VIRTUS FUNDS

Virtus Stone Harbor High Yield Bond Fund

A: VSHDX (92828Y540) | I: SHHYX (92828Y532)

MARKET REVIEW

The U.S. high yield market returned 3.98% in the quarter. The improving macro sentiment and falling Treasury yields sparked a return of retail fund inflows, which further supported the market. The strong inflows, high existing cash balances, and minimal new issue calendar provided strong technical support. Spreads tightened 62 bps, while BB, B, and CCC credits gained 4.32%, 4.32%, and 1.12%, respectively. The yield-to-worst (YTW) ended the quarter at 8.95%.

Europe's high yield rally, which saw returns of 5.33% for the quarter, was mainly driven by mild weather that helped to ease the European energy crisis, averting a potential near-term recession in the region. Additionally, inflation data improved, and China began to fully reopen its economy. CCC credits underperformed, with a gain of 2.45% compared to returns of 5.66% and 5.06% for BBs and Bs. In spread terms, the asset class tightened 134 bps during the quarter, reaching a spread of 495 bps at the end of the quarter.

Market technicals in the U.S. were strong as declining Treasury yields contributed to positive retail flows in the quarter before outflows dominated the last weeks of December. Retail funds reported an inflow of $7.3 billion, while the new issue market priced $16 billion.

Technicals were also positive for Europe as inflows returned and the primary calendar remained minimal. In the quarter, only €8.8 billion euros of bonds priced, bringing the 2022 total to only €32 billion euros – the lowest amount since 2009. Senior secured bonds comprised 57% of new issue – well above the prior record of 46% in 2018. Fund flows turned positive later in the quarter, contributing to only €263 million of outflows. Outflows for the year totaled €12.25 billion euros. These redemptions represent over 14% of the retail fund assets.

In the U.S., ratings trends were negative as financial conditions tightened. For the quarter, 46 issuers were upgraded for a total of $83.7 billion, while 93 issuers were downgraded for a total of $102.4 billion. The upgrade to downgrade ratio was 0.9x during the period. Five issuers left the high yield market for a total of $22.4 billion, and five issuers fell into the high yield market for a total of $6.3 billion. There were no defaults for the third consecutive month in December, keeping the trailing 12-month par default rate at the end of December unchanged at 0.84%. On an issuer basis, the default rate remained below 1% at 0.85%.

Distress and default rates in Europe remained near historically low levels, with only two defaults for €560 million euros during the quarter. The 12-month par default rate ended 2022 at 0.4%, and the issuer default rate ended at 0.3%, according to J.P. Morgan. The distressed ratio increased to 12.4% from 1.6% the prior year but finished lower than the 15.1% October peak.

FUND PERFORMANCE REVIEW (As of 12/30/22)

The Fund returned 4.53% in the fourth quarter versus the ICE BofA US High Yield Constrained Index return of 3.98%.

Positive Contributors

> Strong issue selection within leisure, retail non-food/drug, and chemicals helped the Fund outperform.

> Strong issue selection within CCC-rated bonds also had a positive impact on performance.

> The Fund's underweight and issue selection within the wirelines sector also helped performance.

Performance Detractors

> The Fund's underweight to metals/mining/steel and aerospace/defense detracted from performance.

> An overweight to E&P also hurt performance.

> Issue selection within building products and media/cable also negatively affected performance.

FUND STRATEGY AND POSITIONING (As of 12/30/22)

> Increased overweight to gaming.

> Further reduced underweight to wirelines.

> Reduced exposure to CCC-rated bonds and increased exposure to bonds rated B and BB & above.

OUTLOOK

Recent inflation data has enabled the Fed to slow the pace of rate hikes, bringing conditions closer to a Fed pause. However, the duration of the higher federal funds rate remains uncertain, with a greater risk of recession the longer the Fed waits to begin cutting rates. Though corporate profits have been resilient, weakness in Europe, Asia, North American housing, and lower-income consumers has been noted. Milder weather and the easing energy crisis in Europe, the reopening in China, declining Treasury yields, and lower inflation will positively impact corporate profit outlooks. Corporate balance sheets are healthy, with leverage at pre-pandemic levels and high cash balances, though financial conditions have tightened considerably and point to slower

INDUSTRY ALLOCATIONS (%)	% Fund
E&P	9.86
Media Cable	7.59
Gaming	6.78
Financial/Lease	6.16
Healthcare	6.08
Midstream	5.50
Automotive	5.01
Building Products	4.69
Industrial Other	4.64
Leisure	3.90

Holdings and sector weightings are subject to change. Weightings may not add up to 100% as a result of the use of certain financial instruments, including derivatives, which may be used to gain or reduce market exposure and/or for risk management purposes.

