Virtus Stone Harbor Local Markets Fund

A: VSHEX (92828Y524) | I: SHLMX (92828Y516)

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**.

Currencies

EM currency gains in Q4 of 4.2% reflected the depreciation of the U.S. dollar and Euro strength, which supported currencies from Central and Eastern Europe. The largest gains came from Hungary and Poland, which appreciated by 15.1% and 12.6%, respectively, roughly mirroring last quarter's results. European currencies on average gained 11%. Currencies from Asia and Latin America returned 3.56% and 2.52%, respectively, with appreciation of the Thai baht (+ 9.24%) and the Chilean peso (+12.44%) leading the two regions. Indonesia's rupiah reached a two-year low during the period but stabilized as the Bank of Indonesia intervened; the rupiah declined by -2.18%. The Dominican Republic peso and Colombian peso lagged in Latin America with returns of -4.93% and -5.26%, respectively. In Africa, the downturn of the Egyptian pound -21.07% dominated returns from the region. The pound's selloff accompanied the planned liberalization of the currency as a prior action of a new loan from the IMF, which approved an EFF of US$3 billion on 27 October. South Africa's rand outperformed, returning 5.63%.

Interest Rates

Yields in each EM region declined, reversing some of the increases from the prior quarter. At the regional level, local bond yields fell most in Central and Eastern Europe, where every country's bond market recorded positive returns. In Asia and Latin America, the results were mixed. In Asia, yields fell in Indonesia, Malaysia, Philippines, and Thailand, but increased modestly in China, one of the strongest performing domestic government bond markets in 2022. In Latin America, Chile's bonds outperformed on the government's plans to create a mixed pension system including public and private asset managers. Domestic bond market participants in Chile viewed the development positively as the reform will enable private managers to retain current funds under management. Yields in Mexico, Peru and Uruguay also declined, while Brazil, Colombia, and Dominican Republic yields increased.

Monetary policy tightening or maintenance of elevated policy interest rates kept real interest rates at positive levels in many countries, helping to contain some of the negative spillover effects of rising inflation. At the end of the quarter, countries with positive real interest rates after adjusting for expected inflation over the next 12 months included Brazil, Chile, Colombia, Indonesia, Mexico, Peru, South Africa, and Ukraine.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 7.31% (net of fees) and 7.58% (gross of fees) in the third quarter versus the J.P. Morgan GBI-EM Global Diversified Index return of 8.45%.

Positive Contributors

> **Colombia:** Duration overweight and issue selection.
> **Romania:** Duration overweight and issue selection.
> **South Africa:** Duration overweight.

Negative Contributors

> **Russia:** FX overweight and issue selection.
> **Indonesia:** FX overweight and issue selection.
> **Hungary:** FX underweight and issue selection.

[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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PERFORMANCE ATTRIBUTION BREAKDOWN as of 12/30/2022

Portfolio (gross basis - USD)	7.58
JPM GBI-EMG DIV	8.45
Difference	**-0.87**
Breakdown	
FX Attribution	-0.65
Duration Attribution	-0.21
Issue, Taxes & Other Attribution	-0.13
Miscellaneous Difference	**0.12**

REGIONAL ALLOCATION

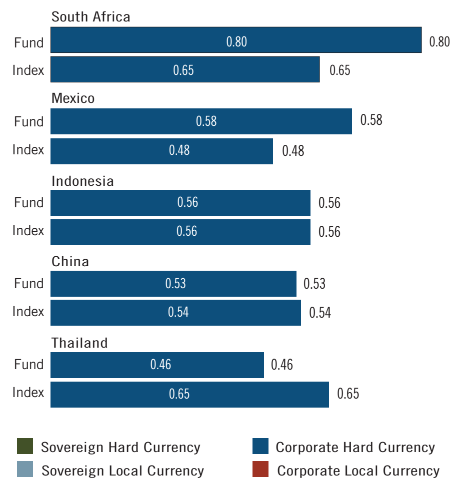
REGIONAL ALLOCATION	% Fund	Benchmark
Africa	13.48	11.17
Asia	29.19	40.07
Europe	16.45	20.31
Latin America	37.29	28.45
Middle East	0.00	0.00
Net Cash	3.59	0.00

