Virtus KAR Small-Cap Core Fund

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

MARKET REVIEW

Stocks recovered with a vengeance in the first quarter from the late sell-off in 2018. It was the stock market's strongest start in a calendar year since 1991, with growth stocks leading the way. Small stocks slightly outperformed large stocks with the Russell 2000® Index returning 14.58% for the quarter, while the S&P 500® Index returned 13.65%. By comparison, international stocks continued to lag U.S. markets with the MSCI EAFE® Index advancing 9.98% and the MSCI Emerging Markets Index returning 9.92%.

Fixed income had a robust quarter for returns as well. The 10-year U.S. Treasury yield continued its descent in the quarter, moving from 2.69% to 2.41% at quarter-end. This decline allowed various fixed income asset classes to generate positive returns. The Bloomberg Barclays U.S. Aggregate Bond Index returned 2.94% for the quarter with credit-sensitive strategies leading the returns.

PERFORMANCE

The Fund (Class I) returned 21.42% in the quarter, outperforming the Russell 2000 Index's 14.58% return. Outperformance was primarily due to strong stock selection in the financial services sector and strong stock selection and an overweight in the technology sector. Gains were somewhat offset by weak stock selection in materials & processing and an underweight in healthcare.

The biggest stock contributors to performance were Autohome and HFF.

> The increase in China-based online automobile company Autohome's share price was driven by continued healthy business results—despite weak new car sales in China—along with improved economic data in March.

> Commercial realtor HFF's stock price had been under pressure most of last year due to the fear that a slowing economy and higher interest rates would dampen the commercial real estate market. The broad market sell-off in the fourth quarter added to the downward pressure on HFF's stock. However, HFF's recent quarterly results, which included 17% revenue growth, helped assuage these concerns, sparking a strong recovery in the stock price. The stock appreciated further after the company announced on March 19 that it was being acquired by Jones Lang LaSalle.

The biggest detractors to performance were RBC Bearings and PriceSmart.

> Ball and roller bearing manufacturer RBC Bearings' shares lagged following weaker-than-anticipated operating results and near-term outlook, driven primarily by production bottleneck issues at subcontractors the company relies on for highly specialized processes. To address these issues, RBC has been working on insourcing some of this work with first capacity expected to come online over the next several months. RBC remains a solid, free cash flow generator, and its balance sheet has improved further with year-to-date debt repayment having exceeded the annual target.

> PriceSmart, which operates membership warehouse clubs in Central America and the Caribbean, has commented on the difficult conditions in sourcing new real estate for additional stores at both the size and cost levels required for its historical business model. The company is testing a new store format with a smaller footprint, requiring less real estate, a smaller upfront investment, and an opportunity to open up more appropriate locations for the PriceSmart concept. In concert with the company introducing this new strategy, certain markets such as Nicaragua, Costa Rica, and Panama have continued to experience challenges.

PORTFOLIO CHANGES

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

OUTLOOK

We believe the likelihood of an outright, meaningful recession over the next 12 to 18 months is low. Within the last 10 years, we have had rolling recessions in cyclical areas like energy, industrials, and materials from 2014 to 2016. Europe is close to or has already entered a recession over the last six months due to slow exports and Brexit fears adversely affecting business confidence. Although the current economic expansion has been lengthy, it hasn't been robust by historical standards. Classic signals of excess business confidence, such as elevated capital spending, inventory buildup in anticipation of robust sales, and additional labor hiring, don't appear prevalent. Even in a slower economic environment (1.5-2.5% GDP growth), we believe U.S. companies should be able to grow earnings in the 5-8% range. This kind of growth, combined with business confidence improving, has the potential to lead to double-digit returns for stocks in 2019.

Effective July 31, 2018, this Fund is closed to new investors. Please see the prospectus for exceptions.

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

TOP TEN HOLDINGS

TOP TEN HOLDINGS	% Fund
Autohome Inc.	10.12
Primerica Inc.	5.97
Teledyne Technologies Inc.	5.86
CDW Corp./DE	5.68
Rightmove PLC	5.67
Copart Inc.	5.55
Aspen Technology Inc.	5.18
Old Dominion Freight Line Inc.	4.77
WABCO Holdings Inc.	4.48
Graco Inc.	4.46

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/19

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 10/18/1996
Fund Class I	21.42	21.42	12.35	22.41	15.87	19.25	10.47
Index	14.58	14.58	2.05	12.92	7.05	15.36	8.28

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 1.03% 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 1.01%.

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® 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. **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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