# Virtus Vontobel Emerging Markets Opportunities Fund

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

## MARKET REVIEW

Downward pressure on emerging market equities continued in the fourth quarter, and while they were the best relative performers on a global basis, the benchmark MSCI Emerging Markets Index ended down for the quarter, with most sectors posting negative returns, and down for the year as well. Weighing on those markets were trade tensions, political uncertainty, tightening monetary policy, and China's worrisome slower economic growth, which is partly due to the government's sensible efforts to reduce shadow lending (leverage provided outside of the formal banking system), including peer-to-peer lending. At the same time, net importers of oil, such as India, benefited from the precipitous drop in the price of Brent crude, which provided much needed relief. In Latin America, country results hinged on local politics, and Southeast Asian markets were mixed.

## PERFORMANCE

Although the Fund's performance was negative in the fourth quarter (-4.36%, Class I), it outperformed the MSCI Emerging Markets Index's -7.47% return. The financials sector was the most significant driver of relative returns, helped by our core Indian holdings, HDFC Bank and Housing Development Finance Corp.

Consistent with our quality growth investment style, we avoided exposure to highly cyclical sectors, such as energy, and were thus spared the effect of the sharp decline in oil prices in the quarter. Detracting from performance were consumer staples stocks, which did not do well in 2018. However, we continue to believe in their ability to prove defensive in most periods of economic weakness over the long term.

## PORTFOLIO POSITIONING

We initiated three new positions in the quarter: Vietnam Dairy (Vinamilk), the largest dairy company in Vietnam, and two Korean companies, SK Hynix, a memory semiconductor manufacturer, and NCSOFT (NC), an online and mobile game developer and publisher.

We exited our positions in financials companies BB Seguridade (Brazil) and Banco Santander Mexico to reallocate capital to better opportunities. We sold Korean consumer staples company Amorepacific as the competitive dynamics in its China business continued to deteriorate—particularly in the mass-market cosmetics segment. Finally, we exited our position in Brazilian information technology company Cielo on the basis of intensifying competition among merchant acquirers in Brazil.

## OUTLOOK

One of our most important observations about emerging markets heading into 2019 concerns the prospect of further interest rate hikes in the United States and monetary policy tightening in Europe. At a high level, we are seeing the return of a vast flow of savings from emerging markets back into countries that have run very low interest rates over the past decade, such as the United States and Europe. As liquidity exits emerging markets, it will raise the price of risk in those markets and also make funding more difficult to achieve in some riskier regions (such as indebted frontier markets).

Yet we think that broad-based alarmism about emerging markets is misplaced, even though it appears that growth is set to slow—following a long run of expansion—as liquidity is withdrawn. We see a relatively healthy structural state underlying emerging economies. Although debt has risen in those markets, much of it is denominated in local currency and financed with domestic savings. An economic downturn in emerging markets could therefore become more manageable, since weakening currencies shouldn't substantially increase debt-servicing costs, and central banks would be able pursue a more normalized monetary policy that does not involve raising interest rates in knee-jerk fashion to support local currency.

As long-term managers pursuing quality growth companies—stable franchises with solid fundamentals, durable earnings power, and long-term growth potential—we are mindful of risks throughout the economic cycle, no matter how robust or negative the environment. With this approach, we expect to capture some of the upside when markets rise—but also accept lower relative returns as a form of insurance, so to speak, that could benefit a portfolio with steadier value accumulation through difficult times, which will invariably arrive. During times such as these, some quality growth companies that have been hit amid market turbulence still have durable fundamentals and long-term growth prospects—and we believe our strategy should benefit from a "coiled-spring" effect as the market comes to recognize them.

Finally, the 2019 outlook of our portfolio based on earnings projections is solid. Since earnings ultimately determine the trajectory of stock prices, we are optimistic at the start of the year, despite a prevailing sense of gloom and doom among investors.

## 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. | 5.61 |
| Tencent Holdings Ltd. | 4.06 |
| Ambev SA Sponsored ADR | 3.91 |
| Unilever NV Cert. of shs | 3.80 |
| Tata Consultancy Services Ltd. | 3.55 |
| Fomento Economico Mexicano SAB de CV Sponsored ADR Class B | 3.54 |
| Housing Development Finance Corp. Ltd. | 3.32 |
| Alibaba Group Holding Ltd. Sponsored ADR | 3.29 |
| NetEase, Inc. Sponsored ADR | 3.16 |
| PT Telekomunikasi Indonesia, Tbk Class B | 2.91 |

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 10/20/1997 |
|---|---|---|---|---|---|---|---|
| Fund Class I | -4.36 | -14.34 | -14.34 | 5.33 | 2.44 | 8.88 | 6.26 |
| Index | -7.47 | -14.58 | -14.58 | 9.25 | 1.65 | 8.02 | 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 1.23%.

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.

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