

Virtus Newfleet Multi-Sector Short Term Bond Fund

A: NARAX (92828R644) | C: PSTCX (92828R628) | C1: PMSTX (92828R594) | I: PMSX (92828R610) | R6: VMSSX (92828W247)

MARKET OVERVIEW

During the second quarter, investors faced multiple challenges and bouts of elevated volatility that carried over from the first quarter. Investors continued to grapple with the potential market implications of the emerging risks of a trade war among major economic powers, geopolitical tensions, the political climate in Washington, and the ongoing evolution of the quantitative easing (QE) programs initiated by the key global central banks in the aftermath of the Financial Crisis. Oil prices moved higher during the three-month period, U.S. economic data modestly improved, the U.S. dollar climbed, and interest rate volatility remained elevated.

As expected, the Federal Reserve (Fed) increased its target rate during the quarter to a range of 1.75%–2.0% at the June Federal Open Market Committee (FOMC) meeting. The European Central Bank and Bank of Japan are expected to continue QE until late 2018 and early 2019, respectively.

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

Most spread sectors underperformed for the quarter, with emerging market high yield bonds the largest underperformer. Long duration assets across sectors underperformed on a total return basis as interest rates rose.

For a more detailed review of the second quarter and our outlook, please see [Newfleet's 2Q18 Market Review & Outlook](#).

HOW THE FUND PERFORMED

The Fund (Class I) returned -0.51% in the second quarter versus the ICE BofAML 1-3 Year A-BBB U.S. Corporate Index return of 0.47%.

Contributors

- > Within the **asset-backed security** (ABS) sector, both allocation and issue selection positively impacted performance during the quarter. The sector generally offers lower volatility, a diversified collateral base, and attractive valuations relative to many other areas of the fixed income market. Expectations are for range-bound spreads with modest room for tightening.
- > Issue selection within the **non-agency residential mortgage-backed security** (RMBS) sector versus the benchmark benefited performance. Similar to ABS, RMBS generally offers lower volatility and a diversified collateral base. In addition, the sector typically is less sensitive to global macro volatility.
- > Issue selection within the **corporate high quality** sector had a positive impact on performance.

Detractors

- > The Fund's underweight to **U.S. Treasuries** was a detractor.
- > An improving economic outlook and higher rates in the U.S. had a negative impact on the Fund's **non-U.S. dollar** exposure. Allocation to the sector and country/issue selection were both detrimental to performance. In this space, we continue to favor higher-yielding countries with an improving fundamental outlook.

- > Exposure to the **emerging markets high yield** sector detracted from performance. Rate increases by the Fed and fear of additional hikes led to outflows from the sector and its underperformance. Volatility that began in the later part of April continued into the quarter and was concentrated in idiosyncratic pockets across emerging markets such as Turkey, Brazil, and Argentina. Overall, the fundamental picture in the emerging markets remains positive. GDP growth remains above trend, inflation is contained, and the business cycle is relatively young.

CURRENT FUND STRATEGY

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

Non-U.S. Exposure: Over the quarter, we reduced the overall non-U.S. and emerging market debt exposure within the Fund based on our concerns of continued macro headwinds for the sectors. Valuations in specific countries are attractive, and we expect fundamentals to remain positive. Fundamentals, however, have peaked and are becoming a bit mixed near term. The Fund's non-U.S. exposure could 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, 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 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 market. 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 investor demand for mortgage credit.

The Fund maintains its higher quality focus and short duration to limit both spread and interest rate volatility.

OUTLOOK

We continue to see value in spread sectors and expect them to benefit from the projected improvement in global growth this year. As favorable conditions for borrowers remain in place, the positive outlook for corporate and consumer fundamentals is on solid footing and the global demand for yield continues to support fixed income market technicals.

Valuations are fair to rich, given that yields and spreads are inside long-term averages in most areas of the fixed income market. Selection and positioning within sectors thus 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), and bank loans. As always, we believe it is important to stay diversified, have granular positions, and emphasize liquid investments.

Virtus Newfleet Multi-Sector Short Term 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: 1993

SECTOR ALLOCATIONS % Invested Assets

Asset Backed Securities	22.60
Corporate - High Quality	21.86
Non-Agency Residential MBS	15.24
Bank Loans	14.40
Corporate - High Yield	8.57
Non-Agency Commercial MBS	4.66
Emerging Market - High Yield	4.34
Mortgage Backed Securities	2.82
Yankee - High Quality	2.78
Non-USD	2.14
Treasury	0.50
Taxable Municipals	0.06
Equity	0.03

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 6/6/2008
Fund Class I	-0.51	-0.80	0.56	2.34	2.52	4.79	4.66
Index	0.47	0.10	0.72	1.55	1.69	2.96	2.90

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 0.75% and reflects the direct and indirect expenses paid by the Fund.

The gross 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 **ICE BofA Merrill Lynch 1-3 Year A-BBB U.S. Corporate Index** measures performance of U.S. corporate bond issues rated A1 through BBB3, inclusive (based on an average of Moody's, S&P, and Fitch), with a remaining term to final maturity less than three years. 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.

Please carefully consider a Fund's investment objectives, risks, charges, and expenses before investing. For this and other information about any Virtus mutual fund, contact your financial representative, call 1-800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.

Distributed by **VP Distributors, LLC**, member FINRA and subsidiary of Virtus Investment Partners, Inc.

2001 07-18 © 2018 Virtus Mutual Funds