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As of June 30, 2023

Executive Summary

The quarter began with a regional banking crisis but, by its end, banks had faded from the headlines and the tumult subsided. Come June, the markets had returned their attention to predicting the next policy move by the Federal Reserve (the Fed), where inflation was going and, always in the background, if and when there might be an economic slowdown. Against this backdrop, the Victory High Income Strategy outperformed its benchmark, the Bloomberg US High Yield 2% Issuer Capped Bond Index, for the quarter ended June 30, 2023, on a gross basis. The Strategy underperformed on a net basis.

Market Update & Commentary

The first quarter closed with the U.S. in the throes of a banking panic that began in regional banks but leaked over to continental Europe in the form of a forced merger of Credit Suisse with UBS. As the second quarter closed, the banking crisis was forgotten and back to the forefront was how to interpret three common harbingers of difficult economic times: rising interest rates, high inflation, and a recession that—seemingly—has loomed on the horizon for some time.

Federal Reserve policy held center stage as the second quarter progressed. By the June meeting, the market was ready to welcome and indeed had come to expect that the Fed would finally pause its hiking campaign; this is what it got, as the Federal Open Market Committee kept rates at 5.15%. But the accompanying hawkish commentary disquieted many, and Chairman Powell's insistence over the ensuing weeks that the Committee was firm in its willingness to hike again if inflation should not abate persuaded many that the Fed may not be done tightening after all. The shift in expectations is evident in the market's pricing of the federal funds rate for January 31, 2024. At the end of the first quarter, the consensus was 4.17%, indicating widespread expectations of rate cuts in the latter months of 2023. By the end of Q2, the implied rate had jumped to 5.29%, revealing that the market believed the Fed could hike again. However grudgingly, the market has come to admit that rates will probably go higher in the near term, rather than lower, and that, because if they go higher, they will likely stay higher for longer. How much longer is anyone's guess, but the numbers to watch are those involving inflation. The Fed wants inflation back at or below 2% and, while headline inflation is well off its peak, core CPI remains stubbornly above 5%. As long as core CPI is elevated, the Fed is likely to keep monetary policy restrictive, and this could be for a while.

Markets whipsawed—sometimes violently—from April to June, but little of this turmoil leaked into the corporate bond market. Corporate credit spreads tightened during the quarter across all rating categories. Still, performance across the major fixed income asset classes during the quarter was mixed as tighter credit spreads in both investment grade and high yield corporate credit were partially offset by an increase in yields along the Treasury curve.

- The Bloomberg U.S. Aggregate Bond Index returned -0.8% during the quarter.

	Yield (%)	Spreads (bps)			Returns (%)	
		3/30/2023	6/30/2023	Δ (+/-)	3M	1YR
Investment Grade (Moody's Ratings)						
U.S. Treasury	4.4	0	0	0	(1.4)	(2.1)
U.S. Aggregate	4.8	56	49	-7	(0.8)	(0.9)
U.S. Credit	5.4	130	113	-17	(0.3)	1.4
Corporate	5.5	140	122	-18	(0.3)	1.5
Aa	4.8	70	60	-10	(0.7)	(0.0)
A	5.3	120	103	-17	(0.4)	0.8
Baa	5.8	169	150	-19	(0.1)	2.5
Crossover	6.7	265	226	-39	0.6	6.1
High Yield (Moody's Ratings)						
U.S. Corporate High Yield	8.6	469	392	-77	1.7	9.1
Ba	7.1	300	251	-49	0.9	8.1
B	8.7	492	400	-92	1.9	9.9
Caa	13.2	1015	837	-178	4.2	9.4
Ca-D	23.1	3636	1,805	1,831	11.5	18.7
Structured Product						
U.S. MBS	4.8	59	51	-7	(0.6)	(1.5)
ABS	5.5	84	68	-16	(0.1)	1.2
CMBS	5.7	142	134	-8	(0.6)	(1.7)

Source: Bloomberg

- Investment grade (IG) corporate bonds returned -0.3% on a yield increase of 30 basis points (commonly abbreviated "bps," with each basis point equal to 1/100th of a percentage point), to 5.5%. Investment grade credit spreads tightened 18 bps to 122 bps, led by bonds rated A and BBB.
- Corporate high yield bonds were up 1.7% to 8.6% as a decline in credit spreads more than offset a higher Treasury curve. High yield spreads fell 77 bps during the quarter.
- Asset-backed securities (ABS) performed best across structured product categories, returning -0.1%. Agency mortgage-backed securities (MBS) and collateralized mortgage-backed securities (CMBS) lagged, with both down 0.6%.

