Virtus Newfleet Multi-Sector Intermediate Bond Fund

A: NAMFX (92828R677) | C: NCMFX (92828R651) | I: VMFIX (92828R289) | R6: VMFRX (92828W544)

MARKET OVERVIEW

The final quarter of 2018 witnessed a meaningful dislocation in risk assets. Fixed income investors and all market participants continued to wrestle with the volatility associated with geopolitical developments, trade rhetoric, mixed global economic signals, and central bankers' desire to normalize monetary policy via policy rate increases and balance sheet adjustment. During the quarter, oil prices corrected, driven by fears of slowing global growth and signs of excess supply. U.S. economic data stayed on a positive trend, which contrasted with other global economies. Primary inflation readings remained in check but pressure in key components (e.g., wages) has started to build.

U.S. Treasuries performed well while spread sector performance was mixed during the quarter. Sectors within the securitized products universe generally outperformed whereas corporate and emerging markets related sectors lagged. Within most spread sectors, assets with short and intermediate duration and those with higher credit ratings outperformed on a total return basis. The high yield sector was the largest underperformer during the period. Following the fourth quarter adjustment, we see value in spread sectors and continue to invest accordingly.

As expected, the Federal Open Market Committee increased its target rate at the December meeting to a range of 2.25-2.50%, its ninth hike in the current tightening cycle. The pace of the Federal Reserve's balance sheet adjustment remains as originally planned, however, recent rhetoric has suggested that greater flexibility may be deployed if deemed necessary. The European Central Bank ended its monthly bond purchases in December as forecast. Maturities will be reinvested for a considerable period and key policy rates are expected to be maintained well into 2019 and beyond, depending on incoming economic data. The Bank of Japan continues to make minor adjustments to its program but there are no substantial changes expected for the next 12-18 months.

During the quarter, the yield curve flattened as yields on shorter maturities rose and yields on longer maturities declined.

For a more detailed review of the fourth quarter and our outlook, please see Newfleet's 4Q18 Market Review & Outlook.

HOW THE FUND PERFORMED

The Fund (Class I) returned -2.73% in the fourth quarter versus the Bloomberg Barclays U.S. Aggregate Bond Index return of 1.64%.

Contributors

> Issue selection within the asset-backed security (ABS) sector contributed positively to performance during the quarter. The sector remains attractive as it generally offers lower volatility, a diversified collateral base, and attractive valuations relative to many other areas of the fixed income markets. Supply in the sector ran at a similar pace as last year and continues to be met with demand as investors seek short duration and spread. Our thesis on the U.S. consumer's ability to lift the economy remains intact.

> Issue selection within the non-agency residential mortgage-backed (RMBS) sector also helped performance. Similar to ABS, RMBS generally offers lower volatility and a diversified collateral base. We see value in the sector versus the agency mortgage-backed (MBS) sector on the basis of incremental yield, shorter duration, and high levels of credit support within the deal structures. Home prices continue to produce 5% year-over-year gains, benefiting the sector.

Detractors

> The underweight to U.S. Treasuries detracted from performance.

> Exposure to the bank loan sector detracted from performance as the risk-off environment and subsequent repricing of risk assets negatively impacted the sector. The possibility of slower growth, a significant drop in energy markets, and prolonged trade talks also reset rate expectations lower into 2019 (with fewer or no increases), resulting in accelerated retail outflows into year end.

> Many of the same market drivers (growth, trade, and commodity prices) that hurt the bank loan sector also affected the corporate high yield sector during the quarter. Positive issuer fundamentals are expected to continue and issuance continues to be light, providing a positive technical, despite outflows from the sector.

> The Fund's allocation to the corporate high quality sector also had a negative impact. The risk-off environment brought on by trade war fears, falling oil, and cyclicality concerns affected the asset class. In addition, the technical picture was strained by persistent outflows and an unfavorable hedging environment for foreign investors.

CURRENT FUND STRATEGY

Sector Changes: We reduced our exposure to corporate high yield and U.S. Treasury securities. We redeployed the sale proceeds primarily into RMBS and high yield bank loans.

Non-U.S. Exposure: Over the quarter, the Fund's overall non-U.S. and emerging market debt exposure modestly increased. Total non-U.S. exposure remains below historical averages, and our total emerging market country exposure is below the six-year average for the Fund. Valuations in specific countries are attractive and the long-term fundamental outlook remains favorable. Fundamentals, however, are balanced near term. The Fund's non-U.S. exposure could receive uplift from positive global growth, a weaker U.S. dollar, supportive commodity prices, and accommodative monetary policy from major global central banks. In this space, we favor sovereigns in larger capital structures.

Securitized Product: Our allocation to the securitized product sectors (RMBS and ABS) continues to play an important role. In addition to a diversified collateral base and attractive valuations relative to many other areas of the fixed income markets, they also offer diversification to the corporate credit allocation within the portfolio. Our consumer focus within the ABS sector has been beneficial as the U.S. consumer continues to show the ability to lift the U.S. economy. RMBS benefits from steady income growth, full employment, good underwriting, and investor demand for mortgage credit.

OUTLOOK

As always, we believe it is important to stay diversified, have granular positions, and emphasize liquid investments. We continue to look for opportunities in all sectors of the bond market, striving to uncover any out-of-favor or undervalued sectors and securities. We favor spread sectors based on improved valuations and sound fundamentals, and highlight the importance of credit selection and positioning in the current environment. We believe some of the best total return and yield opportunities in fixed income can be found in spread sectors. Some of the specific sectors where we see opportunity are out-of-index/off-the-run ABS, RMBS, investment grade corporates, bank loans, and select emerging markets.

Virtus Newfleet Multi-Sector Intermediate Bond Fund

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Newfleet Asset Management, LLC

PORTFOLIO MANAGER

David L. Albrycht, CFA
Industry start date: 1985
Start date with the Fund: 1994

SECTOR ALLOCATIONS

	% Invested Assets
Corporate - High Quality	24.55
Corporate - High Yield	21.71
Bank Loans	17.64
Non-Agency Residential MBS	12.18
Asset Backed Securities	7.43
Emerging Market - High Yield	6.67
Yankee - High Quality	3.90
Non-USD	2.42
Mortgage Backed Securities	1.24
Non-Agency Commercial MBS	1.23
Treasury	0.83
Taxable Municipals	0.17
Equity	0.03

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 10/1/2009
Fund Class I	-2.73	-3.32	-3.32	4.68	2.82	n/a	5.53
Index	1.64	0.01	0.01	2.06	2.52	n/a	3.10

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 0.86%. The net expense ratio is 0.77%, which reflects a contractual expense reimbursement in effect through 1/31/2020. 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 0.74%.

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 **Bloomberg Barclays U.S. Aggregate Bond Index** measures the U.S. investment grade fixed rate bond market. The index is calculated on a total return basis. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and it is not available for direct investment.

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. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, 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. **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. **Bank Loans:** Loans may be unsecured or not fully collateralized, may be subject to restrictions on resale and/or trade infrequently on the secondary market. Loans can carry significant credit and call risk, can be difficult to value and have longer settlement times than other investments, which can make loans relatively illiquid at times. **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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