Virtus Newfleet Multi-Sector Short Term Bond Fund

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

FIXED INCOME MARKET REVIEW

The second quarter of the year was, once again, another quarter of U.S. exceptionalism in global terms. U.S. economic growth remained resilient, labor markets remained sound, and inflation remained above central bank target. Considering these factors, the U.S. stood out among G7 counterparts, a position that is reflected in monetary policy as of the end of the period. Even with this backdrop, the economic data has shown a high degree of variability and resulted in moments of financial market volatility during the quarter. While we are confident that U.S. monetary policy easing is in the pipeline, the timing and magnitude remain uncertain.

While the Federal Reserve (Fed) remained on hold during the period, other developed market central banks have taken the first steps to ease monetary policy since the global tightening cycle that arose in the post-COVID economic environment. The European Central Bank (ECB) as well as central banks in Switzerland, Sweden, and Canada all began to ease policy this year. Global monetary policy is desynchronized, but that may change in the coming months as the "last mile" of the inflation fight comes into clearer view. We are optimistic that we have seen the peak in interest rates this cycle, but also caution that monetary policy acts on the economy unpredictably, and with variable lags, so we will be paying close attention to the incoming data in the weeks and months ahead.

Few positive developments have occurred in the parts of the world that remain plagued by conflict, and though the financial markets have largely discounted day-to-day developments, they still bear monitoring as any further escalation has the potential to be disruptive. Political activity accelerated during the quarter, with important elections in India, Mexico, South Africa, and the EU, with the UK and U.S. on deck. So far, the common theme has been one of surprise outcomes that has led to local financial market dislocations, which we continue to monitor for investment opportunities.

Most risk markets have rejoiced at the Goldilocks environment of slowing inflation, low unemployment, resilient earnings, and economic growth that outperformed expectations. However, data sensitivity remains high, and results were more varied during the quarter. Fixed income sector performance was also variable, with interest rates higher during the period. Spread sectors outperformed U.S. Treasuries and spreads widened marginally. Within spread sectors, risk asset classes outperformed. Except for the very front end, the U.S. Treasury curve shifted higher, and overall, the curve steepened. The 2-year Treasury yield increased 13 basis points (bps), the 5-year Treasury yield increased by 16 bps, the 10-year Treasury yield increased by 20 bps, and the 30-year Treasury yield moved 22 bps higher.

We continue to see value being restored across most of the fixed income sectors in which we invest. Yields remain elevated and bond prices are broadly discounted. We expect the Fed will be successful in returning inflation to acceptable levels over time. We continue to watch data releases to inform our views on the global economic trajectory.

As the markets digest economic and geopolitical developments, we continue to believe active sector and issuer selection is critical to take advantage of market volatility as it arises. Our approach to fixed income—the approach we have implemented for over three decades—enables us to scan the bond market for the most attractive investment opportunities and is, in our view, ideally suited for the current environment.

For more detail on the macroeconomic backdrop and specific sectors, see Newfleet's [2Q24 Market Review & Outlook] on Virtus.com.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 1.29% in the second quarter versus the ICE Boa 1-3 Year A-BBB US Corporate Index return of 1.13%.

Positive Contributors:

> **U.S. Treasury Securities:** The Fund's underweight to U.S. Treasuries had a positive impact, as most spread sectors had positive excess returns during the quarter.

> **Asset-Backed Securities (ABS):** Allocation to and issue selection within the ABS sector had a positive impact on performance during the quarter when compared to the ABS subsector of the Bloomberg U.S. Intermediate Aggregate Bond Index. New issue supply running well ahead of last year's pace was easily absorbed with insatiable demand, driving in spreads. In addition, the credit curve flattened as strong demand for risk tranches within ABS drove spreads tighter.

> **Residential Mortgage-Backed Securities (RMBS):** Allocation to RMBS over agency mortgage-backed securities (MBS) and positioning within RMBS had a positive impact on performance. RMBS outperformed MBS in the period due to demand from yield-oriented investors and strong housing technicals, along with attractive yields for ratings and duration.

> **Bank Loans:** Allocation to bank loans had a positive impact on performance. The bank loans sector outperformed most spread sectors in the quarter due to its high carry and floating rate, data supporting the likelihood of a delay in the Fed's rate cut cycle, the resilient economy, and a positive technical environment.

