VIRTUS MUTUAL FUNDS

Virtus Newfleet Senior Floating Rate Fund

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

MARKET OVERVIEW

Fixed income investors faced substantially similar market themes during the third quarter as in the prior two quarters of 2018. Market participants continued to wrestle with periods of volatility caused by geopolitical developments, trade rhetoric, mixed global economic signals, and the evolution of quantitative easing programs that began in the aftermath of the now decade-old Financial Crisis. During the quarter, oil prices continued their ascent, driven by the outlook for supply/demand dynamics. U.S. economic data stayed on a positive trend, which contrasted with other global economies. Primary inflation readings remained in check, but pressure in key components (i.e., wages) has started to build. As expected, the Federal Open Market Committee increased its target rate at the September meeting to a range of 2.00-2.25%, its eighth hike in the current tightening cycle.

Bank loans was one of the quarter's best-performing sectors, extending its streak of now 13 consecutive months of positive total return. The third quarter produced the strongest quarterly return since the fourth quarter of 2016 as the market bounced back from technically induced weakness in the second quarter in which a wave of supply overwhelmed still-strong demand. The asset class continues to attract investors seeking protection against rising interest rates and higher yield relative to other fixed income options.

The theme of lower quality outperforming higher quality continued over the quarter. CCCs (+3.47%) led the way followed by Bs (+1.96%), and BBs (+1.53%), indicating that credit issues have not been at the forefront of investors' concerns. Second lien loans (+2.33%) also outperformed. On an industry basis, the best performers were those that have experienced a recovery, including retail (+3.37%) and home furnishings (+3.35%). Rising oil prices boosted oil & gas (+2.76%), while the smaller surface transport sector (+2.77%) rose on idiosyncratic credit events. Underperformers at the industry level included metals & minerals (+0.04%), radio & television (+0.84%), and beverage & tobacco (+0.89%).

For a more detailed review of the third quarter and our outlook, please see Newfleet's 3Q18 Market Review & Outlook.

HOW THE FUND PERFORMED

The Fund (Class I) returned 1.84% in the third quarter, in line with the Fund's benchmark, the S&P/LSTA Leveraged Loan Index.

Contributors

> Solid credit selection in manufacturing and healthcare contributed positively to performance.

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

Detractors

> Credit selection in the consumer durables, telecommunications, and automotive industries detracted from returns.

CURRENT FUND STRATEGY

The Fund ended the third quarter with 94.0% invested in senior secured first lien bank loans, 2.2% 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.

> The Fund's largest overweights include housing, telecom, packaging/containers, and gaming/leisure. The largest underweights are to the information technology, financial, and retail industries. We are currently assessing our exposure to housing given the impact that rising rates have had on the industry.

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

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

OUTLOOK

With the Federal Reserve poised for another interest rate hike and the recent breakout of the 10- and 30-year rates, our outlook for bank loans remains positive. This is the type of environment where the bank loan asset class should perform well, as a hedge against rising rates and a source of attractive income. Demand is likely to remain strong from both institutional and retail investors. At the same time, we expect a continuation of positive trends for bank loan issuers in terms of earnings, balance sheets, and the prospects for limited defaults with GDP growth in the area of 3%. Valuations remain an overriding concern as the margin for error is slim with spreads well inside long-term averages. As an ongoing concern, we continue to be selective in new issue participation given the weakening in underwriting that has occurred and its implications for future recovery rates.

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

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PORTFOLIO MANAGERS

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Industry start date: 1985
Start date with Fund: 2008

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

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Industry start date: 1996
Start date with Fund: 2012

AVERAGE ANNUAL TOTAL RETURNS (%) as of 9/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 1/31/2008
Fund Class I	1.84	3.42	4.48	4.57	3.54	5.56	5.00
Index	1.84	4.03	5.19	5.32	4.13	6.15	5.25

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 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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