VIRTUS ETFs

# Virtus Reaves Utilities ETF

**NYSE ARCA | NAV Symbol UTES.NV** | IOPV Symbol UTES.IV | CUSIP 26923G806

## MARKET REVIEW

Utilities stocks advanced in the first quarter despite a rise in interest rates, as investor exuberance surrounding artificial intelligence (AI) shifted to the role utilities will play in providing the huge amounts of electricity and transmission infrastructure needed to power AI expansion.

## PERFORMANCE REVIEW

The Fund advanced 9.21% in the quarter, continuing the rally that started in the fourth quarter of last year, and outperforming the S&P 500® Utilities Index (Utilities Index) by 4.64%. Over the last 12 months, the Fund returned 8.74% versus 0.42% for the Utilities Index.

The Fund paid a first-quarter distribution of $0.26. Net asset value (NAV) per share at quarter-end was $48.51 and the Fund's 30-Day SEC yield[1] was 2.5%.

### Top Contributors to Performance

- **Vistra (VST) and Public Service Enterprise Group (PEG)** both had an exceptionally strong first quarter. Evidence continues to build that nuclear generation is a scarce asset with significantly greater value than other types of dispatchable generation, owing to its zero emissions and fuel reliability characteristics. The Amazon-Talen transaction was the first opportunity for investors to see an actual price associated with that premium, providing a positive catalyst in the nuclear space. We expect more to come.

  VST also closed on its purchase of Energy Harbor, an owner of 3.8 gigawatts of nuclear capacity, which further helped performance.
- **Constellation Energy (CEG)** is one of the largest producers of carbon-free power in the U.S. and owner of over 50% of the country's competitive nuclear generating capacity. Nuclear power has become increasingly valued for its capability to provide reliable, around-the-clock energy without producing carbon emissions. In a February business update, CEG outlined a new long-term growth strategy, targeting minimum annual earnings growth of 10%, with the potential to reach 20% through innovative nuclear attribute monetization strategies. The update also provided transparent disclosures, highlighting a strong balance sheet and healthy free cash flow generation.

  The quarter also witnessed a continued surge in demand for AI-driven data centers. This growing demand translates into a significant need for reliable, clean power, a niche that nuclear energy is well positioned to fill. Notably, Amazon and Talen Energy made headlines with a groundbreaking first-of-its-kind nuclear power purchase agreement, indicating a nuclear power premium of at least 50% to market prices. As one of the largest owners of existing nuclear capacity, CEG is well positioned to capitalize on this scarcity value and secure similar lucrative agreements within its own portfolio.
- **NextEra Energy (NEE)** shares recovered following a weak fourth quarter last year. The Federal Election Commission dismissed allegations that NEE's utility subsidiary had violated any laws. Further, sentiment for its independent power producer benefited alongside improved market expectations for electricity demand.
- **NiSource (NI)** rallied after a weak fourth quarter. After closing the partial sale of its electric utility, the company has a strong balance sheet and limited equity needs over the next few years along with above-average earnings growth potential.

### Top Detractors from Performance

- **Xcel Energy (XEL):** During the quarter, XEL utility Southwestern Public Service was responsible for igniting a wildfire in North Texas. Notably, it became clear that the equipment had been flagged by the company as faulty, raising the risk of liability claims. We exited the position to sidestep further risk.
- **PG&E Corp. (PCG)** shares gave back some of their 2023 outperformance during the first quarter. Regulatory pushback against the company's plan to sell a joint venture interest in its Pacific Generation unit was a headwind. Failure to win commission approval, investors feared, might require the issuance of additional common shares to fund its operations, which would be a more expensive means of raising capital. We remain enthusiastic about the shares and comfortable that the company will continue to raise equity on terms that are favorable to shareholders.
- **Sempra (SRE)** had a quiet first quarter. The company announced solid results early in the reporting season and raised capital expenditures, as many had expected. Given the pace of developments elsewhere in the industry in the weeks that followed, Sempra shares were simply overlooked by investors, in our opinion. We remain constructive about the company's prospects for growth.
- **Dominion (D)** disappointed the market with its analyst day. The company pledged to maintain its dividend despite the high payout ratio, but with increasing capital investment needs and high interest rates, the burden is likely to fall on equity issuance to finance its plans.
- **PNM Resources (PNM)** faced two challenges in the quarter. On the first business day of the year the company terminated its merger agreement with Avangrid, having failed to secure regulatory approval for the transaction. Later in the month, The New Mexico Public Regulation Commission issued a disappointing final order in the company's general rate case. Our original investment thesis in the stock allowed for a high probability that the Avangrid deal would collapse, and we believe that there has been sufficient improvement at the commission to remain enthusiastic about the position. We added to the portfolio holdings during the downturn.