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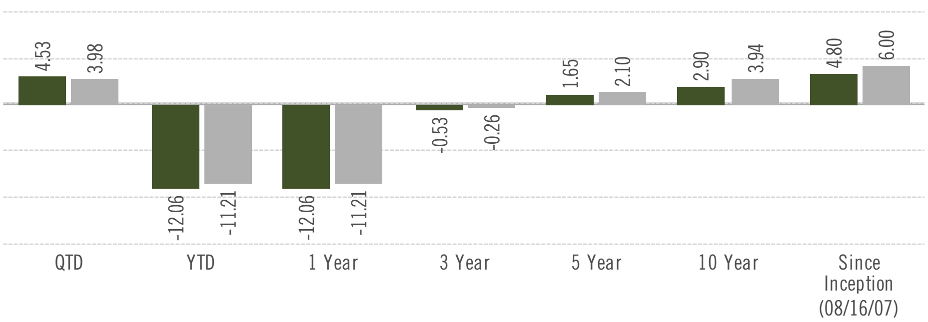
growth and deteriorating credit metrics ahead. Risks remain around the pace and scale of global interest rate hikes, geopolitical events, inflationary pressures, supply chain and labor constraints, the ability of industries to successfully recover lost demand, and COVID. We see opportunity in companies experiencing stable demand, but temporary margin or volume headwinds.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/30/22



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 0.83%. The net expense ratio is 0.66%, which reflects a contractual expense reimbursement in effect through 4/7/2024.

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.

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Stone Harbor Investment Partners

PORTFOLIO MANAGERS

Peter J. Wilby, CFA
Industry start date: 1980
Start date as Fund Portfolio Manager: 2007

James E. Craige, CFA
Industry start date: 1988
Start date as Fund Portfolio Manager: 2018

Matthew Kearns, CFA
Industry start date: 1997
Start date as Fund Portfolio Manager: 2018

Hunter Schwarz
Industry start date: 2003
Start date as Fund Portfolio Manager: 2018

Daniel Berkery, CFA
Industry start date: 1991
Start date as Fund Portfolio Manager: 2010

William Perry
Industry start date: 1984
Start date as Fund Portfolio Manager: 2018

Index: **The ICE BofA U.S. High Yield Constrained Index** contains all securities in the U.S. High Yield Index but caps issuer exposure at 2%. Index constituents are capitalization weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro rata basis. Similarly, the face values of bonds of all other issuers that fall below the 2% cap are increased on a pro rata basis. In the event there are fewer than 50 issues in the Index, each is equally weighted and the face values of their respective bonds are increased or decreased on a pro rata basis. 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.

Notes on Risk: Credit & Interest: Debt instruments are subject to various risks, including credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Counterparties:** There is risk that a party upon whom the portfolio relies to complete a transaction will default. **Derivatives:** Derivatives may include, among other things, futures, options, forwards and swap agreements and may be used in order to hedge portfolio risks, create leverage, or attempt to increase returns. Investments in derivatives may result in increased volatility and the portfolio may incur a loss greater than its principal investment. **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. **Liquidity:** Certain instruments may be difficult or impossible to sell at a time and price beneficial to the portfolio. **Income:** Income received from the portfolio may vary widely over the short- and long-term and/or be less than anticipated if the proceeds from maturing securities in the portfolio are reinvested in lower-yielding securities. **Bank Loans:** Bank loans may be unsecured or not fully collateralized, may be subject to restrictions on resale, may be less liquid and may trade infrequently on the secondary market. Bank loans settle on a delayed basis; thus, sale proceeds may not be available to meet redemptions for a substantial period of time after the sale of the loan. **ABS/MBS:** Changes in interest rates can cause both extension and prepayment risks for asset- and mortgage-backed securities. These securities are also subject to risks associated with the non-repayment of underlying collateral, including losses to the portfolio. **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. Price changes may be short- or long-term. Local, regional or global events such as war or military conflict (e.g., Russia's invasion of Ukraine), acts of terrorism, the spread of infectious illness (e.g., COVID-19 pandemic) 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's manager(s) to invest the portfolio's assets as intended. **Prospectus:** For additional information on risks, please see the fund's prospectus. Distribution Rate is calculated by summing all distributions over the preceding 12 months, and dividing by the NAV on the last business date of the period.

Please consider a Fund's investment objectives, risks, charges, and expenses carefully before investing. For this and other information about any Virtus Fund, contact your financial professional, call 800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

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