Virtus Aviva Multi-Strategy Target Return Fund

A: VMSAX (92835M794) | C: VCMSX (92835M786) | I: VMSIX (92835M778) | R6: VMSRX (92835M687)

MARKET REVIEW

Global markets got off to a mixed start in the fourth quarter but hit an “air pocket” in December, rapidly pricing in an unfeasibly pessimistic outlook, partly driven by thin liquidity caused by seasonal and technical factors. Global equities fell and U.S. rates moved from pricing in hikes to pricing in cuts. The ensuing sell-off in risk assets caused yields to fall and the front end of the U.S. yield curve to invert, adding to worries of an approaching recession. The moves were exacerbated by a panic selling response from retail investors. We had expected a moderation in data as the boost from fiscal stimulus started to fade, but we believe the market reaction was overdone.

PERFORMANCE

The Fund (Class I) returned -5.29% in the quarter. Consistent with its objective to deliver less than half the volatility of global equities, the Fund has exhibited 4.47% annualized volatility (standard deviation) since inception (July 20, 2015), compared to 11.13% for the MSCI All Country World Index (in local currency).

The bulk of negative returns came in December. Given tightening monetary conditions, the Fund was positioned to be long equities and short rates, running the risk that, over shorter time frames, the correlation between these positions reverts to historical norms during risk-off periods. Essentially this is what happened in December when a flight-to-quality bond rally resulted in losses on both the short rate positions and long equity positions. While our portfolio stress tests had identified in advance the potential drawdown of such a market dynamic, the size of the drawdown reflected the outsized magnitude of the market moves.

Market Return Strategies

Our long equity exposures to the U.S., emerging markets (EM), Europe, and global financials all lost ground. Together, these account for the bulk of risk allocation in this section of the portfolio. With the market indiscriminate in its desire to reduce risk throughout December, they all contributed about equally to the Fund’s losses.

Opportunistic Return Strategies

Within these strategies, the duration component accounts for over half of the risk allocation and is focused on the prospect of higher yields in the U.S. and U.K. Most of this risk is allocated to being short U.S. rates and these had the biggest move in December, falling 30 basis points, while the U.K. 10-year moved lower by 10 basis points. In a month, our long U.S. inflation position unwound a significant proportion of gains made since late 2016 despite U.S. wages, employment, and capacity utilization having all made substantial gains in that time. The decline in oil played a role but as with various other markets, pricing looks unjustified given the fundamental backdrop and seems more a function of investors’ desire to derisk.

Risk-Reducing Return Strategies

These strategies contributed modestly relative to losses realized by the rest of the portfolio. The U.S. yield curve-steepening trades benefited from the sharp rally at the curve’s front end, but the contribution from our volatility strategies was disappointing.

PORTFOLIO POSITIONING

We remain more confident on the economic outlook than would be suggested by market pricing and added to areas where we have highest conviction. Within equities, we added exposure through both options strategies and futures positions in the U.S., Europe, and Asia.

We also made changes to address vulnerability. With the Federal Reserve’s change of language around the pace of rate hikes and flexibility in how its balance sheet is managed, we reduced our U.S. short duration strategy exposure.

We added exposure to several EM currencies against the U.S. dollar. EM assets have suffered from higher U.S. rates and a stronger dollar, and we believe they offer an attractive level of carry from this point. We closed our short credit and China vs. U.S. volatility strategies.

We removed our long Brazilian rates position, which performed very strongly post the Brazilian election, and added a strategy long the Norwegian krone against the euro. We expect oil demand to remain firm and saw the recent decline in the krone, which fell alongside the decline in oil, as an opportunity to add exposure. Further changes included introducing a relative value equity strategy, long Canadian vs. Australian equities, which we believe can perform well even if the broader equity market struggles.