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 FX EXPOSURES

TOP 5 FX EXPOSURES	% Fund	Benchmark
Indonesian rupiah	11.09	10.00
Mexican peso	10.95	10.00
Chinese yuan	10.12	10.00
South African rand	10.11	10.00
Brazilian real	10.08	10.00

TOP 5 COUNTRIES (%)



CURRENT FUND STRATEGY

Positioning

> **FX:** Overweight Latin America and Africa (South Africa). Underweight Asia and Central & Eastern Europe

> **Duration:** Neutral relative to benchmark with overweights in select countries including Brazil, Colombia, Mexico, Romania and South Africa. Positioned for roll-down on steep yield curves in Colombia, Indonesia, Romania and South Africa

	YIELD (%)		RATING**		NOTABLE DEVIATIONS			
Strategy	**Portfolio**	**Relative***	**Portfolio**	**Benchmark**	**O/W**		**U/W**	
EM Local Currency Sovereign Debt	7.44	0.12	BBB+	BBB	Duration:	Colombia, South Africa, Mexico	Duration:	Thailand, Malaysia, Czech Republic
					FX:	IDR, RUB, MXN	FX:	CZK, MYR, HUF
					Credit:	Poland, Egypt	Credit:	N/A†

*Relative to **JPMorgan GBI-EM 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 GBI-EM Global Diversified
Benchmark: **JPMorgan GBI-EM Global Diversified Index**.

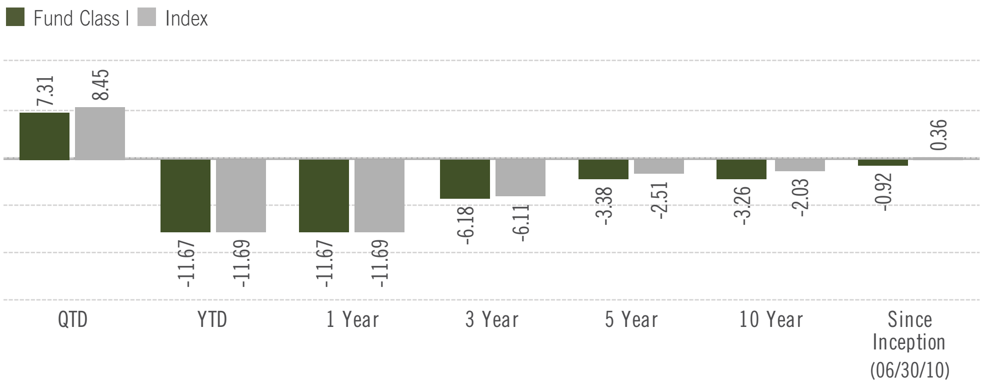
OUTLOOK & STRATEGY

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 local currency debt. 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. Currencies from countries that continue to benefit from elevated terms of trade, including the Mexican peso, the Indonesian rupiah, and the South African rand, are poised to appreciate relative to the U.S. dollar, in our view.

Inflation remains a key factor in the future performance of domestic bonds. Once inflation momentum slows, EM central banks will have room to cut rates again to support growth. We currently favor local debt markets in Mexico, Indonesia, and South Africa, where fundamental developments are favorable and index yield levels remain high relative to forward estimates of inflation. Average bond yields in Mexico, Indonesia, and South Africa closed 2022 at 9.2%, 6.9% and 11%, respectively. In addition, we see attractive opportunities for capturing rolldown returns from steep local bond yield curves in Columbia, Indonesia, Romania, and South Africa.

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 1.23%. The net expense ratio is 1.01%, 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 GBI-EM Global Diversified Index** consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. The weightings among the countries are more evenly distributed within this index. 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

Kumaran Damodaran, Ph.D.
Industry start date: 2000
Start date as Fund Portfolio Manager: 2015

Stuart Sclater-Booth
Industry start date: 1992
Start date as Fund Portfolio Manager: 2017

David A. Oliver, CFA
Industry start date: 1986
Start date as Fund Portfolio Manager: 2011

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

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 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.

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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