INTEGRITY ASSET MANAGEMENT

Victory Integrity Mid-Cap Value Fund — As of March 31, 2024

Quarterly Commentary

And all that is now
And all that is gone
And all that's to come
And everything under the sun is in tune
But the sun is eclipsed by the moon

– Pink Floyd

We had to have an "eclipse" reference this month. It was either Pink Floyd or Bonnie Tyler ("Total Eclipse of the Heart"). Classic rock won out.

Anticipation of Federal Reserve interest rate policy seems to eclipse everything else in the market. The first quarter of 2024 witnessed a reversal of some of the rate-cut euphoria of Q4 2023. The Q4 2023 expectations for significant rate reductions weighed on Q4 portfolio performance. The portfolios benefitted in Q1 from some lessening of those expectations.

We are not sure when or by how much the Federal Reserve will cut interest rates. Furthermore, while not the most likely, we don't completely discount the possibility of zero cuts this year or further increases down the road. We were happy to hear Federal Reserve Chairman Powell state something we have been harping on for some time. Interest rates are not going back to pre-pandemic levels. The post-2008 interest rate environment was unique, not normal. Powell does not think it is likely that we would return to long-run rates that are in the 2% range. He also doesn't see long-term rates around the world returning to levels at or below zero.

Money-losing, long-duration equities have been a big beneficiary of ultra-low interest rates. We've written in the past about the high concentration of these companies in our value benchmarks and our significant underexposure to them. These stocks react favorably to rate reduction expectations. We continue to look for companies that meet our investment criteria and respond favorably to lower rates. We have found some investments, but not enough to completely offset our underexposure.

The upcoming Russell rebalance holds a sliver of good news. Some of the value indexes will likely see the weight of non-earners slightly decrease. Our lead risk analyst, Mike Wayton, projects that non-earners would decrease by approximately 1.6 percentage points in the Russell 2000® Value Index, by almost 1% in the Russell Midcap® Value Index benchmark, and remain roughly the same in the Russell 2500™ Value Index. The exposure will still be significant, but we will take any relief we can find.

Mike also estimates the rebalanced benchmarks will have slightly lower betas, smaller growth rates, and lower valuations. In short, they will be more value-like. The Russell rebalance is scheduled for Friday, June 28. The first official, preliminary index membership lists are expected to be released on Friday, May 24. We will have more certainty around these characteristics as well as sector weights at that time.

Here in Cleveland, we are within the path of totality of the April 8, 2024 eclipse. The last time this happened was 1806. The next occurrence will be 2444. That's about as rare as seeing near-zero to negative interest rates. We don't know if it will be 400 years before zero rates happen again, but we don't think it will be soon. As we have stated before, we believe "normal" rates could provide the catalyst to reverse the significant underperformance of small-caps vs. large-caps and value vs. growth. Time will tell. In the meantime, we will continue to apply our flexible value strategy, searching for undervalued stocks with a catalyst, keeping a close eye on the risk in our portfolios, and striving for consistent, long-term performance for our clients.

The best performing sector of the market was industrials. Communication services was the worst performing sector in the benchmark. Mid cap growth outperformed mid cap value.

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The Victory Integrity Mid-Cap Value Fund (A shares without sales charge) outperformed the Russell Midcap® Value Index for the quarter. Security selection in utilities, technology, health care, and industrials led to outperformance. Stock selection in consumer discretionary hurt performance. Sector weights were a minor positive as our underweight to real estate helped.

Vistra Corp. (VST) and Constellation Energy Corp. (CEG) were the top performers in utilities. Vistra Corp. (VST), up 81%, benefitted from higher power prices as supply continues to shrink amid strong demand growth from data centers. Constellation Energy Corp. (CEG) announced 2024 earnings guidance that was above analysts' estimates, driven by a tight power market due to shrinking baseload supply.

Juniper Networks, Inc. (JNPR) and MKS Instruments, Inc. (MKSI) were the top highlights in technology. Juniper Networks, Inc. (JNPR) announced they would be acquired for a premium by Hewlett Packard (HPE). Better-than-feared guidance as well as progress on de-leveraging the balance sheet boosted shares of MKS Instruments, Inc. (MKSI). Performance in software was a source of weakness as Teradata Corp. (TDC) lagged. Guidance underwhelmed at Teradata Corp. (TDC) as several account losses will erode quicker than expected, while an elongated sales cycle is limiting growth. We exited the position.

Tenet Healthcare Corp. (THC) and Encompass Heath Corp. (EHC) led the way within health care. Favorable trends as contract labor utilization continues to decline as well as improving revenue and cost expectations aided Tenet Healthcare Corp. (THC). The company also announced the sale of two hospitals at favorable terms. Quarterly results that came in ahead of estimates and favorable volume trends were a tailwind for Encompass Health Corp. (EHC).

