# Virtus Newfleet Senior Floating Rate Fund

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

## MARKET OVERVIEW

The overall positive tone for fixed income spread sectors continued into the fourth quarter with short-lived bouts of increased volatility in October and November. Challenges to the status quo included continued geopolitical tensions and the turbulent political climate in Washington, D.C. During the quarter, oil prices moved higher, U.S. economic data modestly improved, and tax reform legislation was passed. As expected, the Federal Reserve (Fed) raised its target rate at the December Federal Open Market Committee (FOMC) meeting to a range of 1.25%-1.50%.

The bank loan market posted a respectable return in the fourth quarter, supported by favorable fundamentals and strong technicals. The loan market rally over the past two years has left little room for price appreciation, so the incremental return has come predominantly from income. While the fourth quarter was the second best quarter of the year on a total return basis, market value returns have been slightly negative throughout the year including the fourth quarter. In terms of industry sectors, notable outperformers during the quarter were publishing (+1.94%), energy (+1.69%), automotive (+1.60%), and utilities (+1.58%). The laggards included cosmetics (-3.15%), home furnishings (-1.55%), and surface transports (-0.87%). By credit quality, BBs performed in line with Bs (+1.09% for both) while CCCs (+2.85%) continued to lead in the risk-on environment. Lastly, second lien loans (+1.68%) outperformed first lien (+1.09%).

For a more detailed review of the fourth quarter and our outlook, please see Newfleet's 4Q17 Market Review and 2018 Bank Loan Market Outlook.

## HOW THE FUND PERFORMED

The Fund (Class I) returned 1.03% in the fourth quarter versus 1.11% for the Fund's benchmark, the S&P/LSTA Leveraged Loan Index.

### Contributors

> Solid credit selection in energy, gaming/leisure, information technology, and retail all contributed positively to performance.

> Our allocation to high yield and remaining fully invested with the modest use of leverage also benefited performance.

### Detractors

> Credit selection in the service, cable/wireless, and utility industry sectors detracted from returns.

> Credit selection in the CCC and distressed credit tiers also modestly detracted.

## CURRENT FUND STRATEGY

The Fund ended the fourth quarter with 90.5% invested in senior secured first lien bank loans, 3% 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 energy, housing, and forest products (packaging). The largest underweights are to the information technology, retail, and financial industries.

> In the new issue market, we continue to see deterioration in credit quality as evidenced by higher leverage and weaker covenant structures. 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

Our outlook for bank loans remains constructive given a combination of solid fundamentals and favorable technicals, partially offset by tight valuations. The fundamental backdrop for loans is in good shape and possibly improving going into 2018 considering synchronized global growth, corporate tax cuts, and expected growth in issuers' revenues, earnings, and cash flow. We remain concerned, however, that the new issuance market is exhibiting late-cycle behavior with rising leverage and loosening credit terms, which may have adverse implications for recovery rates and future default rates. For risk assets in general, oil price volatility, geopolitical tensions, and negative impacts of quantitative tightening all have the potential to disrupt markets. While bank loan valuations appear fair or even rich from a price perspective, they remain attractive on a risk-adjusted basis. The Fed began shrinking its balance sheet in October, which could lead to modestly higher rates that may drive flows into the sector. With spreads so tight, there is limited potential for price appreciation. We are thus forecasting another year of a mostly coupon-clipping return, all else being equal.

Effective May 8, 2017, the Fund's name was changed from Virtus Senior Floating Rate Fund.

## Virtus Newfleet Senior Floating Rate Fund

### INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

### INVESTMENT SUBADVISER

Newfleet Asset Management, LLC

### INVESTMENT PROFESSIONALS

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

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

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

### AVERAGE ANNUAL TOTAL RETURNS as of 12/31/17 in percent

| I Share | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception 1/31/2008 |
|---|---|---|---|---|---|---|---|
| NAV | 1.03 | 3.43 | 3.43 | 3.84 | 3.57 | n/a | 5.04 |
| Index | 1.11 | 4.12 | 4.12 | 4.44 | 4.03 | n/a | 5.24 |

**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 returns reflect the change in share price and the reinvestment of all dividends and capital gains. Class I shares have no sales charge and therefore their returns do not reflect the deduction of a sales charge, which if applied, **would reduce the performance quoted**. Fees and expenses vary among share classes and other share classes do carry sales charges. Class I shares are offered primarily to eligible institutional investors who purchase the minimum amounts required 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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