

Virtus Stone Harbor Emerging Markets Debt Income Fund

A: VSHCX (92828Y565) | I: SHMDX (92828Y557)

MARKET REVIEW

Sector Review “Broad Market”

Following strong gains in the fourth quarter of last year, the global backdrop was more challenging for fixed income investors in the first quarter of 2024. Upside surprises to U.S. economic growth and inflation readings led to upwards pressure on core bond yields, as market participants scaled back expectations for Federal Reserve (Fed) easing over the balance of 2024. However, despite higher core bond yields, external debt returns in emerging markets remained positive, largely due to a continued compression in risk premia for high yield emerging markets (EM) sovereign and corporate issuers. EM fundamentals have been supported by continued disinflation, together with on-going policy easing, which have in turn supported an improvement in growth prospects. Local currency EM debt returns were hurt by renewed strength in the U.S. dollar, although local yields were broadly unchanged during the quarter, notwithstanding the increase in U.S. Treasury yields.

The J.P. Morgan EMBI Global Diversified delivered a total return of 2.0%. Total returns were driven by spread compression and carry, which contributed 3.2%. Average EM spreads tightened by 42 basis points (bps) to 341 bps. Spreads in every region declined, with spreads in Africa and Europe declining by 128 bps and 69 bps, respectively. Offsetting strong spread returns was the effect of rising U.S. Treasury yields, which detracted -1.2% from total returns. The U.S. 10-year Treasury yield increased by 32 bps over the period.

For more on our quarterly market review and outlook, [click here](#).

Investment Grade

The IG sovereign debt segment of the benchmark delivered a total return of -0.8% as rising U.S. yields detracted from the more interest rate-sensitive segment of the benchmark. Despite rising yields, average spreads tightened by 6 bps as the majority of countries in the IG segment had positive spread performance. Romania (+0.7%), Kazakhstan (+0.7%), and China (+0.5%) led the sector in total return. Peru (-1.6%), Philippines (-1.5%), and Uruguay (-1.4%) were the largest underperformers on a total return-basis.

Non-Investment Grade

The high yield segment outperformed IG bonds, on average, as the less interest rate-sensitive portion of the benchmark was not as impacted by rising U.S. rates. HY bonds, on average, posted a total return of 4.9% for the quarter and a return contribution from spread tightening and carry of 5.7%. Ecuador (+51.5%), Pakistan (+27.3%), and Argentina (+25.9%) were the top performers for the quarter. Ecuador's bonds rallied as the government engaged with the IMF on a new program and passed legislation to raise tax rates. Argentina outperformed as President Javier Milei remains committed to fiscal reform including spending cuts. Pakistan saw gains on IMF and external funding support.

The largest underperformers were South Africa (-3.1%) and Senegal (-3.1%), both on political and election volatility. Colombia (-2.4%) also underperformed.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 3.03% (net of fees) and 3.21% (gross of fees) in the first quarter versus the J.P. Morgan EMBI Global Diversified Index return of 2.04%. Country selection decisions in sovereign and corporate debt enhanced excess returns, as did issue selection among sovereign debt. Foreign currency exposure detracted from performance. The portfolio's small underweight in effective duration also detracted modestly from relative returns.

Positive Contributors

- > **Hard Currency Sovereign Debt:** overweight and issue selection in Egypt; underweights in China, Indonesia, Malaysia, and Philippines
- > **Hard Currency Corporate Debt:** out-of-benchmark exposures in Brazil, Colombia, and Mexico

Negative Contributors

- > **Hard Currency Sovereign Debt:** overweights in Venezuela, Mexico, and Saudi Arabia
- > **Local Currency Sovereign Debt:** out-of-benchmark currency exposures in Brazil, Indonesia, South Africa, and Thailand

OUTLOOK & STRATEGY

Our base Case (40% probability) assumes a soft-enough landing that will enable the U.S. Fed to cut interest rates as

the economy and inflation slow in response to higher interest rates. We currently expect between two to three reduction in the Fed funds rate over the balance of the year. The ECB is also likely to cut rates in response to a sluggish domestic economy and lower inflation rates. China is likely to continue its gradual easing policy to sustain growth, although largescale bailouts are unlikely due to moral hazard issues. The three main risks that we have identified include a sharper-than-expected fall in inflation, a sharper-than-expected fall in global growth, and also a more resilient U.S. economy leaving the Fed on hold for an extended period of time.

For external markets, in our base case, we see spreads as being more or less fairly priced at current levels, but lower core interest rates supporting overall total return gains. The major downside for EM risk premia is posed by the global recession scenario—when core rates would likely fall significantly. Total return expectations would also be lower than the Base Case in a scenario where the Fed remains on-hold, as core rates would likely continue their recent move higher.

Within the local currency space, we continue to see scope for local interest rates to fall as easing cycles are maintained. There may also be scope for some weakening of the U.S. dollar once the Fed starts to ease interest rates. Again, the global recession scenario and the Fed on-hold scenario would likely see renewed dollar strength, potentially damaging returns.