Portfolio Performance & Positioning

During the quarter, we increased our allocation to cash and increased our allocation to the following sectors: leisure, healthcare, retailers, and transportation services. We also reduced our holdings in energy, gaming, and wirelines.

Contributors

- Best performers were office real estate investment trusts (REITs), leisure, airlines, technology, banking, and wirelines, as well as an off-index allocation to collateralized loan obligations (CLOs).
- From a credit perspective, our allocation and security selection within BB and B rated credits aided performance.

- Allocation to floating rate loans and CLOs and security selection added the majority to performance.

Detractors

- Sectors that detracted from performance included retail, media and entertainment, wireless, and food and beverage.
- From a credit perspective, bonds rated BBB and CCC detracted from performance.

Performance

Average Annual Returns (%) as of June 30, 2023

Victory High Income Strategy	QTD	YTD	1-YR	3-YR	5-YR	10-YR	Since Inception (September 1999)
Gross of Fees	1.94	5.37	9.51	4.27	3.01	4.30	6.74
Net of Fees	1.73	4.95	8.66	3.48	2.21	3.46	5.81
Bloomberg US High Yield 2% Issuer Capped Bond Index	1.75	5.38	9.07	3.12	3.34	4.43	–

Past performance cannot guarantee future results. Returns for periods greater than one year are annualized. Returns are expressed in U.S. dollars and reflect the reinvestment of dividends and other earnings. Composite and benchmark returns are presented net of non-reclaimable withholding taxes, if any. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Net-of-fees returns reflect gross performance less investment management fees. Net-of-fees returns are calculated by deducting 1/12 of the highest tier of the standard fee schedule in effect for the period noted (the model fee). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equal to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found on Part 2A of its Form ADV.



All investments carry a certain degree of risk, including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class.

The information in this article is based on data obtained from recognized services and sources and is believed to be reliable. Any opinions, projections or recommendations in this report are subject to change without notice and are not intended as individual investment advice.

Information relating to portfolio holdings is based on the representative account in the composite and may vary for other accounts in the strategy due to asset size, client guidelines and other factors. The representative account is believed to most closely reflect the current portfolio management style.

The Victory High Income Composite includes all institutional and retail portfolios invested in a broad range of U.S. dollar-denominated high-yield securities, including bonds (often referred to as “junk” bonds), convertible securities, leveraged loans, or preferred stocks, with an emphasis on non-investment-grade debt securities. Although the composite will invest primarily in U.S. securities, it may invest without limit in dollar-denominated foreign securities and to a limited extent in non-dollar-denominated foreign securities, including in each case emerging-markets securities. The strategy aims to deliver a total return primarily through a yield-focused portfolio that offers a high level of current income. High yield bonds carry increased levels of credit and default risk and are less liquid than government and investment grade bonds. Portfolios in the composite have a target average maturity of 5-10 years. The composite creation date is July 2019 and the composite inception date is September 1999. The benchmark of the composite is the Bloomberg U.S. High Yield 2% Issuer Capped Bond Index. Prior to 4/24/2023, the name of this composite was the USAA High Income Fixed Income Composite.

The benchmark of the composite is the Bloomberg U.S. High Yield 2% Issuer Capped Bond Index. The Bloomberg U.S. High Yield 2% Issuer Capped Bond Index is an index comprised of fixed rate, non-investment-grade debt securities that are dollar denominated and nonconvertible. The index limits the maximum exposure to any one issuer to 2%. The benchmark returns are provided to represent the investment environment existing during the time periods shown and are not covered by the report of independent verifiers. For comparison purposes, the index is fully invested, which includes the reinvestment of income. The returns have been taken from a published source and do not include any transaction fees, management fees, or other costs.

Index returns are provided to represent the investment environment during the periods shown. Index performance does not reflect management fees, transaction costs or expenses that would be incurred with an investment. One cannot invest directly in an index. **Past performance does not guarantee future results.**

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