VIRTUS FUNDS

Virtus Stone Harbor Local Markets Fund

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

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**.

Currencies

EM currencies appreciated relative to the U.S. dollar by 3.2%. Eastern Europe outperformed, led by the Polish zloty and Hungarian forint. Latin America gained 3.0%, led by the Brazilian real and Colombian peso. Laggards included the Turkish lira on inflation differentials, the Dominican Republic's peso on a surprise October policy rate cut and the Uruguay peso, which suffered from the drag coming from a 50% depreciation of Argentina's peso.

Interest Rates

Local bond yields fell 57 basis points to an average yield of 6.2% as yields on 10-year USTs and Bunds declined. Latin America saw the largest declines with yields falling over 120 bps in Brazil, 160 bps in Colombia and 94 bps in Mexico. In Eastern Europe, yields dropped 158 bps in Hungary. South Africa also fell 84 bps on slowing inflation. Asia yields declined 24 bps; however, there was a 21 bps rise in the Philippines.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 9.53% (net of fees) and 9.80% (gross of fees) in the fourth quarter versus the J.P. Morgan GBI-EM Global Diversified Index return of 8.07%. Duration decisions and issue selection enhanced excess returns while currency selection detracted from relative performance.

Positive Contributors

> **Currencies:** Underweights in Chile, China, Dominican Republic, and Malaysia, and overweights in Colombia, Kazakhstan, Russia, and Thailand

> **Interest Rate Duration:** Overweights in Brazil, Colombia, Mexico, Romania, and South Africa

> **Issue Selection, Taxes and Other:** Brazil, Colombia, Egypt*, Mexico, and Poland

Negative Contributors

> **Currencies:** Overweights in India, Indonesia, and Uruguay

> **Interest Rate Duration:** Underweights in Chile, Hungary, Malaysia, and Thailand

> **Issue Selection, Taxes and Other:** China, India, Malaysia, Russia, and Thailand

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.

In all the four scenarios, we see positive returns from EM local bond duration, given the ongoing disinflation in many EM economies. This view worked well in Q4, and we will be looking for relative value opportunities to take advantage of exposure to countries experiencing declining inflation and where bond yields may have lagged during the end of 2023 rally.

At the end of 2023, the portfolio is positioned to monetize this view through overweights in bonds from countries where we see room for easing of monetary policy, in particular Brazil, Mexico, and South Africa. In currencies, we favor currencies from India, Mexico, and Thailand.

***The portfolio sold its position in Egypt on 9 May 2023,** but local FX inconvertibility prevented repatriation of proceeds, which were marked to market by index provider JP Morgan beginning in December 2023 using an alternative FX rate. This remarking of the benchmark led to a decline in the index value of Egypt.

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PERFORMANCE ATTRIBUTION BREAKDOWN as of 12/31/2023

Portfolio (gross basis - USD)	9.80
JPM GBI-EMG DIV	8.07
Difference	**1.73**
Breakdown	
FX Attribution	-0.06
Duration Attribution	0.71
Issue, Taxes & Other Attribution	0.76
Miscellaneous Difference	**0.32**

REGIONAL ALLOCATION	% Fund	Benchmark
Africa	10.56	9.06
Asia	30.83	39.71
Europe	18.29	22.15
Latin America	36.19	29.08
Middle East	0.00	0.00
Net Cash	4.13	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	% Fund	Benchmark
Mexican peso	10.67	10.00
Brazilian real	10.58	10.00
Indonesian rupiah	10.36	10.00
Thai bhat	10.38	9.65
Malaysian ringgit	9.43	10.00

TOP 5 DURATION CONTRIBUTION BY COUNTRIES (YEARS)

	Fund	Index
Mexico	0.72	0.47
South Africa	0.71	0.50
Indonesia	0.56	0.57
Malaysia	0.53	0.65
Thailand	0.49	0.62

CURRENT FUND STRATEGY

Positioning

> **FX:** Overweights in India, Mexico, and Thailand. FX underweights in Colombia, China, and Romania

> **Duration:** Overweights in Brazil, Mexico, and South Africa. Underweight in China, Malaysia, and Thailand

	YIELD (%)		RATING**		NOTABLE DEVIATIONS			
Strategy	Portfolio	Relative*	Portfolio	Benchmark	O/W		U/W	
EM Local Currency Sovereign Debt	7.18	0.66	BBB+	BBB+	Duration:	Mexico, South Africa, Brazil	Duration:	Thailand, Malaysia, China
					FX:	INR, MXN, THB	FX:	CLP, CNY, RON
						Poland	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**.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/23

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 06/30/10
Class I	9.53	12.02	12.02	-3.17	0.90	-0.84	-0.02
JPMorgan GBI-EM Global Diversified Index	8.07	12.70	12.70	-3.16	1.14	0.09	1.22

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 1.26%. The net expense ratio is 1.00%, 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 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: 19992
Start date as Fund Portfolio Manager: 2017

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.

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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