davis Research, Inc. See full disclosure on page 5.

## RETURNS OVER ROLLING 3-YEAR PERIODS

January 1, 1992–December 31, 2018

High yield has delivered compelling returns with shallower declines.

	Best	Worst	% Negative
High yield bonds	26.1%	-7.6%	7%
Large-cap equity	32.8%	-16.1%	20%
Small-cap equity	29.6%	-17.8%	15%

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## AVERAGE 12-MONTH INDEX CORRELATION

July 31, 1984–December 31, 2018

High yield has exhibited low correlation to equities, making it a capable portfolio diversifier.

	S&P 500® Index	Russell 2000® Index	Bloomberg Barclays U.S. Corporate High Yield Bond Index
S&P 500® Index	1.00		
Russell 2000® Index	0.80	1.00	
Bloomberg Barclays U.S. Corporate High Yield Bond Index	0.58	0.53	1.00

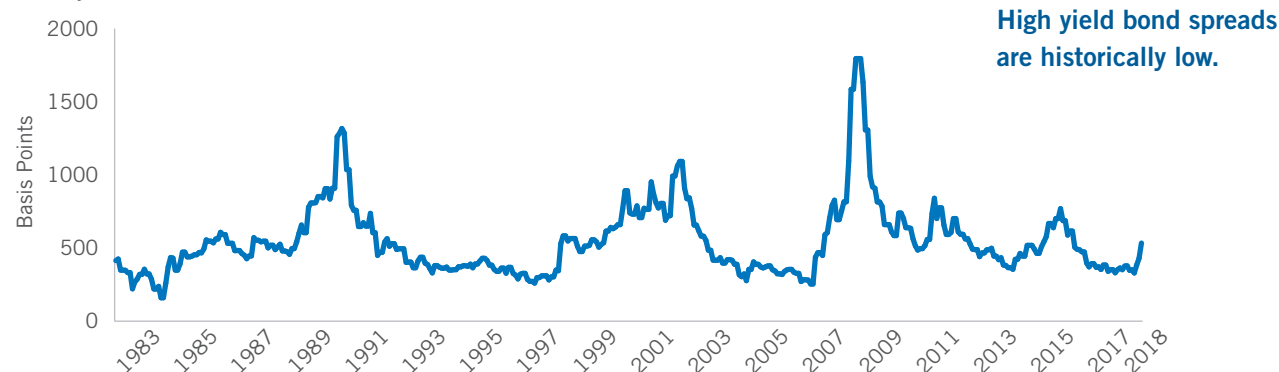
Past performance is not indicative of future results. Source: Ned Davis Research. © 2019 Ned Davis Research, Inc.

## Key Questions

**1) Since spreads are tight, why not wait?** This is a good question from the perspective of a bond investor. But through the lens of a good risk-adjusted alternative to equities, high yield bonds have produced relatively attractive results over the decades. That both equities and high yield might have muted future returns is a shared problem, but one solution has historically had significantly lower volatility without much give-up on returns.

