VIRTUS FUNDS

Virtus KAR Small-Cap Growth Fund

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

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 22.20% in the quarter, outperforming the Russell 2000® Growth Index, which returned 17.14%. Strong stock selection and an overweight in the technology sector, along with strong stock selection in the materials & processing sector, helped lead gains. Weak stock selection and an underweight in the healthcare sector and weak stock selection in consumer staples detracted from performance.

Stocks that contributed the most to performance were Autohome and Paycom Software.

> 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.

> Online payroll and human resource technology provider Paycom Software reported another quarter of strong top- and bottom-line performance. The company's efforts to focus on employee self-service is driving efficiency of its software, making its products that much more valuable and hard for customers to replace.

Stocks that detracted the most were Interactive Brokers Group and The Chefs' Warehouse.

> Shares of electronic brokerage Interactive Brokers declined as long-term interest rates fell in relation to short-term rates and investors turned negative on electronic brokerage stocks as a whole because of potential reductions in net interest margin revenue. Looking through the cyclicality driven by market volatility and interest rates, Interactive Brokers continues to gain client account market share by providing the best value via its lowest cost structure.

> Shares of gourmet foods and restaurant supplier The Chefs' Warehouse declined after the most recent earnings release in which the company reported organic growth continuing to outpace larger peers, but operating margin down slightly year-over-year due to rising labor and fuel costs. This marked a pause in operating margin improvements the company had been reporting. We view the business as well positioned for continued market-share gains and continued going-forward margin expansion via operating leverage.

PORTFOLIO CHANGES

During the quarter, we purchased BlackLine for the portfolio, and we sold our position in Ellie Mae.

> BlackLine is the leader in financial-close automation software. The company has focused on selling to enterprise customers, managing complex accounting across subsidiaries and geographies. The company's solution automates the complex process of reconciling accounts at period-end and it goes to market as a cloud solution. BlackLine's software is able to ingest data from enterprise resource planning (ERP) systems and spreadsheets to create cohesive financial statements that are verified and compliant with regulatory standards.

> We sold mortgage software company Ellie Mae during the quarter as the company was acquired by Thoma Bravo.

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 September 28, 2018, this Fund is closed to new investors. Please see the prospectus for exceptions.

Virtus KAR Small-Cap Growth Fund

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

TOP TEN HOLDINGS

	% Fund
Autohome Inc.	11.56
Auto Trader Group PLC	8.17
Rightmove PLC	5.54
Paycom Software Inc.	5.40
Fox Factory Holding Corp.	5.38
Copart Inc.	4.61
Old Dominion Freight Line Inc.	4.56
Aspen Technology Inc.	4.16
MarketAxess Holdings Inc.	4.14
Interactive Brokers Group Inc.	4.03

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 6/28/2006
Fund Class I	22.20	22.20	23.07	28.68	20.54	21.99	12.53
Index	17.14	17.14	3.85	14.87	8.41	16.52	9.25

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 1.14% 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 1.10%.

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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