

## Virtus GF U.S. Small Cap Focus Fund

### FUND INFORMATION

Inception Date (Class I)	3/12/14
Domicile	Ireland
UCITS IV	Yes
Valuation	Daily
Total Expense Ratio (Class I)	1.15%
Base Currency	USD
Convenience Pricing	EUR, GBP
Total Net Assets (mm)	\$4.6

### Fund Codes

Class	ISIN	Bloomberg
I	IE00BH4GXS19	VGUSCFI
A	IE00BH4GXR02	VGUSCFA
C	IE00BQSBKK65	
R	IE00BQSBKLL72	

### Investment Manager

Kayne Anderson Rudnick Investment Management, LLC

### Investment Professional

Todd Beiley, CFA  
 Portfolio Manager  
 Industry Start Date: 1999

### About Kayne Anderson Rudnick Investment Management, LLC

Kayne Anderson Rudnick believes that superior risk-adjusted returns may be achieved through investment in high-quality companies with market dominance, excellent management, financial strength, and consistent growth, purchased at reasonable prices.

### STRATEGY

The goal of the Virtus GF U.S. Small Cap Focus Fund is to produce exceptional long-term investment results by owning businesses with enduring competitive protections purchased at attractive prices. We employ thorough research in an attempt to understand the advantages and vulnerabilities of a business so that we can more accurately assess its value. We do not attempt to forecast the market, but instead seek to understand individual companies and their worth so that we are in a position to recognize attractive prices when they arise.

### MARKET REVIEW

Stocks were positive in the first quarter of 2017, with the S&P 500® Index advancing 6.07%, international markets up 7.25% (MSCI EAFE® Index, net), and emerging markets even stronger at 11.44% (MSCI Emerging Markets Index, net). The U.S. small-cap market also advanced during the quarter, with the Russell 2000® Index gaining 2.47%.

The style rotation that began following the U.S. election continued during the quarter, as growth benchmarks outperformed value indexes and large stocks outperformed small stocks—the opposite of what happened in 2016. During the quarter, asset classes and equity sectors that benefited the most from Donald Trump’s surprise election cooled off and have lagged materially so far this year. Sectors leading the market’s advance on the Russell 2000 Index include health care (+11.54), technology (+7.13), and materials (+4.64). The energy sector lagged, returning -10.91%, while the consumer staples returned -4.62%.

### PORTFOLIO OVERVIEW

The Fund returned 4.55% (Class I) for the quarter, outperforming the 2.47% return of the Russell 2000® Index. For the quarter, the portfolio benefited from strong stock selection in the technology and financial services sectors, while negative stock selection in the consumer staples and health care sectors detracted from performance.

Positions that contributed the most to performance during the quarter were Autohome and Primerica.

- Autohome’s shares were under pressure last year due to: 1) investments in a new car transaction business at the expense of near-term margins; and 2) management upheaval following Telstra’s decision to sell its controlling stake to Ping An Insurance. With Ping An now in control, the new management team has refocused the business and begun implementing better expense discipline as evidenced by a reduction in headcount during the most recent quarter, which has been a positive for the share price.
- Primerica’s shares had been under pressure in the first half of 2016 over concerns on how the Department of Labor’s Fiduciary Standard Rule would impact the retirement investment account industry. While the rule’s final language was less onerous than feared, some questions remained over the ultimate cost of implementation. The Trump administration has delayed the rule’s implementation and there is a good chance it may never be enacted. With this overhang now removed from Primerica’s stock, investors have focused on the fundamentals of the business, which generated 18% earnings-per-share growth in the most recent quarter.

Holdings that contributed the least to performance during the quarter were The Chefs’ Warehouse and Shutterstock.

- The Chefs’ Warehouse, in the most recent quarter, continued to show strong organic revenue growth, but profitability still declined due mostly to investment being made to grow the business. In addition, guidance for 2017 implies no margin improvement, which was not what investors had expected. Chefs’ uneven business results remain frustrating,

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but we view the investments the company is making to be rational for the long-term health of the business. We continue to expect margins and cash flow to improve over time, so we remain owners of the business.

- Shutterstock's share price had rebounded in the first half of 2016 as concerns regarding the competitive threat from Adobe's new stock photo offering abated. However, a meaningful slowdown in revenue growth the past two quarters sent the share price lower. Our original investment thesis was based on the network effects of Shutterstock's core stock photo marketplace business. Even at lower growth rates, that marketplace business is very profitable and valuable. Unfortunately, the profits from that great business will remain depressed as management seeks growth by investing capital to grow other parts of the company where Shutterstock's competitive advantage is less clear. For these reasons, we sold our position.

## **PURCHASES AND SALES**

During the quarter, we purchased Interactive Brokers Group, and sold our positions in Artisan Partners Asset Management, Aspen Technology, Shutterstock (rationale described above), and Polaris Industries.

- Interactive Brokers is an electronic brokerage and market-making company with customers that include individual investors, hedge funds, mutual funds, registered investment advisors, proprietary

trading groups and introducing brokers. Interactive Brokers is the clear low-cost provider in an industry where costs are important to customers. As a result, the company has grown its customer account base at an industry-leading pace while significant remaining growth opportunities exist.

- We sold Artisan Partners due to our expectation that the company will face ongoing challenges in growing its asset base.
- Our sales of Aspen and Polaris were primarily due to the valuation of those companies' stocks.

## **OUTLOOK**

We believe the stock market and business activity are off to a good start in 2017. Corrections in the equity market may occur at any time, but conditions for a more meaningful equity bear market do not seem to be in place. President Trump's policy agenda is becoming clearer than it was during the election campaign. Still, it is still too early to declare that we have all the details on his agenda for trade policies and foreign affairs. Our patience in not overreacting to last fall's Trump rally has been rewarded. We'll adjust the portfolio if Trump's initiatives become reality, rather than speculation or random proposals. From a stock selection perspective, we'll continue to focus on quality companies with protective moats that can do well in both good and bad economic times.

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**AVERAGE ANNUAL TOTAL RETURNS** as of March 31, 2017 (in percent)

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception 3/12/14
Virtus GF U.S. Small Cap Focus Fund (Class I)	4.55	4.55	17.76	8.09	n/a	n/a	7.30
The Russell 2000® Index	2.47	2.47	26.22	7.22	n/a	n/a	6.58

Class I operating expenses are 1.15%.

Average annual total returns reflect the change in share price and the reinvestment of all dividends and capital gains. Class I shares have no entry charge and therefore its returns do not reflect the deduction of an entry charge, which if applied, would reduce returns. Fees and expenses vary among share classes and other share classes do carry entry charges. For Fund performance of other share classes, please see the Virtus Global Funds Performance Report.

**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 [www.virtus.com](http://www.virtus.com) for performance data current to the most recent month-end.**

The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. 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 is not available for direct investment.

## 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. **Limited Number of Investments:** Because the fund has a limited number of securities, it may be more susceptible to factors adversely affecting its securities than a less concentrated fund. **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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