Virtus Glovista Emerging Markets ETF

4Q18 COMMENTARY

EMEM

NYSE Arca

MARKET REVIEW

In the fourth quarter, emerging market (EM) equities, as represented by the MSCI EM Index, returned -7.48%, strongly outperforming developed market (DM) equities, as represented by the MSCI World Index, which returned -13.42%. The outperformance of EM equities was fueled by the strength and momentum of EM economies (with notable exceptions including China and Korea) versus their DM peers, as well as EM currencies' outperformance of the U.S. dollar. The outperformance of EM currencies is notable during a quarter when risk assets globally came under pressure and the U.S. Federal Reserve continued raising the fed funds rate.

Within the MSCI EM Index, the top-performing countries were Brazil, Indonesia, and Qatar, while the bottom-performing countries were Pakistan, Colombia, and Mexico.

HOW THE FUND PERFORMED

The Fund returned -4.81% in the quarter, roughly in line with the -4.95% return of the benchmark.

Key Contributors

Brazilian equities sharply outperformed major EM equity peers due to the outcome of first-round presidential elections in early October where far-right candidate Jair Bolsonaro (with a market-friendly economic advisor) outperformed expectations, thereby increasing the probability of his victory in the October 28 second-round election.

Indonesian equities strongly outperformed their major EM equity peers due to: 1) improving macro fundamentals including faster-than-expected growth, combined with benign inflation; 2) attractive rupiah currency valuations; and 3) flows into the local fixed-income market on the back of the opening up of the local non-deliverable forwards (NDF) market.

Turkish equities outperformed major EM peers due to improvement in U.S.-Turkish relations, attractiveness of the lira currency, and better-than-expected earnings from the financial sector.

Key Detractors

Mexican equities underperformed their major EM peers owing to the volatility in October, primarily driven by geopolitical developments where President-elect Andrés Manuel Lopez Obrador (AMLO) fanned populist policy fears by announcing the scrapping of a partially built airport project on the back of a referendum and his party's senators' proposed scrapping of some banking fees for consumers.

Russian equities underperformed major EM peers during the quarter, owing primarily to more than a 44% sell-off in crude prices driven by an announcement of an increase in production from OPEC+ Russia in an environment where crude demand has been weakening.

Thai equities underperformed their major EM peers despite boasting a strong current account surplus, owing to their exposure to the energy sector during a quarter where crude oil prices sold off by more than 44% and concerns regarding the impact on tourism from a slowdown in China.

OUTLOOK

For the year 2018, EM equities, as represented by the MSCI EM Index, returned -14.58%, underperforming their DM peers, as represented by the MSCI World Index, which returned -8.71%. Thus, in 2018, EM equities retraced the totality of the relative return outperformance recorded versus their DM equity peers since the generational low levels reached in early January 2016.

PORTFOLIO MANAGEMENT

GLOVISTA INVESTMENTS

Glovista Investments LLC employs a combination of fundamental and quantitative analysis with a focus on bottom-up and top-down stock picking to create its portfolios. Glovista Investments LLC was founded in 2007 with offices in New Jersey, Florida, and California.

Portfolio Managers

Dr. Carlos Asilis
Chief Investment Officer
Industry start date: 1994
Start date with Fund: 2017

Darshan Bhatt, CFA, CMT
Deputy Chief Investment Officer
Industry start date: 2000
Start date with Fund: 2017

Virtus Glovista Emerging Markets ETF

EMEM

Since October 2018, EM equities resumed a period of strong relative outperformance versus their DM peers, which we expect to extend throughout 2019 for various considerations outlined here:

Valuations: EM equity valuations (price-to-earnings ratio) currently trade at a 33% discount versus their U.S. peers, not even calibrating for relative earning cycle stage (developed at extended versus emerging at depressed earnings cycle stage).

Earnings growth: EM economies showed during Q4 2018 improved relative momentum (economic surprise) versus developed peers, which is closely correlated with relative earnings momentum.

Quality: EM corporates continue to display stronger balance sheet strength versus their developed peers, as illustrated by a debt-to-equity ratio below 100 as compared with 115 for U.S. peers and 145 for international developed peers.

Margin: EM corporates look poised to record a strengthening of operating margin performance versus developed peers on a cyclical basis, given the larger amount of slack in factor markets in EM economies vis-à-vis developed economies, especially the U.S.

U.S. dollar: Our expectation for a resumption of a U.S. dollar bear cycle in 2019 reflects the aging of the U.S. economic expansion in comparison to the nascent economic expansion in Japan, as well as the resilient strength of the core eurozone economies and many EM countries.

Positioning: The under-owned status of EM equities, particularly on the part of U.S. institutional investors.

Performance—Total Returns (%) as of 12/31/18

	QTD	YTD	1 YR	3 YR	5 YR	10 YR	Since Inception (11/7/17)
NAV	-4.81	-15.21	-15.21	n/a	n/a	n/a	-10.08
Market Price	-5.35	-15.46	-15.46	n/a	n/a	n/a	-9.91
Benchmark	-4.95	-14.56	-14.56	n/a	n/a	n/a	-9.66

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.

Gross Expense Ratio: 0.71%; Net Expense Ratio: 0.68%.

Net expense ratio reflects a contractual expense waiver in effect through 02/28/19.

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

Expenses are based on estimated amounts for the current fiscal year. The Fund's management fee 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's investment adviser has contractually agreed to waive a portion of the Fund's total operating expenses equal to 0.03% of the Fund's average daily net assets, which will have the effect of reducing the Acquired Fund Fees and Expenses. Unless the Adviser continues the Fee Waiver Agreement, it will terminate on February 28, 2019.

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 p.m. 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 4:00pm 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 **Solactive Most Favored Nations Emerging Markets Index** which is an index of stocks from most favored countries selected from a universe of large liquid emerging market countries (currently fifteen). The Index is designed to provide diversified exposure to stocks within large liquid countries in emerging markets while avoiding exposure to the stocks within weakest countries based on Glovista's proprietary quantitative methodology.

The MSCI Emerging Markets Index (net) is a free float-adjusted market capitalization-weighted index designed to measure equity market performance in the global emerging markets. The index is calculated on a total return basis with net dividends reinvested. The MSCI World Index (net) is a free float-adjusted market capitalization-weighted index that measures developed global market equity performance. The index is calculated on a total return basis with net dividends reinvested.

The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

The commentary is the opinion of the subadviser. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

IMPORTANT RISK CONSIDERATIONS

Exchange-Traded Funds (ETF): The value of an ETF may be more volatile than the underlying portfolio of securities it 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. **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. **Non-Diversified:** The fund is non-diversified and may be more susceptible to factors negatively impacting its holdings to the extent that each security represents a larger portion of the fund's assets. **Fund of Funds:** Because the fund can invest in other funds, it indirectly bears its proportionate share of the operating expenses and management fees of the underlying fund(s). **Correlation to Index:** The performance of the fund and its index may vary somewhat due to factors such as fund flows, transaction costs, and timing differences associated with additions to and deletions from its index. **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.

The Fund is distributed by **ETF Distributors LLC**, an affiliate of Virtus ETF Advisers LLC.

2228 02-19 © 2019 Virtus Exchange-Traded Funds. All RIghts Reserved.

VIRTUS
EXCHANGE-TRADED FUNDS