The Case for Actively Managed Utilities

The Opportunity in Utilities

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Virtus Reaves Utilities ETF
NYSE Arca: UTES

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Key Points

- Utilities constitute a unique asset class with strong fundamentals: high barriers to entry, limited competition, and the historical ability to consistently grow earnings and dividends.
- The utilities sector is currently recovering from recent relative underperformance due to macro headwinds such as inflation and elevated interest rates. Relative forward price/equity ratios to the S&P 500® Index are compelling.
- Fundamentals are strong in the utilities sector. Increasing demand for electricity to expand artificial intelligence (AI) applications presents a timely opportunity for investors.
- The combination of discounted valuations and improving fundamentals for select stocks within the sector highlights the value of an experienced, active manager that has historically outperformed a passive index.

Why Utilities?

Utility companies are essential, monopoly-like businesses that provide non-discretionary services. The sector has traditionally exhibited defensive characteristics, such as high barriers to entry and limited competition.

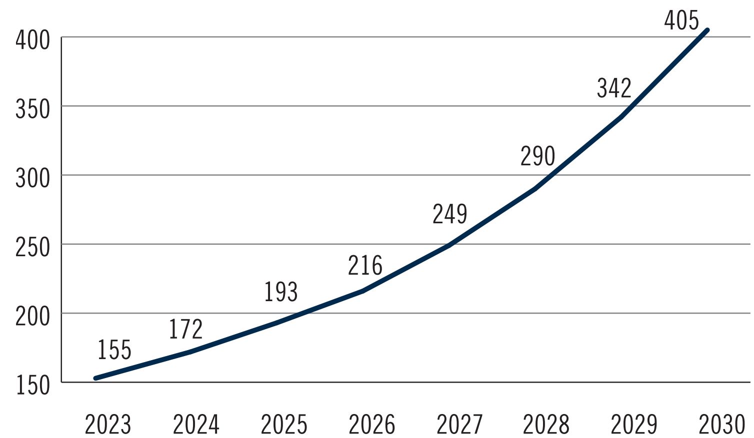
Utilities have historically demonstrated the ability to grow earnings and dividends on a consistent basis, with long-term performance comparable to the S&P 500 Index.

Today, the sector is poised to benefit from expected power demands stemming from the expansion of AI. Combined with compelling relative valuations, we believe there are opportunities in this often overlooked sector.

Electricity demand is growing. AI is the driver.

The adoption of artificial intelligence has rapidly expanded over the last year and a half for many corporations. According to McKinsey's recent Global Survey,[1] one-third of respondent organizations expect to use AI for at least one business function, while 40 percent of respondents expect their organizations to increase their investment in AI technologies.

U.S. DATA CENTER ENERGY CONSUMPTION, TWh



Source: McKinsey Energy Solutions Global Energy Perspective 2023; McKinsey data center demand model.

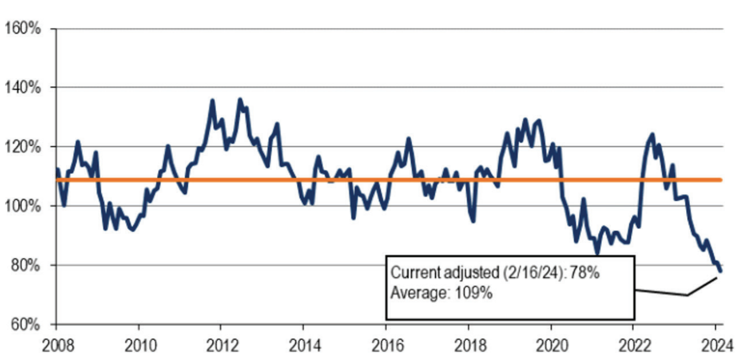
The expansion of AI is creating a dramatic increase in existing data center utilization, highlighting the potential need for more of these "processor hotels" in the years to come. The electricity required to power the chips housed within a growing number of data centers, as well as to physically cool the server stacks, will likely be significant.

Boston Consulting Group expects data center electricity consumption to triple by 2030 to ~309 terawatts, the equivalent of the electricity used by about 40 million U.S homes or a third of the total homes in the country. For most utility companies, electric demand has not grown in over a decade. The growth required to meet the needs of hyperscalers like Amazon and Microsoft is expected to be a fundamental tailwind for many companies within the sector.

Valuations are compelling

Recent poor relative performance has also created significant opportunities in the utilities sector. Macroeconomic headwinds, including higher interest rates and inflation, have impacted the sector's valuations.

UTILITIES SECTOR 2-YEAR FORWARD (CY25) PRICE/EARNINGS RELATIVE TO THE S&P 500® INDEX



Source: Wolfe Utilities & Power Research. FactSet 2/17/24.

