VIRTUS MUTUAL FUNDS

Virtus Vontobel Emerging Markets Opportunities Fund

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

MARKET REVIEW

Volatility continued in emerging market equities through the second quarter, with the benchmark MSCI Emerging Markets (EM) Index falling 7.96% in U.S. dollar terms. Despite solid economic growth momentum in many emerging economies, activity around the globe set the markets toward a risk-off footing. Concerns that prompted a change in outlook included the Federal Reserve continuing to lift interest rates on the back of accelerating inflation, a strong U.S. dollar alongside a sell-off in EM currencies, a continued rise in oil prices, and U.S.-initiated trade negotiations appearing set to impose tariffs, with China threatening retaliation.

Eleven of the MSCI EM benchmark countries delivered double-digit negative returns in U.S. dollar terms over the quarter. Attention was focused on countries continuing to run double deficits (current account and fiscal), and this led to poor performance from markets such as Turkey and Argentina. All MSCI EM sectors posted negative returns in the quarter, with financials and information technology the largest detractors.

PERFORMANCE

For the quarter, the Fund (Class I) returned -7.36%, yet outperformed the -7.96% return of the MSCI EM Index. We believe the stable and consistent earnings profile of our holdings provided a measure of protection as uncertainty returned to emerging markets.

> Big market swings at the country level impacted the portfolio's relative performance. India and Korea were solid positive contributors. On the other side of the scale, Brazil was hit hard during the quarter, and this impacted performance, given our overweight to the country.

> At the sector level, our financials holdings made the strongest contributions, followed by our consumer discretionary holdings. Energy was the best-performing sector in the MSCI EM Index, albeit negative (-4.69%), and the greatest detractor from relative returns as the portfolio is underweight the sector. Our consumer staples holdings also weighed on relative returns.

PORTFOLIO POSITIONING

We purchased four new consumer discretionary stocks: casino and hotel owner/operator Sands China, e-commerce company JD.com, fast food restaurant company Yum China Holdings (all China), and department store Lojas Renner (Brazil). In financials, we purchased two banks, Bancolombia (Columbia) and Kasikornbank (Thailand).

In order to reallocate capital to better opportunities, we sold cigarette manufacturer PT Hanjaya Mandala Sampoerna (Indonesia) and casino and resort company Kangwon Land (Korea).

OUTLOOK

The perception of, and sensitivity to, market risk has steadily increased this year. From trade wars, to rising interest rates, risky corporate debt, inflation fears, and political upset—it all suddenly mattered, and investors bolted. In May, outflows from emerging markets hit $12 billion, the first monthly outflow since November 2016. By the six-month mark, whatever euphoria that had propelled markets to record highs through January had evaporated.

We believe that the big picture for emerging markets looks good. Southeast Asia, in particular, continues to be a solid economic-growth story, given the ongoing rise of the middle class and purchasing power in countries where fiscal and current account balances are relatively stable and positive.

Most of the volatility in the Fund's portfolio has come from Latin America—a region traditionally more volatile than most. Politics plays a role. Both Mexico and Brazil, the two largest LatAm economies, have consequential elections this year.

A key risk in emerging markets may stem from the U.S.—namely the direction of interest rates. Higher U.S. rates, which are a function of inflation, may lead to tighter monetary policy and higher long-term Treasury rates. This can have a domino effect on EM asset flows and currencies. We don't know where U.S. inflation will be in a year's time, but we have confidence that our portfolio holdings will be resilient, even in the face of such headwinds.

The changing landscape for tariffs and trade presents a serious obstacle to EM performance. Our holdings are generally shielded from the worst-case scenarios. We own businesses that rely less on exports and that cater to local, home-grown market demand. They are less commoditized, less cyclical, and thus more durable because of the strength of their brands, market positioning, and superior pricing power that we seek.

We continue to believe that the quality growth consumer staples businesses that we own are durable, that they are performing as expected, and that they are solid investments for which we will be rewarded over time. We are similarly comfortable with our underweight position (relative to the EM Index) in the energy and materials sectors, which are characterized by low-quality, capital-intensive businesses whose earnings are beholden to the volatile commodity markets.

Virtus Vontobel Emerging Markets Opportunities Fund

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	5.31
Alibaba Group Holding Ltd. Sponsored ADR	4.86
Unilever NV Cert. of shs	3.72
Ambev SA Sponsored ADR	3.68
Tata Consultancy Services Ltd.	3.61
Fomento Economico Mexicano SAB de CV Sponsored ADR Class B	3.36
PT Telekomunikasi Indonesia, Tbk Class B	3.28
Housing Development Finance Corp. Ltd.	3.24
Heineken NV	3.01
Taiwan Semiconductor Manufacturing Co., Ltd.	2.96

Holdings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/18

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 10/20/1997
Fund Class I	-7.36	-7.20	1.57	4.86	3.79	4.65	6.83
Index	-7.96	-6.66	8.20	5.60	5.01	2.26	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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