VIRTUS ETFs

Virtus Newfleet ABS/MBS ETF

NYSE ARCA | **NAV Symbol VABS.NV** | IOPV Symbol VABS.IV | CUSIP 92790A603

MARKET OVERVIEW

The theme of higher interest rates and a flight to quality continued to play out during the second quarter. Interest rates backed up materially while investors moved more of their investable dollars to safer parts of the credit curve. Spreads widened across all rating categories but were more pronounced on the lower-rated and higher-leveraged parts of the capital structure. In general, longer-duration, credit-sensitive product underperformed higher-quality, shorter-duration product. The securitized components of the Bloomberg U.S. Aggregate Bond Index returned -0.91% for asset-backed securities (ABS), -2.85% for commercial mortgage-backed securities (CMBS), and -4.01% for mortgage-backed securities (MBS).

The fundamental picture for the U.S. consumer for the second quarter was a bit of a mixed bag. The low unemployment rate, wage gains, a strong excess savings profile, and 11 million job openings were all positives. However, inflation continues to chip away at purchasing power short term. Consumer and mortgage delinquencies continue to stay low from historical standards. The key to sustained strong consumer performance is employment—it remains to be seen if the U.S. can enter a recession with the unemployment rate so low. If unemployment ticks higher, robust deal structures will protect investors from credit losses.

With respect to the commercial mortgage market, fundamental performance is still solid, as evidenced by the benign delinquency profile for all the major asset types. Rent growth has been strong for industrial and multifamily properties, while the increase in domestic travel has helped hotel properties rebound to pre-pandemic levels. However, the outlook for the office sector is still uncertain as the work-from-home phenomenon persists. While office properties demonstrate stability due to long-term leases already in place, the verdict is still out on their medium-term performance as underlying tenant leases begin to roll, especially in high-cost markets. Looking ahead, higher interest rates will negatively affect commercial real estate valuations as cap rates reset higher.

According to the Real Capital Analytics (RCA) National Property Index, which measures appreciation or depreciation based on repeat sales, the commercial real estate market has appreciated 18.60% on a year-over-year basis through May 2022, led by strong performance in multifamily and industrials. Suburban office properties have lagged as RCA reports asset appreciation up 10.5% on a year-over-year basis.

Meanwhile, the housing market is still hot, with the latest report showing 21% year-over-year gain for April 2022. We will be watching closely to see how the residential market performs during the next few quarters as mortgage rates reset sharply higher and affordability issues arise.

On the technical side, ABS and CMBS continue to outpace last year's supply by approximately 15% and 35%, respectively. However, recent spread volatility is leading to lower CMBS supply forecasts for the second half of the year. The residential mortgage-backed securities (RMBS) new issue market ran heavy during the second quarter, and we expect 2022 RMBS supply totals to be higher than 2021 on a net basis.

The new issue market for securitized product has not slowed down, but the duration to bring a new deal to market has lengthened as investors demand more of a spread premium for taking on credit risk with a possible recession looming. Investors are thus now able to put money to work at wider spreads and higher yields.

SECTOR PERFORMANCE

The Fund has significant exposure to ABS, which benefited from demand for shorter duration assets and fundamentals supporting the U.S. consumer, including low unemployment, strong consumer excess savings, and real wage growth—all signs that the consumer will stay timely with its debt service payments. However, consumer sentiment hit an all-time low as consumers came under stress around higher energy, food, rent, and housing costs.

The Fund's other large exposure is non-agency RMBS. Mortgage credit has performed well, with delinquencies at historical lows. Both record homeowner equity and limited exposure to riskier affordability products compared to the market in the last housing crisis figure into our expectation for strong credit performance within this sector. With mortgage rates much higher, we expect a significant drop in activity, leading to less supply for the back half of the year. This technical should allow credit spreads to respond favorably as we end the year. As a result, we have an overweight to the sector.

FUND PERFORMANCE

The Fund returned -1.41% at NAV for the quarter, compared with -1.04% for the ICE BofA 1-3 Year A-BBB US Corporate Index. Since its inception in February 2021, the Fund has returned -2.51% at NAV.

CONTRIBUTORS

- Enhanced Equipment Trust Certificates backed by aircraft assets outperformed as the demand for air travel continued to accelerate.
- Single-asset, single-borrower CMBS floating rate asset backed by commercial real estate that benefited from rates resetting higher during the quarter.

DETRACTORS

- Non-qualified mortgage positions with lower-weighted average mortgage rates experienced widening credit spreads and longer durations due to higher rates and slower prepayment speeds.
- Whole business longer duration deals backed by franchise concepts saw credit spread widening during the quarter.
- High-quality student loan assets underperformed due to their longer duration as U.S. Treasury rates moved higher.

OUTLOOK

Given the partial retracement of spread widening in the investment grade and high yield markets, we feel there are opportunities available within securitized products. Our efforts are focused on the new issue markets, which continue to experience demand across all securitized sectors. We have focused new dollar investments on the more conservative parts of the capital structure and aim to be selective when taking on credit risk. We continue to monitor and adjust the portfolio based on ever-changing economic news. More importantly, we are positioned to take advantage of any future credit dislocations.

