

Virtus KAR Small-Cap Core Fund

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

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) outperformed the Russell 2000 Index during the quarter, returning 3.79% versus 3.58%. Performance was led by strong stock selection in the financial services and producer durables sectors. Factors negatively affecting the portfolio included weak stock selection in technology and an underweight in healthcare.

The biggest contributors to performance during the quarter were Teledyne Technologies and Aspen Technology.

- > In August, Teledyne reported its best quarter in history, with organic sales increasing 8%, driven by broad-based growth across the manufacturer of instrumentation, digital imaging products and software, aerospace and defense electronics, and engineered systems. Operating income also increased, by 35%, driven by the operating leverage of the business. We view Teledyne's success as a result of its differentiated offerings that are facing end markets with positive tailwinds.
- > Asset optimization software company Aspen Technology continues to generate healthy top-line and bottom-line results, with strength in its core offering complemented by solid demand for its new asset performance monitoring suite of products. Additionally, Aspen is seeing some renewed interest from its engineering and construction clients, the segment that has been struggling most with the decline in oil prices. The company's annual contract value is forecast to accelerate this year beyond the softer growth seen in the last few years.

The biggest detractors from the portfolio were Autohome and Rightmove.

- > Escalating trade friction between China and the U.S., and the potential impact the conflicts could have on China's economy, have weighed on China-based auto website company Autohome's stock. In addition, new car sales have been weak in China following the demise of many peer-to-peer lending platforms.
- > Rightmove is the leading website for residential properties for sale or rent in the U.K. The company's shares declined due to weak trends in U.K. residential real estate, commission pressure facing agents, and the potential fallout from Brexit.

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



Jon Christensen, CFA
Industry start date: 1995
Start date with Fund: 2008



Todd Beiley, CFA
Industry start date: 1999
Start date with Fund: 2009

TOP TEN HOLDINGS

% Fund

Autohome, Inc. Sponsored ADR Class A	6.96
Teledyne Technologies Inc.	5.53
Primerica, Inc.	5.34
Old Dominion Freight Line, Inc.	5.31
Aspen Technology, Inc.	5.31
CDW Corp.	4.96
Rightmove PLC	4.75
WABCO Holdings Inc.	4.36
Copart, Inc.	4.28
Pool Corp.	3.82

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 10/18/1996
Fund Class I	3.79	15.18	26.73	25.23	15.95	14.90	10.55
Index	3.58	11.51	15.24	17.12	11.07	11.11	8.92

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 1.07% 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 1.05%.

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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