VIRTUS FUNDS

Virtus AllianzGI Short Duration High Income Fund

A: ASHAX (92838V544) | C: ASHCX (92838V536) | INST: ASHIX (92838V510) | P: ASHPX (92838V528) | R6: ASHSX (92838V643)

MARKET ENVIRONMENT

The U.S. high-yield bond market advanced in the second quarter with the ICE BofA U.S. High Yield Index returning 2.8%. By way of comparison, the 10-year U.S. Treasury returned 3.2% and the S&P 500® Index gained 8.6%.

Investors weighed stronger-than-expected first-quarter earnings results, positive second-quarter guidance, and a robust economic recovery against rising inflation and the timing of future monetary policy adjustments.

First-quarter financial results for S&P 500 companies exceeded estimates due to stronger-than-expected earnings and revenues. Earnings surpassed estimates by more than 22%, with 86% of the companies beating their projections, according to FactSet. Additionally, second-quarter 2021 earnings growth estimates strengthened over the period with a record-high number of S&P 500 companies issuing positive EPS and sales guidance.

The economy continued to rapidly recover during the period. The unemployment rate declined, jobless claims hit a pandemic-era low, housing industry statistics were constructive, and surveys of manufacturing and service sector activity remained robust. Conversely, inflation metrics were mixed.

The Federal Reserve (Fed) left its benchmark rate and monthly asset purchases unchanged. Fed Chair Jerome Powell acknowledged that taper discussions had begun but reinforced the message that the rise in inflation appears transitory. The Fed's new dot plot forecast incorporated 50 basis points (bps) of tightening in 2023, reflecting a faster recovery in economic activity and higher inflation expectations.

Against this backdrop, the U.S. Treasury yield curve flattened with short-dated yields rising and long-dated yields falling. The 3-month, 2-year, 5-year, and 10-year yields finished at 0.05%, 0.25%, 0.88%, and 1.44%, respectively.

Performance dispersion among credit quality categories tightened compared to the previous quarter. BB rated issues recovered sharply, concurrent with a decline in interest rates, but CCC rated issues continued to outperform higher-quality high yield.

The top-performing industries were theaters & entertainment, energy, and consumer goods. The bottom-performing industries were health care, utilities, and packaging.

Primary market activity remained robust in the quarter with new high-yield issuance totaling $140.5 billion across 212 issues. Year-to-date new issuance of $299.1 billion is on track to surpass 2020's record of $449.9 billion. Refinancing remained the greatest use of proceeds at 60% of the quarter's total. Fund flows were -$4.1 billion.

The credit ratings upgrade cycle accelerated, and default rates declined sharply quarter over quarter. The trailing 12-month default rates on an issuer-weighted basis and a dollar-weighted basis fell to 3.02% and 1.63%, respectively.

PORTFOLIO SPECIFICS

For the quarter, the Virtus AllianzGI Short Duration High Income Fund returned 1.36% (Class Inst shares). By comparison, the ICE BofA 1-3 Year BB U.S. Cash Pay High Yield Index returned 1.44%.

The Short Duration High Income strategy remains an attractive solution as investors adjust to the optionality of the Fed, transitory inflation risk, and a lift of the yield curve without taking excessive credit risk or price volatility.

Fundamental credit research, low duration, and liquidity are key tenets and goals for the U.S. Short Duration High Income strategy that seeks to strike an attractive balance between risk and expected return. The managers continued to reinvest capital prudently to defend and evaluate credit risk against the global environment.

Since inception, the U.S. Short Duration High Income strategy remains U.S.-centric and consumer focused with non-domestic exposure and trade risk more limited versus the broader markets. The portfolio continues to stay up in quality while avoiding the lowest quality credits with average credit quality in the portfolio at B1/BB-. Emphasis remains on credit quality, liquidity, and minimizing premiums paid.

The U.S. Short Duration High Income strategy is an active solution with relatively high security turnover and not managed to a benchmark. Passive strategies may carry greater tail risk, show greater dispersion of returns, are highly ratings dependent, and may not protect well against downside volatility and incur permanent losses of capital, while the U.S. Short Duration High Income strategy selectively invests in opportunities that present lower volatility, risk-adjusted returns in line within the mandate, investment philosophy and Fund guidelines. Average duration in the portfolio continues to remain relatively low and well below the average yield and coupon.

Performance in the quarter benefited from industry weightings and a consistent credit selection framework. Industries contributing the most to performance in the period were financial services, energy, and support services. No industries detracted from performance in the quarter.

Liquidity remained in focus to pay distributions, meet redemptions, and take advantage of reinvestment opportunities. Purchases were made in real estate development & management, gas distribution, and health facilities, among other industries. Exposure that was reduced during the period included telecom-satellite.

MARKET OUTLOOK

The U.S. economy and corporate earnings are projected to grow significantly in 2021.

Expansion in the United States is expected to continue as the post-COVID reopening accelerates. Additional supporting factors include an increase in business spending and investment, pent-up consumer demand, excess household savings, U.S. fiscal stimulus, and a further recovery in the labor market.

Revenue growth and corporate profitability should be strong. U.S. companies are well positioned to benefit from operating leverage as strengthening top-line growth is met with productivity gains, driving margin expansion, and bottom-line growth.

Potential risks include higher interest rates due to faster-than-expected economic growth or a sustained rise in inflation, as well as a potentially less accommodative Fed.