OUTLOOK

Given that we do not believe there will be a global recession in 2019, the year-end market moves look overdone. While global growth might not be as strong as it proved to be in 2017, we continue to see broadly robust fundamentals underpinning the global economy with major regions still growing above their long-term growth potential. We continue to be net-long equities, albeit selectively. While favoring positions such as European mid caps, EM small caps, and global financials, we also hold sector thematic strategies, such as U.S. data infrastructure, and relative value positions, such as long U.S. industrials vs. the S&P 500® Index, which can perform well even if broader equities struggle. We have reduced our short duration stance but retained long inflation exposures.

We recognize that Fund performance has not been where we want it to be, but we remain confident in our long-term positioning. We believe the portfolio changes made in the fourth quarter and first weeks of 2019 have enhanced the portfolio while retaining exposure to our key convictions.

Virtus Aviva Multi-Strategy Target Return Fund

INVESTMENT ADVISER

Virtus Alternative Investment Advisers, Inc.

INVESTMENT SUBADVISER

Aviva Investors Americas LLC

CHAIR OF THE STRATEGIC INVESTMENT GROUP

Euan Munro, FIA
Industry start date: 1992
Start date with Fund: 2015

PORTFOLIO MANAGERS

Peter Fitzgerald, CFA
Industry start date: 1995
Start date with Fund: 2015

James McAlevey, CFA
Industry start date: 2000
Start date with Fund: 2018

Mark Robertson
Industry start date: 2000
Start date with Fund: 2018

TOP TEN STRATEGIES BY RISK	% ANN. POSITION VOL.
Duration - Short US rates	2.33
Equities - Long global financials	2.04
Equities - Long emerging equities	1.46
Duration - Short UK long-end rates	1.00
Duration - US long-end yield curve steepener	0.96
Equities - Long European equities	0.96
Equities - Long global equities	0.95
Inflation - Long US inflation	0.94
Property - Long Japanese REITs	0.83
Currency - Short Asian currencies	0.79

Source: Aviva Investors. Top Ten Strategies by Risk, as measured by Annualized Position Volatility, and Portfolio Risk Breakdown 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 7/20/2015
Fund Class I	-5.29	-4.90	-4.90	-2.07	n/a	n/a	-2.00
Index	0.36	1.26	1.26	0.74	n/a	n/a	0.66

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.

Benchmark since inception performance is reported from 7/31/2015.

The fund class gross expense ratio is 1.93%. The net expense ratio is 1.51%, which reflects a contractual expense reimbursement in effect through 2/28/2019. 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 1.44%.

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 **Federal Funds Rate** is the interest rate paid on overnight loans made between depository institutions. This index is the weighted average of rates on brokered trades and represents the arithmetic mean of all daily rates for a given month. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

Standard Deviation: Measures variability of returns around the average return for an investment portfolio. Higher standard deviation suggests greater risk.

Aviva Investors Americas LLC (AIA) is the named subadviser to the Virtus Aviva Multi-Strategy Target Return Fund and utilizes the services of Aviva Investors Global Services Limited (AIGSL) and its other affiliates (collectively, Aviva Investors) to manage the Fund. These affiliates are Participating Affiliates as that term is used in relief granted by the SEC. The listed Portfolio managers are associated with AIGSL.

The portfolio managers utilize derivatives to implement the majority of the fund's investment strategies. Considering each investment strategy's contribution to overall risk may present a clearer picture of how the fund is positioned relative to each investment's market value. Risk is defined as volatility, as calculated by FinAnalytica, and is a one month annualized standard deviation, which measures dispersion of returns. It may not be indicative of future risk, and is not a predictor of returns.

Notes on Risk: Equity Securities: The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market 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. **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. **Derivatives:** Investments in derivatives such as futures, options, forwards, and swaps may increase volatility or cause a loss greater than the principal investment. **Leverage:** When a fund leverages its portfolio, the value of its shares may be more volatile and all other risks may be compounded. **Counterparties:** There is risk that a party upon whom the fund relies to complete a transaction will default. **Portfolio Turnover:** The fund's principal investments strategies will result in a consistently high portfolio turnover rate. A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when fund shares are held in a taxable account. **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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