Performance Detractors:

> **Corporate High Yield Selection:** Issue selection and positioning within the corporate high yield sector versus the Bloomberg High Yield 2% Issuer Capped Bond Index was negative for the period.

> **Bank Loans Selection:** While the allocation to the bank loans sector had a positive impact on performance, issue selection and the Fund's up-in-quality positioning versus the Credit Suisse Leveraged Loan Index was slightly negative for the period.

CURRENT FUND STRATEGY AND POSITIONING

- Increased exposure to bank loans, corporate high yield securities, and cash.
- Reduced exposure to U.S. Treasuries, commercial mortgage-backed securities (CMBS), and investment grade corporates.
- In addition to changes to the Fund's sector allocation during the quarter, we continue to optimize positioning within sectors based on our view of the best relative value.

Emerging Markets (EM) and Non-U.S. Exposure: The EMBI Global Bond Index returned 0.44% for the second quarter, with the high yield component (0.69%) outperforming investment grade (0.25%). Overall EM performance was driven by many of the same factors that drove the first quarter's: the timing of the Fed, and EM elections in South Africa, Mexico, India, and the Dominican Republic. Despite mostly constructive comments out of the IMF meetings in April, performance was choppy for EM, with much of it driven by Treasury volatility. The phased inclusion of Venezuelan bonds back into the EMBI Global Bond Index began in April and concluded at the end of June, contributing roughly 50 bps of spread to the index. Overall exposure to EM in the Fund was largely unchanged in the quarter, although we did increase our overall corporate exposure slightly by purchasing some Latin American and Asian names. We also added a handful of sovereign names whose valuations remained attractive relative to their fundamental stories.

Investment Grade Corporates: Spreads approached their five-year lows in May but widened 9 bps in June to wind up 4 bps wider on the quarter (+93). Valuations have been the bottleneck in an otherwise healthy market from a fundamental and technical perspective. Supply was in-line with the five-year average, while retail fund flows were halved from their robust Q1 pace. First quarter earnings were strong and the outlook for the second half of the year is for double-digit earnings growth. Perhaps we see this declining as GDP estimates have softened in June. During the second quarter, we tempered our overweight to financials and rotated into some utility, tech, and non-cyclical credits. We still favor BBB credits overall but have shifted to a higher-quality mix given the compression.

Corporate High Yield: The high yield market as represented by the Bloomberg High Yield 2% Issuer Capped Bond Index returned 1.09% in the second quarter, slightly below the first quarter's 1.5% return, bringing the year-to-date total return to 2.58%. Returns have been driven by carry as rising risk-free rates and widening credit spreads hampered returns. The credit spread of the index has widened 8 bps during the quarter to +311 bps but there is a divergence across rating tiers—BB credit spreads were 7 bps tighter while CCC credit spreads were 58 wider. Consequently, while the index was 24 bps wide of the year-to-date low in early May, the BB and B indices are still trading at extremely tight levels relative to history, while the CCC index is closer to its long-term averages. Like the most recent commentaries, below average credit spreads can be justified by attractive all-in yields, stable fundamentals, and a strong technical (while gross issuance is up meaningfully versus last year, net issuance remains more muted). There was generally low variation in performance across industries, with investors remaining cautious on issuers in the cable, wireline, and media industries, where secular issues remain. In the Fund, high yield's allocation has been relatively stable and below long-term averages. Trades during the quarter were generally focused on adding some higher-quality names with yields in the 6-7% range. Buys were funded with the sale of a higher beta advertising name where valuations have materially improved, along with several other trading names with tighter valuations and limited upside.

Securitized: All securitized sectors had positive total returns for the quarter despite interest rates being volatile and slightly higher. We saw the credit curve flatten as investors continued to reach for yield, driving outperformance from subordinate tranches. Spreads for securitized assets were mainly flat-to-tighter as demand for spread product remained firm. Supply across the securitized spectrum of deals was robust compared to 2023. While signs of consumer stress began to appear amongst certain cohorts, unemployment remains low, and overall deal structures remain solid. As in the first quarter, we continued to invest our marginal dollars into the more conservative parts of the capital structure. We also maintained our overweight in ABS and RMBS as fundamentals and technical factors were both tailwinds for performance. Our exposure to the CMBS sector was rewarded again this quarter as credit spreads held firm versus investment grade corporate bond alternatives. We maintained our underweight of agency MBS versus non-agency RMBS.

