

Virtus Duff & Phelps Water Fund

A: AWTAX (92838V494) | C: AWTCX (92838V486) | INST: AWTIX (92838V460) | P: AWPX (92838V478)

MARKET REVIEW

Water investments (as measured by the S&P Global Water Index (net)) increased 14.98% in the fourth quarter, supported by favorable fundamentals and improved investor sentiment. Both the water equipment and technology and infrastructure subsectors contributed positively during the period.

Water equipment and technology companies led performance during the quarter. International industrials, particularly in Europe, shined after lagging for most of 2023 as activity stabilized, albeit at weak levels. Companies exposed to the municipal end-market, including engineering and consulting firms, distributors, and equipment manufacturers, also performed well due to the rising level of infrastructure investment and adoption of technology, including advanced metering infrastructure, contaminant testing and treatment, and services incorporating artificial intelligence. Companies involved in the residential and non-residential sectors capped off a strong year, boosted by the decline in interest rates late in the quarter.

The water infrastructure subsector contributed positively in the quarter. International utilities in Brazil and the United Kingdom led the group, as both benefited from improving regulatory backdrops, while water utilities in Asia remained weak due to continued economic woes. U.S. utilities generated positive performance, as lower interest rates combined with resilient growth driven by robust investment backlogs and attractive valuations pushed the group higher after a mostly challenging year.

PERFORMANCE REVIEW

Performance was driven by favorable fundamentals underpinning strong earnings and improved investor sentiment boosting valuations.

At the security level, the largest positive contributors to performance were Xylem Inc. and Core & Main Inc. Xylem is the largest pure-play water equipment and services company in the U.S. with significant exposure to the municipal and industrial end-markets. Xylem had a volatile start to the year as the company announced the acquisition of Evoqua Water Technologies and experienced management turnover in the CEO and CFO positions. Despite the acquisition and management changes, the company continued to perform extremely well as infrastructure and technology demand remained strong. We believe the company is well positioned for growth moving into 2024 as fundamentals remain strong in their key end-markets and supply chain constraints for the advanced metering business are greatly improved. Core & Main closed out a stellar year with strong performance during the quarter, capturing elevated construction activity given its favorable positioning as a market-leading distributor in the municipal, non-residential, and residential end-markets. During the quarter, the company initiated an attractive long-term outlook that featured 6%-12% sales growth and continued margin expansion, and also posted a resilient 2024 outlook despite economic uncertainty. The company is also benefiting from legacy private equity ownership exiting its position, improving the stock's liquidity, and enabling Core & Main to highlight its return-of-capital capabilities by participating in share buybacks.

The largest detractors from performance were China Water Affairs Group Ltd. and Valmont Industries Inc. China Water Affairs is a leading water utility in China with water supply and wastewater treatment operations. The equity was under pressure in the quarter as macroeconomic headwinds in the country weighed on volume growth and new connections. On a more positive note, the direct drinking water business continued to grow at a rapid pace and the company continues toward a spinoff of the subsidiary, which we believe will result in a value uplift for China Water Affairs Group. Valmont contributed negatively during the quarter following a disappointing earnings update, which included a guidance reduction tied to softness in telecom investment and timing of international agricultural projects as well as an impairment of its technology offerings due to soft agriculture fundamentals. While lower agriculture commodity prices and poor farmer sentiment present near-term challenges, the company remains well positioned to benefit over the long term from secular growth in rising infrastructure investment and demand for agriculture solutions that combat drought and improve food resilience.

OUTLOOK

Secular growth trends in the water sector remain in place as communities across the world invest in solutions to combat water scarcity and water quality challenges. Due to robust government and corporate support, investment in the water sector is set to inflect positively over the next several years. This step-change in investment is expected to benefit companies that are building and rehabilitating infrastructure and those companies that are developing and deploying technology in the water sector. Additionally, the reshaping of supply chains and water-quality regulation are driving water investment across many industries.

