

Virtus Newfleet Tax-Exempt Bond Fund

A: HXBZX (92828W312) | C: PXCZX (92828W296) | I: HXBIX (92828W288)

MARKET OVERVIEW

Tax-exempt municipal bonds continued to perform well in the third quarter. Following a consistent trend, longer maturity bonds outperformed the front end of the yield curve, and lower quality outperformed higher quality as investors have been willing to take additional risk in their quest for yield.

Positive technical conditions – a combination of manageable supply and good demand – have driven performance this year. The end of the summer marked the end of the negative net supply period in the municipal market, which has been highly supportive of market performance. The coming months will tell how the market reacts in a seasonal period of typically higher issuance and lower coupon/redemption income. From a valuations perspective, municipal securities still offer attractive taxable equivalent yields, though credit spreads remain historically tight given the demand for yield. Issuer fundamentals continue to be challenged by high fixed cost burdens, pension liabilities, and healthcare expenses, while state and local taxes show only modest growth.

For a more detailed overview of the third quarter and our outlook, please see [Newfleet's Q3 Municipal Bond Market Review at Virtus.com](#).

HOW THE FUND PERFORMED

The Fund (Class I) returned 0.87% in the third quarter versus 1.12% for the Fund's benchmark, the BofA Merrill Lynch 1-22 Year U.S. Municipal Securities Index (ML Index).

Contributors

- > The larger contributors to relative performance during the quarter were tobacco bonds, bonds in the 10+ year maturity range, and lower-rated issues.
- > The Fund's exposure to Illinois bonds helped performance, once the budget was passed in early July and Moody's re-affirmed the state's Baa3 rating.

Detractors

The Fund's lower allocation to the 20+ year maturity range and higher coupon profile detracted from performance during the quarter.

CURRENT FUND STRATEGY

The Fund's duration was 5.3 years on September 30, 2017, compared to that of the ML Index at 5.6 years.

At quarter end, the Fund had a 32.8% allocation to A-rated Bonds, 10.6% exposure to BBB-rated credits, and 1.3% to below investment grade bonds (excluding Puerto Rico).

We continue to look for opportunities to increase exposure in the 10- to 20-year maturity range in select A and BBB rated bonds with spread (although fewer and fewer lower-rated candidates exist in the current market environment). We have added some high quality paper as these bonds are more fairly priced and provide more yield stability in this rich market. We still believe this area of the curve represents the best value. The 15-year and 20-year bonds capture 84% and 93%, respectively, of the yield available on a 30-year bond with much less duration risk.

OUTLOOK

The crowded legislative agenda, including tax reform, suggests that any major impact on the municipal bond market is not likely for the remainder of the year. We thus expect the municipal market to mostly track U.S. Treasury yields, though with less volatility. Given the compression of spreads (i.e., between high quality and lower-rated municipal bonds) driven by yield-seeking investors, our focus is on higher quality investments because we do not believe in many cases that there is adequate compensation for assuming additional risk. Finally, with the wide variance in creditworthiness among issuers, we remain diligent in our rigorous credit reviews.

Virtus Newfleet Tax-Exempt Bond Fund

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Newfleet Asset Management, LLC

INVESTMENT PROFESSIONALS



Tim Heaney, CFA

Industry start date: 1990

Start date with the Fund: 2012



Lisa Leonard

Industry start date: 1986

Start date with the Fund: 2012

SECTOR ALLOCATIONS

% Fund

Prerefunded / Escrowed to Maturity	14.03
Water & Sewer	13.10
Transportation	11.56
Hospital	11.31
Leasing	7.91
Education	6.75
Electric	6.56
Special Tax	6.22
Miscellaneous Revenue	5.93
Airport Revenue	4.33
State General Obligation	4.18
Local General Obligation	2.28
Cash	1.85
Housing	1.78
Tax Allocation	1.49
Tobacco Asset-Backed	0.72

Sector weights are subject to change.

AVERAGE ANNUAL TOTAL RETURNS as of 9/30/17 in percent

I Share	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 2/23/1996
NAV	0.87	4.10	0.73	2.57	2.39	4.49	4.99
Index	1.12	4.26	1.07	2.85	2.73	4.36	4.97

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.

Benchmark since inception performance is reported from 2/29/1996.

The fund class gross expense ratio is 0.76%. The net expense ratio is 0.60%, which reflects a contractual expense reimbursement in effect through 4/30/2018.

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 **Tax-Exempt Bond Linked Benchmark** consists of the BofA Merrill Lynch 1-22 Year U.S. Municipal Securities Index, a subset of the BofA Merrill Lynch U.S. Municipal Securities Index including all securities with a remaining term to final maturity less than 22 years, calculated on a total return basis. Performance of the Tax-Exempt Bond Linked Benchmark prior to 6/30/2012 is that of the Bloomberg Barclays Municipal Bond Index. The **Bloomberg Barclays Municipal Bond Index** is a market capitalization-weighted index that measures the long-term tax-exempt bond market. The index is calculated on a total return basis. Indexes are unmanaged, returns do not reflect any fees, expenses, or sales charges, and are 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. **Municipal Market:** Events negatively impacting a municipal security, or the municipal bond market in general, may cause the fund to decrease in value. **State & AMT Tax:** A portion of income may be subject to some state and/or local taxes and, for certain investors, a portion may be subject to the federal alternative minimum tax. **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. **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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