

Virtus Newfleet Multi-Sector Intermediate Bond Fund

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

MARKET OVERVIEW

Fixed income investors faced substantially similar market themes during the third quarter as in the prior two quarters of 2018. Market participants continued to wrestle with periods of volatility caused by geopolitical developments, trade rhetoric, mixed global economic signals, and the evolution of quantitative easing programs that began in the aftermath of the now decade-old Financial Crisis. During the quarter, oil prices continued their ascent, driven by the outlook for supply/demand dynamics. 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 (i.e., wages) has started to build.

As expected, the Federal Open Market Committee (FOMC) increased its target rate at the September meeting to a range of 2.00-2.25%. The pace of the Federal Reserve's (Fed) balance sheet adjustment remains as originally deployed. The European Central Bank remains on track to end its monthly bond purchases at the end of 2018 while reinvesting proceeds from maturities and maintaining key policy rates well into 2019 and beyond if deemed necessary by incoming economic data. The Bank of Japan made some minor adjustments to its purchase program during the quarter, but no substantial changes are expected for the next 12-18 months.

During the quarter, yields were higher across the curve though slightly more pronounced at the front end. Overall, the curve flattened.

Most spread sectors outperformed during the quarter led by high yield corporates and bank loans, both demonstrating their resilience in a rising rate environment. Across other spread sectors, tightening spreads offset price declines from rising rates to a greater degree for longer duration assets relative to their shorter duration counterparts. Additionally, lower credit ratings outperformed higher quality on a total return basis. Non-U.S. dollar was the largest underperformer during the period.

For a more detailed review of the third quarter and our outlook, please see [Newfleet's 3Q18 Market Review & Outlook](#).

HOW THE FUND PERFORMED

The Fund (Class I) returned 1.54% in the third quarter versus the Bloomberg Barclays U.S. Aggregate Bond Index return of 0.02%.

Contributors

- > The Fund's underweight to **U.S. Treasuries** benefited performance.
- > Exposure to the **corporate high yield** sector contributed positively. The sector was among the top performers during the quarter despite emerging markets instability, specifically in Argentina and Turkey. Solid earnings, lack of supply, and inflows into the sector in the past couple of months have been beneficial.
- > Allocation to the **non-agency residential mortgage-backed security** (RMBS) sector versus agency mortgages, helped performance as did issue selection. RMBS generally offers lower volatility and a diversified collateral base. In addition, the sector typically is less sensitive to global macro volatility.

- > Allocation to the **bank loan** sector contributed positively. One of the quarter's best-performing sectors, loans continue to provide a compelling investment due to the strong fundamental backdrop, protection against rising rates, and attractive income carry profile.
- > Issue selection within the **corporate high quality** sector had a positive impact on performance.

Detractors

- > Rising idiosyncratic risks and attractive U.S. growth and rate dynamics have negatively impacted the **non-U.S. dollar** exposure within the Fund. Allocation to the sector and country/issue selection were both detrimental to performance. In this space, we continue to favor higher-yielding countries with improving fundamental outlooks.

CURRENT FUND STRATEGY

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

Non-U.S. Exposure: Over the quarter, we reduced the overall non-U.S. and emerging market debt exposure based on continued macro headwinds for the sector and rising idiosyncratic risks. Valuations in specific countries are attractive and long-term fundamental trends are favorable. Fundamentals, however, have peaked and are becoming a bit mixed near term. The Fund's non-U.S. exposure could receive an 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. 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.

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 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 the continued strength in the housing market and investor demand for mortgage credit.

OUTLOOK

We continue to see opportunity in spread sectors. Benign consumer, housing, and corporate fundamentals as well as the global demand for yield continue to underpin our strategy. Recognizing that valuations are fair to rich given that spreads are inside long-term averages in most areas of the fixed income market, selection and positioning within sectors are critical. Some of the specific sectors where we see opportunity are out-of-index/off-the-run ABS, RMBS, investment grade corporates (BBB rated and financials), and leveraged finance (bank loans and corporate high yield), with the allocation mix driven by each fund's risk tolerance.

Virtus Newfleet Multi-Sector Intermediate Bond Fund

INVESTMENT ADVISER

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PORTFOLIO MANAGER



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

SECTOR ALLOCATIONS % Invested Assets

| | |
|------------------------------|-------|
| Corporate - High Yield | 27.92 |
| Corporate - High Quality | 24.24 |
| Bank Loans | 15.03 |
| Non-Agency Residential MBS | 10.07 |
| Asset Backed Securities | 6.57 |
| Emerging Market - High Yield | 5.31 |
| Yankee - High Quality | 4.03 |
| Non-USD | 2.40 |
| Treasury | 2.18 |
| Mortgage Backed Securities | 1.05 |
| Non-Agency Commercial MBS | 1.04 |
| Taxable Municipals | 0.15 |
| Equity | 0.03 |

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 9/30/18

| | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception 10/1/2009 |
|--------------|------|-------|--------|--------|--------|---------|---------------------------|
| Fund Class I | 1.54 | -0.61 | 0.14 | 5.40 | 3.85 | n/a | 6.02 |
| Index | 0.02 | -1.60 | -1.22 | 1.31 | 2.16 | n/a | 3.00 |

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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