Virtus Newfleet Multi-Sector Bond ETF

NYSE ARCA | NAV Symbol NFLT.NV | IOPV Symbol NFLT.IV | CUSIP 26923G707

MARKET OVERVIEW

The second quarter of 2020 witnessed an unprecedented global monetary and fiscal policy response to combat the most severe economic disruption since the Global Financial Crisis of 2008-2009 due to the COVID-19 pandemic. Policymakers responded forcefully with a series of maneuvers to restore function to financial markets and shield citizens from serious hardship as a result of the abrupt stop in economic activity. Programs were designed to support the newly unemployed, businesses of all sizes, states and municipalities, and several areas of the securitization markets. The ultimate human and economic toll is not yet known. However, our expectation remains that policymakers will fine-tune their response as warranted.

Stay-at-home orders and mandated business closings proved unambiguously damaging for local, regional, and global economic growth during the quarter; near-term corporate earnings results are likely to be negative. We are optimistic, however, that the trough in economic activity and corporate earnings will occur in the second quarter with a rebound in the second half of the year and into 2021. Progress has been made in restarting parts of the economy around the country and activity is rebounding, though a second disruptive shutdown remains a concern. Financial markets have reacted positively to the monetary and fiscal policy response, rebound in economic activity, and attractive valuations by moving aggressively higher during the period. We believe elevated cash levels and a high degree of personal savings will be a tailwind to growth in the coming quarters as everyone adjusts to a near-term new normal.

Spread sectors outperformed U.S. Treasuries during the quarter led by higher beta sectors such as corporate high yield, high yield bank loans, and emerging market (EM) debt. Within most sectors (with the exception of high yield), lower quality and longer duration outperformed. Corporate credit outperformed securitized sectors such as commercial mortgage-backed securities (CMBS), non-agency residential mortgage-backed securities (RMBS), and asset-backed securities (ABS).

We continue to see value in spread sectors. While there is no doubt that COVID-19 will prove disruptive to economies in the near term, we are confident that the crisis will be resolved with time. Our multi-sector approach to fixed income investing enables us to scan the bond market for the most attractive investment opportunities wherever they may be and is ideally suited for the current environment.

For more detail on the macroeconomic backdrop and specific sectors, see Newfleet's 2Q20 Market Review & Outlook.

HOW THE FUND PERFORMED

The Fund returned 9.54% in the second quarter versus the Bloomberg Barclays U.S. Aggregate Bond Index return of 2.90%.

Positive Contributors

- Underweight U.S. Treasury and agency mortgage-backed securities and overweight spread sectors.
- Allocation to, and issue selection within, non-agency RMBS. Securitized sectors, like most credit sectors, experienced a strong recovery. Stimulus programs have kept consumers in better shape than initially feared as furloughed employees return to work. For many, stay-at-home orders have dramatically increased the intrinsic value of residential real estate. In addition, subscription levels have far exceeded pre-COVID-19 levels as investors have cash that needs to get to work.
- Allocations to the corporate high yield, bank loan, investment grade corporate, and Yankee high quality sectors. Issue selection within the investment grade corporate sector was a key driver of the sector's strong performance. The recovery in these sectors extended through the quarter as easing restrictions and additional policy support reinforced expectations that global activity has bottomed and will recover. The high yield asset class, in particular, saw robust inflows. In the investment grade space, fund flows returned to positive territory, foreign demand picked up, and the Fed's intervention has introduced a large buyer to the market.

Detractors

- Although underweight the benchmark, the Fund's allocation to U.S. Treasuries underperformed spread sectors.

CURRENT FUND STRATEGY

Sector Changes: We reduced exposure to cash, U.S. Treasuries, and non-agency RMBS. We increased exposure primarily to corporate high yield and corporate high quality securities.

Non-U.S. Exposure: We increased the overall non-U.S. and EM debt exposure. Given the global spread of COVID-19 and downward revisions to global growth, we have shifted our EM bias from buy to hold as we continue to evaluate an optimal country mix and trade up in liquidity. We are using this volatile and uncertain time in the markets to look for names we believe are undervalued yet can sustain the current macro backdrop. We continue to favor sovereigns in larger capital structures and emphasize high grade over high yield (though the high yield component has increased over the quarter where returns had lagged) and hard currency over local market exposure.

Corporate High Quality: Spreads within the sector retraced 80% of their first quarter widening. With the Fed serving as a backstop and incremental buyer of securities, the market completely opened up with second quarter issuance the highest on record with gross supply of $834 billion. The rating agencies, which have downgraded over $100 billion of securities to the high yield market, have paused their downgrade activity and appear to be giving issuers the time required to adjust to the new environment. We believe the Fed stepping in to eliminate a disorderly downgrade cycle fundamentally changes the equation for the high quality sector and we feel comfortable adding to risk positions in this sector. While we continue to favor BBB issuers, we are finding ratings to be less relevant amid the turmoil. Opportunities are materializing across the board and we are targeting names with strong liquidity, resilient earnings, and high free cash flows. While we are generally industry agnostic in this environment, the utility exposure in the portfolio was increased over the quarter.

Corporate High Yield: The market had a particularly strong quarter as a result of fiscal and monetary policy stimulus plus attractive valuations. While dispersion in valuations has been reduced, the market still remains bifurcated between names exposed to COVID and those that are not. We were very active in the new issue market given attractive new issue concessions and valuations, adding names both in industries that are exposed to COVID and those that are not. For COVID-exposed names, we generally targeted names with significant liquidity and/or had security attached to the bonds. We also increased exposure to energy, although generally in lower-risk parts of the industry such as midstream and refining rather than highly leveraged oil and gas producers. The Fund remains underweight energy exposure relative to the corporate high yield index.

