

Virtus KAR Emerging Markets Small-Cap Fund

A: VAESX (92828W627) | C: VCESX (92828W619) | I: VIESX (92828W593)

MARKET REVIEW

Emerging market equities rallied strongly during the fourth quarter, outperforming most global equity benchmarks, and ended the year up 18.42% (MSCI Emerging Markets Small Cap Index). Despite slower economic growth in many emerging market countries, emerging market equities ended the year on a positive note driven by easing trade tensions between the U.S. and China, as well as increasingly accommodative central banks around the world, creating hopes for stabilization in the global economy.

Brazil was the best performing market in both the quarter and year. Since President Bolsonaro's election at year-end 2018, the economy has showed positive growth, legislators approved a major overhaul of the country's pension laws, and the central bank continued to lower rates. Chile was one of the worst performing markets for the quarter and year, impacted by ongoing civil protests.

PERFORMANCE

The Fund (Class I) returned 6.70% in the quarter, underperforming the Index, which returned 9.52%. It is not surprising that the portfolio lagged when the market rallied nearly 10% in a short period of time. For the full year, the Fund outperformed its benchmark, returning 18.28% versus 11.51%. Stock selection was the primary driver of this outperformance as we had several companies generate outsized gains during the year with strong developments in business fundamentals.

The strongest contributors to performance during the quarter were Sea Limited and 58.com.

- > Sea Limited is a Southeast Asian e-commerce/online video gaming business. The company reported strong third quarter results. Both its e-commerce and gaming businesses grew more than investors expected and management raised full year guidance for both businesses.
- > Despite a slowing economic backdrop in China, 58.com's businesses reported solid results with total revenue and profits growing strongly. Traffic to the online classifieds company's platforms continued to grow robustly despite soft industry trends in both the real estate and jobs segments.

The weakest contributors to performance during the quarter were Union Auction Public and Baozun.

- > Union Auction is the largest operator of used and salvaged car auctions in Thailand. Shares fell after the company reported slower third quarter earnings growth compared to the first half of the year. The decline in new car sales in Thailand also accelerated due to stricter lending standards by financial institutions. Despite these near-term headwinds, Union Auction continues to generate impressive earnings growth and its competitive position remains intact. With an attractive dividend yield and long-term growth prospects, we added to our position in the quarter.
- > Baozun is the largest provider of e-commerce solutions to domestic and global consumer companies in China. The company helps brands sell their products on major e-commerce platforms like Tmall and JD.com. We liked Baozun's leadership position and high switching costs its customers would incur if they decided to change providers. However, we underestimated the capital requirements of the business. After Baozun reported third quarter earnings, it became clear that margins will stay under pressure longer than we expected. More importantly, we lost confidence in the company's profitability level and returns over the long term. We sold our position during the quarter.

PURCHASES AND SALES

During the quarter, we added several holdings to the portfolio: distilled spirits manufacturer Anhui Gujing Distillery (China), healthcare and leisure products company Haw Par (Singapore), and online recruiting services business SaraminHR (South Korea).

We sold several holdings in the quarter: e-commerce business Baozun (China) (discussed above), event marketing company Pico Far East Holdings (Singapore), paint manufacturer Sniezka (Poland), and brewery Union de Cervecerias Peruanas Backus y Johnston (Peru).

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS



Craig Thrasher, CFA
Industry start date: 2003
Start date as Fund Portfolio Manager: 2013



Hyung Kim
Industry start date: 2004
Start date as Fund Portfolio Manager: 2017

TOP TEN HOLDINGS

% Fund

HeadHunter Group PLC	6.14
Vostok New Ventures Ltd.	4.91
Taisun Int'l Holding Corp.	4.35
Sea Ltd.	3.70
NICE Information Service Co. Ltd.	3.59
Addcn Technology C.o Ltd.	3.47
58.com Inc.	3.34
Heineken Malaysia Bhd	3.16
Voltronic Power Technology Corp.	3.07
Sarana Menara Nusantara Tbk PT	2.92

Holdings are subject to change.

TOP FIVE CONTRIBUTORS % Contribution

Sea Ltd.	0.93
58.com Inc.	0.87
HeadHunter Group PLC	0.73
Sarana Menara Nusantara Tbk PT	0.65
Auto Trader Group PLC	0.65

TOP FIVE DETRACTORS % Contribution

Union Auction PCL	-0.55
Baozun Inc.	-0.46
Ace Hardware Indonesia Tbk PT	-0.31
Cia Cervecerias Unidas SA	-0.26
Humanica PCL	-0.09

% Contribution: Absolute weighted contribution.

To obtain the top/bottom holdings calculation methodology, call 800-243-4361.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/19

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 12/17/2013
Fund Class I	6.70	18.28	18.28	13.60	7.29	n/a	6.04
Index	9.52	11.51	11.51	6.70	2.97	n/a	2.92

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit virtus.com for performance data current to the most recent month end. This share class has no sales charges and is not available to all investors. Other share classes have sales charges. See virtus.com for details.

The fund class gross expense ratio is 1.68%. The net expense ratio is 1.62%, which reflects a contractual expense reimbursement in effect through 1/31/2021. 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 1.60%.

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.

Index: The **MSCI Emerging Markets Small Cap Index (net)** is a free float-adjusted market capitalization-weighted index designed to measure small cap equity market performance in the global emerging markets. The index is calculated on a total return basis with net 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 mediumsized companies may enhance that risk. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Non-Diversified:** The fund is non-diversified and may be more susceptible to factors negatively impacting its holdings to the extent that each security represents a larger portion of the fund's assets. **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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