

Virtus InfraCap U.S. Preferred Stock ETF

NYSE ARCA | NAV Symbol PFFA.NV | IOPV Symbol PFFA.IV | CUSIP 26923G822

MARKET OVERVIEW

In the fourth quarter of 2023, preferred stocks underperformed the broader equities market, primarily due to a steep drop in the risk-free rate beginning in mid-October.

In the preferred marketplace, active managers have the potential to outperform in the current market by (1) favoring preferred stocks that have been on their watchlist in sectors and/or companies that become oversold, (2) harvesting gains in securities that are higher credit quality but lower yielding, (3) purchasing higher yielding non-investment grade issuers that the manager believes have durable asset coverage, or (4) managing position and concentration size. We also continue to add value for shareholders by adding fixed-to-floating-rate exposure when conversion dates are in the near future and the floating rate adjustment is expected to be higher than the fixed rate.

We continue to believe there are attractive opportunities in fixed to floating preferreds, even as rate increases moderate, due to the fact that they will still reset at higher yields than their current fixed rates. Investors in preferred stocks with a floating-rate coupon are generally positioned to benefit from an increase in interest rates, credit spreads (i.e., risk premiums), or both. However, because preferred stocks are typically callable and perpetual, redemption timing is uncertain. Accordingly, active managers in the preferred stock space will monitor for this timing to act opportunistically to add value.

HOW THE FUND PERFORMED

For the quarter, the Fund returned 8.93% on NAV, while the Fund's benchmark, the S&P U.S. Preferred Stock Index (Benchmark Index), returned 5.99%.

The Fund paid a monthly dividend of \$0.165 per share for each month of the quarter, while NAV at quarter-end was \$20.42 and the Fund had a 30-day SEC yield¹ of 10.09%. This annualized figure reflects the distributions and dividends received during the period, after the deduction of Fund expenses.

The Fund's overweight exposure to: (1) select REIT sub-sectors, (2) fixed-to-floating or floating preferreds, and (3) higher yielding preferred stocks contributed to the Fund's outperformance during the quarter. We are still seeing many opportunities across the preferred stock market in 2024 (e.g., in fixed rates, floating rates, investment grade securities, and non-investment grade securities) and continue to select sectors and securities accordingly. The Fund maintained large overweight positions in the real estate and industrial sectors relative to the Benchmark Index. Our view is that the yield and credit profiles of these sectors are more attractive to hold through this market cycle than the financial sector (which was illustrated during the recent banking crisis in 2023). At the end of the quarter, the real estate allocation was 27.2%, compared to 7.1% for the Benchmark Index, and the allocation to the industrial sector was 9.9% versus 1.5% for the Benchmark Index. The Fund's underweight to the financial sector is substantial, with a weighting of 14.6% compared to 43.4% for the Benchmark Index. We believe the real estate and industrial sectors have better risk adjusted total return opportunities. The Fund ended the quarter with a leverage of 24.25% of net asset value, below the trailing twelve-month average of 25.86%. The Fund has a 50.7% weighting in fixed-to-floating-rate preferred shares.

The Fund expects to pay a monthly dividend of \$0.165 per share. The Fund's strategy of maximizing yield-to-call generated substantial optimization profits during the quarter. The use of leverage also contributed to the amount of income available for distribution.

TOP CONTRIBUTORS

- ▶ **Global Net Lease** is a real estate investment trust focused on commercial real estate with operations throughout the United States and worldwide.
- ▶ **AES Corporation** is involved in the acquisition, development, ownership, and operations of energy power plants globally.
- ▶ **Textainer Group Holdings** is one of the world's leading lessors and managers of shipping containers.
- ▶ **FTAI Aviation** provides a complete suite of aviation products that include aircraft leasing, engine leasing, and engine repairs, as well as CFM56 engines, modules, and materials.
- ▶ **RPT Realty** owns and operates a national portfolio of open-air shopping destinations principally located in top U.S. markets.

BOTTOM CONTRIBUTORS

- ▶ **Babcock and Wilcox** provides power generation equipment.
- ▶ **Healthcare Trust Inc.** focuses on acquiring a diversified portfolio of healthcare real estate, with an emphasis on senior housing and medical office buildings.
- ▶ **Energy Transfer** owns and operates a portfolio of energy assets.
- ▶ **B. Riley Financial** offers diversified financial services.

PORTFOLIO DISCUSSION

During the quarter, we maintained our overweight positions in real estate preferreds due to favorable fundamentals taking place in the industry. Mortgage rates are beginning to come down and increased transaction activity has allowed for favorable price discovery.

OUTLOOK

We are forecasting that 2024 will be "The Year of Global Rate Cuts." These rate cuts and associated increases in the global monetary base are likely to support equity and bond markets and push the 10-Year Treasury rates into the 3-3.5% range. We believe that interest sensitive sectors will outperform in 2024 as these rate cuts occur.

