REPRINTED FROM AUGUST 27, 2018

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Providing Stable Risk-Adjusted Income Through a Leveraged Finance ETF

FRANK OSSINO is Senior Managing Director, Senior Portfolio Manager and Sector Head of Newfleet Asset Management, LLC. Mr. Ossino serves as a Senior Portfolio Manager of Newfleet's Floating Rate Bank Loan, High Yield, and Flexible Credit Strategies in both separately managed and pooled vehicles as well as mutual fund and ETF formats through a number of subadvisory relationships. Additionally, Mr. Ossino is responsible for the structuring and management of Newfleet's CLO platform. Prior to joining Newfleet in 2012, Mr. Ossino was a Portfolio Manager at Harford Investment Management Company from 2004 to 2011 and Hartford Funds subadviser Wellington Management in 2012, where he managed mutual funds focused on bank loans and a commingled bank loan portfolio for institutional investors. Previously, he held a variety of credit analyst and portfolio management positions at CIGNA from 2002 to 2004, HVB Bank from 2000 to 2002 and FleetBoston Financial from 1996 to 2000. Mr. Ossino earned his M.S. in international economics and finance from Brandeis University and Luigi Bocconi University in Milan, Italy, and a B.S. in economics, cum laude, from Brandeis University. He began his career in the investment industry in 1996.

SECTOR — GENERAL INVESTING

TWST: Would you mind briefly telling us what funds you manage and your areas of expertise?

Mr. Ossino: Newfleet Asset Management is a Hartford, Connecticut-based boutique fixed income firm that has 38 professionals and $12 billion in assets under management. I am the Sector Head of the floating-rate loan asset class, which is a roughly $2.5 billion business. The loan and high yield markets are closely related, so I partner with our High Yield Sector Head, Jon Stanley, who covers about $1.5 billion of high yield securities.

We manage multisector products as well as dedicated strategies that come in mutual fund form and exchange-traded fund — ETF — form, as well as separately managed accounts, or SMAs; collateralized loan obligations, or CLOs; and even UCITS, or undertakings for the collective investment of transferable securities. So we manage solely fixed income portfolios under dedicated and multisector mandates across various distribution channels.

TWST: When you look across the possibilities that investors have today, do you have any thoughts about them broadly, including the growth of ETFs and/or SMAs? What is your personal perspective? What are your high-level thoughts about the pros and cons across these investment types?

Mr. Ossino: The advent of various wrappers is providing a lot of options for investors. There are investors who may have a particular credit quality or liquidity need, regardless of whether they are retail or institutional investors. There is a broadening of opportunity sets not only across asset classes but across various types of products, and that is good for the end user.

Just thinking about the loan market, there are mutual funds that might work for investors seeking active mark-to-market daily access. An ETF user may find passive, broad exposure attractive. Institutional investors might look for a portfolio with a specific credit quality or industry bias, and they might leverage the portfolio. Institutional investor mandates are often longer term where mark-to-market is less important. It is overall good for the market that there are different options for the client. It allows the client to say, "Here is what I am looking for, here are my criteria, and now let me find the strategy and portfolio construct that best fits my needs."

TWST: One of the funds you manage is called the Virtus Newfleet Dynamic Credit ETF. Tell us about this.

Mr. Ossino: The Virtus Newfleet Dynamic Credit ETF (NYSEARCA:BLHY) was born out of the needs of investors we have been discussing here. BLHY is a strategy we created in ETF form that we already had been managing in mutual fund form for a subadvisory client. It is a strategy that has the ability to buy both floating-rate loans as well as high yield corporate bonds in any allocation mix. The portfolio could be 0% to 100% in either direction across both floating-rate loans and high yield securities.

We had success on the mutual fund side with this strategy, so we built it on the ETF side for a client that utilized ETFs but did not invest in mutual funds. So BLHY filled this need while at the same time allowed other investors to have exposure to a compelling strategy regardless of the product form.

