

Virtus KAR Small-Cap Growth Fund

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

MARKET REVIEW

Stocks got off to a very strong start in the quarter but shifted into correction mode in early February and stayed there on concerns over inflation, trade, and large technology stocks. The S&P 500® Index closed the quarter down 0.76%. Growth stocks outperformed value stocks, and small stocks slightly outperformed their larger counterparts. Developed foreign markets, represented by the MSCI EAFE® Index, were down 1.53%, and emerging markets, as measured by the MSCI Emerging Markets Index, were up 1.42%. Equity volatility, represented by the CBOE Volatility Index (VIX®), staged a pickup, which was expected coming off of 2017's exceptionally low levels. On the fixed-income front, the Bloomberg Barclays U.S. Aggregate Bond Index fell 1.46%. The 10-year U.S. Treasury yield rose during the quarter from 2.40% to 2.74%, which pressured many fixed-income issues and bond proxies in the equity market.

PERFORMANCE

The Fund (Class I) returned 8.33% for the quarter, outperforming the 2.30% return of the Russell 2000® Growth Index. Returns were primarily driven by strong stock selection in the producer durables, technology, and financial services sectors. An underweight in the healthcare sector offset some of the gains.

Autohome and MercadoLibre made the most positive contributions to performance in the quarter.

- > Autohome reported strong fourth-quarter earnings, with revenue growth in excess of 30% and profit margins higher than a year earlier. The China-based auto sales website continues to benefit from the secular shift of ad revenues to online media. Given Autohome's strong competitive positioning, improved capital allocation discipline, and expected long-term growth of the Chinese car market, we remain owners.
- > Shares of Latin American online marketplace operator MercadoLibre have recovered meaningfully since the company began its free-shipping initiative last year. While free shipping has put pressure on the company's margins, revenue growth has accelerated, which should increase the network effects of the marketplace over the long term. While we continue to look favorably on MercadoLibre's business and management team, we sold our position because the market cap had surpassed a size appropriate for this portfolio.

National Research and Fox Factory Holding were the biggest detractors from performance in the quarter.

- > Shares of healthcare solutions provider National Research fell in the quarter following solid growth in 2017. Revenues continue to grow, but margins have been impacted by

higher client service costs. As the healthcare community focuses more on outcomes-based reimbursement, we believe the company should be a direct beneficiary.

- > "Ride dynamics" manufacturer Fox Factory's growth has decelerated from an atypically high level in early 2017 that was driven by initial production of the Ford Raptor vehicle platform, for which Fox supplies suspension products.

PORTFOLIO CHANGES

We bought Moelis & Co., Rightmove, and Auto Trader Group during the quarter, and we sold our position in MercadoLibre (rationale provided under Performance).

- > Global investment bank Moelis & Co. (MC) provides financial advisory, restructuring, and capital-raising services. MC's founders have focused on hiring high-performing managing directors and cultivating a distinct firm culture and reputation, which has allowed the company to quickly take market share and climb the M&A league tables. While other firms could try to copy this model, successful execution is far from certain.
- > Rightmove is the leading website for residential properties for sale or rent in the U.K. The company has established a strong network effect as U.K. home buyers have shifted their home-purchasing behavior. This has given Rightmove considerable pricing power and margin expansion opportunities. The company has had double-digit revenue growth over the past five years, its balance sheet is clean, and management has allocated free cash flow in a prudent manner.
- > Auto Trader operates the leading online automotive marketplace in the U.K., with four times the buyer traffic and double the number of car listings than those of its closest competitor. The strength of the Auto Trader brand in the U.K. is evident; more than 80% of time spent on automotive classified websites is spent on Auto Trader, the site has more dealer reviews than any other site, and it does more valuations of used cars than any other site.

OUTLOOK

We want to underscore that market corrections, while unpredictable, sharp, and painful, are necessary to remove excessive speculation and to shake out weak stockholders. We still believe that businesses will be growing their earnings over the next couple of years and that the market will ultimately reward this growth with positive returns in the mid-to-high single-digit range. The shape of the yield curve is certainly worth monitoring over the next year or two, and we would like to see it steepen. As always, we remain focused on investing in high-quality businesses that we believe offer a sustainable competitive edge.

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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: 2009



Todd Beiley, CFA
Industry start date: 1999
Start date with Fund: 2008

TOP TEN HOLDINGS

% Fund

Autohome, Inc. Sponsored ADR Class A	9.19
Fox Factory Holding Corp.	4.87
Auto Trader Group PLC	4.86
Old Dominion Freight Line, Inc.	4.76
HEICO Corporation Class A	4.56
Ollie's Bargain Outlet Holdings Inc	4.53
Copart, Inc.	4.42
Interactive Brokers Group, Inc. Class A	4.25
Rightmove PLC	4.12
Aspen Technology, Inc.	3.92

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 6/28/2006
Fund Class I	8.33	8.33	40.10	21.66	19.41	14.84	11.68
Index	2.30	2.30	18.63	8.77	12.90	10.95	9.73

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 1.21% 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 1.17%.

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® 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.

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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