Virtus WMC Global Factor Opportunities ETF

1Q19 COMMENTARY

VGFO

NYSE Arca

MARKET OVERVIEW

- **United States:** U.S. equities led the market rally, driven by a dovish shift in Federal Reserve (Fed) policy and guidance, U.S.-China trade deal optimism, relatively strong Q4 earnings, and corporate buybacks. The Fed left benchmark rates unchanged, signaling a more patient approach toward future rate adjustments.
- **Europe:** European equities gained as central banks put quantitative tightening on hold and valuations appeared attractive. The European Central Bank slashed its growth forecast to 1.1% from 1.7%, and unveiled stimulus measures to revive the eurozone economy amid slowing growth, political uncertainty, and ongoing trade tensions.
- **Japan:** Japanese equities rose though lagged global markets. Inflation fell, prompting the Bank of Japan to maintain its key short-term interest rate and continue its asset purchase program. High beta stocks and companies with high foreign revenue exposure led the rally.
- **Emerging Markets (EM):** EM equities rose, bolstered by the Fed's decision to keep rates unchanged. EM markets were led by beta, large-cap, and top-line growth factors. The strong performance in trend-following factors marked a reversal from 2018 performance.

HOW THE FUND PERFORMED

During the quarter, the Fund underperformed the MSCI ACWI Index, returning 11.81% versus 12.18%, respectively. The Fund's underperformance was driven by factor exposures in the U.S. and EM, but was partially offset by contributions from factor exposures, including in Japan and Europe.

- **United States:** The U.S. allocation slightly underperformed the MSCI United States Index, driven by underperformance in our mean-reversion (free cash flow yield) and risk-aversion (low volatility) factors. Mean-reversion factors experienced strong performance in January but the gains were short-lived and were eventually erased during the risk-off, mega-cap led rally of March. Our risk-aversion allocation also detracted as the market rewarded higher beta names in January at the expense of low volatility. Trend-following (positive sentiment) outperformed the U.S., as overweight exposure to information technology drove performance, led by software and services companies like Cadence Design Systems and Worldpay. Our U.S. factor selection remains unchanged from the beginning of the year and reflects our cautious outlook.
- **Europe:** The Europe allocation marginally outperformed the MSCI Europe Index, as positive performance in trend-following and risk-aversion offset lackluster performance in mean-reversion factors. Mean-reversion (free cash flow yield) saw strong performance in January, only to severely underperform in March. Trend-following (positive sentiment) benefited from an overweight exposure to information technology, where positions in software and services companies outperformed. The risk-aversion factor (low volatility) benefited from positioning within energy as stocks the factor owned (e.g., BP) outperformed other stocks in the sector. Our positioning in the Europe allocation remains unchanged from the beginning of the year, reflecting our cautious outlook with allocations.
- **Japan:** The Japan allocation outperformed Japanese equities as negative relative performance in mean-reversion and trend-following (positive earnings revisions) was more than offset by outperformance in risk-aversion. The mean-reversion factor (low enterprise value to sales) was hurt by positioning in energy—both by being overweight oil and gas companies and by positioning within the industry (e.g., overweight JXTG Holdings). Performance within the risk-aversion factor (quality yield) was boosted by favoring outperforming consumer discretionary names such as Astellas Pharmaceuticals. We are maintaining our allocations to low enterprise value to sales (mean-reversion), and positive earnings revisions (trend-following), however, at quarter-end, we moved back into low volatility from quality yield (risk-aversion) as we sought to reduce our exposure to cyclical risk.
- **Emerging Markets:** The EM allocation underperformed the MSCI EM Index, driven by risk-aversion and mean-reversion, and, in particular, an underweight to Chinese e-commerce stock Alibaba, which saw a strong resurgence in the quarter. Within mean-reversion (low enterprise value to sales), exposure to stocks in the energy and petrochemical complex, such as Korean industrials firm Daelim Industrial, detracted. The risk-aversion factor (low EPS dispersion) underperformed primarily due to exposure to banks, particularly in South Africa and Malaysia. The trend-following factor (positive earnings revisions) partially offset these headwinds, as the factor outperformed. This was driven by overweight exposure to real estate and underweight exposure to banks.

PORTFOLIO MANAGEMENT

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Portfolio Managers

Gregg R. Thomas, CFA
Senior Managing Director and Portfolio Manager
Industry start date: 1993
Start date as Fund Portfolio Manager: 2017

Thomas S. Simon, CFA, FRM
Senior Managing Director and Portfolio Manager
Industry start date: 2001
Start date as Fund Portfolio Manager: 2017

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OUTLOOK

Economic data has signaled a coordinated global growth deceleration. Key risks include an inflation surprise in the U.S., which may force the Fed to act more decisively, ongoing political uncertainty in Europe as Brexit's deadline approaches, and unresolved trade negotiations particularly between the U.S. and China. We expect continued volatility.