The strategy was developed while we were discussing how the leveraged finance or non-investment-grade market was evolving. We found that loans and high yield over the last 20 years or so have slowly been converging. Wall Street is now writing loan and high yield research in the same breath. The sales organizations are now largely consolidated at many banks. They trade both loans and high yield through the same trading desk. Wall Street is increasingly referring to bank loans and high yield as leveraged finance, rather than viewing them as separate asset classes. We also felt that there is value to the client when investing in the broadest opportunity set possible.

Highlights

Frank Ossino discusses the Virtus Newfleet Dynamic Credit ETF. The ETF has the ability to buy both floating-rate loans and high yield corporate bonds. The strategy was developed to give investors the broadest exposure to the leveraged finance market. According to Mr. Ossino, this broad opportunity set provides a stable risk-adjusted income stream and attractive long-term outcomes. Mr. Ossino's process takes an active approach to traditional core credit and fundamental credit analysis. Currently, the portfolio is positioned for interest rate risk, rather than credit risk, and the positions are roughly 60% loans, 35% high yield and 5% cash.

Companies discussed: CEVA Logistics AG (SWX:CEVA).

The loan market is roughly a trillion dollars. The high yield market is just over a trillion dollars. It was our view that having a portfolio with a $2 trillion-plus opportunity set gave us a bigger pond to fish in, not only from an absolute size perspective but also from an industry perspective. For example, the energy market is roughly 4% of the loan market, but it makes up between 14% and 15% of the high yield market.

So as an investor, I would like to consider every investable opportunity rather than just what is available in a single dedicated strategy. I also found it interesting that, within the homebuilders or building materials industry, the loan market doesn't have any construction companies. There are no homebuilders in the loan building materials index, but half of the 4% that makes up building materials in high yield are construction companies. So again, it is about giving the client the broadest exposure within this now larger opportunity set.

The borrowers are moving in this direction as well. Roughly 50% of non-investment-grade borrowers have a floating-rate loan issue as well as a high yield bond. Our analyst team consists of eight analysts who cover both loans and high yield, so we can choose where we want to be in a borrower's capital structure. Sometimes that means a loan, and sometimes that will be the bond. It is allowing us to maximize the opportunity set. Certainly, the lines are getting gray.

There is a company that's in the market right now, **CEVA Group**, or **CEVA Logistics** (SWX:CEVA), and they are going to issue a floating-rate loan as well as a secured note. Here's a situation where these issues are going to be very similar. They are both secured by company collateral, but one is floating rate and the other fixed rate. Having a portfolio that can actually choose on an unconstrained basis between the two is attractive.

From an investor perspective, the client now can focus on making the decision at the leveraged finance level rather than asking, "Should I buy loans or high yield separately, and in what mix?" We are certainly simplifying the selection process for the client and also reducing portfolio and manager correlation risk. We take potentially being overexposed to either a credit, or a certain credit quality, or an asset class out of the equation. Naturally, the client needs to be comfortable outsourcing the complexity involved with these various levers to a professional manager. In addition, this is a rate hedge product. Loans and high yield are the best-performing fixed income asset classes year to date — through July — in this rising rate environment.

Going back to your original question, a lot of these products have been devised as a solution for the client to have income-producing assets. If you believe that leveraged finance is really one asset class, as we do at Newfleet, then you want to provide the client with the broadest opportunity set to provide a stable risk-adjusted income stream and maximize an attractive long-term outcome over time.

Investors who own HYG and BKLN, and other similar dedicated passive ETFs, can add value to fixed income portfolios by consolidating positions, in our view. They no longer need to own two portfolios and the corresponding inefficiencies. Certainly, the performance of BLHY is showing that in its year-to-date performance and since the second quarter of 2017 when it became fully invested. We are finding that our ability to actively shift between asset classes and along credit quality and then within a borrower's capital structure have all added value.

