

## 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 USA Small Cap Index declined slightly in what was a volatile first quarter. Global equities performed well in January, driven by the ongoing theme of synchronized economic growth around the globe. Performance reversed in dramatic fashion in February and March, with equities declining substantially due to increased concern over inflation and trade disputes. Given heightened market uncertainty, more defensive sectors like healthcare and consumer staples outperformed, while more economically sensitive sectors like energy and materials performed poorly.

### PERFORMANCE

The Fund (Class I) outperformed its benchmark, the MSCI All Country World Ex USA Small Cap Index, producing a positive return of 5.50% in a down quarter for the benchmark, which returned -0.35%. Given the more defensive nature of our holdings, we typically expect our portfolio to outperform the benchmark in volatile or down markets.

Autohome and Vostok New Ventures were the largest contributors to performance in the quarter.

- > Autohome, which operates the leading online automotive-information destination in China, was 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. Autohome's profitability has improved dramatically since the company exited its unprofitable e-commerce initiative, allowing the exceptional characteristics of its core media and lead-generation businesses to become more salient to investors.
- > Vostok New Ventures, an investment holding company in Sweden, also had strong first-quarter performance. Vostok owns stakes in a variety of non-publicly listed entities around the world. The stock reacted positively to Vostok's full-year 2017 earnings announcement, which indicated that the company's largest holding, Russian online classifieds company Avito, recorded accelerating revenue growth and increasing profit margins.

JOST Werke and Sniezka were the largest detractors from performance in the quarter.

- > JOST Werke, a leading global producer of safety-critical commercial truck and trailer components, was the largest detractor from performance. The stock declined in March after an analyst at a large investment bank downgraded it, citing a lack of near-term share price catalysts. As long-term investors, we do not consider near-term catalysts to be an important part of our analysis. Instead, we focus on the long-term competitive position of the company, which continues to be robust.

- > Sniezka, a leading paint company in Poland, also underperformed in the first quarter. The company reported uninspiring results, as price increases in raw materials led the company to raise prices to their customers, which dampened demand. Overall, the company remains well positioned and highly profitable, and continues to distribute substantial and growing dividends to shareholders.

### PORTFOLIO CHANGES

During the quarter, the Fund purchased Douzone Bizon, a computer software company in South Korea, and sold Distell Group, a multinational brewing and beverage company in South Africa.

### NEW GICS SECTOR: COMMUNICATION SERVICES

Last quarter, we discussed having a number of holdings in the online classifieds industry because we believe the economics are exceptional and durable for the dominant incumbent players that we own. These investments account for a large weight in the portfolio in the information technology sector, as categorized by the Global Industry Classification Standard (GICS).

We have always believed that these companies are more like media companies than technology companies, since they have displaced the local newspaper as the primary method of advertising real estate, automobiles, and jobs. Recently, GICS announced that it will be creating a new sector, communication services, to reflect the evolving nature of the media landscape. The online classifieds investments that we hold will be moved to this new sector, which will significantly change our sector exposure in terms of GICS classifications. Most notably, our weighting in information technology will be reduced dramatically, and we will have a substantial weight in the new communication services sector.

These changes are anticipated to be implemented at the end of the third quarter of 2018. They will have no actual impact on the portfolio or how we invest. We only point it out because it will have a substantial impact on portfolio composition as categorized by some third-party information providers, and because we have received a number of questions recently about our large exposure to the technology sector.

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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

Autohome, Inc. Sponsored ADR Class A	5.20
Rightmove PLC	5.15
Auto Trader Group PLC	5.13
Vostok New Ventures Ltd. Shs Swedish Depository Receipts	4.95
Scout24 AG	4.89
Fabryka Farb i Lakierow Sniezka S.A.	3.24
Ascential PLC	3.22
Alten SA	2.98
Howden Joinery Group PLC	2.94
Heineken Malaysia Bhd.	2.75

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 9/5/2012
Fund Class I	5.50	5.50	24.45	15.61	12.88	n/a	15.00
Index	-0.35	-0.35	20.60	10.40	8.57	n/a	10.90

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](http://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](http://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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