Utility stocks trailed the S&P 500 in four of the last five years, posting their worst year of relative performance ever in 2023. Utilities valuations are compelling. The sector was recently at its lowest relative forward price/equity ratio to the S&P 500 in over a decade.

The sector also moved up quickly this year, despite rising interest rates. Utilities are now up more than the S&P 500. We believe this highlights the market beginning to value the strong underlying fundamentals of the sector, coupled with expectations of improving macroeconomic conditions.

[1] https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai-in-2023-generative-AIs-breakout-year

Active versus passive

Utilities constitute a unique asset class. We believe their characteristics, including high barriers to entry, limited competition, and the historical ability to consistently grow earnings and dividends are among the reasons why they remain unique. The sector is also the least correlated to the S&P 500 and boasts one of the higher yields in the index. However, not all utilities are alike. It takes years of experience to fully grasp the complexities impacting the utilities sector and their equity valuations. The team at Reaves Asset Management includes specialists with decades of experience in actively managing utilities portfolios.

Reaves' fundamental research of utility companies that operate in 51 different regulatory jurisdictions, all with differing business fundamentals, highlights the benefits of active management in the sector. This team's experience is expressed in the performance the Virtus Reaves Utilities ETF (NYSE Arca: UTES, "the Fund"). It is the only fully transparent actively managed ETF in the utilities space.

Reaves' active management in the utilities space has helped the Fund outperform its passive, market-cap-weighted S&P 500® Utilities Index year to date and over the last 1-, 3-, and 5-year time periods, as well as since inception.

ANNUALIZED TOTAL RETURNS (%) AS OF MARCH 31, 2024

	QTD	YTD	1 Year	3 Year	5 Year	Since Inception (09/23/15)
UTES NAV	9.21	9.21	8.74	7.85	7.72	10.73
UTES Market	9.24	9.24	8.76	7.84	7.71	10.73
S&P 500® Utilities Index	4.57	4.57	0.42	4.14	5.87	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 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.

Index: 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.

5-Star Morningstar Rating[2]

★★★★★

KEY FEATURES

Focus on Profitability

The Reaves team looks for companies that have demonstrated the ability to consistently grow their earnings and dividends, selecting high-quality growth investments within the sector.

Active Advantage

The Fund is actively managed by portfolio managers with decades of experience in the utilities space and research analysts with an average of 20+ years of industry experience.

Wider Universe

Reaves' mandate allows them to select investments from a universe more than twice the size of the passive benchmark, and to overweight their best ideas.

[2] As of 3/28/2024, the Fund was rated 5 stars out of 59 funds within the Utilities category overall and for the 3-year period; and 5 stars out of 58 funds within the Utilities category for the 5-year period. Morningstar ratings are based on risk-adjusted returns. Strong Ratings are not indicative of positive fund performance.

To learn more about Virtus ETFs, visit virtus.com or call 1-800-243-4361.

About Virtus Investment Partners, Inc.

Virtus Investment Partners (NYSE: VRTS) is a distinctive partnership of boutique investment managers singularly committed to the long-term success of individual and institutional investors. We provide investment management products and services from our affiliated managers, each with a distinct investment style and autonomous investment process, as well as select subadvisers. Investment solutions are available across multiple disciplines and product types to meet a wide array of investor needs. Additional information about our firm, investment partners, and strategies is available at virtus.com.

IMPORTANT RISK CONSIDERATIONS

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. **Private Credit Funds:** Private credit funds that invest in closed-end funds and business development companies bear the risks of these underlying assets, including liquidity, industry, currency, valuation, and credit risks. **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 or medium-sized companies may enhance that risk. **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. **Fund of Funds:** Because the fund can invest in other funds, it indirectly bears its proportionate share of the operating expenses and management fees of the underlying fund(s). **Passive Strategy/Index Risk:** A passive investment strategy seeking to track the performance of the underlying Index may result in the fund holding securities regardless of market conditions or their current or projected performance. This could cause the fund's returns to be lower than if the fund employed an active strategy. **Correlation to Index:** The performance of the fund and its index may vary somewhat due to factors such as fund flows, transaction costs, and timing differences associated with additions to and deletions from its index. **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. **Closed-End Funds:** Closed-end funds may trade at a discount or premium from their net asset values, which may affect whether an investor will realize gains or losses. They may also employ leverage, which may increase volatility. **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 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.

GLOSSARY

Two-Year Forward Price/Earnings: Per share stock price divided by the latest 24-months earnings per share.

MORNINGSTAR

Morningstar Rating™ for funds, or 'star rating,' is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Ratings do not take into account the effect of sales charges and loads. Past performance is no guarantee of future results.

Please consider the Fund's objectives, risks, charges, and expenses before investing. Contact us at 1.800.243.4361 or visit www.virtus.com for a prospectus, which contains this and other information about the Fund. Read the prospectus carefully before investing.

Not FDIC Insured	May Lose Value	Not Bank Guaranteed

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