ECONOMIC OUTLOOK: SLOW PROGRESS

AVIVA INVESTORS
May 2016

Key points

While global inflationary pressures are muted, the U.S. headline rate is likely to be close to target by the end of 2016.

We expect the Federal Reserve to hike rates at least once in 2016.

The pace of recovery in the eurozone remains disappointing, with the outlook for the bloc not aided by Q1 2016 currency appreciation.

Further policy stimulus from central banks in China and Japan is likely, and an extension of the European Central Bank's asset purchase program can't be ruled out.

Stewart Robertson*
Senior Economist,
London

Stewart is responsible for our economic research and analysis of the UK and main European markets, working alongside the other economists in our Strategy Team. He joined the investment industry in 1993 and Aviva Investors in March 2005.

*Investment professionals listed are members of AIA's participating affiliate, Aviva Investors Global Services ("AIGSL").

While the U.S. is likely to lead global growth higher in 2016, risks such as disappointing Chinese expansion, even lower commodity prices, and geopolitical shocks persist, says Stewart Robertson.

The start of 2016 was marked by a sharp increase in volatility in financial markets, as growth fears sparked weaker oil prices, wider credit spreads, and sharply lower equity prices. While economic data has generally turned for the better since the start of 2016, global growth expectations for the remainder of the year have been marked down. This reflects weaker growth in both "developed" and "emerging" market economies. While the U.S. is likely to lead global growth higher in 2016, risks such as disappointing Chinese expansion, even lower commodity prices, and geopolitical shocks persist.

Inflation outlook subdued

Global inflationary pressures remain muted, with excess capacity and the fall in energy prices weighing on both core and headline inflation. By contrast, there is relatively little slack in the U.S., and measures of core inflation, which exclude changes in food and energy prices from calculations, are close to their pre-2008 global financial crisis averages. Assuming no further decline in oil prices, headline inflation is also likely to be close to target by the end of 2016. Given this backdrop, we expect the U.S. Federal Reserve (Fed) to hike rates once or twice in 2016. Elsewhere, inflation is likely to be well below target as spare capacity is slowly eroded. Further policy stimulus from central banks in China and Japan is likely, while an extension of the European Central Bank's (ECB) asset purchase program can't be ruled out.

Looser policy combats disinflation risks

U.S. economic expansion, which slowed towards the end of 2015 to a little below trend, was mixed in Q1 2016. The underlying drivers of growth, however, remain in place, with strong disposable income growth underpinning further gains in household consumption, while the drag from manufacturing and energy activity subsides.

Although the plunge in oil prices continues to weigh on the Canadian economy, some export sectors outside of energy have improved, supported by a weaker exchange rate and U.S. demand. Fiscal measures introduced in Q1 2016 will help to boost growth, but further monetary policy easing may be necessary.

The pace of the eurozone recovery remains disappointing, with little sign of improvement in the region's growth prospects. The ECB's March 2016 policy-easing package looks sufficient in its scale and scope to help underpin the recovery, but downside risks remain. Headline inflation is set to remain very low for much of 2016, risking a further de-anchoring of inflation expectations. Moreover, the outlook for the bloc is not aided by the euro's appreciation in 2016.

In Japan, the Bank of Japan (BoJ) shocked markets in January by introducing negative rates. While the yield on long-dated Japanese government bonds has fallen more than shorter maturities, the yen has strengthened on increasing concerns over global growth.[1] That makes it increasingly difficult for the BoJ to achieve its inflation target, particularly as domestic conditions have deteriorated. We expect the BoJ to ease policy again before the end of 2016, with further fiscal stimulus also possible.

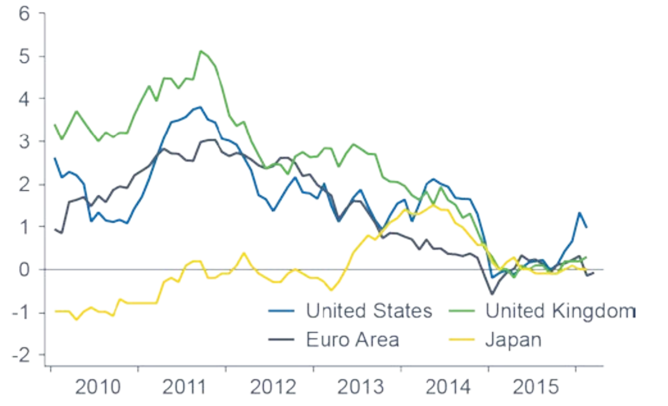
While UK growth has slowed in recent quarters, it remains around trend. The near-term outlook has been dominated by the upcoming June UK referendum on EU membership. While our central scenario is for current arrangements with the group to be retained, there would be significant downside risk in the event of a vote to exit. Absent that outcome, we see healthy domestic demand, continuing falls in the unemployment rate, and that the risk of a rate hike is greater than the market foresees.

