VIRTUS MUTUAL FUNDS

Virtus Newfleet Senior Floating Rate Fund

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

MARKET OVERVIEW

Swept up in the widespread repricing of risk, bank loans endured a difficult fourth quarter with three months of negative returns capped by the worst December month since 2008. Still, bank loans outperformed high yield and equities in the quarter and, for the full year, managed to produce a positive return while high yield, investment grade corporates, and equities landed in negative territory. Retail investors' concerns over slowing growth and a pause or halt to Federal Reserve rate hikes resulted in massive fund outflows. We consider the selloff in loans a technical dislocation rather than a response to credit concerns.

All of the industries within the Credit Suisse Leveraged Loan Index posted negative returns for the quarter, led down by media/telecom-broadcasting (-5.04%), retail (-4.56%), metals & minerals (-4.51%), food & drug (-4.43), and energy (-4.30%). Outperformers included land transport (-1.31%), utility (-2.14%), automotive (-2.30%) and service (-2.38%).On a credit quality basis, Bs (-2.85%) outperformed BBs (-3.18%) and CCCs (-4.01%).

Fundamentals for the bank loan issuer universe are overall good, and U.S. macroeconomic data are generally supportive. Minimal debt is due in 2019-2020, and we do not think a recession is on the horizon. Prospectively, however, pressures are building as evidenced by reduced forward guidance in the most recent earnings season as issuers took into account numerous concerns, including the slowing global economy.

The plunge in demand from retail investors negatively impacted loan prices as funds sold loans to meet redemptions. The bank loan market ended December with an average price of 94.09 and a yield to maturity of 7.64%. The income profile is attractive, and lower prices now introduce total return potential to the asset class.

For additional commentary on bank loans, see *Newfleet's 2019 Bank Loan Market Outlook*, and January loan market update, *Shedding light on the recent year-end volatility and early 2019 snap back. An opportunity*.

HOW THE FUND PERFORMED

The Fund (Class I) returned -4.22% in the fourth quarter versus the Credit Suisse Leveraged Loan Index return of -3.08%.

Contributors

> Solid credit selection in housing and manufacturing contributed positively to performance, as did an underweight to the retail industry.

Detractors

> Detractors included credit selection in the energy, service, and forest products industries.

> Being overinvested with modest leverage in a down market, the Fund's high yield allocation (as part of our liquidity strategy), and exposure to larger deals were also detrimental.

CURRENT FUND STRATEGY

The Fund ended the fourth quarter with 94.8% invested in senior secured first lien bank loans, 2.6% in non-first lien bank loans, and the majority of the remaining exposure in high yield bonds as part of our liquidity strategy.

> Overall, the broad market selloff has created opportunities to compare relative value across credits and industries and to refine our investment theses. We are now revisiting the secondary market for total return opportunities that have been created by the volatility.

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

> The Fund's largest overweights include housing, packaging/containers, cable/wireless, and gaming/leisure. The largest underweights are to the information technology, diversified media, 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 are comfortable with our liquidity position and cautiously monitor and consider it daily in managing the Fund.

OUTLOOK

We are still comfortable with our base case gross, risk-adjusted 6% forecast for bank loans in 2019. A 2-2.5% GDP growth environment is supportive of risk assets in terms of borrowers' ability to pay. For the loan market specifically, a pickup in collateralized loan obligation demand and a stabilization of retail fund flows (which we have already seen in January) would be positive. The heightened demand for loans in 2018 saw the bulk of new issuance seemingly diverted from the high yield to the loan market. A range-bound interest rate environment could see issuance revert to the still-favorable high yield market because investors no longer feel the need for the rate hedge that loans provide, easing the potential negative technical from lower retail demand. While the rate hedge feature may make less sense in the near term, at current yields and attractive entry points, investors can get equity-like returns in a senior secured floating rate investment. The case for owning bank loans is thus well beyond just rates. As an ongoing concern, we continue to be selective in new issue participation given the weakening in underwriting that has occurred and its implication for recovery rates in the future.

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 12/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 1/31/2008
Fund Class I	-4.22	-0.95	-0.95	3.69	2.27	7.01	4.47
Index	-3.08	1.14	1.14	5.03	3.33	8.30	4.58

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 0.90%. The net expense ratio is 0.84%, which reflects a contractual expense reimbursement in effect through 1/31/2020.

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 **Credit Suisse Leveraged Loan Index** is a market-weighted index that tracks the investable universe of the U.S. dollar denominated leveraged loans. The index is calculated on a total return basis, is unmanaged and not available for direct investment. The unmanaged index returns do not reflect any fees, expenses, or sales charges.

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.

Please carefully consider a Fund's investment objectives, risks, charges, and expenses before investing. For this and other information about any Virtus mutual fund, contact your financial representative, call 1-800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.

Distributed by **VP Distributors, LLC**, member FINRA and subsidiary of Virtus Investment Partners, Inc.