

Virtus KAR International Small-Cap Fund

A: VISAX (92828W841) | C: VCISX (92828W833) | I: VIISX (92828W825) | R6: VRISX (92828W551)

MARKET REVIEW

The MSCI All Country World ex U.S. Small Cap Index declined 2.60% in the second quarter, driven primarily by the strengthening U.S. dollar, which appreciated 5.00% (U.S. Dollar Index). Energy was the only sector within the Index to post a gain. More defensive sectors, such as consumer staples and healthcare, maintained smaller losses compared to financials and industrials, which were significantly more affected. The rising U.S. dollar also had a disproportionate impact on emerging market stocks, which saw losses that were significantly greater than those in developed market stocks during the quarter and for the year.

PERFORMANCE

The Fund (Class I) returned 2.29% in the quarter, outperforming the -2.60% return of its benchmark, the MSCI All Country World ex U.S. Small Cap Index. It was the second consecutive quarter in which the Fund had positive returns while the Index declined. Given the more defensive nature of our holdings, we typically expect our portfolio to outperform the benchmark in volatile or down markets.

The strongest contributors to performance were Autohome, Auto Trader, and Rightmove.

- > Autohome, which operates the leading online automotive information destination in China, was once again the largest contributor to performance. We have written about Autohome extensively in previous commentaries as it was our largest detractor from performance in 2016 and then by far our best-performing stock in 2017 and 2018. The company's margins have continued to expand since exiting its unprofitable e-commerce initiative, and the exceptional characteristics of its core media and lead-generation business have become more evident to investors.
- > Two other online classifieds holdings, Auto Trader and Rightmove, were among the top contributors in the quarter, as well. Auto Trader and Rightmove operate the leading automotive and real estate portals in the U.K., respectively. In addition to generating consistently strong earnings results, both companies' shares increased following the May announcement of the sale of U.K.-listed ZPG, a comparable business, to private equity firm Silver Lake at a substantial premium.

Wawel, WABCO, and Vostok New Ventures were the portfolio's weakest performers.

- > The largest detractor was Zaklady Przemyslu Cukierniczego Wawel (Wawel), a leading confectionary company in Poland. There were no negative fundamental developments at Wawel during the quarter, but the stock has been down this year more or less in line with the overall Polish market, which has been weak.
- > Commercial vehicle parts manufacturer WABCO's recent financial results showed organic growth in revenues and an improvement in profit margins. As a result, management increased its guidance for the year, but the company's shares have remained weak due to fears of rising inflation and the potential dampening of future results. We have no special insight regarding inflation and tariffs, so we remain focused on assessing the strength of the company's competitive position, which remains intact. Many tailwinds remain in place and WABCO is positioned to continue to outgrow global commercial-truck production by increasing its content per vehicle. As a result, we remain owners of the business.
- > Vostok New Ventures, an investment holding company listed in Sweden, also detracted from performance. While the stock was essentially flat, a decline in the Swedish krona resulted in negative returns in U.S. dollar terms. The relatively large weight of our holding in Vostok made it one of the larger detractors. There are no fundamental concerns for Vostok, and the stock has meaningfully outperformed overall in 2018.

PORTFOLIO CHANGES

During the quarter, the Fund purchased CAREL Industries, an Italian manufacturer of technology and humidification systems for air conditioning and refrigeration, Money Forward, a Japanese software company, and Chinese technology company SINA Corp.

The Fund sold three holdings in the quarter: German project management company Amadeus Fire, Qualitech Public Company, an engineering services business in Thailand, and Rimoni Industries, an industrial mold manufacturer in Israel.

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS



Craig Stone
Industry start date: 1989
Start date with Fund: 2012



Craig Thrasher, CFA
Industry start date: 2003
Start date with Fund: 2012

TOP TEN HOLDINGS

	% Fund
Auto Trader Group PLC	5.65
Rightmove PLC	5.44
Scout24 AG	4.90
Vostok New Ventures Ltd. Shs	4.80
Swedish Depository Receipts	4.15
Autohome, Inc. Sponsored ADR Class A	4.15
Sabre Insurance Group PLC	3.55
WABCO Holdings Inc.	3.42
Pason Systems Inc.	3.04
Alten SA	3.03
Haw Par Corp. Ltd.	2.99

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	2.29	7.91	16.89	15.12	13.21	n/a	14.75
Index	-2.60	-2.94	10.57	7.94	8.98	n/a	9.91

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 1.44%. The net expense ratio is 1.40%, 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: The **MSCI ACWI ex U.S. Small Cap Index (net)** is a free float-adjusted market capitalization-weighted index that measures small-cap equity performance of developed and emerging markets, excluding the U.S. The index is calculated on a total return basis with net dividends reinvested. 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: 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. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Limited Number of Investments:** Because the fund has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a less concentrated fund. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund. **Prospectus:** For additional information on risks, please see the fund's prospectus.

The commentary is the opinion of the subadviser. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

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