Virtus Stone Harbor Emerging Markets Debt Income Fund

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

MARKET REVIEW

Sector Review "Broad Market"

Emerging markets (EM) debt rebounded in Q4 as stabilizing inflation and the prospect of an easing in U.S. monetary policy turbocharged performance. Lower bond yields in developed countries, tempered inflation expectations, and a weaker U.S. dollar drove the improvement in performance. In December, the Federal Reserve (Fed) maintained its policy rate, recognizing that long-term inflation expectations had anchored helped by tighter monetary policy, while employment remained robust. The Fed's decision signaled potential rate cuts in 2024. A widespread rally ensued across EM external debt (sovereign and corporate), EM currencies and domestic bond markets. A key factor underpinning the more optimistic outlook for these markets was the leading role of EMs in disinflation.

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

Investment Grade

The IG sovereign benchmark returned 8.2% in Q4 as declining U.S. Treasury (UST) yields boosted performance. Spreads tightened 12 bps on average, with gains across most countries. Hungary (+10.9%), Mexico (+10.9%), and Indonesia (+10.1%) led the sector in total return. Panama underperformed (+2.5%) on mine closure concerns. Each region benefitted from the decline in developed market yields and spread compression.

Non-Investment Grade

The HY sovereign index gained 10.1%, led by sharp rebounds in stressed credits. Argentina (+38.4%) rallied on newly-elected President Javier Milei's announcement of cuts to state spending and peso devaluation. Pakistan (+34.6%) benefitted from IMF support despite political uncertainty. Tunisia (+21.2%) saw gains from surging tourism and exports. Venezuela outperformed with an 80.2% return on lifting of U.S. sanctions. At the regional level, recovering commodities revenue supported returns from Latin America. However, escalating geopolitical tensions weighed on Lebanon (-26%) and Ukraine (-7.3%), and declines in exports from the mining and natural gas sectors underscored Bolivia's 13.5% decline.

At the regional level, HY sovereigns outperformed IG bonds in Asia by 6.27% (14.37% vs 8.10%) but underperformed in Gulf States/Middle East by 1.99% (5.93% vs 7.92%). IG bonds from the Gulf States, which tend to issue debt with long-duration, benefitted most from the decline in UST yields.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 11.11% (net of fees) and 11.31% (gross of fees) in the fourth quarter versus the J.P. Morgan EMBI Global Diversified Index return of 9.16%. Country selection decisions in sovereign and corporate debt enhanced excess returns, as did issue selection among sovereigns. Foreign currency exposure also enhanced performance. The portfolio's small underweight in effective duration detracted modestly from relative returns.

Positive Contributors

> **Hard Currency Sovereign Debt:** overweights in Venezuela and Pakistan; underweights in China and Malaysia; and issue selection in Oman, Turkey, and Indonesia

> **Hard Currency Corporate Debt:** out-of-benchmark exposures in Ghana, Kazakhstan, and Singapore

> **Local Currency Sovereign Debt:** out-of-benchmark currency exposures in Brazil, Mexico, Poland, South Africa, China, and Thailand

Negative Contributors

> **Hard Currency Sovereign Debt:** overweights in Ecuador, Iraq, and Lebanon; issue selection in Peru and Angola; an underweight in Sri Lanka

> **Hard Currency Corporate Debt:** out-of-benchmark exposure in Mexico

> **Local Currency Sovereign Debt:** out-of-benchmark exposure in Indonesia

OUTLOOK & STRATEGY

Our base case (35% probability) assumes that inflation continues falling globally, growth slows, and the Fed keeps rates flat through early 2024 and starts cutting rates in the summer. If we are wrong, we believe the two most likely scenarios will lead the Fed to cut policy rates more aggressively, either to contain an economic downturn (25% probability), or to keep up with falling inflation while growth in the U.S. converges toward trend (30% probability). These point to lower U.S. policy rates by mid-year. Another scenario leads the Fed to hike policy rates as inflation turns back higher. We only assign a 10% probability to this outcome.

Yield and carry continue to support strong, positive projected returns on external sovereign and corporate debt, in our view. The yield on the JP Morgan EMBI Global Diversified has declined to 7.9% from 8.6% a year ago, while the high yield portion of the benchmark yields 11% compared to 12.26% a year ago. However, yields on both of these market segments remain 250 basis points above their average yields over the past decade. Similarly, yields of U.S. dollar-denominated corporate bonds from emerging markets are 140 bps above the ten-year average yield. To generate negative returns on sovereign or corporate debt over the next year would require significant combined shifts higher in U.S. Treasury yields and spreads, outcomes we believe have low probabilities in the current environment.

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Effective January 30, 2023, this Fund's name has changed.

PERFORMANCE ATTRIBUTION BREAKDOWN as of 12/31/2023

Portfolio (gross basis – USD)	11.31
JPM EMBIG DIV	9.16
Difference	**2.15**
Breakdown	
Hard Currency Sovereign Allocation	**2.15**
Country Selection	1.91
Issue Selection	**0.25**
Local Currency Allocation	**0.02**
FX Exposure	0.07
Yield & Yield Change	-0.05
Hard Currency Corporate Allocation	**0.07**
Country Selection	0.07
Issue Selection	0.00
Treasury Attribution	**-0.03**
Miscellaneous Difference	**-0.06**

REGIONAL ALLOCATION

REGIONAL ALLOCATION	% Fund	Benchmark
Africa	14.58	11.51
Asia	11.92	18.04
Europe	15.13	15.04
Latin America	36.40	33.46
Middle East	21.33	21.96
Net Cash	0.65	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

SECTOR DISTRIBUTION	% Fund	Benchmark
Sovereign Hard Currency	83.43	100.00
Corporate Hard Currency	14.06	0.00
Sovereign Local Currency	1.86	0.00
Corporate Local Currency	0.00	0.00
Net Cash	0.65	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	4.02	5.12	0.26	0.00	4.38	0.00	8.66	5.12
Turkey	4.43	4.65	0.00	0.00	0.32	0.00	4.75	4.65
Saudi Arabia	4.51	4.81	0.00	0.00	0.05	0.00	4.55	4.81
Indonesia	3.62	4.91	0.19	0.00	0.72	0.00	4.54	4.91
Colombia	3.09	2.99	0.12	0.00	0.85	0.00	4.06	2.99

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 India, Kazakhstan, and Mexico.

	YIELD (%)		RATING**		NOTABLE DEVIATIONS	
Strategy	Portfolio	Relative*	Portfolio	Benchmark	O/W	U/W
Sovereign Hard Currency	7.48	0.83	BB	BB+	Iraq, Venezuela, Ghana	China, Malaysia, Uruguay
Corporate Hard Currency	9.54	N/A	BB	N/A	Mexico, Kazakhstan, India	N/A†
Sovereign Local Currency	7.18	N/A	BBB+	N/A	Brazil, Mexico, Thailand	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 12/31/23

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 08/16/07
Class I	11.11	14.82	14.82	-3.50	2.08	2.79	4.78
J.P. Morgan EMBI Global Diversified Index	9.16	11.09	11.09	-3.56	1.67	3.22	5.10

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 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. 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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