Virtus Stone Harbor Emerging Markets Debt Fund

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

MARKET REVIEW

Sector Review "Broad Market"

The potential for a "softish" landing of the global economy provided a supportive backdrop for emerging markets (EM) debt returns in Q4. Risks related to growth and inflation were balanced for most of the period, though growth concerns increased at the quarter's end as the U.S. reported weakness in recent economic activity. The termination of the zero-COVID policy in China and introduction of new measures to support the Chinese property market highlighted concerns over growth among policy makers for the world's second largest economy. Nevertheless, with improvements in inflation data and the anchoring of inflation expectations by the U.S. Federal Reserve (the Fed), markets reversed some of the trends from earlier in the year: the U.S. dollar weakened; EM currencies appreciated; government bond yields fell; and credit spreads tightened. Modest inflows into EM credit markets resumed in Q4, but flows remained substantially negative for the year. Tracking indices for the three sectors of emerging markets (EM) debt[1]—hard currency sovereign debt, local currency sovereign debt, and hard currency corporate debt—delivered total returns of 8.11%, 8.45%, and 4.72%, respectively. These results outperformed other major credit sectors and contrasted with the negative returns for all of 2022.

For more on our quarterly market review and outlook, **click here**.

Investment Grade

The EM investment grade (IG) sovereign benchmark posted a total return of 5.19% in Q4. The largest contributors to the index's gains mirrored the largest detractors from benchmark returns last quarter. Indonesia, Chile, and Panama were the largest contributors this quarter, returning 6.49%, 7.80% and 7.72%, respectively. The largest detractors were Croatia, Poland and Kuwait, which returned 1.47%, 1.73%, and 2.42%, respectively. All investment grade countries posted positive returns, which were supported by falling U.S. Treasury yields. Spreads compressed in all countries except China, generating positive excess returns over U.S. Treasuries. Kazakhstan and Romania outperformed on a spread basis, posting excess returns of 9.05% and 9.50%, respectively.

High Yield

Non-investment grade or "high yield (HY)" bonds delivered on average a total return of 11.24%, with exceptional returns from several countries. The benchmark's standouts were Ecuador and Argentina, which posted total returns of 38.19% and 36.59%, respectively. Ecuador's gains reflected the country's appeasement of indigenous country leaders in an agreement reached in October and easing of political tensions ahead of upcoming regional elections. While social unrest remained a risk at the end of 2022, the government under President Guillermo Lasso had secured near-term financing sources from the IMF and other multilateral lenders. In Argentina, bond prices gained in October following the completion of the IMF's second review of the EFF, triggering a disbursement of US$3.8 billion. In December, the Executive Board of the IMF completed the third review of Argentina's 30-month Extended Fund Facility (EFF) arrangement on, allowing for an immediate disbursement of approximately US$6 billion and bringing total disbursements under the arrangement to roughly US$23.5 billion. The IMF funds are expected to be used to repay Argentina's obligations to the IMF as part of a previous lending program.

Venezuela debt, which has been excluded from benchmark return calculations since 2020, also posted standout returns, ranging from 88% to 121% depending on the issue. In November, the U.S. Office of Foreign Assets Control (OFAC) of the U.S. Treasury authorized Chevron's joint ventures in Venezuela to resume oil production and export to the United States. OFAC had suspended Chevron's production/exporting privileges in 2020. The authorization followed the resumption of talks between the Venezuela government under Nicolas Maduro and the opposition.

Suriname, Zambia, and Ghana, three countries currently in default on their external debt, underperformed with returns of -12.22%, -7.72% and -6.72%, respectively. In the cases of Suriname and Zambia, delays in debt restructuring negotiations weighed on bond prices. Ghana's debt standstill in October led to declines in the country's sovereign bond prices.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 11.24 % (net of fees) and 11.44% (gross of fees) in the fourth quarter versus the J.P. Morgan EMBI Global Diversified Index return of 8.11%.