TWST: Is this ETF, to any extent, linked to any sort of index? Can you elaborate on the process and the rules that govern it?

Mr. Ossino: The index is a customized benchmark: 50% of the S&P/LSTA Leveraged Loan Index and 50% of the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Index. We are tracking the indices from a benchmark perspective. This is an active ETF, so it has SEC- and NYSE-imposed governors primarily around underlying security-level liquidity requirements.

BLHY follows the same multisector process that we use consistently at Newfleet. Jon and I, on a monthly basis, present our views on the loan and high yield markets to the other sector heads, and those sector heads present views on their asset classes as well. So every month we receive a broad picture of other asset classes, including emerging markets, municipals and investment-grade credit. We take that information and, as a first step, overlay it onto the relative value between the loan market and the high yield market.

In the spring of 2016, for example, it was our view that there was more value in high yield than there was in loans. So we added high yield versus loans. To give you another example, coming into this year, we felt the rising rate environment was going to start to pick up some steam, and so we increased our loan exposure versus high yield.

The second lever in the process relates to credit quality. How do we feel about the credit cycle? Right now, we feel good about credit and macroeconomic fundamentals. The macro economy is in good shape and improving, so that might drive whether or not we want to put risk on or take risk off. In late 2014 and 2015, we were taking risk off. The summer of 2016 through 2017, we were putting risk on. Today, given where valuations are in the loan market and the high yield market and the richness of those valuations, we are reassessing our risk positions with a bias to perhaps start taking some credit risk off, given our view that we are in the later stages of the credit cycle.

Then, finally, regarding the issuer's capital structure, we ask, "Do we want to be safe by being in secured loans, or are there borrowers that we are very comfortable with, whereby we should be going down the capital structure to earn a little bit of extra income?" In sum, our process is about traditional core credit and fundamental credit analysis with an active approach. We are not scared to sell, whether to protect against credit events, reflect a change in our investment thesis or to capture relative value between the two asset classes.

TWST: What is your security selection telling you about either individual companies or, perhaps more appropriately, individual sectors?

Mr. Ossino: Right now, the portfolio is positioned with roughly 60% loans and 35% high yield and the remainder in cash. That says that we are positioned more for interest rate risk than for credit risk.

As I mentioned, credit fundamentals are in good shape. We do not forecast a recession in the near and medium terms. A roughly 2.5% domestic GDP environment is good for the fixed income market. Borrowers are paying interest and principal, and we are seeing good topline and bottom-line results. Margins are stable and improving. We just had a very good first-quarter earnings season, and it looks like the second quarter is off to a good start. Balance sheets are also in good shape. There are not a lot of debt maturities due in the next couple of years. Fundamentally speaking, that is all good for credit.

"Going back to your original question, a lot of these products have been devised as a solution for the client to have income-producing assets. If you believe that leveraged finance is really one asset class, as we do at Newfleet, then you want to provide the client with the broadest opportunity set to provide a stable risk-adjusted income stream and maximize an attractive long-term outcome over time."

So while we are thinking about taking some risk off, generally speaking, we still like credit today. The reason we are eyes wide open is we believe risk-adjusted valuations may be tight given that the looseness of the credit underwriting today is starting to get aggressive. The old cliche is that the worst deals are done in the best of times. That feels like where we are today. We are seeing a lot of first-time borrowers and a lot of industries with excessive leverage. The documentation is starting to get very loose. These could be the seeds for the next cycle, but it is our job as managers to analyze through that and look for the best-structured companies from a documentation perspective and for businesses that can operate with a leveraged capital structure.

The interest rate side of the equation is interesting because accommodation has created an environment in which yields have gotten low and tight, and durations have really been pushed out. Only slight movements in interest rates have had a large impact on returns. The investment-grade market has a negative total return year to date, and the Bloomberg Barclays Aggregate Bond Index is also negative.

The reason is because when the investment-grade market, for example, at the beginning of the year was only yielding 3% with a duration of over seven years, a small movement in rates negatively impacted returns.