Preferred stocks are still trading at a large discount to par value, -14.6% vs. an average discount of only 0.5%. Preferred stocks are supported by the fact that almost all of the \$25 par listed preferred securities are issued by larger capitalization public companies that are committed to maintaining strong credit metrics. This commitment is evidenced by the low 30-year default rate of 0.3% per year vs. over 3% for high-yield bonds and 0.1% for investment-grade bonds.² We believe that the strong fundamentals of preferred stock issuers combined with declining long-term interest rates are likely to result in preferred stocks returning to only a modest discount to par as they have in the past.

Investing in preferred stocks through active managers is an attractive opportunity at this time, given that (1) interest rate sensitivities are of increasing importance, (2) credit-driven considerations remain, (3) market dislocations are emerging, and (4) preferred stocks trading towards par can be sold at gains and substituted for similar yielding securities at discounted prices.

¹30-day SEC yield is a standardized yield calculated according to a formula set by the SEC and is subject to change.

²30-year default rates from 1990 to 2019 are sourced from Moody's Investor Services.

PORTFOLIO MANAGEMENT

Infrastructure Capital Advisors, LLC (ICA)

INVESTMENT PROFESSIONALS



Jay D. Hatfield
Chief Investment Officer
Industry start date: 2000
Start date as Fund Portfolio Manager: 2018



Edward Ryan
Chief Investment Officer
Industry start date: 1980
Start date as Fund Portfolio Manager: 2018

TOP TEN HOLDINGS

	% Fund
SCE Trust III	5.33
NuStar Energy LP	3.40
Global Net Lease Inc.	3.24
RLJ Lodging Trust cv pfd 1.95%	2.98
NuStar Energy LP	2.93
Ftai Aviation Ltd.	2.85
DigitalBridge Group Inc.	2.68
New York Mortgage Trust Inc.	2.62
AES Corp Equity Unit Cons of 1 PC 15.02.24 + 1/10 10% CCRPP Sh A	2.35
SLM Corp.	2.15

Holdings are subject to change. To view the full list of holdings, please visit virtus.com.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 12/31/23

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (05/15/18)
NAV	8.93	24.82	24.82	6.99	8.29	n/a	5.88
Market Price	9.81	26.21	26.21	7.42	8.47	n/a	6.08
Index	5.99	12.02	12.02	-1.06	4.23	n/a	3.16

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

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

The fund class gross expense ratio is 1.40%.

The Total Expense Ratio represents the Fund's Total Annual Fund Operating Expenses, which includes the management fee and other expenses where applicable, except for certain payments that are paid directly by the Fund, as described in the Prospectus.

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 **S&P U.S. Preferred Stock Index** measures performance of the U.S. preferred stock market. Preferred stocks pay dividends at a specified rate and receive preference over common stocks in terms of dividend payments and liquidation of assets. The index is calculated on a total return basis with dividend 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.

IOPV, or Indicative Optimized Portfolio Value, is a calculation disseminated by the stock exchange that approximates the Fund's NAV every fifteen seconds throughout the trading day.

TOP FIVE CONTRIBUTORS

	% Contribution
GNL 7-1/2 PERP	0.61
AES 6-7/8	0.44
TGH 6-1/4 PERP	0.34
FTAI 8 PERP	0.33
RPT 7-1/4 PERP	0.33

BOTTOM FIVE CONTRIBUTORS

	% Contribution
BW 7-3/4 PERP	-1.31
BW 8-1/8	-0.20
HEATRU 7-1/8 PERP	-0.11
ET 9-1/4 PERP	-0.09
RILY 6	-0.06

% Contribution: Absolute weighted contribution.

To obtain the top/bottom holdings calculation methodology, call 800-243-4361.

Notes on Risk: 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 to the fund of owning shares of an ETF may exceed the cost of investing directly in the underlying securities. **Preferred Stocks:** Preferred stocks may decline in price, fail to pay dividends, or be illiquid.

Leverage: When a portfolio is leveraged, the value of its securities may be more volatile and all other risks may be compounded. **Options:** Selling call options may limit the opportunity to profit from the increase in price of the underlying asset. Selling put options risks loss if the option is exercised while the price of the underlying asset is rising. Buying options risks loss of the premium paid for those options. **Non-Diversified:** The portfolio is not diversified and may be more susceptible to factors negatively impacting its holdings to the extent the fund invests more of its assets in the securities of fewer issuers than would a diversified portfolio. **Market Price/NAV:** At the time of purchase and/or sale, an investor's shares may have a market price that is above or below the fund's NAV, which may increase the investor's risk of loss. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **Prospectus:** For additional information on risks, please see the fund's prospectus.

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.

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