

Virtus KAR International Small-Cap Fund

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

MARKET REVIEW

International small-cap equities, as measured by the MSCI All Country World ex. U.S. Small Cap Index, declined 1.51% in the third quarter. Through quarter-end, the benchmark index was down 4.41% year to date, and down 10.17% from the peak level reached in January 2018.

In 2017 and early 2018, investor optimism was being fueled by improving economic conditions globally—the so-called synchronized growth story. The picture is clearly much different now. While the U.S. markets have continued to move higher, global stocks have suffered as the growth outlook has deteriorated in many areas. After a strong 2017, growth in Europe has started to slow. China is attempting to rein in ballooning debt levels while dealing with escalating trade tensions with the U.S. Emerging markets broadly have suffered from U.S. dollar strength, as well as from country-specific issues in places like Turkey. Collectively, this has been a significant headwind for global equities.

During the quarter's selloff, declines were broad-based, with emerging markets faring worse than developed markets. Chinese stocks were particularly weak, reflecting weaker economic data and increasing trade fears. In general, areas perceived as offering relative safety outperformed. In terms of countries, Japan and South Korea were relatively strong performers. As for sectors, healthcare performed particularly well on a relative basis, up for the quarter and for the year. Another standout sector was energy, which benefited from rising oil prices.

PERFORMANCE

The Fund (Class I) underperformed the MSCI All Country World ex. U.S. Small Cap Index during the quarter, with a -3.53% return versus the benchmark's -1.51%.

The Fund's underperformance was largely driven by significant declines in our two U.S.-listed Chinese ADRs: Autohome and SINA. Autohome operates the leading online automotive information destination in China, and has been the top contributor to portfolio performance over the last two years. SINA is a technology company whose largest asset is a controlling stake in Weibo, one of the largest social media platforms in China. The stocks have sold off along with many other Chinese companies as investors have increasingly become concerned about a slowdown in the Chinese economy and escalating trade tensions. The fundamentals of both businesses continue to be sound, with excellent revenue and profit growth reported in the most recent quarter.

Two online classifieds holdings, U.K.-based Rightmove and Scout24 in Germany, declined in the quarter following a strong first half of the year (both stocks were top contributors to Fund performance in the second quarter). Both companies have exhibited remarkably consistent results with strong pricing power, leading to steady earnings growth.

On the positive side, our largest contributor to performance was Webstep, an IT consulting firm located in Norway. The company reported strong earnings results in the second quarter, with significantly better-than-expected revenue and profit growth.

Lumax International, the leading process control solutions provider in Taiwan, was another strong performer in the quarter. After a period of lackluster growth due to a lack of capital spending in the oil and gas sector, Lumax reported exceptional results in the second quarter, with revenues up 27% and earnings up more than 100%.

Auto Trader, the largest online automotive classifieds marketplace in the U.K., also performed relatively well. Despite dampened demand for new and used cars in the U.K., Auto Trader has continued to grow revenues and increase margins due to its strong pricing power and new product offerings.

PORTFOLIO CHANGES

During the quarter, the Fund sold several holdings: French engineering consulting firm Altran and two Japanese holdings, Firstlogic, which operates an online real estate marketplace, and Interworks, a recruitment website. The Fund did not make any new purchases during the quarter.

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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	4.92
Vostok New Ventures Ltd. Shs Swedish Depository Receipts	4.73
Rightmove PLC	4.68
Scout24 AG	4.30
Sabre Insurance Group PLC	3.96
Haw Par Corp. Ltd.	3.63
WABCO Holdings Inc.	3.56
Autohome, Inc. Sponsored ADR Class A	3.32
SINA Corp.	3.12
Alten SA	3.07

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 9/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 9/5/2012
Fund Class I	-3.53	4.11	7.58	19.74	9.98	n/a	13.43
Index	-1.51	-4.41	1.86	11.24	6.14	n/a	9.21

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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