Positive Contributors

> **Argentina Overweight and Issue Selection:** Argentina's bond prices gained in October following the completion of the IMF's second review of the EFF, triggering a disbursement of US$3.8 billion. In December, the Executive Board of the IMF completed the third review of Argentina's 30-month Extended Fund Facility (EFF) arrangement, allowing for an immediate disbursement of approximately US$6 billion and bringing total disbursements under the arrangement to roughly US$23.5 billion.

> **China Underweight:** China's sovereign spread widened 3 basis points as the benchmark spread tightened 108 basis points.

> **Venezuela Overweight:** While Venezuela's bonds remain restricted for U.S. investors, the country's sovereign and quasi sovereign bond prices moved higher during the period in response to limited scope of sanctions relief. In November, the U.S. Treasury Department issued a license to allow Chevron to resume some operations in the country for six months. Based on a joint statement by the US, Canada, the United Kingdom, and the European Union, the move to relieve some of the sanctions is intended to incentivize Nicolas Maduro to negotiate a process for a free and fair elections in 2024.

Performance Detractors

> **Mexico Off-benchmark Hard Currency Corporate Debt:** The Fund's exposure to Poinsettia Finance detracted from relative returns.

[1] J.P. Morgan EMBI Global Diversified, J.P. Morgan GBI-EM Global Diversified, and J.P. Morgan CEMBI Broad Diversified.

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- **Angola Issue Selection:** Out-of-benchmark, short duration, quarterly amortization bonds, underperformed longer duration bullet maturities.
- **Ecuador Overweight:** Ecuador bond prices declined as indigenous groups disputed the government's reduction of fuel price subsidies. Political uncertainties lingered, but the government announced in September that it had agreed with Chinese lenders to restructure outstanding financial debt, providing significant debt relief.

PERFORMANCE ATTRIBUTION BREAKDOWN as of 12/30/2022

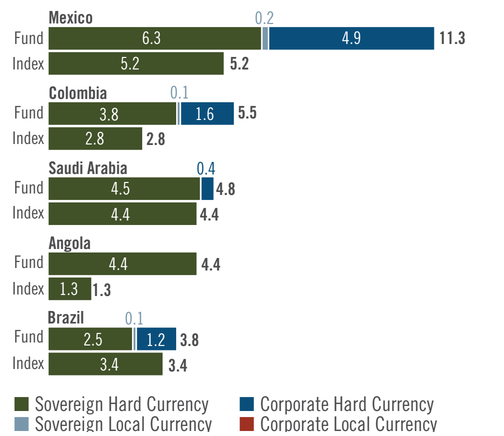
Portfolio (gross basis – USD)	11.44
JPM EMBIG DIV	8.11
Difference	**3.33**
Breakdown	
Hard Currency Sovereign Allocation	3.44
Country Selection	2.58
Issue Selection	0.86
Local Currency Allocation	**0.03**
FX Exposure	0.03
Yield & Yield Change	0.00
Hard Currency Corporate Allocation	**-0.44**
Country Selection	-0.44
Issue Selection	0.00
Treasury Attribution	**0.12**
Miscellaneous Difference	**0.19**

REGIONAL ALLOCATION

REGIONAL ALLOCATION	% Fund	Benchmark
Africa	20.05	12.33
Asia	9.82	18.33
Europe	10.89	14.06
Latin America	40.18	33.35
Middle East	14.29	21.94
Net Cash	4.76	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.

TOP 5 COUNTRIES (%)



SECTOR DISTRIBUTION

SECTOR DISTRIBUTION	% Fund	Benchmark
Sovereign Hard Currency	77.82	100.00
Corporate Hard Currency	16.17	0.00
Sovereign Local Currency	1.23	0.00
Corporate Local Currency	0.01	0.00
Net Cash	4.76	0.00

Sector weights are subject to change.