The loan market and the high yield market are positive year to date because, on the loan side at least, the floating-rate nature allows us to reset these loans generally every three months based off of LIBOR — London Interbank Offered Rate. As LIBOR has gone up, the interest rate carry has gone up in loans. So we are effectively immune to interest rate increases in loans.

On the high yield side, the return was negative in the first quarter. Because of the velocity of the interest rate increases, high yield didn't have enough time to produce offsetting income. Now that the second quarter is behind us, rates have — at least in the near term — stabilized into a range, and high yield now is positive for the year, and that is because it has had enough time to produce income to offset the interest rate side of the equation. So we are positioned for interest rate risk. We are still comfortable with credit risk, but we are reassessing risk positions as managers.

bond. Think about no-income-verification mortgages written just before the 2008 crisis. That was a top-of-the-market sign in the mortgage market. Banks were lending money to people to buy homes without doing proper due diligence. When the marginal borrower can no longer support the debt that they took on, or they lose a major customer, or they never had experience managing that type of leverage, they default and likely file for bankruptcy. The market eventually rebalances itself, and the cycle starts all over again.

The best deals are then done in the worst of times. That was really 2009 and 2010 when investors wanted to make sure that deals were well-structured and adequately priced. We wanted to make sure that the risk/reward relationship worked for us, and then, the cycle starts all over again. If you were to ask me where we are in that cycle, I don't think we are in the ninth inning. The game has been extended through tax cuts and deregulation and an improving economy. We are in a long seventh inning if you were to ask me to give you a baseball analogy, but we are certainly not in the second or third inning.

"The loan market and the high yield market are positive year to date because, on the loan side at least, the floating-rate nature allows us to reset these loans generally every three months based off of LIBOR — London Interbank Offered Rate. As LIBOR has gone up, the interest rate carry has gone up in loans. So we are effectively immune to interest rate increases in loans."

TWST: You talked about the looseness of some of the lending. How do you define that? Is it really a reflection truly of the economy having gotten to be relatively good in terms of the stock market and corporate profits?

Mr. Ossino: Cycles ebb and flow. They boom and bust. In very good times, the economy is running well, unemployment is low, and there is good growth. In good times, people typically stretch for returns by adding risk, whether from the stock market, a high yield market or emerging markets. Investors have a tendency to continually reach for that extra incremental return.

Right now, there is very strong demand for risk assets. A lot of that has been driven by global accommodation that pushed investors out the risk curve to find higher returns. You had to incrementally take on more risk. As that happens, it becomes circular. Those potential returns push us out into ever-riskier deals. The issuers and the investment banks recognize this, and so they push the envelope on what they can actually execute in the market, whether that is a first-time borrower coming to the market or an IPO for a company that perhaps is not yet making any earnings.

The documentation gets very loose, whether this is more leverage or the documentation terms of the loan or the

TWST: Can you explain a little bit more about how you hedge against rising interest rates?

Mr. Ossino: The rate hedge is really embedded in the underlying securities BLHY is buying. The loan market is a floating-rate instrument. So when a borrower issues floating-rate loans, those loans are typically made on the basis of LIBOR, often three-month LIBOR, plus a credit spread. As LIBOR goes up or down, we reset the borrowing just like an adjustable-rate mortgage. The difference is that we adjust every three months. If LIBOR goes from 2% to 3% and the spread is 4%, the borrower now owes me 3% LIBOR plus 4% — the spread — which is 7%. Three months ago, they owed me 2% LIBOR plus 4% — the spread — or 6%. So the interest rate on the loan goes up. Effectively, we are immune to that rising rate environment, and that has been happening.

LIBOR is up about 65 basis points thus far this year, and the U.S. 10-year Treasury is higher as well. The loan market return is positive at roughly 2% for the year. A lot of that is driven by the income carry, which has improved as LIBOR has increased. The high yield market is typically a very good hedge to rising rates as well, to the extent that it has enough time to generate income.

