VIRTUS MUTUAL FUNDS

Virtus Newfleet Multi-Sector Intermediate Bond Fund

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

MARKET OVERVIEW

The overall positive tone for fixed income spread sectors was challenged in the first quarter with bouts of elevated volatility. Investors were forced to interpret the potential market implications of the emerging risks of a trade war among major economic powers; the changing composition of the Federal Open Market Committee (FOMC), including a new chair; as well as the ongoing evolution of the quantitative easing (QE) programs initiated by the key global central banks in the aftermath of the financial crisis. During the quarter, oil prices moved higher, U.S. economic data modestly improved, and interest rate volatility remained elevated. As expected, the Federal Reserve increased its target rate to a range of 1.5%–1.75% at the March FOMC meeting.

With the exception of bank loans, spread sectors had negative returns for the quarter with investment grade corporate bonds being the biggest underperformer. Long-duration assets across sectors underperformed on a total return basis as interest rates rose.

For a more detailed review of the first quarter and our outlook, please see Newfleet's 1Q18 Market Review & Outlook.

HOW THE FUND PERFORMED

The Fund (Class I) outperformed its benchmark in the first quarter with a return of -0.60% versus the Bloomberg Barclays U.S. Aggregate Bond Index return of -1.46%.

Contributors

> The **non-U.S.-dollar** sector was a primary contributor as positive emerging markets growth expectations relative to those of the U.S. were supportive to the sector's performance. Country and issue selection were beneficial. We continue to favor higher-yielding countries with an improving fundamental outlook.

> Allocation to the **bank loan** sector was a positive contributor as loans benefited from rising interest rates, improving fundamentals, and positive supply and demand dynamics.

> The Fund's allocation to, and issue selection within, the **corporate high yield** sector contributed to performance as the Fund's exposure outperformed the benchmark. Volatility spurred by rising rates impacted risky asset classes during the quarter. Negative flows into the sector and the lack of the main, positive technical exhibited in 2017 (demand exceeding supply) also impacted performance. Overall, fundamentals are improving and positive global growth is supportive of the sector.

> The Fund's underweight to **corporate high quality**, and issue selection within the sector, were beneficial. With spreads hitting ten-year lows, combined with a negative shift in technicals, the sector was among the weaker performers year to date.

Detractors

> The Fund's underweight to **U.S. Treasuries** detracted as most spread sectors underperformed Treasuries.

> Allocations to **emerging markets high yield** and **yankee high quality** were detractors, primarily driven by rising U.S. rates and increased equity market volatility caused, in part, by shifting investor expectations for U.S. inflation and fears of a trade war.

CURRENT FUND STRATEGY

Sector Changes: We reduced our exposure to corporate high yield and agency mortgage-backed securities (MBS). We redeployed the sale proceeds primarily into high yield bank loans and residential mortgage-backed securities (RMBS).

Non-U.S. Exposure: Over the quarter, we marginally reduced the overall non-U.S. exposure within the Fund but continued to overweight exposure to emerging markets. Valuations in specific countries are attractive and fundamentals are slowly improving with further improvement expected in 2018 driven by Brazil, Argentina, and Russia. The Fund's non-U.S. exposure could continue to receive an uplift from improving global growth, stronger-than-anticipated Chinese 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. Total non-U.S. exposure remains below historical averages, but our total emerging market country exposure is slightly above the five-year average for the Fund.

Securitized Product: Our allocation to the securitized product sectors (RMBS and asset-backed securities (ABS)) continues to play an important role. These sectors 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 U.S. consumers' continued ability to drive the U.S. economy. RMBS benefits from the continuing improvement in the housing market and demand for mortgage credit.

OUTLOOK

We continue to see value in spread sectors and expect them to benefit from the projected improvement in global growth this year. Sound and improving fundamentals, strong technicals, and still-accommodative central banks remain supportive. Recognizing that valuations are fair to rich in many areas of the fixed income market, selection and positioning within sectors is critical. Some of the specific sectors where we see value are out-of-index/off-the-run ABS, RMBS, investment grade corporates (BBB rated and financials), bank loans, selective corporate high yield, and emerging market bonds. As always, we believe it is important to stay diversified, have granular positions, and emphasize liquid investments.

Effective May 8, 2017, the Fund's name was changed from Virtus Multi-Sector Intermediate Bond Fund.

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 Yield	27.76
Corporate - High Quality	21.43
Bank Loans	10.17
Emerging Market - High Yield	9.83
Non-Agency Residential MBS	9.81
Asset Backed Securities	5.81
Yankee - High Quality	4.97
Non-USD	3.47
Equity	2.63
Mortgage Backed Securities	1.89
Treasury	1.21
Non-Agency Commercial MBS	0.91
Taxable Municipals	0.12

Sector weights 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 10/1/2009
Fund Class I	-0.60	-0.60	3.74	4.57	3.56	n/a	6.39
Index	-1.46	-1.46	1.20	1.20	1.82	n/a	3.20

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 0.88%. The net expense ratio is 0.77%, 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 0.74%.

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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