VIRTUS MUTUAL FUNDS

Virtus Duff & Phelps Real Estate Securities Fund

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

MARKET REVIEW

During the quarter, U.S. real estate equities outperformed the broader market, recovering from the soft start to the year and a string of quarterly underperformance versus the broader market. REITs, as measured by the FTSE NAREIT Equity REITs Index (benchmark), returned 10.04% in the second quarter, outperforming the 3.43% return of the S&P 500® Index.

Amidst the strong recovery, we witnessed the outperformance of lower quality REITs, as many early year laggards surpassed blue chip stocks. For example, within healthcare, the best performing REITs included those that cut rents to their operator tenants after rental coverage eroded on margin pressures, such as higher labor costs and heightened supply in senior housing. While the rental relief was partial in nature in a number of cases, it led to a robust bounce in many of the worst-performing healthcare REITs. With Q2 earnings season, we expect REITs that own higher quality enduring properties to deliver better fundamentals and growth optics, which should lead to improved relative performance.

The top five property sectors on a total return basis were self-storage on expectations of better relative organic growth and less adverse impact from new supply; healthcare on a deep value bounce subsequent to lower rent resets and M&A; lodging on M&A and better fundamental optics; specialty, with prison REITs leading; and shopping centers on a deep value bounce and a better showing at industry conferences.

The bottom-performers included the three residential sectors, which outperformed in the first quarter. Single-family homes led the laggards, followed by data centers, which continued to consolidate after outperforming in 2017, apartments, manufactured homes, and office. We anticipate the residential sectors and select office names with better rental markets to deliver solid fundamentals this upcoming earnings season.

PERFORMANCE

Given the low quality, high-yield-led environment, the Fund (Class I) trailed the benchmark, with a return of 8.63% versus 10.04%, on both security selection and property sector allocation.

The strongest sector contributors were regional malls, on both security selection and our underweight allocation, single-family homes on selection, office on selection, and industrial on our overweight allocation.

At the security level, the largest contributors were our overweight position in DCT Industrial (industrial), which agreed to be acquired by Prologis (industrial), our zero weighting of laggard Boston Properties (office), and our overweight to outperforming Cyrus One (data centers), Highwoods Properties (office), and American Homes 4 Rent (single-family homes).

The largest detractor was healthcare on security selection and our underweight allocation due to low quality outperformance, as well as M&A away. Welltower announced the acquisition of skilled nursing Quality Care Properties, a former low quality, non-core spin-off of HCP, Inc. The bid for Quality Care Properties helped lift healthcare REITs with previously poor performing skilled nursing exposure, as did negative rent resets in an effort to convince the market the trouble was behind them.

Apartments and lodging also detracted with M&A away, including the announced privatization by Greystar/Blackstone of student housing REIT, Education Realty Trust, and the announced privatization by Blackstone of LaSalle Hotel Properties, which outperformed our lodging positions. Both companies had disappointed the market operationally in recent periods. Shopping centers detracted on a low quality deep value bounce, and specialty also detracted due to our zero weight allocation, as prison REITs led the sector.

At the security level, two of the largest detractors were recipients of the highlighted privatization bids by Blackstone, Gramercy Property Trust and Education Realty Trust. Healthcare Trust of America (healthcare), Regency Shopping Centers (retail), Alexandria Real Estate (office), and Summit Properties (lodging) were among the top five detractors.

OUTLOOK

In our view, the U.S. real estate rental market cycle offers room for further growth as we expect overall market demand to exceed supply across most property sectors and major cities. A backdrop of low, but positive, global economic growth and manageable new real estate supply are positive fundamental tailwinds for global real estate going forward.

Combined with supportive real estate asset pricing, we maintain our view for another positive total return year for global real estate in 2018.Total return drivers for the asset class include approximately 5-6% global cash flow growth and 4% dividend yield with above-average growth in the U.S. A key message for U.S. REIT investors is to focus on rents, not rates.

From a balanced perspective, we note both upside drivers and downside risks. Upside drivers include greater-than-expected global growth driving higher occupancies and rents, asset inflows from a rotation out of bonds and rebalancing from broader equities, and increased potential for M&A and privatization given institutional investors' appetite for high quality, core real estate. Downside risks include the cessation of real estate cap rate compression and potential expansion, accelerated new commercial real estate supply; and interest rates rising faster and higher than a lift in net operating income growth and replacement costs can absorb. Global macro risks include diverging monetary and fiscal policies and ongoing political risks.

Virtus Duff & Phelps 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: 1998

Frank J. Haggerty, Jr., CFA
Industry start date: 1996
Start date with Fund: 2007

TOP TEN HOLDINGS

	% Fund
Digital Realty Trust, Inc.	5.71
AvalonBay Communities, Inc.	5.24
Simon Property Group, Inc.	5.17
Equinix, Inc.	4.81
Prologis, Inc.	4.66
Host Hotels & Resorts, Inc.	4.17
Duke Realty Corp.	3.85
Sun Communities, Inc.	3.79
Alexandria Real Estate Equities, Inc.	3.75
DCT Industrial Trust Inc.	3.51

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 12/29/2006
Fund Class I	8.63	0.98	5.45	7.41	8.24	7.79	4.87
Index	10.04	1.02	3.50	8.06	8.31	7.94	4.96

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 1.11%.

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.

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.

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. **Real Estate:** The fund may be negatively affected by factors specific to the real estate market, including interest rates, leverage, property, and management. **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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