In 1994, for example, we had seven rate increases in 12 months. The high yield market return was negative, and the loan market was positive. The reason high yield was negative was because it just didn't have enough time to make offsetting coupon.

In 2004 to 2006, we had 17 rate increases, and high yield was one of the best-performing asset classes. The difference was that while the small methodical rate increases were happening, the economy was improving, and the spreads were tightening in high yield, but more importantly, the income was generated to more than offset the interest rate risk. When we look at year-to-date performance this year, the loan market is the best-performing asset class because of its floating-rate characteristic, but high yield is also now positive for the year because it is creating that income carry that is offsetting gradual rate increases.

TWST: Why should investors turn to you and your colleagues to manage money? Why should they move to this type of fund versus your competition?

Mr. Ossino: In the ETF universe, I don't know if another product exists that looks like BLHY. I personally cannot find an active non-investment-grade credit ETF that invests in both loans and high yield on an unconstrained basis without using derivatives and without using leverage. BLHY combines investing in the loan market and the high yield market into one portfolio, allowing us to find the best risk-adjusted returns across those asset classes as well as those borrowers' capital structures.

As it relates to Newfleet specifically, we have been managing fixed income portfolios for over 25 years, and our core focus is in multisector strategies. We pride ourselves in combining multiple asset classes into single strategies and looking for relative value dislocations within various asset classes. This process is really in our DNA. On the leveraged finance side, our experience and active investment style and philosophy using core fundamental credit analysis over time is what allows us to provide good long-term risk-adjusted outcomes for our investors.

TWST: Just on a final note, what has surprised you as you've been doing your research and analysis over the last few months? Has anything stood out?

Mr. Ossino: What has happened in the last eight weeks or so is that the volatility in the equity market driven by trade wars or geopolitics, coupled with rates stabilizing and a strong economy, is jump-starting the mergers and acquisitions market and the LBO market. The market is digesting an increased amount of new issue supply coming into the non-investment-grade credit universe over this short period. In the loan space, that is creating a little bit of price discovery or some weakness in secondary markets. The loan market is working through excess supply.

We view that as a good buying opportunity or at least a dollar-cost-averaging opportunity. Deals have to widen to clear the market. What is also surprising on the high yield side is that because of the investor demand for loans, a lot of borrowers are going to the loan market instead of the high yield market. The technical picture on the high yield side is the exact opposite with less supply in that market. This technical is creating a good environment for high yield and some positive returns.

The proof on BLHY is to look at BLHY versus the two major passive indices — HYG on the high yield side and BKLN on the loan side. You can actually see the value in BLHY versus its passive cousins. Year to date, we are outperforming a 50-50 blend of both of those ETFs. So the proof statement is our ability to be dynamic across both asset classes and to be active.

TWST: Thank you. (KJL)

"In the ETF universe, I don't know if another product exists that looks like BLHY. I personally cannot find an active non-investment-grade credit ETF that invests in both loans and high yield on an unconstrained basis without using derivatives and without using leverage."

To learn more about the Virtus Newfleet Dynamic Credit ETF or the other strategies managed by Newfleet Asset Management, please contact us at 800-243-4361 or visit Virtus.com.

VIRTUS
EXCHANGE-TRADED FUNDS

This reprint must be accompanied by a current fact sheet for the Virtus Newfleet Dynamic Credit ETF.

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 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.

Newfleet Asset Management's industry trends and observations are the result of research conducted by the portfolio management/research team. These observations reflect their industry expertise and have been prepared using sources of information generally believed to be reliable; however, their accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice.

Investing involves risk, including loss of your investment. Applicable sales charges, if included, would reduce performance rankings shown. This article has been edited.

Virtus ETFs are distributed by **ETF Distributors, LLC,** an affiliate of Virtus ETF Advisers LLC.

5594 09-18