

Virtus KAR Small-Cap Value Fund

A: PQSAX (92828N684) | C: PQSCX (92828N676) | I: PXQSX (92828N668) | R6: VQSRX (92828N411)

MARKET REVIEW

The fourth quarter capped off a year of extraordinary returns for equity investors. Following a very weak fourth quarter in 2018, stocks recovered all those losses and more in 2019. For the year, U.S. large-cap stocks returned 31.49% (S&P 500® Index), U.S. small-cap stocks returned 25.52% (Russell 2000® Index), and international developed markets were up 22.01% (MSCI EAFE®). Emerging market stocks, despite a trade dispute, still managed a robust return of 18.42% (MSCI Emerging Markets Index). Growth stocks continued to outperform value stocks despite the threat of potential regulatory changes for large technology companies in 2019.

PERFORMANCE

The Fund delivered positive performance for the quarter, returning 5.80% (Class I), though underperformed the Russell 2000® Value Index, which returned 8.49%. Weak stock selection in the materials & processing and technology sectors detracted from performance. An underweight in utilities and positive stock selection in the consumer discretionary sector contributed to performance.

The strongest contributors to performance were SiteOne Landscape Supply and Thor Industries.

- > With strong, organic daily sales growth this quarter, landscape company SiteOne is on track to deliver mid-single digit full-year growth, despite poor weather at the start of 2019. Its barcode initiative has been successful in the pilot branches and will be rolled out to remaining branches in the first half of 2020. In addition, management noted that branches located in markets where they have a full product line tend to be higher performers and with higher margins.
- > In 2019, RV manufacturer Thor completed the acquisition of Erwin Hymer Group, a market-leading manufacturer of recreational vehicles in Europe. This acquisition is likely to yield multiple benefits, including geographic diversification of the business. Also, because Thor is more of an assembler than a true manufacturer, the company's profitability in the current industry downturn has continued to produce cash flow that has been utilized to pay down debt incurred from the acquisition.

The weakest contributors to performance were Cinemark and Core Laboratories.

- > Movie theater chain Cinemark's shares lagged, driven by investor concerns over the near-term U.S. box office outlook and proliferation of alternative forms of viewership. Importantly, Cinemark has continued to grow attendance and drive increased monetization through ticket and concession spending. We believe that the box office will show resilience as movie theaters continue to represent a relatively inexpensive form of out-of-home entertainment. The company also remains a solid free cash-flow generator, returning excess cash to shareholders via regular cash dividends.
- > Core Laboratories, which provides core and fluid analysis to the petroleum industry, has suffered over the past five years amid a severe cyclical downturn in the industry. More recently, a drop in U.S. onshore drilling activity and ongoing delays with international projects have added to the pressure on its business and caused management to reduce the company's dividend.

PURCHASES AND SALES

No new purchases or complete sales were made for the portfolio during the quarter.

OUTLOOK

On the surface, 2020 appears to present fewer concerns than 2019 did at its start. The stock market attained numerous new highs in December, reflecting this outlook. Despite a reduction in uncertainty, it is not a heroic assumption to expect returns in 2020 to not be as good as they were in 2019. We believe corporate profits should improve in 2020 with 5-10% growth even as overall GDP growth slows, likely in the 1-1.5% range. Modest economic growth coupled with stronger growth overseas could lead to continued improving corporate profitability. The Federal Reserve will likely hold interest rates steady if this kind of environment unfolds. Rhetoric surrounding the presidential election is sure to create some volatility in 2020, but it is premature to handicap any outcomes.

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS



Julie Kutasov
Industry start date: 2001
Start date as Fund Portfolio Manager: 2008



Craig Stone
Industry start date: 1989
Start date as Fund Portfolio Manager: 2009

TOP TEN HOLDINGS

	% Fund
SiteOne Landscape Supply Inc.	6.22
The Scotts Miracle-Gro Co.	6.18
MGM Growth Properties LLC	5.06
RBC Bearings Inc.	4.95
Thor Industries Inc.	4.90
Brooks Automation Inc.	4.49
Primerica Inc.	4.26
Bank of Hawaii Corp.	4.03
Watsco Inc.	4.02
Houlihan Lokey Inc.	3.79

Holdings are subject to change.

TOP FIVE CONTRIBUTORS

	% Contribution
SiteOne Landscape Supply Inc.	1.34
Thor Industries Inc.	1.29
Brooks Automation Inc.	0.58
National Beverage Corp.	0.51
Badger Meter Inc.	0.48

TOP FIVE DETRACTORS

	% Contribution
Cinemark Holdings Inc.	-0.42
Core Laboratories NV	-0.31
RBC Bearings Inc.	-0.25
The Cheesecake Factory Inc.	-0.24
CoreLogic Inc./United States	-0.22

% 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 6/28/2006
Fund Class I	5.80	24.86	24.86	7.67	8.93	11.87	8.60
Index	8.49	22.39	22.39	4.77	6.99	10.56	6.95

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 0.99%.

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 **Russell 2000® Value Index** is a market capitalization-weighted index of value-oriented stocks of the smallest 2,000 companies in the Russell Universe, which comprises the 3,000 largest 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 it 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. **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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