China to put growth first

The National People's Congress session in March 2016 appears to have prioritized Chinese growth over other objectives after attempts to rebalance output away from export-driven activity. That means more aggressive credit and fiscal stimuli to boost investment spending, pushing back the reform process. While it limits the near-term risk of a sharper slowdown and should support global growth, it should also increase the economy's imbalances and business' indebtedness, storing up bigger problems in the longer term. We expect only a modest depreciation in the yuan, with tighter capital controls in China for the remainder of 2016. The country's stimulus measures have at least helped moderate the growth slowdown elsewhere in Asia.

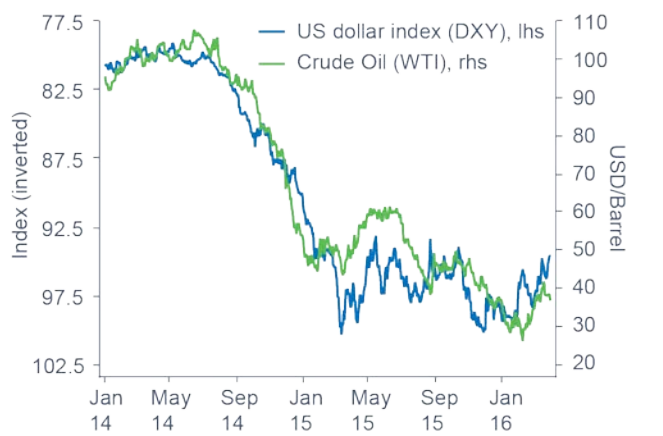
Meanwhile, the recent stabilization in commodity prices, weaker U.S. dollar, and associated moderating inflation outlook offers a glimmer of hope for Latin America.

Global inflation still depressed by oil prices (%)



Source: Macrobond, March 2016. **Past performance is no guarantee of future results.**

Oil prices stronger and the dollar weaker



Source: Macrobond, March 2016. **Past performance is no guarantee of future results.**

[1] *Financial Times*, April 2016

Important Information

Unless stated otherwise, any sources and opinions expressed are those of Aviva Investors Global Services Limited (Aviva Investors) as of March 31, 2016. Opinions, estimates, forecasts, and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. Information contained herein has been obtained from sources believed to be reliable, but has not been independently verified by Aviva Investors and is not guaranteed to be accurate. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations. **Past performance is no guarantee of future results.**

The name “Aviva Investors” as used in this presentation refers to the global organization of affiliated asset management businesses operating under the Aviva Investors name. Each Aviva Investors’ affiliate is a subsidiary of Aviva plc, a publicly- traded multi-national financial services company headquartered in the United Kingdom.

Aviva Investors Americas LLC (AIA) is the named subadviser to the Virtus Multi-Strategy Target Return Fund and utilizes the services of Aviva Investors Global Services Limited (AIGSL) and its other affiliates (collectively, Aviva Investors) to manage the Fund. These affiliates are Participating Affiliates as that term is used in relief granted by the SEC. The listed investment professionals are associated with AIGSL.

IMPORTANT RISK CONSIDERATIONS
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. **Credit & Interest:** Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. **Derivatives:** Investments in derivatives such as futures, options, forwards, and swaps may increase volatility or cause a loss greater than the principal investment. **Leverage:** When a fund leverages its portfolio, the value of its shares may be more volatile and all other risks may be compounded. **Counterparties:** There is risk that a party upon whom the fund relies to complete a transaction will default. **Portfolio Turnover:** The fund’s principal investment strategies will result in a consistently high portfolio turnover rate. A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when fund shares are held in a taxable account. **Prospectus:** For additional information on risks, please see the fund’s prospectus.

Investors should carefully consider the investment objectives, risks, charges, and expenses of any Virtus Mutual Fund before investing. The prospectus and summary prospectus contain this and other information about the fund. Please contact your financial representative, call 1-800-243-4361, or visit www.virtus.com to obtain a current prospectus and/or summary prospectus. You should read the prospectus and/or summary prospectus carefully before you invest or send money.

Not all products or marketing materials are available at all firms.
Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.
Distributed by **VP Distributors, LLC**, member FINRA and subsidiary of Virtus Investment Partners, Inc.