

Virtus KAR Small-Mid Cap Growth Fund

A: VAKSX (92836N817) | C: VCKSX (92836N791) | I: VIKSX (92836N783) | R6: VRKSX (92836N775)

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

The Virtus KAR Small-Mid Cap Growth Fund returned 8.29% (Class I) in the quarter, underperforming the Russell 2500™ Growth Index, which returned 12.59%. Stock selection was the challenge in the quarter as investors flocked to the most beaten down and levered names in the benchmark. Stock selection in the healthcare and information technology sectors detracted the most from performance, while stock selection in the industrials sector and an underweight position in energy contributed positively during the quarter.

Fair Isaac and Simpson Manufacturing were the largest contributors to performance during the quarter.

- > Shares of Fair Isaac (FICO) outperformed in the quarter as the data analytics and credit scoring company continued to produce strong financial results despite a weak loan origination market due to its ability to raise credit score pricing. Additionally, its software business continued to deliver on its land-and-expand strategy. Management also presented strong guidance for the upcoming fiscal year, which we believe will benefit the company similarly to this past fiscal year.
- > Simpson Manufacturing’s shares benefited from healthy results and continued pricing power in its end markets. The building materials company also benefited from investor expectations for lower interest rates and a strong housing market when affordability for buyers improves.

Silk Road Medical and Ryan Specialty were the largest detractors from performance in the quarter.

- > Medical device company Silk Road reported weak results in the third quarter, confirming fears that the business was experiencing increased competition from other treatment methods for preventing stroke, as well as stubbornly low adoption rates for its less invasive TCAR procedure among

trained physicians. The company’s CEO also stepped down. We exited our position during the quarter as Silk Road’s competitive position was not as strong as we had anticipated.

- > Shares in Ryan Specialty, a provider of specialty insurance products and solutions, declined in the quarter as investors anticipated the potential for slowing interest rate increases across the property and casualty insurance industry as inflation moderates.

PORTFOLIO CHANGES

During the quarter, we purchased Aspen Technology, Moelis, and Simpson Manufacturing (discussed above). We sold our position in Copart as the market capitalization of the online car auctions company is outside the portfolio’s small- and mid-cap mandate. We also sold Silk Road Medical (also discussed above).

- > Aspen Technology is one of the largest process optimization software companies. Its software runs mission critical operations in oil and gas, chemicals, engineering and construction, and other industrial segments. The software has high switching costs and, as a result, has experienced durable earnings growth even in challenging markets.
- > Moelis is a boutique investment bank founded by Kenneth Moelis, a well-known investment banker, just before the 2007-08 global financial crisis. As it did during the crisis, the company recently took advantage of weaker M&A markets to help attract strong talent to take share when dealmaking returned. As interest rates normalize, we expect pent-up demand, particularly among private equity clients, to drive earnings growth.
- > Simpson Manufacturing is one of the leading manufacturers of wood construction connectors. Its Strong-Tie products have a dominant position in the market, often specified by local building codes. As a result, it enjoys healthy profitability and an ability to enact regular price increases. We believe the company benefits from being homebuilder-agnostic and from the continued housing shortage in the U.S.

OUTLOOK

With the Federal Reserve’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



Julie Biel, CFA

Industry start date: 2004
Start date as Fund Portfolio Manager: 2020



Chris Wright, CFA

Industry start date: 2012
Start date as Fund Portfolio Manager: 2022

TOP TEN HOLDINGS

% Fund

Fair Isaac Corp.	6.58
West Pharmaceutical Services Inc.	4.82
Bentley Systems Inc.	4.70
HEICO Corp.	4.62
Ryan Specialty Holdings Inc.	4.56
Rightmove PLC	4.33
nCino Inc.	4.16
Simpson Manufacturing Co. Inc.	4.04
FactSet Research Systems Inc.	3.78
Teledyne Technologies Inc.	3.75

Holdings are subject to change.

TOP FIVE CONTRIBUTORS % Contribution

Fair Isaac Corp.	1.74
Simpson Manufacturing Co Inc.	1.52
MarketAxess Holdings Inc.	1.08
Moelis & Co.	0.77
Aspen Technology Inc.	0.64

TOP FIVE DETRACTORS % Contribution

Silk Road Medical, Inc.	-0.78
Ryan Specialty Holdings Inc.	-0.61
HealthEquity Inc.	-0.37
West Pharmaceutical Services Inc.	-0.35
Atrion Corp.	-0.15

% 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 (12/08/20)
Fund Class I	8.29	18.92	18.92	-0.99	n/a	n/a	-0.23
Index	12.59	18.93	18.93	-2.68	n/a	n/a	-1.24

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](https://www.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](https://www.virtus.com) for details.

The fund class gross expense ratio is 2.57%. The net expense ratio is 1.05%, which reflects a contractual expense reimbursement in effect through 1/31/2024.

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™ Growth Index** is a market capitalization-weighted index of growth-oriented stocks 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. **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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