Positive stock selection in industrials was paced by Saia, Inc. (SAIA), Carlisle Companies Inc. (CSL), and PACCAR Inc. (PCAR). Strong earnings that demonstrated better operating leverage and cost controls lifted shares of Saia, Inc. (SAIA). A strong fourth quarter earnings report and the bottoming of commercial roofing orders helped drive strong performance in Carlisle Companies Inc. (CSL). PACCAR Inc. (PCAR) provided upside guidance on sales as customer demand has been stronger than expected. Valmont Industries, Inc. (VMI) limited performance as the company provided a weaker-than-expected 2024 earnings guide on further downside to its agricultural irrigation business.

Victoria's Secret & Company (VSCO), Caesars Entertainment Inc. (CZR), and Visteon Corp. (VC) hampered performance within consumer discretionary. Victoria's Secret & Company (VSCO) issued disappointing guidance resulting from intimates category weakness. Caesars Entertainment Inc. (CZR) preannounced results that trailed expectations as their business was impacted by construction, lower player profitability, and finalized union labor negotiations. Visteon Corp. (VC) lagged as auto production was lower than expected and semiconductor availability continued to weigh on the supply chain. Marriott Vacations Worldwide Corp. (VAC) and Ralph Lauren Corporation Class A (RL) were bright spots. Marriott Vacations Worldwide Corp. (VAC) rebounded after delivering better-than-feared earnings and guidance. Ralph Lauren Corporation Class A (RL) delivered solid earnings as the brand continues to benefit from initiatives to keep inventory clean and elevate AURs (average unit retail).

Energy was a positive, as our average holding outperformed the benchmark (+20% versus +14%). Antero Resources Corp. (AR) was our top contributor. The company beat results on better commodity pricing and plans for lower capex.

Our underweight in real estate helped offset a couple of detractors. Apartment Income REIT Corp. (AIRC) and Realty Income Corp. (O) underperformed due to reduced expectations for near-term interest rate cuts.

Overall performance in materials was flat. Berry Global Group Inc. (BERY) and Chemours Co. (CC) underperformed. Concurrent with fourth quarter results, Berry Global Group Inc. (BERY) announced the spin-off of its healthcare business, which negatively surprised investors who expected a full sale. Chemours Co. (CC) announced a delay to its fourth quarter earnings call and material weaknesses to its internal controls. We exited the position ahead of the CEO and CFO being fired. Martin Marietta Materials, Inc. (MLM) aided performance. A solid fourth quarter report and the expectation of increased business as Inflation Reduction Act money is distributed lifted shares.

In financials, stock selection in capital markets hurt performance as we did not own Coinbase Global, Inc. Class A (COIN), up 52%, which cost us 18 basis points. Insurance aided performance as our average holding outperformed the index (+19% versus +15%), led by Hartford Financial Services Group, Inc. (HIG) and Reinsurance Group of America, Inc. (RGA), up 29% and 20%, respectively.

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Quarterly Commentary

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All investing involves risk, including the potential loss of principal. In addition to the normal risks associated with investing, investments in small- and mid-cap companies typically exhibit higher volatility. Investments concentrated in an industry or group of industries may face more risks and exhibit higher volatility than investments that are more broadly diversified over industries or sectors. The financial services industry is subject to extensive government regulation that affects the scope of their activities, the prices they can charge and capital maintenance. The industry is subject to severe competition and can be significantly affected by market conditions and activity. Investments in companies in the industrials sector may be adversely affected by changes in supply and demand for products and services, governmental regulation and changes spending policies, world events and economic conditions. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. The value of your investment is also subject to geopolitical risks such as wars, terrorism, environmental disasters, and public health crises; the risk of technology malfunctions or disruptions; and the responses to such events by governments and/or individual companies.

The Russell Midcap® Value Index is a market-capitalization-weighted index that measures the performance of Russell Midcap® Index companies with relatively lower price-to-book ratios and lower forecasted growth.

Fund holdings mentioned in the Quarterly Commentary are as of 3/31/24 and the percentages shown are based on net assets as of that date. Fund holdings are subject to change and should not be considered purchase recommendations. There is no assurance that the securities mentioned remain in the Fund's portfolio or that securities sold have not been repurchased. The Fund's top ten holdings as of 3/31/24 were: PACCAR Inc (1.5%), Ferguson Plc (1.5%), Parker-Hannifin Corp (1.4%), Phillips 66 (1.4%), Westinghouse Air Brake Technologies Corp (1.3%), Constellation Energy Corp (1.3%), Realty Income Corp (1.2%), ITT, Inc (1.2%), Celanese Corp (1.2%), and Corteva Inc (1.2%). Top holdings do not reflect cash, money market instruments, or options/futures contracts holdings. The most currently available data regarding portfolio holdings can be found on our website, www.vcm.com.

Contributors and Detractors Source: FactSet. The contributors and detractors mentioned are presented to illustrate examples of the Fund's investments and may not be representative of the Fund's current or future investments.

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