VIRTUS FUNDS

Virtus AllianzGI High Yield Bond

A: AYBAX (92838V858) | ADMIN: AYBVX (92838V809) | C: AYBCX (92838V866) | INST: AYBIX (92838V700) | P: AYBPX (92838V882)

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 gauges increased.

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 is transitory. 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. BB-rated, B-rated, and CCC-rated bonds returned 2.9%, 2.1%, and 4.1%, respectively, for the quarter.

The top-performing industries were theaters & entertainment, energy, and consumer goods. The bottom-performing industries were healthcare, 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 negative at -$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 High Yield Bond Fund returned 2.84% (Class I shares). The benchmark ICE BofA U.S. High Yield Index returned 2.77%.

Nearly all industries and issues in the portfolio finished higher for the quarter. Notably, relative outperformance was achieved despite the Fund's overweight positioning in higher quality credits, which lagged the lowest quality credits.

Industry allocations that helped relative performance during the period included basic industry & real estate, air transportation, and media content. In basic industry & real estate, security selection was positive, helped by REIT and homebuilding exposure. In air transportation, select airline operators that have focused on controlling costs and bolstering liquidity continued to be a source of strength as customer demand for travel accelerates. In media content, security selection was also positive, aided by a streaming entertainment issuer that should benefit from an improving content slate and initiatives to grow both sales and earnings.

Industry allocations that hurt relative performance during the period included energy, theaters & entertainment, and personal & household products. In energy, portfolio performance was positive but lagged the industry return. Not owning select outperforming low-quality credits detracted. In theaters & entertainment, all positions advanced, but the portfolio underperformed the industry.

Purchases consisted of attractive total return opportunities within the primary and secondary markets. Investments included pharmaceutical, waste management, and software issues, while auto & truck manufacturing and gaming & leisure product exposures were reduced. Transactions also consisted of issue swaps in packaged foods, aerospace, and automotive, among other issuers.

MARKET OUTLOOK

The U.S. economy and corporate earnings are projected to grow significantly in 2021 as the post-COVID reopening accelerates. Additional supporting factors include an increase in business spending and investment, pent-up consumer demand, excess household savings, ongoing and potentially new 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 is still 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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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. 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.

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Allianz Global Investors

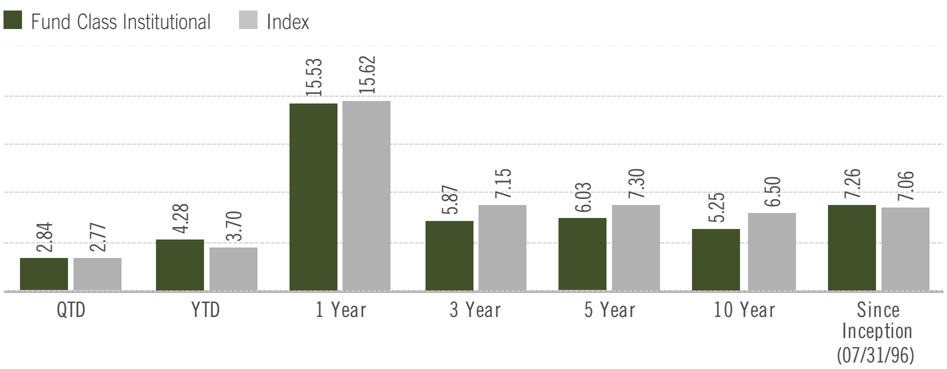
PORTFOLIO MANAGERS

Douglas G. Forsyth, CFA
Industry start date: 1991
Start date as Fund Portfolio Manager: 1996

David J. Oberto
Industry start date: 2003
Start date as Fund Portfolio Manager: 2017

William (Brit) L. Stickney
Industry start date: 1989
Start date as Fund Portfolio Manager: 1999

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 0.87%. The net expense ratio is 0.83%, 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 US High Yield Index** The ICE BofA US High Yield Index tracks the performance of below investment grade U.S. dollar denominated corporate bonds publicly issued in the U.S. domestic market and includes issues with a credit rating of BBB or below. 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
Reorganized Sfxe Preferred Stock 15	8.11
Energizer Holdings, Inc. 7.50 % Cum Conv Red Pfd Registered Shs Series -A-	2.40
OneMain Finance Corp., 6.6250% 01/15/2028	1.27
Ford Motor Co., 9.0000% 04/22/2025	1.26
Tenet Healthcare Corp, 6.2500% 02/01/2027	1.06
Occidental Petroleum Corp., 5.5500% 03/15/2026	1.01
Ford Motor Co., 9.6250% 04/22/2030	0.96
Royal Caribbean Cruises Ltd., 11.5000% 06/01/2025	0.95
TransDigm Inc., 6.3750% 06/15/2026	0.95
Sprint Corp., 7.6250% 03/01/2026	0.91

Holdings are subject to change.

Notes on Risk: 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. **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. **Counterparties:** There is risk that a party upon whom the portfolio relies to complete a transaction will default. **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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