OUTLOOK

Our multi-sector relative value approach enables us to take advantage of opportunities when events that trigger volatility, such as inflation worries, an economic slowdown, or geopolitical concerns, affect valuations. In the current environment, we believe some of the best total return and yield opportunities can be found in spread sectors. However, spreads in some sectors do not seem to be fully reflecting the risks and are largely pricing in a soft landing. The Fund's exposure to spread sectors that would typically be more negatively impacted, such as corporate high yield and EM, are below long-term averages. Credit selection and positioning remain key. Specific sectors that demonstrate the best relative value for us include out-of-index/off-the-run ABS, bank loans, non-agency RMBS, and the BBB-quality tier within corporate investment grade.

The Fund maintains its higher-quality focus and short duration to limit both spread and interest rate volatility. As always, we aim to stay diversified, maintain granular positions, and emphasize liquid investments.

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Newfleet Asset Management

PORTFOLIO MANAGER

David L. Albrycht, CFA
Industry start date: 1985
Start date with the Fund: 1993

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/24

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (06/06/08)
Fund Class I	1.29	2.74	7.42	1.36	2.23	2.30	3.91
Index	1.13	2.02	6.12	1.00	1.90	2.02	2.72

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will f luctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit virtus.com for performance data current to the most recent month end. This share class has no sales charges and is not available to all investors. Other share classes have sales charges. See virtus.com for details.

The fund class gross expense ratio is 0.73%. The net expense ratio is 0.65%, which reflects a contractual expense reimbursement in effect through 1/31/2025.

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.

Index: The **ICE BofA 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.

The **Bloomberg Intermediate U.S. Corporate Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers that have between 1 and up to, but not including, 10 years to maturity.

The **Credit Suisse Leveraged Loan Index** is a market-weighted index that tracks the investable universe of the U.S. dollar denominated leveraged loans. 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 is not available for direct investment.

The **J.P. Morgan EMBI Global Bond Index** is a market value-weighted index of U.S. dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by emerging markets' sovereign and quasi-sovereign entities.

The **J.P. Morgan EMBI Global Diversified Bond Index** tracks the total return for the U.S. dollar-denominated emerging markets debt, including Brady bonds, Eurobonds, and loans. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

The **Bloomberg U.S. High-Yield 2% Issuer Capped Bond Index** is a market capitalization-weighted index that measures fixed rate noninvestment grade debt securities of U.S. and non-U.S. corporations. No single issuer accounts for more than 2% of market cap.

The **Bloomberg U.S. Intermediate Aggregate Bond Index** measures securities in the intermediate maturity range of the U.S. investment grade fixed rate bond market.

Newfleet Asset Management is a division of Virtus Fixed Income Advisers, LLC ("VFIA"), an SEC registered investment adviser.

SECTOR ALLOCATION

SECTOR ALLOCATION	% Fund
Asset-Backed Securities	26.07
Corporate - High Quality	19.75
Non-Agency Residential MBS	18.45
Bank Loans	11.04
Corporate - High Yield	7.18
Treasury	5.79
Non-Agency Commercial MBS	4.20
Mortgage-Backed Securities	2.78
Emerging Market - High Yield	2.14
Yankee - High Quality	1.33
Cash	1.29
Equity	0.00

Sector weights are subject to change.

Notes on Risk: Credit & Interest: Debt instruments are subject to various risks, including credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **High Yield Fixed Income Securities (Junk Bonds):** There is a greater risk of issuer default, less liquidity, and increased price volatility related to high yield securities than investment grade securities. **Bank Loans:** Bank loans may be unsecured or not fully collateralized, may be subject to restrictions on resale, may be less liquid and may trade infrequently on the secondary market. Bank loans settle on a delayed basis; thus, sale proceeds may not be available to meet redemptions for a substantial period of time after the sale of the loan. **Foreign & Emerging Markets:** Investing in foreign securities, especially in emerging markets, subjects the portfolio to additional risks such as increased volatility, currency fluctuations, less liquidity, and political, regulatory, economic, and market risk. **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 non-repayment of underlying collateral, including losses to the portfolio. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **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 consider a Fund's investment objectives, risks, charges, and expenses carefully before investing. For this and other information about any Virtus Fund, contact your financial professional, call 800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

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