

Virtus Newfleet Low Duration Income Fund

A: HIMZX (92828W346) | C: PCMZX (92828W338) | I: HIBIX (92828W320)

MARKET OVERVIEW

The overall positive tone for fixed income spread sectors continued into the fourth quarter with short-lived bouts of increased volatility in October and November. Challenges to the status quo included continued geopolitical tensions and the turbulent political climate in Washington D.C. During the quarter, oil prices moved higher, U.S. economic data modestly improved, and tax reform legislation was passed. As expected, the Federal Reserve raised its target rate at the December FOMC meeting to a range of 1.25%-1.50%.

Most spread sectors outperformed U.S. Treasuries during the fourth quarter as spreads tightened and interest rates remained low.

For a more detailed review of the fourth quarter and our outlook, please see Newfleet's [4Q17 Market Review](#) and [2018 Fixed Income Market Outlook](#).

HOW THE FUND PERFORMED

The Fund (Class I) outperformed its benchmark in the fourth quarter with a return of 0.21% versus the ICE BofA Merrill Lynch 1-5 Year US Corporate & Government Bond Index return of -0.28%. For the year, the Fund returned 2.62% versus 1.32% for the Index.

Contributors

- > Our underweight to **U.S. Treasuries** benefited performance as most spread sectors outperformed the government sector.
- > Allocation to the **Bank Loan** sector was a positive contributor as loans benefited from rising interest rates and positive supply and demand dynamics.
- > **Non-Agency Residential Mortgage-Backed Securities (RMBS)** benefited from the ongoing improvement in the housing market and investor demand for mortgage credit.
- > Issue selection within the **Asset-Backed Securities (ABS)** sector had a positive impact on performance, specifically our out-of-index credit-sensitive securities.

Detractors

Agency Mortgage-Backed Securities: Despite being underweight the benchmark, our allocation to the sector slightly detracted from performance during the quarter as spread sectors outperformed.

CURRENT FUND STRATEGY

Sector Changes: We reduced our exposure to ABS and agency mortgage-backed securities. We redeployed the sale proceeds primarily into U.S. Treasuries and Yankee high quality bonds.

Securitized Product: Our allocation to RMBS and ABS continues to play an important role. These segments of the market offer a diversified collateral base and attractive valuations relative to many other areas of the fixed income markets. They also offer diversification to the portfolio's corporate credit allocation. Our consumer focus within the ABS sector benefits from the U.S. consumer's continued ability to drive the U.S. economy. RMBS benefits from the continuing improvement in the housing market and demand for mortgage credit.

OUTLOOK

As we look ahead to 2018, we expect that spread sectors will continue to perform well in the current environment of steady GDP growth, subdued inflation, and a favorable macroeconomic backdrop. We are constructive on spread sectors based on sound and improving fundamentals, strong technicals, and still-accommodative central banks. We recognize, however, that valuations are fair to rich in many areas of the fixed income market. With spreads well inside of long-term averages, issue selection and positioning within sectors is critical. There are, of course, risks that include the unprecedented retreat from quantitative easing by the major central banks, oil price volatility, geopolitical tensions, economic developments in China, the path of the U.S. dollar, and continued gridlock in Washington, D.C.

As always, we believe it is important to stay diversified, have granular positions, and emphasize liquid investments. We will continue to look for opportunities in all sectors of the bond market, striving to uncover any out-of-favor or undervalued sectors and securities. With strong demand for fixed income by investors and a supportive environment, spread sectors continue to offer attractive investment opportunities to investors searching for total return and yield.

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INVESTMENT ADVISER

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INVESTMENT PROFESSIONALS



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Start date with the Fund: 2012



Benjamin Caron, CFA
Industry start date: 1997
Start date with the Fund: 2012



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SECTOR ALLOCATIONS

% Fund

Asset Backed Securities	26.95
Corporate - High Quality	19.97
Non-Agency Residential MBS	14.95
Mortgage Backed Securities	10.01
Non-Agency Commercial MBS	7.03
Bank Loans	6.31
Treasury	6.09
Corporate - High Yield	3.87
Cash	1.95
Yankee - High Quality	1.52
Emerging Market - High Yield	1.29
Taxable Municipals	0.05

Sector weights 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 2/23/1996
NAV	0.21	2.62	2.62	2.15	1.91	3.66	4.42
Index	-0.28	1.32	1.32	1.49	1.34	3.24	4.64

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 0.87%. The net expense ratio is 0.51%, 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 0.50%.

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.

Index: The **Low Duration Income Fund Linked Benchmark** consists of the BofA Merrill Lynch 1-5 Year US Corporate & Government Bond Index which tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market, including US Treasury, US agency, foreign government, supranational and corporate securities, with a remaining term to final maturity less than 5 years, 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. Performance of the Low Duration Income Linked Benchmark prior to 2/1/2017 is that of the Bloomberg Barclays U.S. Intermediate Government/Credit Bond Index.

Notes on 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. **ABS/MBS:** Changes in interest rates can cause both extension and prepayment risks for asset- and mortgage-backed securities. These securities are also subject to risks associated with the repayment of underlying collateral. **Foreign Investing:** Investing internationally involves additional risks such as currency, political, accounting, economic, and market risk. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. **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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