Virtus Newfleet ABS/MBS ETF

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

MARKET OVERVIEW

As Treasury rates rallied significantly during the fourth quarter amid hopes for a soft landing, the demand for securitized product was very strong. As a result, investors embraced credit risk in the consumer and housing sectors. Credit spreads for all securitized products tightened significantly versus U.S. Treasuries, generating positive excess spread versus risk-free assets. Even the much-maligned commercial real estate sector tightened in spreads as the prospect of lower rates bode well for future refinancings. As a result of the above, the total returns for the securitized sectors of the Bloomberg U.S. Aggregate Bond Index were an impressive 3.48% for asset-backed securities (ABS), 5.25% for commercial mortgage-backed securities (CMBS), and 7.48% for agency mortgage-backed securities (MBS) for the quarter.

SECTOR PERFORMANCE

The Fund has significant exposure to ABS, which returned 3.48% for the quarter. From a technical perspective, ABS supply was strong and steady throughout the quarter, ending the year by slightly eclipsing 2022 issuance levels.

U.S. consumer fundamentals remained positive during the quarter, with job openings still plentiful (1.34 openings per unemployed), a low unemployment rate (3.7%), and strong wage gains for the lower-income quintile. According to the Bank of America Institute, median household savings and checking balances by income level continue to exceed 2019 levels, indicating dry powder on the sidelines. While credit card spending has trended higher, credit card utilization rates remain below pre-pandemic levels. Delinquency levels, which had climbed higher than pre-pandemic levels for lower-income consumers, leveled off during the fourth quarter. Auto inventory levels are below production levels. Inventory levels remaining below production levels bode well for recovery values on defaulted loans.

The Fund's other large exposure is non-agency residential mortgage-backed securities (RMBS). The housing sector continues to perform—mortgage rates rallied back somewhat but remain 200 basis points higher than 20-year averages. Despite affordability headwinds from higher rates, mortgage credit fundamentals are still very solid. Within the residential housing market, national home price appreciation shows another 5% growth for 2023 despite the headwinds. Only 2% of mortgaged properties have negative equity. The monthly supply of existing homes is also still historically low, creating a floor for any potential price declines, while mortgage delinquency rates remain near all-time lows. The fourth quarter was positive from an agency MBS index price level, while non-agency RMBS continues to offer relative value versus the more technically driven agency MBS market. RMBS valuations continue to be bolstered by strong technicals (60% less supply YTD), while high levels of homeowner equity and stringent underwriting supports the asset class's credit performance.

FUND PERFORMANCE

The Fund returned 2.57% at NAV for the quarter versus the ICE BofA 1-3 Year A-BBB US Corporate Index returns of 3.06%.

CONTRIBUTORS

- Numerous whole business securitizations with longer durations coupled with the strong demand for credit helped performance.
- Overall good demand for the additional spread offered by ABS, CMBS, and RMBS versus their investment grade corporate bond peers.

DETRACTORS

- One subordinate subprime auto deal we exited that had traded down due to credit concerns.
- A few MBS securities that exhibited slower prepayments.

OUTLOOK

Credit spreads rallied significantly during the quarter, in some cases reaching levels that street analysts were predicting for the end of 2024. Securitized product spreads appear attractive versus their investment grade corporate peers with similar maturities. Though interest rates rallied significantly, yield opportunities still appear attractive, especially on the front end of the yield curve. In ABS, investors had an insatiable demand for credit risk as the most leveraged components of capital structures saw the most investor interest. Agency MBS has become less attractive versus investment grade corporate debt after the late 4Q rally. Non-agency RMBS still appears undervalued given its risk return profiles and the favorable technical setup. Within commercial real estate, spreads of the senior tranches of most CMBS deals tightened for the quarter, but the more credit-sensitive junior tranches remained flat. Looking ahead, given current credit spreads, we believe spreads can continue to rally during the first quarter of 2024 under current economic conditions.

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 12/31/23

	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (02/09/21)
NAV	2.57	7.68	7.68	n/a	n/a	n/a	0.86
Market Price	2.55	7.60	7.60	n/a	n/a	n/a	0.83
Index	3.06	5.70	5.70	n/a	n/a	n/a	0.42

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 11/28/2024.

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 Adviser has agreed to waive a portion of the management fee equal to 0.10% through at least November 28, 2024, which will have the effect of reducing the Fund's total expenses to 0.39%, excluding certain expenses as discussed above.

TOP TEN HOLDINGS

	% Fund
ACC Auto Trust 2021-A, 3.7900% 04/15/2027	3.45
Mercury Financial Credit Card Master Trust, 8.0400% 09/20/2027	3.37
JP Morgan Trust 2015-5, 6.7884%	3.11
Hotwire Funding LLC, 4.4590% 11/20/2051	2.92
Alaska Airlines 2020-1 Class A Pass Through Trust, 4.8000% 08/15/2027	2.91
NBC Funding LLC, 2.9890% 07/30/2051	2.83
Adams Outdoor Advertising LP, 6.9670% 07/15/2053	2.79
Avis Budget Rental Car Funding AESOP LLC, 3.0400% 09/22/2025	2.77
Auxilior Term Funding 2023-1 LLC, 7.2700% 12/16/2030	2.26
Affirm Asset Securitization Trust 2023-B, 6.8200% 09/15/2028	2.25

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

SECTOR ALLOCATION

	% Fund
Asset Backed Securities	53.19
Non-Agency Residential MBS	32.08
Non-Agency Commercial MBS	9.99
Corporate - High Quality	2.94
Cash	1.79

Industry weights are subject to change.

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. 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. **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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