

## 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 increased 6.56% in the fourth quarter of 2017 and returned 31.70% for the year. Accelerating economic growth across all major economies led to particularly strong global equity markets in 2017. International returns were also bolstered by an approximately 10% decline in the U.S. dollar over the course of the year. Emerging market equities outperformed developed markets, with small-cap stocks in India and Brazil advancing over 50%. All sectors had robust gains in 2017 with the exception of energy, which, despite rising oil prices, had flatter returns.

### PERFORMANCE

The Fund underperformed the MSCI All Country World ex. U.S. Small Cap Index in the fourth quarter, with a return of 3.33% (Class I) versus 6.56% for the benchmark, and also underperformed for the year, with a return of 28.48% (Class I) versus 31.65% for the benchmark. Given the strong market performance and the tendency of our companies to be more defensive in nature, this result is not surprising.

For the year, Autohome and Euler Hermes were the largest contributors to performance.

> Autohome, which operates the leading online automotive information destination in China, was by far the largest contributor to performance in 2017 – and once again a top contributor in the quarter. We have written about Autohome in the past as it was one of our worst-performing stocks in 2015 and 2016. However, over the last year, Autohome shares increased dramatically as recent cost reductions in unprofitable business lines led to dramatic margin improvement and highlighted the strength of the company's core media and lead generation business.

> Euler Hermes, the largest credit insurer globally, rallied in the fourth quarter after controlling shareholder Allianz offered a buyout of the shares they did not previously own at a significant premium.

Sarine Technologies and Vostok New Ventures were the largest detractors from performance over the year.

> Our largest detractor in 2017 was Sarine Technologies, the global leader in diamond processing equipment. Sarine's results were negatively impacted recently by brazen technology infringement in its largest market, India. With uncertainty relating to whether or when this issue will be resolved favorably, we decided to exit our position in the company.

> Vostok New Ventures is an investment holding company in Sweden that owns stakes in a variety of non-publicly listed entities around the world, mainly in emerging markets. The stock declined subsequent to our third quarter purchase when the company reported lower-than-expected growth in two of its largest investments. We continue to believe that the long-term fundamentals of the companies in Vostok's investment portfolio are extremely promising, and Vostok remains one of our largest holdings.

### PORTFOLIO POSITIONING

The Fund owns several stocks in the online classifieds industry, including Rightmove (#1 in U.K. real estate), Auto Trader (#1 in U.K. auto), Scout24 (#1 in German real estate), Autohome (#1 in Chinese auto), and REA Group (#1 in Australian real estate). Online classifieds have essentially replaced the local newspaper as the location of choice for advertising things like real estate, automobiles, or employment. Much like the newspaper business, these markets tend to be dominated by one or two large players, with smaller contenders struggling to maintain a viable business. Once a dominant incumbent has been established, it leads to a strong network effect and relatively stable market shares over time. Importantly for us, the economics of the business are phenomenal for the dominant players. Auto Trader and Rightmove, for example, have an *after-tax* net profit margin of over 50%. We believe these strong economics are sustainable for many years into the future as it is extremely difficult to displace incumbent players in this industry. Our large exposure to this industry is a reflection of our view on the durability of the businesses, the exceptional profitability potential, and what we view as reasonable valuations on the stocks.

### PORTFOLIO CHANGES

During the fourth quarter, the Fund purchased Webstep (Norway), an IT service management company; investment holding company Vostok New Ventures (Sweden); Ascential (U.K.), a business-to-business media business specializing in exhibitions and festivals, and information services; and Sabre Insurance (U.K.).

During the quarter, the Fund sold Sarine Technologies (Israel), which manufactures diamond processing equipment; insurance provider Hiscox (U.K.), Rotork (U.K.), which manufactures industrial flow control equipment; Oyj Tikkurila (Finland), a paint manufacturer; insurer Topdanmark (Denmark); and Carsales (Australia), the largest online auto classifieds site in that country.

## Virtus KAR International Small-Cap Fund

### INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

### INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

### INVESTMENT PROFESSIONALS



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



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

### TOP TEN HOLDINGS

	% Fund
Rightmove plc	5.27
Auto Trader Group plc	5.21
Scout24 AG	4.71
Vostok New Ventures Ltd Shs	
Swedish Depository Receipts	4.69
Autohome, Inc. Sponsored ADR	4.38
Euler Hermes Group S.A.	3.46
Howden Joinery Group plc	3.33
Heineken Malaysia Bhd.	3.04
Ascential plc	2.75
Webstep AS	2.75

Holdings are subject to change.

### AVERAGE ANNUAL TOTAL RETURNS as of 12/31/17 in percent

I Share	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 9/5/2012
NAV	3.33	28.48	28.48	15.52	14.18	n/a	14.59
Index	6.56	31.65	31.65	11.96	10.03	n/a	11.51

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 returns reflect the change in share price and the reinvestment of all dividends and capital gains. Class I shares have no sales charge and therefore their returns do not reflect the deduction of a sales charge, which if applied, would reduce the performance quoted. Fees and expenses vary among share classes and other share classes do carry sales charges. Class I shares are offered primarily to eligible institutional investors who purchase the minimum amounts required 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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