In the second quarter, much of the growth in inflation appeared transitory, driven by reopening-sensitive categories and supply chain bottlenecks that should ease into year-end. Wage and rental inflation require closer monitoring as the year progresses.

A less accommodative Fed is possible given the central bank's most recent commentary and dot plot forecast. While a policy adjustment could be interpreted as hawkish, the Fed remains very flexible, with the anticipated timing of the first hike approximately a year and half away. An upper bound federal funds target rate of 75 bps still resides well below the last cycle's peak (250 bps). Furthermore, the 10-year Treasury yield at 1.44% (as of June) remains very low in absolute and relative terms. Lastly, the labor market—one of the Fed's mandates—has yet to fully recover.

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QUARTERLY COMMENTARY

A coupon-like return is possible for the U.S. high yield bond market in 2021. Credit metrics, default rates, and ratings trends should continue to improve into year-end. Along those lines, many market strategists have reduced their default rate expectations for 2021. Robust new supply in 2021 has allowed company managements to reduce interest expenses and push out debt maturities, decreasing near-term refinancing obligations.

U.S. high yield bonds should contribute from both a diversification and a relative-performance perspective, offering a very compelling yield opportunity compared to negative and depressed yields globally with lower interest-rate sensitivity.

The Short Duration High Income strategy remains an attractive fixed income solution as investors adjust to a Fed that is willing to tolerate higher levels of inflation without taking excess credit risk or price volatility that may be amplified in low yielding and high premium, long-dated assets.

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Allianz Global Investors

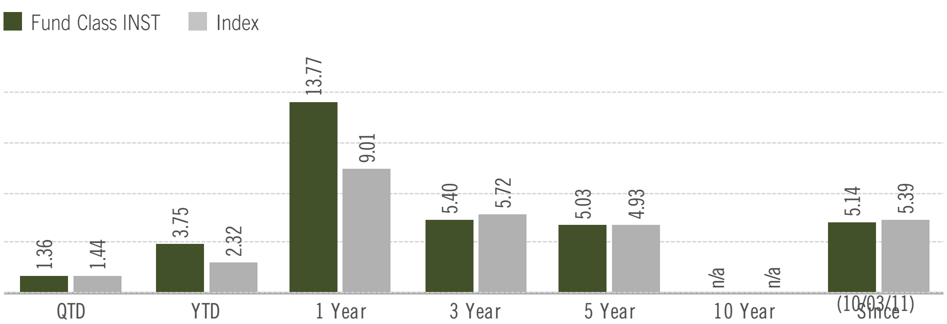
PORTFOLIO MANAGERS

Douglas G. Forsyth, CFA
Industry start date: 1991
Start date as Fund Portfolio Manager: 2013

James Dudnick, CFA
Industry start date: 2000
Start date as Fund Portfolio Manager: 2014

Steven Gish, CFA
Industry start date: 1995
Start date as Fund Portfolio Manager: 2014

AVERAGE ANNUAL TOTAL RETURNS (%) as of 06/30/21



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 0.75%. The net expense ratio is 0.60%, which reflects a contractual expense reimbursement in effect through 2/1/2023.

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 **ICE BofA 1-3 Year BB US Cash Pay High Yield Index** is a subset of the ICE BofA US Cash Pay High Yield Index including all securities with a remaining term to final maturity less than 3 years and rated BB1 through BB3, inclusive. The ICE BofA US Cash Pay High Yield Index tracks the performance of U.S. dollar denominated below investment grade corporate debt, currently in a coupon paying period, that is publicly issued in the U.S. domestic market. The index is calculated on a total return basis. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

TOP TEN HOLDINGS

TOP TEN HOLDINGS	% Fund
Global Aircraft Leasing Co., Ltd. 6.5000% 09/15/2024	3.65
CVR Energy Inc. 5.2500% 02/15/2025	3.55
Connect Finco SARL / Connect US Finco LLC, 6.7500% 10/01/2026	3.52
PBF Holding Co LLC / PBF Finance Corp. 7.2500% 06/15/2025	3.09
Alliance Data Systems Corporation 4.7500% 12/15/2024	2.55
New Fortress Energy Inc. 6.7500% 09/15/2025	2.30
NRG Energy Inc. 7.2500% 05/15/2026	2.26
Ford Motor Co. 8.5000% 04/21/2023	2.14
Tesla Inc. 5.3000% 08/15/2025	2.07
PG&E Corporation Loan, 06/23/2025	1.86

Holdings are subject to change.

Notes on Risk: Debt Instruments: Debt instruments are subject to greater levels of credit and liquidity risk, may be speculative and may decline in value due to changes in interest rates or an issuer's or counterparty's deterioration or default. **High Yield Fixed Income Securities:** There is a greater risk of issuer default, less liquidity, and increased price volatility related to high yield securities than investment grade securities. **Market Volatility:** Local, regional, or global events such as war, acts of terrorism, the spread of infectious illness or other public health issues, recessions, or other events could have a significant impact on the portfolio and its investments, including hampering the ability of the portfolio manager(s) to invest the portfolio's assets as intended. **Issuer Risk:** The portfolio will be affected by factors specific to the issuers of securities and other instruments in which the portfolio invests, including actual or perceived changes in the financial condition or business prospects of such issuers. **Interest Rate:** The values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced for securities with longer maturities. **Credit Risk:** If the issuer of a debt instrument fails to pay interest or principal in a timely manner, or negative perceptions exist in the market of the issuer's ability to make such payments, the price of the security may decline. **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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