

Virtus KAR Mid-Cap Growth Fund

A: PHSKX (92828N767) | C: PSKCX (92828N742) | I: PICMX (92828N734) | R6: VRMGX (92828N254)

MARKET REVIEW

Domestic equities continued to march ahead in the third quarter, with the S&P 500® Index gaining 7.71% and the Russell 2000® Index advancing 3.58%. Trade war concerns continued to mount during the quarter, which led to weakness in international stocks, both developed and emerging markets. The MSCI EAFE® Index managed a modest gain for the quarter, up 1.35%, while the MSCI Emerging Markets Index slipped 1.09%. Interest rates continued to rise modestly during the quarter, with the 10-year U.S. Treasury yield moving from 2.86% to 3.06%, but the spread between the 10-year and 2-year yields narrowed further.

PERFORMANCE

The Fund (Class I) returned 5.31% in the quarter, underperforming the Russell Midcap® Growth Index, which returned 7.57% for the period. Factors negatively affecting the portfolio included an overweight in the communication services sector and weak stock selection in consumer discretionary. Losses were partially offset by an underweight in materials and strong stock selection in healthcare.

Trade Desk and Paycom Software contributed the most to performance during the quarter.

- > The Trade Desk (TTD) is a digital advertising platform that allows ad agencies to purchase advertising across a myriad of channels—websites, apps, music, and TV streaming—using data to optimize spending decisions. In many ways, it is applying the advantages of Facebook's advertising platform to ads outside their walled garden but with slightly less targeting precision. That said, there is a large unmet need for advertising efficiency. Historically, ad tech businesses were opaque and fraught with conflicts of interest. By solely focusing on ad agencies and skewing heavily to do-it-yourself, TTD has become a go-to platform in the rapidly growing programmatic advertising market (3% of global advertising, 14% of internet advertising). Its access to inventory, bidding technology, and data-infused targeting proficiency has distanced it from competitors and aided the company in delivering record results of late that have trounced Wall Street's expectations.
- > Paycom's cloud-based HCM and payroll software have carved out a niche as a nimble SaaS, serving small- and medium-sized businesses. Its out-of-the-box solution, low-cost R&D, and sales office strategy combine to give the company some of the best margins among SaaS peers. After a lull in new sales-office openings in 2017, the company has ramped them up this year, which has

contributed to a reacceleration of growth. Paycom has also developed a differentiated mobile offering that increases user engagement, which is expected to drive customer value and, ultimately, retention and product upsell.

Avalara and Autohome Holdings detracted the most from performance in the quarter.

- > Tax compliance software company Avalara experienced revenue growth of 25% in the most recent quarter, and forecasted future revenue growth in the 20%-25% range. The company's stock valuation needed to correct, as investors had valued the company with different growth expectations after the IPO in June.
- > Chinese car site Autohome shares are down by more than 40% since June as auto sales in China slowed and then went into decline. Concerns also remain over the macroeconomic health of the country after U.S. tariffs. Given Autohome's strong competitive positioning, improved capital allocation, and expected long-term growth of the Chinese car market, we remain owners of the business.

PORTFOLIO CHANGES

During the quarter, we bought Elanco Animal Health, a developer and marketer of products for companion and food animals in the U.S. and worldwide; GrubHub, an online and mobile food-ordering company that connects diners with local restaurants; and STAAR Surgical, which is in the business of implantable eye lenses. We sold asset management company Victory Capital Holdings and local-search service provider Yelp.

OUTLOOK

A flat Treasury yield curve continues to concern investors, the U.S. and China are locked in an ongoing trade spat, and troubles in emerging markets persist. Circumstances may change but uncertainty and volatility in markets are to be expected. While we do pay attention to such factors causing concern, we also remain focused on the economic and business fundamentals. The U.S. appears to be one of the pillars of strength in the global economy today, with third-quarter GDP growth projected to be strong and various sectors continuing to expand. As always, we are committed to investing in high-quality businesses that have a sustainable competitive edge. In our view, this approach is the best long-term strategy in today's environment of heightened market and geopolitical uncertainty.

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS



Douglas S. Foreman, CFA
Industry start date: 1986
Start date with Fund: 2012

TOP TEN HOLDINGS

	% Fund
Netflix, Inc.	4.96
Trade Desk, Inc. Class A	3.63
HealthEquity Inc.	3.09
Teladoc Health, Inc.	3.01
Monster Beverage Corp.	2.82
Paycom Software, Inc.	2.71
Illumina, Inc.	2.71
MercadoLibre, Inc.	2.69
Autohome, Inc. Sponsored ADR Class A	2.58
Gartner, Inc.	2.54

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 9/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 9/13/2007
Fund Class I	5.31	28.63	35.72	24.22	14.95	12.47	8.21
Index	7.57	13.38	21.10	16.65	13.00	13.46	9.64

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 1.24%. The net expense ratio is 1.15%, which reflects a contractual expense reimbursement in effect through 1/31/2019.

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® Growth Index** is a market capitalization-weighted index of medium capitalization, growth-oriented 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.

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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