Virtus Vontobel Emerging Markets Opportunities Fund

A: HEMZX (92828W387) | C: PICEX (92828W379) | I: HIEMX (92828W361) | R6: VREMX (92828W353)

MARKET REVIEW

Emerging market (EM) equities came under pressure again in the third quarter, with the MSCI Emerging Markets Index down 1.09%, bringing its year-to-date return to -7.68%, in U.S. dollar (USD) terms. Global trade frictions, a strengthening U.S. dollar, and tighter Federal Reserve monetary policy all served to drive assets away from riskier EM countries. In addition, rising oil prices have had an impact on oil-importing EM countries—such as Turkey, India, and South Africa—spurring higher inflation and bigger deficits, and putting pressure on their currencies. Many EM countries' currencies sold off, with Turkey, Argentina, and South Africa among the hardest hit. From a sector perspective, consumer discretionary and healthcare had a negative impact on broad EM performance, while energy and materials helped.

PERFORMANCE

During the quarter, the Fund (Class I) underperformed the MSCI Emerging Markets Index, with a return of -3.48% versus -1.09%, respectively.

The Fund's underperformance was largely due to our underweight to energy, which was the best-performing sector in the Index (up 14% in USD terms). Oil prices continued to rise alongside the supply constraints on Iran. We are typically underweight commodity businesses as their earnings tend to be volatile and unpredictable.

In addition, two of the portfolio's long-standing Indian positions, HDFC Bank and Housing Development Finance Corporation, were negatively impacted by general concerns about a potential slowdown in economic growth in India and pressure on the rupee.

On the positive side, earnings across the portfolio's holdings continued to show healthy growth, and the Mexican holdings performed well following the presidential election in July.

PORTFOLIO POSITIONING

We purchased Inner Mongolia Yili Industrial Group (Yili), one of the largest dairy producers in China and the eighth-largest dairy producer in the world.

In financials, we sold Remgro, a South African holding company. Although Remgro has a good track record of generating shareholder value, we feel its growth potential is limited. We also sold Thai Beverage Public Co. and casino and resort company Las Vegas Sands to reallocate capital to better opportunities. Lastly, we sold Chinese e-commerce holding JD.com, as we were concerned about the potential for disruption and management of the business, given the legal issues surrounding the company's CEO.

OUTLOOK

An old adage asserts that a successful stock picker has to be both a contrarian and an optimist. With EM equities plummeting this year, we have ample opportunity to be both. Where some see the end of a performance run in EM equities, we see the current climate as just another headwind in a decades-long pathway of growth.

We believe that investors will eventually distinguish between developing economies that are robust because of good governance, real investments, and progressive structural reform—and those that simply have ridden a favorable credit or commodity wave. We anticipate that the performance of more troubled frontier markets such as Argentina (where we have no exposure) will be isolated from, rather than lumped together with, the broader class of EM stocks. But until then, the baby is getting thrown out with the bathwater.

Stronger-performing EM economies include India and Indonesia, where GDP is growing in the mid-to-high single digits. China's economy, despite a pullback by some of its largest technology companies this year, is still generating 6%-plus GDP growth. Elections and trade war fears failed to dampen Mexico's growth trajectory, and even Brazil, with its scandal-plagued government and stymied reforms, managed to turn out positive GDP growth so far this year.

Mexico is a case in point. In the fourth quarter of 2017, our Mexican holdings—Walmex, Banco Santander Mexico, and FEMSA—were a significant drag on performance. Worries about redrafting NAFTA and the July 2018 election with a radical populist in the lead dominated the negative headlines at that time. Fast-forward to today and although populist Andrés Manuel López Obrador won the election, he appears thus far to support business-friendly initiatives such as corporate tax reductions. A deal with President Trump for U.S.-Mexico trade relations has been settled. This clarity has helped to calm the market, and, while the worrywarts have cashed out, our companies continued to report better-than-expected results.

In our view, quality companies with long-term, sustainable earnings can grow even in times of political and market turmoil. Once the dust settles, we expect patient shareholders like ourselves to eventually be rewarded. With a two decade-long EM track record under our belt, our view is that issues currently plaguing emerging markets are neither as widespread nor as damaging to long-term potential as many nearsighted headlines might suggest. It's important for investors to look through the turbulence, maintain a long-term perspective, and have confidence that they are holding quality businesses with the strongest potential for long-term growth.

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INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Vontobel Asset Management

PORTFOLIO MANAGERS

Matthew Benkendorf
Industry start date: 1998
Start date with Fund: 2016

Brian Bandsma
Industry start date: 1998
Start date with Fund: 2016

Jin Zhang, CFA
Industry start date: 1995
Start date with Fund: 2016

TOP TEN HOLDINGS

	% Fund
HDFC Bank Ltd.	4.91
Alibaba Group Holding Ltd. Sponsored ADR	4.48
Fomento Economico Mexicano SAB de CV Sponsored ADR Class B	3.90
Ambev SA Sponsored ADR	3.89
Tata Consultancy Services Ltd.	3.77
Taiwan Semiconductor Manufacturing Co., Ltd.	3.74
Unilever NV Cert. of shs	3.72
Tencent Holdings Ltd.	3.63
Heineken NV	2.90
PT Telekomunikasi Indonesia, Tbk Class B	2.75

Holdings are subject to change.

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

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 10/20/1997
Fund Class I	-3.48	-10.43	-5.46	7.36	3.32	6.90	6.56
Index	-1.09	-7.68	-0.81	12.36	3.61	5.40	n/a

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 1.29% and reflects the direct and indirect expenses paid by the Fund.

The gross expense ratio minus the indirect expenses incurred by the underlying funds in which the Fund invests is 1.28%.

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 **MSCI Emerging Markets Index (net)** is a free float-adjusted market capitalization-weighted index designed to measure equity market performance in the global emerging markets. 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 it is not available for direct investment.

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. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Geographic Concentration:** A fund that focuses its investments in a particular geographic location will be highly sensitive to financial, economic, political, and other developments affecting the fiscal stability of that location. **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. **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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