In the U.S., market valuations have bounced back considerably since a 20% correction in 2018, but are still lower than the highs reached at the beginning of 2018. We continue to see most mean-reversion factors trading at close to record lows. Inflation disappointed throughout the quarter, allowing the Fed to maintain its patient, data-dependent approach to rate policy. We also started to see an improvement in the breadth of analyst revisions, perhaps in response to the Fed.

In Europe and Japan, weak export demand and slowing global growth has resulted in reduced industrial production. Economic fundamentals in more domestic-focused segments remain strong. We have seen an early uptick in earnings sentiment in mean-reversion factors in Europe. These factors look cheap relative to history, though not to the same extremes.

Meanwhile, the economic cycle across emerging markets continues to weaken despite the emergence of certain bright spots, including potential growth stabilization in China.

We remain vigilant in managing risk and look to mean-reversion and trend-following factor exposures to provide upside participation and risk-aversion factor exposures to mitigate downside risk. This should smooth the path of performance and mitigate the cyclicality of style factor exposures.

Factor Outlook by Region (as of 3/31/19)

	U.S.	Europe	Japan	EM
Value	✔	✔	✔	—
Momentum	✘	✘	✘	✔
Quality	✔	—	—	✘

✔ Positive ✘ Negative — Neutral

Investments outside of these four regions seek neutral exposure to the benchmark.

Performance—Total Returns (%) as of 3/31/19

	QTD	YTD	1 YR	3 YR	5 YR	10 YR	Since Inception (10/10/17)
NAV	11.81	11.81	0.84	n/a	n/a	n/a	3.68
Market Price	11.85	11.85	0.59	n/a	n/a	n/a	3.94
Benchmark	12.18	12.18	2.60	n/a	n/a	n/a	4.10

Returns for periods of less than one year are cumulative total returns.

Performance data quoted represents past results. Past performance is not a guarantee of future results. Current performance may be higher or lower than performance quoted. Investment return and principal value will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Please visit www.virtus.com for performance data current to the most recent month-end.

Expense Ratio: 0.49% Gross/Net

Expenses are based on estimated amounts for the current fiscal year. The gross expense ratio represents the Fund's management fee, which is structured as a "unified fee," out of which the Fund's adviser pays all routine expenses, except for certain payments as described in the prospectus, which are paid by the Fund.

The Fund is an exchange-traded fund ("ETF"). The "net asset value" (NAV) of the Fund is determined at the close of each business day, and represents the dollar value of one share of the Fund; it is calculated by taking the total assets of the Fund, subtracting total liabilities, and dividing by the total number of shares outstanding. The NAV of the Fund is not necessarily the same as its intraday trading value. Fund investors should not expect to buy or sell shares at NAV because shares of ETFs such as the Fund are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Thus, shares may trade at a premium or discount to their NAV in the secondary market. Brokerage commissions will reduce returns. NAV returns are calculated using the Fund's daily 4:00 pm NAV, and include the reinvestment of all dividends and other distributions (reinvested at the Fund's NAV on distribution ex-date). Market price returns are calculated using the 4:00 pm midpoint between the bid and offer, and include the reinvestment of all dividends and other distributions (reinvested at the 4:00 pm bid/offer midpoint on distribution ex-date). Market price returns do not represent the return you would receive if you traded at other times.

Benchmark: The Fund's benchmark is the **MSCI ACWI Index (net)**, which is a free float-adjusted market capitalization-weighted index that measures equity performance of developed and 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 is not available for direct investment.

The Fund is an actively managed exchange-traded fund and does not seek to replicate the performance of a specified index. The Fund may have a higher portfolio turnover than funds that seek to replicate the performance of an index.

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IMPORTANT RISK CONSIDERATIONS

Exchange-Traded Funds: The value of an ETF may be more volatile than the underlying portfolio of securities the ETF is designed to track. The costs of owning the ETF may exceed the cost of investing directly in the underlying securities. **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:** That events negatively affecting the fiscal stability of a state, country, or region will cause the value of the fund's shares to decrease. Because the fund concentrates its assets in a state, country, or region, the fund is more vulnerable to those areas' financial, economic, or other political developments. **Equity REITs:** The fund may be negatively affected by factors specific to the real estate market, including interest rates, leverage, property, and management. **Derivatives:** Investments in derivatives such as futures, options, forwards, and swaps may increase volatility or cause a loss greater than the principal investment. **Prospectus:** For additional information on risks, please see the fund's prospectus.

Please consider the Fund's objectives, risks, charges, and expenses before investing. Contact us at 1-800-243-4361 or visit www.virtus.com for a prospectus, which contains this and other information about the Fund. Read the prospectus carefully before investing.

Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.

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