VIRTUS MUTUAL FUNDS

Virtus Newfleet Senior Floating Rate Fund

A: PSFRX (92828R545) | C: PFSRX (92828R537) | I: PSFIX (92828R529) | R6: VRSFX (92828W254)

MARKET OVERVIEW

During the second quarter, investors faced multiple challenges and bouts of elevated volatility that carried over from the first quarter. Investors continued to grapple with the potential market implications of the emerging risks of a trade war among major economic powers, geopolitical tensions, the political climate in Washington, and the ongoing evolution of the quantitative easing (QE) programs initiated by the key global central banks in the aftermath of the Financial Crisis. Oil prices moved higher during the three-month period, U.S. economic data modestly improved, the U.S. dollar climbed, and interest rate volatility remained elevated. As expected, the Federal Reserve (Fed) increased its target rate during the quarter to a range of 1.75%–2.0% at the June Federal Open Market Committee (FOMC) meeting.

Bank loans were one of the quarter's best performing sectors as investors continued to seek protection against rising interest rates and higher yield relative to other fixed income options. Total returns, however, weakened progressively throughout the quarter due to a large wave of supply into the loan market that overwhelmed still-strong demand. Bank loan fundamentals remained on solid footing and did not account for price softness during the quarter.

On a credit quality basis, CCCs (+1.90%) outperformed over the quarter, followed by Bs (+0.79%) and BBs (+0.46%), indicating that credit issues were not at the forefront of investors' concerns over the quarter. On an industry basis, metals/minerals (+3.92%), surface transport (+2.79%), retailers (+1.68%), and oil & gas (+1.49%) were the quarter's top performers while home furnishings (-1.95%), radio/TV (-0.57%), and automotive (-0.45%) lagged.

For a more detailed review of the second quarter and our outlook, please see Newfleet's 2Q18 Market Review & Outlook.

HOW THE FUND PERFORMED

The Fund (Class I) returned 0.42% in the second quarter versus 0.70% for the Fund's benchmark, the S&P/LSTA Leveraged Loan Index.

Contributors

> Solid credit selection in energy, automotive, and financials all contributed positively to performance.

> Remaining fully invested with the modest use of leverage also benefited performance.

Detractors

> Credit selection in the forest products, manufacturing, and broadcasting industries detracted from returns.

CURRENT FUND STRATEGY

The Fund ended the second quarter with 93.5% invested in senior secured first lien bank loans, 2.4% in non-first lien bank loans, and the majority of the remaining exposure in high yield bonds as part of our liquidity strategy.

> The Fund's credit quality exposure has migrated slightly to single Bs as we selectively added some risk while also selling above-par higher quality credits. This is not a change in our philosophy but just optimization of the portfolio. We will continue to have a slight underweight to securities rated B and below in the aggregate, and a modest overweight to BBs.

> Our high yield allocation remains in place to support our liquidity strategy.

> We continue to review the secondary market for total return opportunities but these have become fewer and farther between.

> The Fund's largest overweights include housing, telecom, and broadcasting. The largest underweights include information technology, financial, and retail.

> In the new issue market, we continue to see deterioration in credit quality as evidenced by higher leverage and weaker underwriting standards. The latter include a higher number of covenant-lite transactions, structures with less subordinated cushion, and increased adjustments to cash flow metrics. We see this vintage of new loan transactions as aggressive, and are passing on a substantial number of new deals.

> We are comfortable with our liquidity position and cautiously monitor and consider it daily in managing the Fund.

OUTLOOK

We remain constructive on the bank loan asset class but are cognizant of some longer-term concerns. The loan market has grown substantially over the past few years and a degradation in underwriting has occurred, foreshadowing lower recovery rates down the road. We have thus become very selective in new issue participation. We otherwise have a very favorable outlook for credit and our investment thesis for loans remains intact, that is, that bank loans can provide a hedge against rising interest rates, attractive risk-adjusted relative returns, and income.

Virtus Newfleet Senior Floating Rate Fund

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Newfleet Asset Management, LLC

PORTFOLIO MANAGERS

David L. Albrycht, CFA
Industry start date: 1985
Start date with Fund: 2008

Kyle A. Jennings, CFA
Industry start date: 1992
Start date with Fund: 2008

Francesco Ossino
Industry start date: 1996
Start date with Fund: 2012

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 1/31/2008
Fund Class I	0.42	1.55	3.57	3.46	3.42	4.82	4.94
Index	0.70	2.16	4.37	4.21	4.00	5.19	5.20

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 0.87%. The net expense ratio is 0.81%, which reflects a contractual expense reimbursement in effect through 1/31/2019. This ratio reflects the direct and indirect expenses paid by the Fund.

The net expense ratio minus the indirect expenses incurred by the underlying funds in which the Fund invests is 0.80%.

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 **S&P/LSTA Leveraged Loan Index** is a daily total return index that uses LSTA/LPC Mark-to-Market Pricing to calculate market value change. On a real-time basis, the Index tracks the current outstanding balance and spread over LIBOR for fully funded term loans. The facilities included in the Index represent a broad cross section of leveraged loans syndicated in the United States, including dollar-denominated loans to overseas issuers. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

Notes on Risk: Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Bank Loans:** Loans may be unsecured or not fully collateralized, may be subject to restrictions on resale and/or trade infrequently on the secondary market. Loans can carry significant credit and call risk, can be difficult to value and have longer settlement times than other investments, which can make loans relatively illiquid at times. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. **Leverage:** When a fund leverages its portfolio, the value of its shares may be more volatile and all other risks may be compounded. **Liquidity:** Certain securities may be difficult to sell at a time and price beneficial to the 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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