PERFORMANCE ATTRIBUTION BREAKDOWN as of 03/31/2024

Portfolio (gross basis – USD)	3.21
JPM EMBIG DIV	2.04
Difference	1.17
Breakdown	
Hard Currency Sovereign Allocation	1.05
Country Selection	0.55
Issue Selection	0.50
Local Currency Allocation	-0.10
FX Exposure	-0.05
Yield & Yield Change	-0.05
Hard Currency Corporate Allocation	0.25
Country Selection	0.25
Issue Selection	0.00
Treasury Attribution	0.02
Miscellaneous Difference	-0.04

REGIONAL ALLOCATION % Fund Benchmark

Africa	16.38	12.39
Asia	9.01	17.22
Europe	15.98	16.40
Latin America	38.13	32.86
Middle East	20.14	21.13
Net Cash	0.37	0.00

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.

SECTOR DISTRIBUTION	% Fund	Benchmark
Sovereign Hard Currency	83.76	100.00
Corporate Hard Currency	13.68	0.00
Sovereign Local Currency	2.19	0.00
Corporate Local Currency	0.00	0.00
Net Cash	0.37	0.00

Sector weights are subject to change.

TOP 5 COUNTRIES (%)

	Sovereign-Hard		Sovereign-Local		Corporate-Hard		Total	
	Fund	Index	Fund	Index	Fund	Index	Fund	Index
Mexico	6.44	4.96	0.33	0.00	3.19	0.00	9.96	4.96
Saudi Arabia	5.72	4.89	0.00	0.00	0.07	0.00	5.79	4.89
Colombia	3.72	2.77	0.16	0.00	1.11	0.00	4.99	2.77
Turkey	4.41	4.43	0.00	0.00	0.32	0.00	4.73	4.43
Brazil	3.21	3.26	0.28	0.00	1.13	0.00	4.62	3.26

CURRENT FUND STRATEGY

Positioning

- > Overweight non-investment grade bonds vs investment grade debt
- > Regional overweights in Latin America and Africa; underweights in Asia and Middle East, and slight overweight Europe
- > Off-benchmark exposure in select local currency debt markets and U.S. dollar-denominated emerging market corporate debt, particularly in Brazil, Mexico, and South Africa.

Strategy	YIELD (%)		RATING**		NOTABLE DEVIATIONS	
	Portfolio	Relative*	Portfolio	Benchmark	O/W	U/W
Sovereign Hard Currency	7.52	0.86	BB	BB+	Mexico, Iraq, Venezuela	China, Philippines, Poland
Corporate Hard Currency	9.06	N/A	BB	N/A	Mexico, Brazil, Colombia	N/A†
Sovereign Local Currency	7.41	N/A	BBB+	N/A	Brazil, Mexico, Indonesia	N/A†

*Relative to JPMorgan EMBI Global Diversified Index.

**Credit ratings issued by Nationally Recognized Statistical Rating Organizations assess the credit worthiness of the issuers of the underlying securities and not to the Fund or its shares. Ratings are measured using a scale that ranges from AAA (highest) to NR (not rated). Not rated securities do not necessarily indicate low quality. The security's credit rating does not eliminate risk and credit ratings are subject to change. Credit Quality reflects a weighted average composite of the ratings of Standard & Poor's Corporation, Fitch, Moody's Investors Service, Inc and DBRS. Ratings are then adjusted to the Standard & Poor's rating tiers shown. In the case where the composite is in between two ratings the rating will be rounded down. A composite will not be generated if the bond is only rated by one of the four rating agencies. Expected ratings and unsolicited ratings, designated by 'e' and 'u', are not included in calculating the composite.

†Not in the JPM CEMBI-Broad Diversified.

Benchmark: JPMorgan EMBI Global Diversified Index.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 03/31/24

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 08/16/07
Class I	3.03	3.03	15.51	-0.94	0.94	2.73	4.90
J.P. Morgan EMBI Global Diversified Index	2.04	2.04	11.28	-1.40	0.71	3.05	5.15

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 0.82%. The net expense ratio is 0.74%, which reflects a contractual expense reimbursement in effect through 9/30/2024.

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 J.P. Morgan EMBI Global Diversified Index (EMBI Global Diversified) tracks total returns for U.S. dollar-denominated debt instruments issued by emerging markets sovereign and quasi-sovereign entities: Brady bonds, loans, and Eurobonds. The index limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global. 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.

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: 2011

James E. Craige, CFA

Industry start date: 1988

Start date as Fund Portfolio Manager: 2011

Stuart Sclater-Booth

Industry start date: 19992

Start date as Fund Portfolio Manager: 2017

Kumaran Damodaran, Ph.D.

Industry start date: 2000

Start date as Fund Portfolio Manager: 2015

David A. Oliver, CFA

Industry start date: 1986

Start date as Fund Portfolio Manager: 2011

Notes on Risk: Emerging Markets Investing: Emerging markets securities may be more volatile, or more greatly affected by negative conditions, than those of their counterparts in more established foreign markets. **Foreign Investing:** Investing in foreign securities subjects the portfolio 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. **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. **Currency Rate:** Fluctuations in the exchange rates between the U.S. dollar and foreign currencies may negatively affect the value of the portfolio's shares. **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. **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.

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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