

## Virtus Duff & Phelps Real Estate Securities Fund

A: PHRAX (92828R586) | C: PHRCX (92828R560) | I: PHRIX (92828R552) | R6: VRREX (92828W528)

### MARKET REVIEW

The investment landscape throughout 2023 was marked by the undulating trajectory of interest rates. The first three quarters saw interest rates navigating a terrain of heightened volatility as they moved to levels not seen since 2007. This created an environment of uncertainty for investors, primarily in bonds and capital-intensive sectors, such as real estate. However, a pivotal moment occurred in late October as softer CPI data allowed central banks some breathing room, which signaled a notable shift in this trend. For context, the yield on the U.S. 10-year Treasury started the year at 3.9% and peaked at 5.0% in late October, before finishing the year at 3.9% for a full round trip.

The notable decline in interest rates, over the last two months, played a big role in propelling global financial markets higher. Amidst the broader market rally, sectors sensitive to interest rate movements, such as technology and longer-maturity bonds, experienced notable gains. However, the S&P real estate sector demonstrated remarkable resilience, coming in as the top-performing S&P sector over the fourth quarter. Performance across real estate was led by sectors that had been primarily out of favor over the year, such as regional malls, cell-tower, and office. Conversely, the property sectors that led real estate for most of the year lagged the broad index, such as healthcare, single-family rentals, and data centers. Despite interest rates moving higher over the past two years, listed real estate has demonstrated operational efficiency through positive earnings and cash flow growth.

### PORTFOLIO REVIEW

The strategy underperformed the benchmark during the quarter, with sector allocation as the main driver, which was partially offset by positive security selection. While we outperformed for the first two months of the quarter, the market took an aggressive interpretation of the timing of the Federal Reserve's (Fed) first rate cut from Chairman Powell's remarks in December, and, in our view, caused those companies with relatively poor fundamental outlooks and balance sheets to outperform significantly, thus leading to underperformance for the strategy in the quarter. As we go to print, we see that being unwound.

Relative performance for the strategy was driven by an overweight allocation to telecommunication REITs, followed by selection within the healthcare sector, and selection and underweight to apartment REITs. The strategy's selection within the self-storage sector was the largest detractor, due to the underweight in Extra Space Storage. Furthermore, the strategy's overweight to single-family homes and underweight to the specialty sector detracted from performance.

At the security selection level, our largest positive attribution contributors came from overweight positions to Ventas (VTR) and Apartment Income REIT (AIRC), and not owning Omega Healthcare (OHI). VTR benefited from increased occupancy, which helped preserve and increase growth prospects looking into the years ahead. OHI underperformed on lingering tenant health concerns as compared to peers. AIRC outperformed on good earnings,

highlighting its potential for above average earnings and funds from operations (FFO) growth, compared to the broad apartment sector.

The underweight to Extra Space Storage (EXR) was the portfolio's primary detractor, followed by not owning Essex Property Trust (ESS) and an overweight to Public Storage (PSA). Following a period of underperformance for EXR due to concerns on its floating rate exposure and execution of its Life Storage merger, the company bounced back after its earnings result suggested that merger synergies were on track, and that the deceleration in pricing trends may have eased. While this is a step in the right direction, we currently prefer those with more primary market exposure and less merger execution risk. Despite posting better returns than the index, PSA lagged the storage sector, leading to negative selection. ESS gained traction after posting better-than-anticipated earnings and highlighting improving delinquency rates. We remain underweight ESS on the concern that the West Coast's lag in economic reopening and outbound migration trends may continue.

### INVESTMENT OUTLOOK

We expect global economic growth to slow in response to higher interest rates and quantitative tightening. Unlike last year, in 2024 we expect the Fed to lower rates to curtail hard landing risk surrounding the November presidential election.

Just as we expect the economy to slow, we expect listed real estate cash flow to remain positive yet decelerate across many property sectors, as companies absorb higher financial and operating costs. Quality and resiliency in the form of well-positioned balance sheets and sustainable growth in cash flow and dividends will likely be preferred by investors as we continue to face an uncertain economic environment.

Fundamentally, secular growth drivers should continue to benefit data centers and logistics. Within the U.S. healthcare property sector, senior housing operating properties and skilled nursing facilities will continue to see an improvement in occupancy. And pricing power should increase further in senior housing. Self-storage has been impacted by the moderation in housing turnover caused by higher interest rates and, in certain markets, a higher level of new supply, which is negatively impacting pricing for new customers. The residential apartments subsector in the U.S. is also in the process of digesting a significant amount of new supply over the next 12 to 18 months. The office property sector will likely remain one of the more challenging and controversial sectors.

Given the capital that has been raised by private equity sponsors on a global basis, the new year may see a pick-up in public-to-private M&A activity, particularly if debt availability and pricing improve and global listed real estate continues to trade at discounted valuations.

In our view, listed real estate has shown an ability to outperform following the end of a rising interest rate cycle, and should clearly be a beneficiary of lower rates. With an abundance of private capital on the sidelines and discounted pricing available via listed real estate, arguably at wholesale prices, we see listed real estate as much more attractive than private real estate.

## 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 as Fund Portfolio Manager: 1998



**Frank J. Haggerty, Jr., CFA**  
 Industry start date: 1996  
 Start date as Fund Portfolio Manager: 2007

## TOP TEN HOLDINGS

	% Fund
Prologis Inc.	11.67
Equinix Inc.	7.07
Digital Realty Trust Inc.	5.27
Public Storage	4.94
Realty Income Corp.	4.91
Ventas Inc.	4.70
Welltower Inc.	4.54
Sun Communities Inc.	4.46
VICI Properties Inc.	4.44
Simon Property Group Inc.	4.26
Holdings are subject to change.	

## AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/23

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (12/29/06)
Fund Class I	15.31	11.16	11.16	6.51	8.61	8.01	5.33
Index	16.22	13.73	13.73	7.21	7.39	7.65	5.16

**Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit [virtus.com](http://virtus.com) for performance data current to the most recent month end. This share class has no sales charges and is not available to all investors. Other share classes have sales charges. See [virtus.com](http://virtus.com) for details.**

The fund class gross expense ratio is 1.08%.

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.

Index: The **FTSE Nareit Equity REITs Index** is a free-float market capitalization-weighted index measuring equity tax-qualified real estate investment trusts, which meet minimum size and liquidity criteria, that are listed on the New York Stock Exchange, the American Stock Exchange and the NASDAQ National Market System.

The index is calculated on a total return basis with 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.

## TOP FIVE CONTRIBUTORS % Contribution

Prologis Inc.	2.25
Simon Property Group Inc.	1.26
Ventas Inc.	0.91
American Tower Corp.	0.87
Equinix Inc.	0.86

## TOP FIVE DETRACTORS % Contribution

Extra Space Storage Inc.	-0.17
Douglas Emmett, Inc.	-0.02
Healthpeak Properties Inc.	0.06
Mid-America Apartment Communities Inc.	0.09
Sabra Health Care REIT Inc.	0.09

**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, medium, or large-sized companies may enhance that risk. **Real Estate:** The portfolio may be negatively affected by factors specific to the real estate market, including interest rates, leverage, property, and management. **Industry/Sector Concentration:** A portfolio 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 portfolio. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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