

Virtus KAR Small-Cap Value Fund

A: PQSAX (92828N684) | C: PQSCX (92828N676) | I: PXQSX (92828N668) | R6: VQSRX (92828N411)

MARKET REVIEW

Domestic equities continued to march ahead in the third quarter, with the S&P 500® Index gaining 7.71% and the Russell 2000® Index advancing 3.58%. Trade war concerns continued to mount during the quarter, which led to weakness in international stocks, both developed and emerging markets. The MSCI EAFE® Index managed a modest gain for the quarter, up 1.35%, while the MSCI Emerging Markets Index slipped 1.09%. Interest rates continued to rise modestly during the quarter, with the 10-year U.S. Treasury yield moving from 2.86% to 3.06%, but the spread between the 10-year and 2-year yields narrowed further.

PERFORMANCE

The Fund (Class I) returned 4.06%, outperforming the Russell 2000® Value Index during the quarter, which returned 1.60%. Performance was driven by strong stock selection in the financial services and consumer staples sectors. Gains were partially offset by weak stock selection in consumer discretionary and an underweight in utilities.

RBC Bearings and Jack Henry & Associates were the biggest contributors to performance in the quarter.

- > RBC shares performed strongly following the ball and roller bearing manufacturer's reports of solid, better-than-expected operating results. The positive performance was driven by impressive top-line growth, supported by robust industrial demand, and margin expansion.
- > Jack Henry, which provides banking software and technology solutions, reported strong revenue growth from new core-processing implementations and further adoption of the company's payment solutions by its clients. Guidance for the next fiscal year calls for high single-digit revenue growth and double-digit EPS growth. Given the high switching costs inherent in its services and the opportunity for continued business growth, we remain shareholders.

Thor Industries and RE/MAX Holdings were the largest detractors from performance.

- > Shares of RV manufacturer Thor have come under pressure recently due to industry fears of a peak in the current RV cycle. Industry participants point to both increased inventories at dealers and reduced volume of unit sales as cause for concern. In the recent quarter, Thor's revenues fell, and the company's order backlog also decreased. The company has added manufacturing capacity, and this is likely to influence ordering patterns from dealers as Thor possesses the capacity to more aptly respond to demand. While Thor does operate in a cyclical industry, the competitive dynamics and positioning of the company remain intact.
- > Real estate company RE/MAX shares declined due to weak existing-home sales trends, as well as higher costs the company is incurring to build out its technology infrastructure.

PORTFOLIO CHANGES

No new purchases or complete sales were made in the portfolio during the quarter.

OUTLOOK

A flat Treasury yield curve continues to concern investors, the U.S. and China are locked in an ongoing trade spat, and troubles in emerging markets persist. Circumstances may change but uncertainty and volatility in markets are to be expected. While we pay attention to such factors causing concern, we also remain focused on the economic and business fundamentals. The U.S. appears to be one of the pillars of strength in the global economy today, with third-quarter GDP growth projected to be strong and various sectors continuing to expand. As always, we are committed to investing in high-quality businesses that have a sustainable competitive edge. In our view, this approach is the best long-term strategy in today's environment of heightened market and geopolitical uncertainty.

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS



Julie Kutasov
Industry start date: 2001
Start date with Fund: 2008



Craig Stone
Industry start date: 1989
Start date with Fund: 2009

TOP TEN HOLDINGS

% Fund

Cheesecake Factory Inc.	4.91
RBC Bearings Inc.	4.60
MGM Growth Properties LLC Class A	4.57
National Beverage Corp.	4.39
SiteOne Landscape Supply, Inc.	4.10
Core Laboratories NV	3.90
Scotts Miracle-Gro Co.Class A	3.81
Badger Meter, Inc.	3.75
Primerica, Inc.	3.71
Cinemark Holdings, Inc.	3.68

Holdings 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 6/28/2006
Fund Class I	4.06	2.90	7.62	17.19	11.35	11.75	9.35
Index	1.60	7.14	9.33	16.12	9.91	9.52	7.72

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 1.05% 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 1.03%.

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 **Russell 2000® Value Index** is a market capitalization-weighted index of value-oriented stocks of the smallest 2,000 companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. 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: 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. **Limited Number of Investments:** Because the fund has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a less concentrated fund. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund.

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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