

Virtus KAR Small-Mid Cap Core Fund

A: VKSAX (92828N221) | C: VKSCX (92828N213) | I: VKSIX (92828N197) | R6: VKSRX (92828N189)

MARKET REVIEW

2023 proved to be an outstanding year for capital markets. At the start of the year, investors were braced for an imminent recession, but it never materialized, and the fourth quarter ended up being the strongest quarter of the year. Large-cap stocks, as measured by the S&P 500® Index, advanced 11.69% in the fourth quarter alone, bringing the year-to-date return to 26.29%. Large-cap growth stocks, as measured by the Russell 1000® Growth Index, gained 14.16% in the quarter, outperforming large-cap value stocks, as measured by the Russell 1000® Value Index, which returned 9.50%.

The “Magnificent Seven” mega-cap tech stocks (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) were responsible for most of the outperformance by large-cap growth stocks during the year. However, market breadth started to improve in the fourth quarter, as small-cap stocks, as measured by the Russell 2000® Index, advanced 14.03% in the quarter. Falling interest rates, due to the continued improvement in the inflation outlook, was the principal reason that equities performed so well during the quarter.

FUND PERFORMANCE

During the quarter, the Virtus KAR Small-Mid Cap Core Fund returned 11.85% (Class I), underperforming the Russell 2500™ Index, which returned 13.35%. Stock selection in the financials and consumer discretionary sectors detracted from performance, while stock selection in the industrials sector and an underweight position in the energy sector contributed positively to performance.

Equifax and Thor Industries were the largest contributors to performance during the quarter.

- > Equifax's shares outperformed due to market optimism that interest rates have peaked as the Federal Reserve (Fed) paused interest rate hikes in the beginning of November. Of the U.S. credit bureaus, Equifax has greater exposure to the mortgage markets, which have been severely depressed due to the high interest rate environment, so the signaling of rate cuts drove a strong rally in shares in the quarter.
- > Thor Industries continues to feel the effects of the significant downdraft in industry-wide recreational vehicle (RV) sales. However, the RV company continues to operate largely as an assembler and not a vertical manufacturer, which helps the business continue to generate free cash flow, even as RV sales decline. Also, the business's valuation multiple expansion has aided the performance of the stock.

Choice Hotels International and LPL Financial were the largest detractors from performance in the quarter.

- > We believe multinational hospitality company Choice Hotels' underperformance was likely related to its hostile bid to acquire another hotel chain.
- > LPL Financial reported a quarter of organic asset growth driven by market share gains, while profit margins were down due to seasonality and expense recognition timing. The financial services company derives a significant portion of its profit from net interest earned on client operational cash balances, and the expectation of lower interest rates negatively influenced expectations for LPL's future profit trajectory. This caused the shares to underperform.

PORTFOLIO CHANGES

During the quarter, we purchased Zurn Elkay Water Solutions, a leading provider of specification-driven, highly engineered, and mission-critical water management solutions to new construction and retrofit construction projects. There were no complete sales from the portfolio.

OUTLOOK

With the Fed's hiking cycle likely behind us and corporate earnings growth likely to resume, we believe 2024 should be a favorable year for equity returns. Coming into 2024, investor sentiment is nowhere near as negative as it was coming into 2023, but there is still plenty of cash on the sidelines built up over the last year. As short-term interest rates decline and the yield curve moves to flat, or even positively sloped, we believe this capital will make its way into fixed income and equity markets. From our perspective, returns in 2024 are unlikely to be as robust as they were in 2023 but are likely to be in line with earnings growth. We also expect that 2024 will experience more volatility due to the U.S. presidential election, which is likely to be contentious.

Related Reading: [Q4 KAR Market Review & Outlook](#)

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 as Fund Portfolio Manager: 2018



Julie Kutasov

Industry start date: 2001
Start date as Fund Portfolio Manager: 2018



Craig Stone

Industry start date: 1989
Start date as Fund Portfolio Manager: 2018

TOP TEN HOLDINGS

% Fund

Bentley Systems Inc.	5.00
Pool Corp.	4.61
Lennox International Inc.	4.30
The Cooper Cos. Inc.	4.27
Nordson Corp.	4.04
ANSYS Inc.	3.90
Thor Industries Inc.	3.87
Watsco Inc.	3.61
Charles River Laboratories International Inc.	3.56
Equifax Inc.	3.55

Holdings are subject to change.

TOP FIVE CONTRIBUTORS % Contribution

Equifax Inc.	1.00
Thor Industries Inc.	0.87
ANSYS Inc.	0.79
Lennox International Inc.	0.78
The Cooper Cos. Inc.	0.76

TOP FIVE DETRACTORS % Contribution

Choice Hotels International Inc.	-0.18
LPL Financial Holdings Inc.	-0.16
Interactive Brokers Group Inc.	-0.12
SiteOne Landscape Supply Inc.	-0.03
Exponent Inc.	0.09

% Contribution: Absolute weighted contribution.

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

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/23

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (03/07/18)
Fund Class I	11.85	23.61	23.61	4.01	15.83	n/a	11.85
Index	13.35	17.42	17.42	4.24	11.67	n/a	7.60

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 1.01%.

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 2500™ Index** is a market capitalization-weighted index of the 2,500 smallest 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 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, medium, or large-sized companies may enhance that risk. **Technology Concentration:** Because the portfolio is presently heavily weighted in the technology sector, it will be impacted by that sector's performance more than a portfolio with broader sector diversification. **Limited Number of Investments:** Because the portfolio has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a portfolio with a greater number of securities. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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