Virtus Duff & Phelps Global Real Estate Securities Fund

A: VGSAX (92828R412) | C: VGSCX (92828R396) | I: VGISX (92828R388) | R6: VRGEX (92828W239)

MARKET REVIEW

Global markets came under pressure as economic and political worries compounded, culminating in one of the worst December drawdowns in decades. Global equities fell 13.42% (MSCI World Index), while global real estate securities declined 5.69% (FTSE EPRA Nareit Developed Index—the benchmark), expressed in U.S. dollars.

Movement in the U.S. dollar continued to be a headwind, increasing 1.1% in the quarter, as measured by the U.S. Dollar Spot Index, and hit intra-year highs as global growth concerns, a precipitous decline in oil, and increased Brexit concerns weighed on other currencies.

Amid global growth concerns, the Federal Reserve (Fed) increased rates in December for the fourth time in 2018, and articulated two probable rate increases for 2019 and further balance sheet unwinding. However, Fed Chair Powell articulated a more reassuring message on January 4, noting the central bank would be receptive to using all of its tools, depending on the economic data and market environment.

The fourth quarter equity sell-off led to significant discounts for REITs globally versus private market valuations. At the same time, capital continued to be raised for private real estate funds, boosting the potential of M&A.

The top-performing countries in the benchmark index during the quarter were New Zealand, Japan, Belgium, Hong Kong, and Sweden, on a total return basis measured in U.S. dollars. Of these, New Zealand and Japan posted positive returns and all but Hong Kong outperformed the index on the year. Beyond healthy underlying real estate fundamentals, New Zealand and Japan's quarterly performance was aided by positive movements in the New Zealand dollar and Japanese yen, both of which appreciated relative to the U.S. dollar.

The bottom-performing countries were the Netherlands, France, Italy, Ireland, and Finland. European-focused retail real estate companies in the Netherlands and France continued to be under pressure given their mixed fundamental outlook and the expected negative impact to French retail sales from late-year populist protests. French office stocks also underperformed. Irish office and residential real estate shares performed poorly as contentiousness surrounding what to do with the Irish border after the U.K. leaves the EU continues to override a healthy Irish economy and real estate market.

PERFORMANCE

For the quarter, the Fund (Class I) returned -6.88%, underperforming the -5.69% return of the benchmark. Country allocation and security selection contributed about equally to the underperformance.

Combining country allocation and security selection, the top contributors were the Netherlands, Australia, and India. Security selection drove Australia performance and country allocation drove performance in the Netherlands and India.

> At the country allocation level, our underweight allocation to the Netherlands—the worst performing country in the quarter—and out-of-benchmark exposure to India, via our holding in Ascendas India Trust, an office park-focused firm, made the biggest contributions.

> At the security level, the largest contributors were our overweight exposures to TLG Immobilien AG, a German mid-cap diversified real estate company; Extra Space Storage, a U.S. large-cap self-storage REIT; Sun Communities, a U.S. mid-cap manufactured home REIT; and National Storage, an Australian small-cap self-storage REIT.

Combining country allocation and security selection, the top detractors were the U.S., China, and Hong Kong. Security selection was the primary detractor in the U.S. and Hong Kong, while country allocation detracted in China.

> At the country allocation level, our out-of-benchmark exposure to China-focused data center real estate firm GDS Holdings, and our overweight exposure to Ireland—one of the worst-performing countries in the quarter—were the biggest detractors.

> At the security level, the biggest detractors were our lack of exposure to Welltower and Ventas, U.S. large-cap healthcare REITs, and to Realty Income, a U.S. large-cap freestanding REIT, and our overweight exposure to RLJ Lodging Trust, a U.S. mid-cap lodging REIT. Given their historically defensive nature, U.S. freestanding and healthcare REITs were relative outperformers during the quarter, while U.S. lodging REITs were laggards given their higher degree of economic sensitivity.

OUTLOOK

We expect continued variance in global growth and regional real estate fundamentals. Regionally, we are looking to Ireland, Australia, and the U.S. for growth leadership. We expect opportunities for active managers such as ourselves, who are focused on owner-operators of high quality real estate with solid balance sheets and proven management teams, to deliver outperformance versus the broader REIT market. Overall, we expect cash flow and dividend growth for global real estate securities to be solid once again in 2019.

Key themes include:

> *Rents, not rates:* While there is likely to be upward pressure on interest rates in many markets, rental rate growth—particularly for high quality real estate—will continue to support further cash flow and dividend growth.

> *New supply:* While new supply levels are generally catching up to years of undersupply, selective geographic markets and property sectors will remain impacted by new development.

> *Balance sheet health:* Cash flow and dividend growth rates are converging across many global markets, but U.S. balance sheets are benefiting from more active pruning and remain better positioned with less leverage than most international markets.

> *M&A tailwind:* M&A activity picked up in 2018, driven by healthy discounts to NAV in public real estate security markets, as well as large pools of private equity real estate capital looking to be put to work. We expect this to continue.

Related Reading: Global Listed Real Estate: 2018 Review & 2019 Outlook, available on virtus.com.

Virtus Duff & Phelps Global Real Estate Securities Fund

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Duff & Phelps Investment Management Co.

PORTFOLIO MANAGERS

Geoffrey P. Dybas, CFA
Industry start date: 1989
Start date with Fund: 2009

Frank J. Haggerty, Jr., CFA
Industry start date: 1996
Start date with Fund: 2009

TOP TEN HOLDINGS

	% FUND
Prologis, Inc.	4.21
Vonovia SE	3.35
Digital Realty Trust, Inc.	3.03
Simon Property Group, Inc.	3.02
Mitsubishi Estate Company, Ltd.	3.00
Wharf Real Estate Investment Co. Ltd.	2.86
Link Real Estate Investment Trust	2.55
Sun Communities, Inc.	2.53
Alexandria Real Estate Equities, Inc.	2.52
UNITE Group PLC	2.50

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 3/2/2009
Fund Class I	-6.88	-4.65	-4.65	3.95	7.06	n/a	15.85
Index	-5.69	-5.63	-5.63	2.72	4.34	n/a	14.13

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 1.19%. The net expense ratio is 1.15%, 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 **FTSE EPRA Nareit Developed Index (net)** is a free-float market capitalization-weighted index measuring publicly traded equity REITs and listed property companies from developed markets, which meet minimum size and liquidity requirements. The index is calculated on a total return basis with net dividends reinvested. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

The **MSCI World Index (net)** is a free float-adjusted market capitalization-weighted index that measures developed global market equity performance. The index is calculated on a total return basis with net dividends reinvested.

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Notes on Risk: Equity Securities: The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund. **Real Estate:** The fund may be negatively affected by factors specific to the real estate market, including interest rates, leverage, property, and management. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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