We see several near-term catalysts for water investment, including strong infrastructure spending in developed markets, water quality regulation (PFAS in the U.S.), government infrastructure spending (IIJA), and continued focus on resiliency spending from corporates and governments globally. Water companies, including E&Cs, utilities, and equipment and technology providers will benefit as projects move forward. On the regulatory front, the EPA is expected to finalize PFAS regulation in March 2024, which will catalyze significant investment in testing, treatment, and remediation equipment and technology. Additionally, corporations are increasingly investing in water technologies as they reshore supply chains, improve operational resiliency, and capitalize on megatrends tied to growth in semiconductors, electrification, and health care, all of which require substantial water supply, advanced water treatment, and water efficiency programs, such as implementing water reuse capabilities. These initiatives are expected to support significant earnings growth for companies in the water infrastructure and technology subsectors in the years ahead.

We remain constructive on the outlook for the water sector as fundamentals in most end-markets remain healthy and secular growth outlooks are intact. We continue to favor companies with exposure to municipal and industrial end-markets with leading market share in subsectors outgrowing the broader water market. Additionally, we believe water infrastructure companies are well positioned given resilient business models and strong growth outlooks. These companies also stand to benefit from reduced inflation, and in turn, lower interest rates.

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Duff & Phelps Investment Management Co.

PORTFOLIO MANAGERS



David D. Grumhaus, Jr.
Industry start date: 1989
Start date as Fund Portfolio Manager: 2022



Nicholas Holmes, CFA
Industry start date: 2010
Start date as Fund Portfolio Manager: 2023



Evan Lang, CFA
Industry start date: 2014
Start date as Fund Portfolio Manager: 2022

TOP TEN HOLDINGS

	% Fund
Xylem Inc./NY	9.90
American Water Works Co. Inc.	7.86
Essential Utilities Inc.	7.01
Severn Trent PLC	6.84
Tetra Tech Inc.	4.23
Veolia Environnement SA	4.13
Ecolab Inc.	3.91
Core & Main Inc.	3.84
United Utilities Group PLC	3.53
Stantec Inc.	3.46

Holdings are subject to change.

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

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (07/15/08)
Fund Class INST	14.07	12.38	12.38	3.85	11.77	7.02	7.38
Index 1	11.03	22.20	22.20	5.75	11.72	7.92	7.24
Index 2	14.98	14.82	14.82	5.92	13.06	8.78	8.61

TOP FIVE CONTRIBUTORS % Contribution

Xylem Inc./NY	2.28
Core & Main Inc.	1.25
Severn Trent PLC	1.04
Stantec Inc.	0.80
Cia de Saneamento Basico do Estado de Sao Paulo SABESP	0.76

TOP FIVE DETRACTORS % Contribution

China Water Affairs Group Ltd.	-0.18
Valmont Industries Inc.	-0.07
Danaher Corp.	0.03
Lindsay Corp.	0.09
SJW Group	0.10

% Contribution: Absolute weighted contribution.

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

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 1.22%. The net expense ratio is 0.93%, which reflects a contractual expense reimbursement in effect through 2/1/2024.

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 1: The **MSCI AC World Index (net)** is a free float-adjusted market capitalization-weighted index that measures equity performance of developed and emerging markets. The index is calculated on a total return basis with net dividends reinvested. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

Index 2: The **S&P Global Water Index (net)** is a modified capitalization-weighted index comprised of 50 of the largest publicly traded companies in water-related businesses that meet specific invest ability requirements. The index is designed to provide liquid exposure to the leading publicly-listed companies in the global water industry, from both developed markets and emerging markets. The index is calculated on a total return basis with net 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: 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. **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. **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. **Water-Related Risk:** Because the portfolio focuses its investments in water-related companies, it is particularly affected by events or factors relating to this sector, which may increase risk and volatility. **Focused Investments:** To the extent the portfolio focuses its investments on a limited number of issuers, sectors, industries or geographic regions, it may be subject to increased risk and volatility. **Foreign Investing:** Investing in foreign securities subjects the fund to additional risks such as increased volatility; currency fluctuations; less liquidity; less publicly available information about the foreign investment; and political, regulatory, economic, and market risk. **Sustainable Investing:** Because the portfolio focuses on investments in companies that the Manager believes exhibit strong environmental, social, and corporate governance records, the portfolio's universe of investments may be smaller than that of other portfolios and broad equity benchmark indices. ESG factors may not be considered for every investment decision and there is no guarantee that the integration of ESG factors will result in better performance. **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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