Securitized Product: The recovery in the securitized sectors was driven by the swift and large actions of the Fed coupled with fiscal stimulus plans directly aimed to benefit consumers. However, not all components of the securitized space had a direct benefit. This allowed us to use the volatility to take advantage of dislocations due to the lack of a direct response from the Fed. This included sub-prime auto ABS and all non-agency RMBS. Valuations were attractive throughout most of the quarter as prices lagged the quick turnaround of investment grade corporate bonds. Many of the securities we own are first or second pay, meaning we receive all cash on a prioritized basis versus other classes in the deals. The securitized product component of the portfolio continues to offer a significant yield pickup to comparable U.S. Treasury securities. The portfolio is diversified by asset type, obligor, and geographic region. It is of higher quality and short term in nature.

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OUTLOOK

As always, we believe it is important to stay diversified, have granular positions, and emphasize liquid investments. The coronavirus, like other events that trigger volatility in the market, can affect valuations and create opportunities that we can take advantage of in the course of implementing our multi-sector relative value approach. We highlight the importance of credit selection and positioning in the current environment. Given the widening in spreads late in the first quarter of 2020, valuations had cheapened substantially and we continue to identify opportunities in spread sectors, including those within non-investment grade sectors that we have added to and may continue to add to in the portfolios. Even with the recovery since the end of March, valuations look attractive in many spread sectors that we believe offer some of the best total return and yield opportunities in fixed income. Some of the specific sectors where we are finding the best relative value opportunities are corporate high yield, investment grade corporates, EM debt, out-of-index/off-the-run ABS, and non-agency RMBS.

PORTFOLIO MANAGEMENT

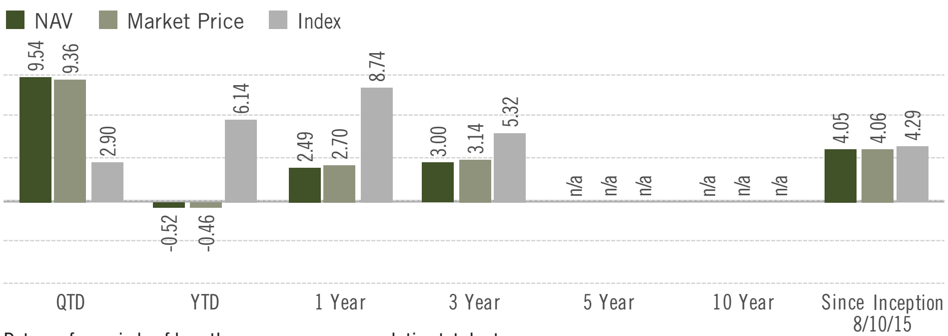
Newfleet Asset Management

INVESTMENT PROFESSIONALS

David L. Albrycht, CFA
President and Chief Investment Officer Industry start date: 1985
Start date as Fund Portfolio Manager: 2015

Benjamin Caron, CFA
Managing Director and Portfolio Manager Industry start date: 1997
Start date as Fund Portfolio Manager: 2019

AVERAGE ANNUAL TOTAL RETURNS (%) as of 6/30/20



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

TOP TEN HOLDINGS

TOP TEN HOLDINGS	% Fund
United States Treasury Note/Bond, 1.7500% 06/15/2022	3.90
Arbys Funding 2015-1A LLC, 4.9690% 10/30/2045	1.62
Pertamina Persero PT, 6.4500% 05/30/2044	1.60
KazMunayGas National Co JSC, 4.7500% 04/19/2027	1.59
BHP Billiton Finance USA Ltd, 6.7500% 10/19/2075	1.35
United States Treasury Note/Bond, 2.2500% 03/31/2021	1.26
Sequoia Mortgage Trust 2013-8, 3.5182%	1.14
Russian Foreign Bond - Eurobond, 4.3750% 03/21/2029	1.11
Tencent Holdings Ltd, 3.9750% 04/11/2029	1.10
Israel Government International Bond, 2.7500% 07/03/2030	1.08

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

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 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's investment adviser has entered into an expense limitation agreement to limit the Fund's total operating expenses (excluding certain expenses as described in the prospectus) so that such expenses do not exceed 0.49% of the Fund's average daily net assets through February 28, 2021.

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 **Bloomberg Barclays U.S. Aggregate Bond Index** measures the U.S. investment grade fixed rate bond market.The index is calculated using a float-adjusted, capitalization-weighted methodology on a total-return basis. 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.

The Fund's distribution rate includes a return of capital. Please refer to periodic Section 19a-1 shareholder notices for estimated amounts and sources of distributions, and please see the Fund's annual report for other financial details, including the Fund's distribution coverage ratio, for the most recent fiscal year.

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.

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. **Credit & Interest:** Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. Bank Loans: Loans may be unsecured or not fully collateralized, may be subject to restrictions on resale and/or trade infrequently on the secondary market. Loans can carry significant credit and call risk, can be difficult to value, and have longer settlement times than other investments, which can make loans relatively illiquid at times. **ABS/MBS:** Changes in interest rates can cause both extension and prepayment risks for asset- and mortgage-backed securities. These securities are also subject to risks associated with the repayment of underlying collateral. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. 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:** Local, regional or global events such as war, acts of terrorism, the spread of infectious illness or other public health issue, recessions, or other events could have a significant impact on the fund and its investments, including hampering the ability of the fund's portfolio manager(s) to invest the fund's 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.

Please consider a Fund's investment objectives, risks, charges, and expenses carefully before investing. For this and other information about any Virtus Fund, contact your financial professional, call 800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

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