VIRTUS FUNDS

Virtus KAR Small-Cap Growth Fund

A: PSGAX (92828N627) | C: PSGCX (92828N619) | I: PXSGX (92828N593) | R6: VRSGX (02828N247)

MARKET REVIEW

The first quarter saw a continuation of 2023 trends with investors favoring stocks with strong growth prospects, in many cases driven by opportunities in artificial intelligence. As the quarter progressed, economic and inflation data came in ahead of expectations, leading investors to realize there could be fewer interest rate cuts this year than previously expected.

The S&P 500® Index advanced 10.56% in the quarter, its largest first quarter gain since 2019. Large-cap growth stocks, as measured by the Russell 1000® Growth Index, were the best performers in the quarter, gaining 11.41%. Value stocks, as measured by the Russell 1000® Value Index, lagged growth stocks, returning 8.99%. Small-cap stocks, as measured by the Russell 2000® Index, underperformed their larger-cap counterparts, advancing 5.18%.

FUND PERFORMANCE

The Virtus KAR Small-Cap Growth Fund returned 3.86% (Class I) in the quarter, underperforming the Russell 2000® Growth Index, which returned 7.58%. Stock selection in the information technology sector, combined with stock selection and an overweight in the consumer discretionary sector, detracted from performance. Stock selection in financials contributed positively to performance, as did stock selection and an underweight in the healthcare sector.

Ryan Specialty and Interactive Brokers Group were the largest contributors to performance in the quarter.

> Ryan Specialty, a provider of specialty insurance services, experienced increasing premium flow into the excess & surplus lines segment of the property and casualty insurance market as underwriters sought more flexibility with setting rates and policy terms.

> Interactive Brokers Group reported continued growth in revenues and profits, as well as growth in customer accounts and customer equity. This strong fundamental business performance caused the brokerage firm's shares to appreciate.

The biggest detractors from performance during the quarter were Endava and Fox Factory.

> Endava reported headwinds in vertical and geographic markets that the software development company has outsized exposure to, including the payments, banking & capital markets, the United Kingdom, and the European region. As a result, management revised downward previous expectations for growth in the size of existing projects with customers.

> Fox Factory, which makes suspension components for recreational and commercial vehicles, continued to suffer from a downdraft in its specialty sports business as demand continues to normalize following the pandemic and retail inventory has ballooned. Additionally, revenue in the company's powered vehicle group was hurt by a labor strike at its original equipment manufacturing facility.

PORTFOLIO CHANGES

During the quarter, we purchased Smith Douglas Homes, and we sold BILL, MarketAxess, and Mesa Laboratories.

> Smith Douglas Homes is an asset-light homebuilder. The company utilizes a unique business approach that allows it to assume less risk than other homebuilders and produce higher returns on tangible capital relative to its peers.

> BILL's business has become largely driven by the financial software company's ability to monetize payment volume flowing over its network between customers and their suppliers, as well as BILL's customers' employee spending on the Divvy card. Software subscriptions account for just 20% of total revenue. From its payment and card volume, it is unclear what BILL's sustainable economic model will ultimately be. Also, we dislike management's acquisition behavior and heavy share issuance.

> MarketAxess became the dominant platform for electronic corporate bond trading in the aftermath of the 2008 global financial crisis as dealers receded from the market. A dealer-friendly competitor has since encroached on the company's competitive position, aided by the desire among dealers to reestablish themselves in the market. Although we still believe MarketAxess is a good business in a duopolistic market structure, future pricing power is less clear and the remaining market opportunity likely muted. With these competitive changes in mind, coupled with the stock's premium valuation, we sold our holdings.

> Mesa Laboratories' costly acquisition strategy over the past few years has brought the life sciences business into more competitive markets and hurt profitability. Concurrently, leverage has increased, and equity holders have been diluted through stock issuance. We sold our stock because of management's poor capital allocation behavior.

OUTLOOK

One large challenge coming out of the Covid-19 pandemic is how to parse the underlying strength in the economy. Our supply chains were whipsawed, our employment patterns changed dramatically, and we saw unprecedented monetary and fiscal support. This makes it hard to gauge how much of the U.S. economy's strength is due to fundamentals versus other exogenous effects. And while interest rates have increased materially in a short period of time, they are only modestly restrictive compared to the long-run average. As a result of low rates and strong government support during the pandemic, we believe the tide lifted all companies and made it easier for everyone to prosper. However, without this added assistance, we expect that more fundamental factors will drive corporate profits and thus equity performance going forward. In this environment, we believe companies that are competitively advantaged with better profitability, cash flow, and lower leverage will be able to better distinguish themselves going forward.

Related Reading: 1Q 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: 2009

Todd Beiley, CFA
Industry start date: 1999
Start date as Fund Portfolio Manager: 2008

AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/24

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (06/28/06)
Fund Class I	3.86	3.86	9.99	-2.44	8.40	14.31	11.35
Index	7.58	7.58	20.35	-2.68	7.38	7.89	8.72

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 1.09%.

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® Growth Index** is a market capitalization-weighted index of growth-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.

TOP TEN HOLDINGS

	% Fund
Ryan Specialty Holdings Inc.	9.46
Morningstar Inc.	7.36
AAON Inc.	7.31
Auto Trader Group PLC	5.75
ServisFirst Bancshares Inc.	4.47
Rightmove PLC	4.47
nCino Inc.	4.37
Fox Factory Holding Corp.	4.14
Dream Finders Homes Inc.	3.82
SPS Commerce Inc.	3.37

Holdings are subject to change.

TOP FIVE CONTRIBUTORS

	% Contribution
Ryan Specialty Holdings Inc.	2.31
Interactive Brokers Group Inc.	1.44
AAON Inc.	1.25
MediaAlpha Inc.	1.02
Dream Finders Homes Inc.	0.75

TOP FIVE DETRACTORS

	% Contribution
Endava PLC	-2.32
Fox Factory Holding Corp.	-1.00
MarketAxess Holdings Inc.	-0.77
Goosehead Insurance Inc.	-0.33
Rightmove PLC	-0.28

% Contribution: Absolute weighted contribution.

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

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, medium, or large-sized companies may enhance that risk. **Foreign Investing:** Investing in foreign securities subjects the fund to additional risks such as increased volatility; currency fluctuations; less liquidity; less publicly available information about the foreign investment; and political, regulatory, economic, and market risk. **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. **Sector Focused Investing:** Events negatively affecting a particular industry or market sector in which the portfolio focuses its investments may cause the value of the portfolio to decrease. **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. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its 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.

Please consider a Fund's investment objectives, risks, charges, and expenses carefully before investing. For this and other information about any Virtus Fund, contact your financial professional, call 800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

Not FDIC Insured | May Lose Value | Not Bank Guaranteed

Distributed by **VP Distributors, LLC**, member FINRA and subsidiary of Virtus Investment Partners, Inc.
2018 4-24 © 2024 Virtus Mutual Funds