## OUTLOOK

The total amount of data center usage is expected to rise by two and a half times globally by 2030, creating huge power and infrastructure needs. According to McKinsey, increased usage of data centers is likely to lead to an incremental 250 terawatts of power demand in the United States by 2030, a compound annual growth rate of 15%. For perspective, this is equivalent to the amount of electricity currently used by one-third of the homes in the United States.

The amount of new power generation needed to support the build-out of AI will be a significant growth driver for most utilities. At least 30 gigawatts of new generation are needed, though the ultimate amount may be significantly higher. The initial growth phase is focused on utilizing clean, 24/7 power, so we believe companies that own existing nuclear plants are at a significant advantage. Renewable energy with battery storage will also be in demand, as will, eventually, natural gas with carbon capture and advanced new nuclear.

Besides new generation, utilities will need to make investments in transmission and distribution equipment to support the increase in electric demand. Southern Company, for example, expects electric sales growth to average 6% from 2025 through 2028 after being close to flat for the last couple decades. Growth like this has not happened since air conditioning first became popular. All told, we expect rate base growth for most utilities to accelerate in the second half of the 2020s.

Until now, AI has had a positive influence on our data center and power generation investments. The potential increase in growth for the average utility has mostly been ignored, probably because of the distraction from higher interest rates. As growth potential turns into reality, the benefit for the average utility may no longer go unnoticed.

[1] 30-day SEC yield is a standardized yield calculated according to a formula set by the SEC and is subject to change.

## PORTFOLIO MANAGEMENT

Reaves Asset Management

## INVESTMENT PROFESSIONALS

**John P. Bartlett, CFA**
President, Portfolio Manager, Research Analyst
Industry start date: 1993
Start date as Fund Portfolio Manager: 2015

**Joseph 'Jay' Rhame, III, CFA**
Chief Executive Officer, Portfolio Manager, Research Analyst
Industry start date: 2005
Start date as Fund Portfolio Manager: 2015

## AVERAGE ANNUAL TOTAL RETURNS (%) as of 3/31/24

| | QTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception (09/23/15) |
|---|---|---|---|---|---|---|---|
| NAV | 9.21 | 9.21 | 8.74 | 7.85 | 7.72 | n/a | 10.73 |
| Market Price | 9.24 | 9.24 | 8.76 | 7.84 | 7.71 | n/a | 10.73 |
| Index | 4.57 | 4.57 | 0.42 | 4.14 | 5.87 | n/a | 9.02 |

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 total expense ratio is 0.49%.

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.

## TOP TEN HOLDINGS

| | % Fund |
|---|---|
| NextEra Energy Inc. | 14.29 |
| Vistra Corp. | 9.14 |
| Constellation Energy Corp. | 7.91 |
| Public Service Enterprise Group Inc. | 7.17 |
| PG&E Corp. | 6.67 |
| Sempra | 5.73 |
| Edison International | 4.74 |
| Atmos Energy Corp. | 4.65 |
| DTE Energy Co. | 4.65 |
| NiSource Inc. | 4.53 |

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

## TOP FIVE CONTRIBUTORS

| | % Contribution |
|---|---|
| Vistra Corp. | 4.46 |
| Constellation Energy Corp. | 3.20 |
| NextEra Energy Inc. | 1.40 |
| Public Service Enterprise Group Inc. | 0.79 |
| NiSource Inc. | 0.25 |

## BOTTOM FIVE CONTRIBUTORS

| | % Contribution |
|---|---|
| Xcel Energy Inc. | -1.06 |
| PG&E Corp. | -0.40 |
| Sempra | -0.20 |
| PNM Resources Inc. | -0.20 |
| Dominion Energy | -0.04 |

% Contribution: Absolute weighted contribution.

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

Benchmark: The **S&P 500® Utilities Index** is a free-float market capitalization-weighted index comprised of companies included in the S&P 500® utilities sector. The index is calculated on a total return basis with 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.

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.

**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. **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, medium, or large-sized companies may enhance that risk. **Utilities Sector Concentration:** The portfolio's investments are concentrated in the utilities sector and may present more risks than if the portfolio were broadly diversified. **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.

**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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