## HIGH YIELD BOND SPREADS

January 31, 1983–December 31, 2018

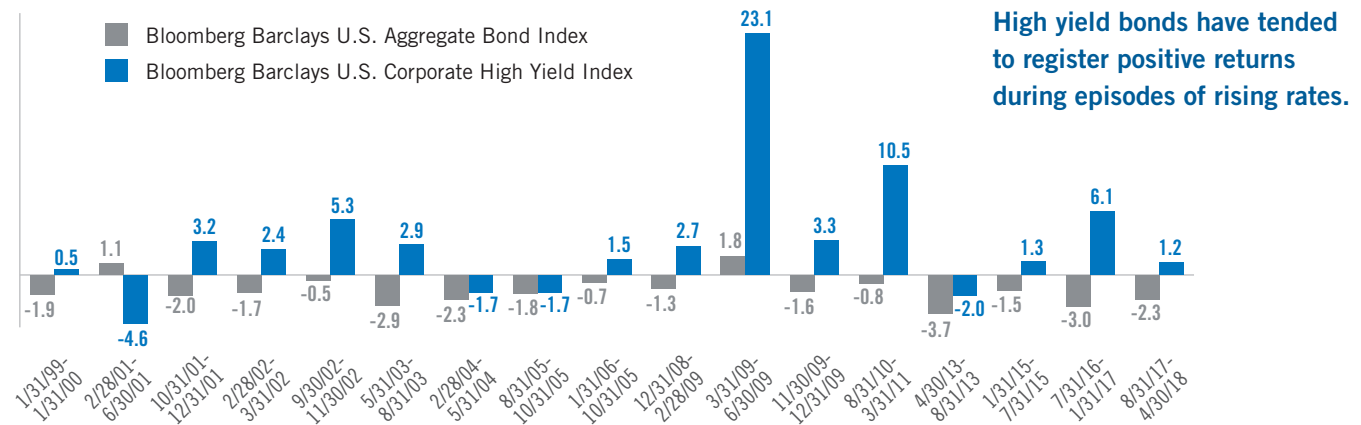


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**2) What about the inherent illiquidity of “junk” bonds?** This legitimate concern is best tackled by an actively managed portfolio of high yield bonds. A passive approach to bond investing is generally fraught with problems. The high yield universe is not equally replicated, plus bonds trade quite differently than stocks. Professional bond pickers can sort through and choose attractive issues while managing risks such as wide bid-offer spreads and other inefficiencies.

**3) What happens when interest rates rise?** Bond investors are justifiably concerned about the value of their investments when rates rise. However, high yield and investment grade bonds have acted very differently in rising rate environments.

**PERFORMANCE WHEN RATES RISE**



**Past performance is not indicative of future results.** Time periods since 6/30/97 when month end 10-Year Treasury yields rose at least 50 basis points. Data sources: Bloomberg, Bloomberg Barclays.

**A Time for Difficult Decisions**

In the current market environment, investors have difficult decisions to make. Growing our wealth is a must, but we don’t want to take too much risk to do so—especially when both equities and bonds exhibit higher valuations. We’ve suggested that high-yield credit might serve as a “best of both worlds” allocation:

- Historically, it has produced attractive results relative to equities but with a smoother ride.
- Skilled active managers in the high yield bond market can navigate this environment without being compelled to buy the entire market, regardless of valuation and liquidity.
- The quality of the “ride” matters when holding any risky asset. The more volatile an investment, the more critical it is to leverage skilled portfolio construction expertise.

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## VIRTUS NEWFLEET HIGH YIELD FUND

Class A: PHCHX    Class C: PGHCX    Class I: PHCIX    Class R6: VRHYX

## VIRTUS SEIX HIGH YIELD FUND

Class A: HYPGX    Class I: SAMHX    Class R: HYLX    Class R6: HYIZX

## VIRTUS SEIX HIGH INCOME FUND

Class A: SAHIX    Class I: STHTX    Class R: STHIX    Class R6: STHZX



To learn more about credit as an equity substitute and Virtus' suite of high yield solutions, please contact us at 1-800-243-4361 or visit [virtus.com](http://virtus.com)

**Index Definitions**—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 **Bloomberg Barclays U.S. Corporate High Yield Bond Index** measures fixed rate non-investment grade debt securities of U.S. corporations, calculated on a total return basis. The **S&P 500® Index** is a free-float market-capitalization weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

**CAPE Ratio:** Price earnings ratio based on average inflation-adjusted earnings from the previous 10 years, known as the Cyclically Adjusted PE Ratio (CAPE Ratio), Shiller PE Ratio, or PE 10. **Maximum Drawdown:** The peak-to-trough decline during a specific record period of an investment, fund, or commodity. A drawdown is usually quoted as the percentage between the peak and the trough. **Up/Down Capture Ratios:** Measures how well a manager was able to replicate or improve on phases of positive benchmark returns and how badly the manager was affected by phases of negative benchmark returns.

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### IMPORTANT RISK CONSIDERATIONS

**Fundamental Risk of Investing:** There can be no assurance that the fund will achieve its investment objectives. An investment in the shares of the fund is subject to the risk of loss of principal; shares may decrease in value. **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. **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. **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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