

Virtus KAR Small-Cap Core Fund

A: PKSAX (92828N551) | C: PKSCX (92828N536) | I: PKSFX (92828N528) | R6: VSCRX (92828N429)

MARKET REVIEW

2022 was a very volatile and difficult year for equity and fixed income markets, with investors losing money in both asset classes for only the third time since 1926. Fortunately, the year ended on a positive note with U.S. large-cap stocks, as measured by the S&P 500® Index, rallying to a 7.56% return in the fourth quarter. Value stocks performed better than hard-hit growth stocks, with the Russell 1000® Value Index up 12.42% and the Russell 1000® Growth Index up 2.20% in the fourth quarter. Small-capitalization stocks, as measured by the Russell 2000® Index, returned 6.23% in the quarter, slightly underperforming U.S. large-cap stocks. Emerging market stocks, as measured by the MSCI Emerging Markets Index, outperformed U.S. large-cap stocks for the period, gaining 9.70%.

FUND PERFORMANCE

The Virtus KAR Small-Cap Core Fund returned 8.28% (Class I) in the fourth quarter, outperforming the Russell 2000 Index, which returned 6.23%. Stock selection and an overweight position in the industrials sector, combined with stock selection and an underweight position in the healthcare sector, contributed positively to performance. Stock selection in the information technology and consumer discretionary sectors detracted from performance.

EMCOR Group and The Toro Company were the largest contributors to performance during the quarter.

- > Shares of engineering and construction company EMCOR reacted favorably to the rebound in profitability in the quarter. Strong demand further led management to raise guidance for the year. We believe EMCOR continues to win larger and more complex projects due to its reputation, and the company remains a strong capital allocator.
- > Toro, which manufactures turf maintenance and landscaping equipment, experienced solid demand for its products and has been able to pass through pricing to combat inflationary pressures and drive improved profitability.

Aspen Technology and Manhattan Associates were the largest detractors from performance during the quarter.

- > The merger of industrial software company Aspen Technology with another software business closed in May 2022, which made the comparability of reported financials this quarter challenging relative to previous quarters. Despite the uncertain macroeconomic environment, demand from clients remains strong, and the merger business has already helped Aspen source deals in new industry verticals. Management reiterated its guidance for the current fiscal year and highlighted the company's increased scale and access to new geographies and verticals. Despite these positives, the share price came under pressure in December as markets became more challenging and concerns rose about a highly anticipated recession in 2023.
- > Manhattan Associates reported strong sales and growth in the latest quarter even though profit margins declined as the supply chain solutions company continued to hire to meet demand. However, the shares declined after management announced its forward year's guidance with greater conservatism due to current macroeconomic uncertainty.

PORTFOLIO CHANGES

There were no new purchases or complete sales from the portfolio during the quarter.

OUTLOOK

The Federal Reserve's hawkish monetary policy combined with improving supply chain issues appears to be working to reduce the core inflation rate. Inflation concerns, however, have been replaced by impending recession fears in the market. We certainly witnessed a slowdown in growth over the last year, and we are likely to see a continued slowdown over the next six to 12 months. The stock market seems to have already priced in a moderate recession for 2023. This has to be the most anticipated recession in the history of corporate America. It does not mean that a recession cannot occur, but it does suggest a hard landing is less probable. Recession fears will not disappear overnight, so investors should expect continued volatility in 2023 and will need to be patient. Additionally, the top-heavy S&P 500 companies—MAMAA (Meta, Apple, Microsoft, Amazon, and Alphabet) stocks in particular—are having significant fundamental growth issues, which has not been the case since 2008. In our view, this may bode well for many small- and medium-sized companies that can continue to grow in a lackluster economic environment.

Related Reading: [Q4 KAR Market Review & Outlook](#)

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Kayne Anderson Rudnick Investment Management, LLC

PORTFOLIO MANAGERS



Jon Christensen, CFA
 Industry start date: 1995
 Start date as Fund Portfolio Manager: 2008



Todd Bailey, CFA
 Industry start date: 1999
 Start date as Fund Portfolio Manager: 2009

TOP TEN HOLDINGS

	% Fund
EMCOR Group Inc.	6.75
FTI Consulting Inc.	6.64
Simpson Manufacturing Co. Inc.	5.19
Primerica Inc.	5.12
The Toro Co.	4.71
Landstar System Inc.	4.70
First Hawaiian Inc.	4.57
Acushnet Holdings Corp.	4.39
Graco Inc.	4.17
Manhattan Associates Inc.	4.06

Holdings are subject to change.

TOP CONTRIBUTORS

	% Contribution
EMCOR Group Inc.	1.61
The Toro Co.	1.22
RLI Corp.	0.83
Primerica Inc.	0.73
Watts Water Technologies Inc.	0.61

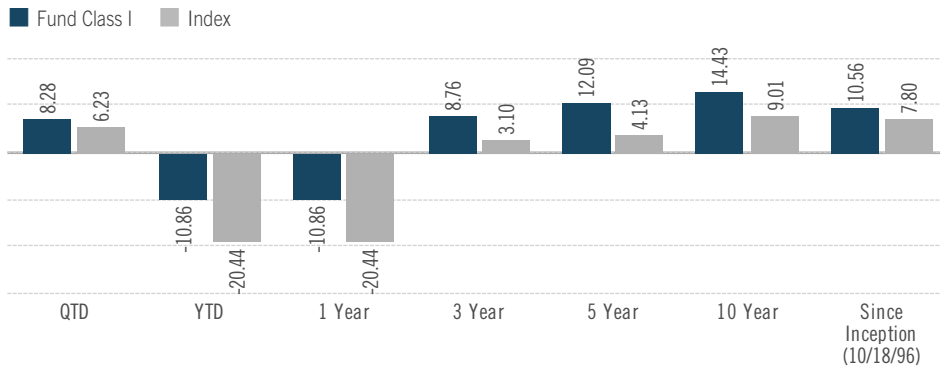
TOP DETRACTORS

	% Contribution
Aspen Technology Inc.	-0.42
Manhattan Associates Inc.	-0.41
FTI Consulting Inc.	-0.30
LCI Industries	-0.23
Acushnet Holdings Corp.	-0.09

% Contribution: Absolute weighted contribution.

To obtain the top/bottom holdings calculation methodology, call 800-243-4361.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/30/22



Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate 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 1.00%.

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 **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest 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. **Industrial Concentration:** Because the portfolio is presently heavily weighted in the industrial sector, it will be impacted by that sector's performance more than a portfolio with broader sector diversification. **Limited Number of Investments:** Because the portfolio has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a portfolio with a greater number of securities. **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. Price changes may be short- or long-term. Local, regional, or global events such as war (e.g., Russia's invasion of Ukraine), acts of terrorism, the spread of infectious illness (e.g., COVID-19 pandemic) or other public health issues, recessions, or other events could have a significant impact on the portfolio and its investments, including hampering the ability of the portfolio's manager(s) to invest the portfolio's 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.

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