PORTFOLIO MANAGEMENT

Newfleet Asset Management

INVESTMENT PROFESSIONALS

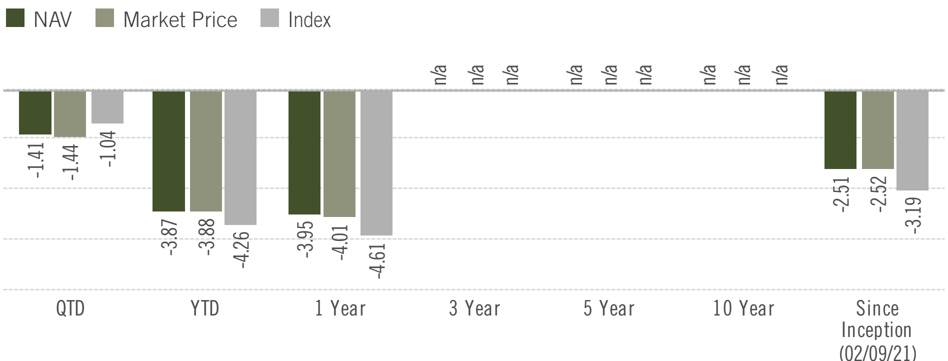
David L. Albrycht, CFA
President and Chief Investment Officer
Industry start date: 1985
Start date as Fund Portfolio Manager: 2021

Nicodemus Rinaldi
Portfolio Manager – Asset-Backed Securities & Commercial Mortgage-Backed Securities
Industry start date: 1992
Start date as Fund Portfolio Manager: 2021

Andrew Szabo, CFA
Portfolio Manager – Agency & Residential Mortgage-Backed Securities
Industry start date: 1986
Start date as Fund Portfolio Manager: 2021

Zachary Szyndlar, CFA
Portfolio Manager and Credit Analyst – Securitized Products
Industry start date: 2013
Start date as Fund Portfolio Manager: 2021

AVERAGE ANNUAL TOTAL RETURNS (%) as of 06/30/22



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 0.49%. The net expense ratio is 0.39%, which reflects a contractual expense reimbursement in effect through 11/28/2022.

TOP TEN HOLDINGS

	% Fund
New Residential Mortgage Loan Trust 2018-4, 2.6736%	3.51
Tricolor Auto Securitization Trust 2022-1, 5.3800% 01/15/2026	2.99
ACC Auto Trust 2021-A, 3.7900% 04/15/2027	2.85
Navient Private Education Refi Loan Trust 2021-E, 0.9700% 12/16/2069	2.83
American Credit Acceptance Receivables Trust 2021-3, 0.9800% 11/15/2027	2.82
Angel Oak Mortgage Trust 2021-8, 1.8200%	2.80
BPR Trust 2021-KEN, 2.5740%	2.42
Avis Budget Rental Car Funding AESOP LLC, 2.0200% 02/20/2027	2.25
Upstart Securitization Trust 2022-2, 4.3700% 05/20/2032	2.00
GLS Auto Receivables Issuer Trust 2019-4, 3.0600% 08/15/2025	1.97

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

SECTOR ALLOCATIONS

	% Fund
Asset-Backed Securities	55.53
Non-Agency Residential MBS	33.51
Non-Agency Commercial MBS	7.99
Corporate - High Quality	1.74
Corporate - High Yield	0.84
Cash	0.40

Industry weights are subject to change.

The management fee is structured as a 'unified fee', out of which the Fund's adviser pays all of the ordinary operating expenses of the Fund, except for the following expenses, each of which is paid by the Fund: the Fund's management fee; payments under any 12b-1 plan; and other fees as described in the prospectus. The Adviser has agreed to waive a portion of the management fee equal to 0.10% through at least November 28, 2022, which will have the effect of reducing the Fund's total expenses to 0.39%, excluding certain expenses as discussed above.
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. 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. 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

Index: **The ICE BofA 1-3 Year A-BBB US Corporate Index** measures performance of U.S. corporate bond issues rated A through BBB, inclusive (based on an average of Moody's, S&P and Fitch), with a remaining term to final maturity less than 3 years. The index is calculated 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. 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. Newfleet Asset Management is a division of Virtus Fixed Income Advisers, LLC ("VFIA"), an SEC registered investment adviser.

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. **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 non-repayment of underlying collateral, including losses to the portfolio. **Credit & Interest:** Debt instruments are subject to various risks, including credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Variable Distribution Risk:** Periodic distributions by investments of variable or floating interest rates vary with fluctuations in market interest rates. **Derivatives:** Derivatives may include, among other things, futures, options, forwards and swap agreements and may be used in order to hedge portfolio risks, create leverage, or attempt to increase returns. Investments in derivatives may result in increased volatility and the fund may incur a loss greater than its principal investment. **Sector Focused Investing:** Events negatively affecting a particular market sector in which the portfolio focuses its investments may cause the value of the portfolio to decrease. **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. Price changes may be short- or long-term. 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 portfolio's assets as intended. **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. **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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