CURRENT FUND STRATEGY

Positioning

- Neutral U.S. Treasury duration
- Overweight non-investment grade bonds vs investment grade debt
- Regional overweights in Latin America and Africa and underweight in Asia and Europe
- Off-benchmark exposure in select local currency debt markets and U.S. dollar-denominated emerging market corporate debt

	YIELD (%)		RATING**		NOTABLE DEVIATIONS	
Strategy	**Portfolio**	**Relative***	**Portfolio**	**Benchmark**	**O/W**	**U/W**
Sovereign Hard Currency	11.24	2.89	BB-	BB-	Angola, Romania, Tunisia	China, Philippines, Oman
Corporate Hard Currency	11.87	N/A	BB	N/A	Mexico, Colombia, Brazil	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.**

OUTLOOK & STRATEGY

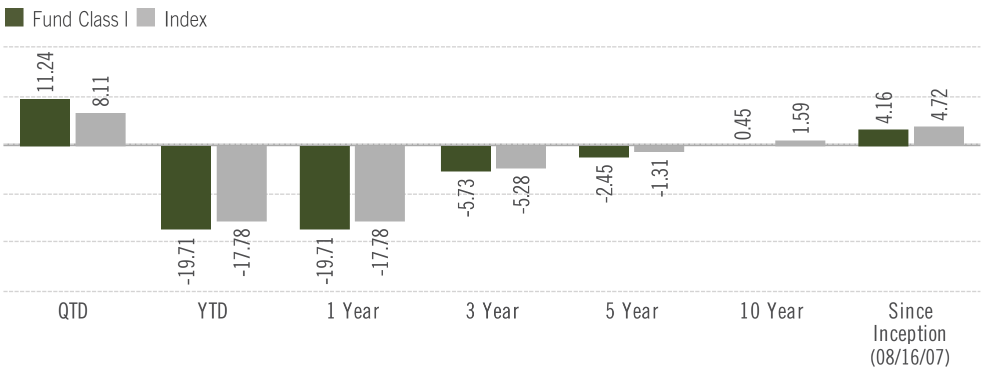
We expect slower growth, not recession, over the next 12 months and assign a 45% probability to this "softish landing" scenario, an increase from our assessment at the end of Q3. A central bank-led recession, driven by a combination of tighter monetary policies and elevated energy prices, remains a major risk, which we assign a 35% likelihood. In addition, since our publication of our Q4 Market Review and outlook, forward rates on U.S. inflation-linked securities further suggest that the Fed's interest rate hikes have anchored inflation expectations. Accordingly, we increased our estimated probability for a third scenario in which the Fed and other central banks ease monetary policies as inflation reverses course in response to lower growth (20% probability).

From today's valuations, we see attractive return potential for each of the segments of the market. Current bond prices are historically low, credit spreads are wide, real effective exchange rates are historically low relative to the US dollar, and local interest rates are high, particularly if inflation peaks in the near term in some EM countries, as we expect it will.

Price and yield dislocations remain largest in high yield sovereign debt, in our view. Despite the strong returns in Q4, EM sovereign bonds remained underpriced relative to developed country credit fixed income alternatives. Current spreads in the sub-investment grade segment of the external sovereign debt market ranked in the 93rd percentile of spreads over the past 20 years. When they have traded at today's spreads in the past two decades, EM sovereign high yield bonds have posted positive returns in 100% of the ensuing 1-year and 3-year investment periods. In comparison, U.S. high yield and U.S. investment grade corporate debt have also posted positive returns in many periods, but not as consistently as EM debt. While EM assets began to outperform in Q4, we believe their runway for continued outperformance remained long based on the historical experience.

In EM corporate debt, with few exceptions, credit fundamentals remain strong and provide significant buffers against risks of recession and inflation. We currently favor low-cost commodity producers, which continue to benefit from historically high commodity prices. In our base case, the number of EM companies in default decelerates as most of the defaults in Russia and in China's property sector have already occurred. We also anticipate favorable technical conditions for EM corporate debt in the year ahead.

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 0.80%. The net expense ratio is 0.73%, 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.

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
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Start date as Fund Portfolio Manager: 2017

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Industry start date: 2000
Start date as Fund Portfolio Manager: 2015

William Perry
Industry start date: 1984
Start date as Fund Portfolio Manager: 2012

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 thaninvestment 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. Price changes may be short- or long-term. Local, regional or global events such as war (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.

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