VIRTUS MUTUAL FUNDS

Virtus Herzfeld Fund

A: VHFAX (92828W874) | C: VHFCX (92828W866) | I: VHFIX (92828W858)

MARKET REVIEW

Closed-end funds (CEFs) rebounded after a weak first quarter, gaining an average of 2.06% as discounts narrowed from -6.21% to -5.54%. Six of the seven fund categories we track exhibited discount narrowing. Senior loans were the sole exception, widening 188 basis points in the quarter despite an average gain of 1.00% at NAV. The CEF universe is still underwater for the year despite the second quarter rebound as two-thirds of all CEFs have negative returns. However, there has been a wide disparity in returns as domestic funds, both equity and fixed income, vastly outperformed foreign funds, both equity and fixed income. As the trade war heats up, investors have been less inclined to invest overseas as there is more uncertainty and increased currency risk in those investments.

PERFORMANCE

For the second quarter, the Fund (Class I) returned 2.30%, outperforming the 0.26% return of the composite benchmark. At quarter-end, the average weighted discount of the CEF holdings in the portfolio was -9.85%, compared with -10.13% in the previous quarter—a narrowing of 28 basis points. The outperformance was attributed to the rebound in energy CEFs during the quarter and a large rights offering that we participated in.

Top contributors to performance were energy and MLP CEFs, NexPoint Strategic Opportunities Fund (NHF), and healthcare CEFs.

> Energy and MLP CEFs were the runaway winners in the quarter, as they rebounded from a weak first quarter. Our energy positions gained an average of 11.18% in the quarter and were responsible for 1.37 percentage points of the Fund's returns. They continue to be inexpensive based on historical underlying valuations and wide discounts, and we expect them to increase their distributions.

> The Fund participated in a 1-for-3 rights offering by NHF in June where we were able to purchase a large position at the $21.30 offering price. NHF finished the month at $21.95, with an additional $0.20 distribution, for a total return of 3.98% from the purchase date. This is the third corporate action for NHF that we have participated in, with the prior two events also generating significant alpha.

> Our three healthcare CEF holdings gained between 3.05% and 6.84% in the quarter despite all of them exhibiting discount widening. Our Tekla Capital-managed CEFs renewed their share buyback programs of up to 12% of outstanding shares for the next year, which we believe should put a floor on further widening discounts.

Top detractors to performance were emerging markets CEFs, Boulder Growth and Income Fund (BIF), and Asian CEFs.

> The Fund participated in a 32.5% tender offer for Aberdeen Emerging Market Equity Income Fund (AEF) that ended up being the worst performer in the quarter. The tender offer coincided with a major selloff in emerging markets. We tendered all shares so our position was locked up until after the tender was finalized. AEF ending up selling off more than the benefit of the tendered shares, resulting in a rare loss around a corporate action for the Fund.

> BIF was our largest detractor as it is one of the Fund's largest positions and it dropped 3.72% in the quarter. BIF's large concentration in financials was the major driver of the underperformance as its three largest holdings—Berkshire Hathaway A shares, JPMorgan Chase & Co., and Berkshire Hathaway B shares—declined 5.70%, 4.77%, and 6.43%, respectively, in the quarter. BIF's discount also widened 110 basis points in addition to the poor underlying performance.

> Our exposure to Asian CEFs took a hit late in the quarter as the Trump administration's trade tariffs led to a sharp selloff in Asian securities. Our holdings in China Fund (CHN), Taiwan Fund (TWN), Japan Smaller Capitalization Fund (JOF), Templeton Dragon Fund (TDF), and Aberdeen Japan Equity Fund (JEQ) all dropped as the trade war with China heated up and investors expected trade disruptions and more economic uncertainty for the largest economy in the region.

OUTLOOK

We remain bullish on energy and healthcare CEFs while continuing to add to some of our deeply discounted fixed income CEF holdings that stand to benefit from rising short-term rates. Discounts remain wide in energy CEFs even though they continue to trade near all-time low valuations with solid growth estimates. Oil also closed the quarter at multi-year highs, and we expect energy CEFs to play some catch-up to the price of oil. Cheap valuations, potential M&A, and recent potential breakthroughs in the treatment of Parkinson's disease and ALS should continue to lead the healthcare rally.

Virtus Herzfeld Fund

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Thomas J. Herzfeld Advisors

PORTFOLIO MANAGERS

Thomas J. Herzfeld
Industry start date: 1968
Start date with Fund: 2012

Erik M. Herzfeld
Industry start date: 1998
Start date with Fund: 2012

TOP TEN HOLDINGS

	% Fund
NexPoint Strategic Opportunities Fund	11.09
Central Securities Corp.	6.65
Boulder Growth & Income Fund Inc.	5.36
Tekla Healthcare Opportunities Fund	5.25
Eagle Point Credit Co., Inc.	4.07
Adams Natural Resources Fund Inc.	3.89
Tekla World Healthcare Fund	3.78
iShares Floating Rate Bond ETF	3.57
PIMCO Enhanced Short Maturity Active ETF	3.16
Aberdeen Total Dynamic Dividend Fund ofBenef Interest	2.97

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 9/5/2012
Fund Class I	2.30	0.11	7.94	8.23	8.39	n/a	8.19
Index	0.26	-0.83	6.25	5.70	6.64	n/a	6.89

Performance data quoted represents past results. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate so your shares, when redeemed, may be worth more or less than their original cost. Please visit virtus.com for performance data current to the most recent month-end.

The fund class gross expense ratio is 2.37%. The net expense ratio is 2.35%, which reflects a contractual expense reimbursement in effect through 1/31/2019. This ratio reflects the direct and indirect expenses paid by the Fund.

The net expense ratio minus the indirect expenses incurred by the underlying funds in which the Fund invests is 1.35%.

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. Class I shares have no sales charges or distribution or service fees, therefore their returns do not reflect these expenses. Fees and expenses vary, and other share classes are subject to sales charges and fees. Class I shares are offered primarily to eligible institutional investors who purchase the minimum amounts required as described in the prospectus and may not be available to all investors. For fund performance on other share classes, please visit www.virtus.com.

Index: Composite: **60% MSCI AC World Index (net) / 40% Bloomberg Barclays U.S. Aggregate Bond Index**. The MSCI AC World Index (net) is a free float-adjusted market capitalization-weighted index that measures equity performance of developed and emerging markets. The index is calculated on a total return basis with net dividends reinvested. The Bloomberg Barclays U.S. Aggregate Bond Index measures the U.S. investment grade fixed rate bond market. 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.

Notes on Risk: Closed-end Funds: Closed-end funds may trade at a discount from their net asset values, which may affect whether the fund will realize gains or losses. They may also employ leverage, which may increase volatility. **Equity Securities:** The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Credit & Interest:** Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Fund of Funds:** Because the fund can invest in other funds, it indirectly bears its proportionate share of the operating expenses and management fees of the underlying fund(s). **Prospectus:** For additional information on risks, please see the fund's prospectus.

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