STATE TAX EXEMPT BOND FUNDS QUARTERLY COMMENTARY

VICTORY income investors
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of March 31, 2024

Victory California Bond Fund // Victory New York Bond Fund // Victory Virginia Bond Fund

Performance Summary

The municipal market experienced negative returns this quarter. The expectation that the federal funds rate will stay higher for longer resulted in an upward swing of the Treasury curve across all maturity dates (tenors), and this upward shift in yields largely drove performance throughout the beginning of 2024. The Bloomberg Municipal Bond Index returned -0.39% for the first quarter of 2024, beating the Bloomberg U.S. Aggregate Bond Index, which returned -0.78%. Performance was largely driven by the Treasury yield curve, as the Federal Reserve kept the target range for the federal funds rate at 5.25%–5.50% throughout the quarter amidst hotter-than-expected inflation. The market narrative surrounding monetary policy shifted within the first quarter, moving on from “how soon can the market expect the first interest rate cut,” initially priced in for March at the beginning of the quarter, to some market participants questioning at the end of the quarter whether there will even be a rate cut in 2024. As such, the market has reduced expectations for future rate cuts, which drove yields upward. The yield of the Bloomberg Municipal Bond Index closed the quarter at 3.49%, compared to 3.22% at the end of the fourth quarter of 2023. While muni yields have moderated slightly since the peak 2023 level of 4.49% seen in October 2023, we continue to believe that current yield levels offer investors an attractive entry point into the muni market and are even more attractive when you consider the tax-free treatment of most municipal bonds.

Market Review & Outlook

The Bloomberg Municipal Bond Index returned -0.39% for the first quarter of 2024. The fixed income sector saw broad underperformance in the first quarter due to rising yields. The first quarter return for the Bloomberg U.S. Aggregate Bond Index was -0.78%; for the Bloomberg U.S. Universal Index, -0.47%; and for the Bloomberg U.S. Treasury Index, -0.96%.

See below for an update on some of the key metrics in the muni market that we continue to monitor.

- AAA muni yields (the benchmark rate of the safest municipal securities) are higher than they were at the close of 2023. Bloomberg AAA muni yields increased across the yield curve in the first quarter. While yields are not at the peaks seen in late 2023, they remain elevated. As a reminder, an increase in bond yields means that bond prices decrease and vice versa. See below for yield changes from 3/31/2023 to 3/31/2024 at several key maturities.
  - 3-year: 2.30% to 2.81%
  - 10-year: 2.27% to 2.51%
  - 30-year: 3.37% to 3.73%
- Fund flows for municipal bond mutual funds are positive for the year so far at approximately $9.9 billion (according to Lipper), following two consecutive years of outflows.
- Credit spreads (the difference between riskier bonds and AAA bonds) tightened over the past few months. The BBB credit spread decreased to 0.95% from 1.25% at the end of the fourth quarter of 2023.

Returns across the Victory Income Investors tax-exempt funds for the first quarter outperformed the Bloomberg Municipal Bond Index.

We believe that the creditworthiness of muni borrowers (issuers) will remain strong in the near term, as many borrowers have improved their financial position coming out of the coronavirus-induced slowdown (often helped by generous amounts of federal stimulus aid).

We remain committed to our core competency of evaluating, taking, and managing credit risk in the municipal market. We continue to build our portfolios bond by bond, relying on our assessment of fundamental credit risk and attempting to capture and distribute incremental yield in an effort to drive higher long-term income to our investors. While there might be some volatility in the muni market in the short term, we remain confident that the right approach is to focus on what matters in the long term.

We believe municipal bonds continue to represent an attractive investment opportunity on a relative basis. At the end of the first quarter, the yield on the Bloomberg Municipal Bond Index was 3.49%, which is a taxable-equivalent yield of 5.90% (in the highest tax bracket). After factoring in the benefit of the tax exemption, we believe munis look attractive vs. the (taxable) Bloomberg U.S. Aggregate Bond Index, which yielded 4.85% at quarter-end.

Fund Performance and Positioning

During the first quarter, the Victory California Bond Fund, the Victory New York Bond Fund, and the Victory Virginia Bond Fund (Fund Shares) all outperformed their respective benchmark indices. See page 3 for other share classes.

Victory California Bond Fund

With 39 million people, California has the largest economy in the United States. Its economy is vast, broad, and diverse and continues to recover from the economic and fiscal impact from the peak of the pandemic. The preliminary February seasonally adjusted unemployment rate for California was 5.3% (versus 3.8% for the U.S.), which ranked 50th among the states, but it is a marked improvement from the high in May of 2020 and is back to pre-COVID levels.

Fiscal 2023 proved to be a tough year for California. In part, this was due to the Federal Reserve raising rates, which led to higher borrowing costs and reduced money available for investment. According to the Legislative Analyst’s Office (LAO), those headwinds led to a downturn in California’s economy in 2022 and a decline in California’s revenues from what was assumed in the 2023 Budget Act forecast. In addition, the income tax filing deadline was delayed from April 18 to October 16 (or November 16 if extended) for those impacted by severe winter storms. Due to California's high dependence upon economically sensitive personal income taxes, and the state adopting the 2023–2024 budget prior to receiving the much lower than anticipated income taxes, California is facing a $68 billion budget deficit. Fortunately, unlike previous volatile years, California's budgetary reserves and liquidity are much stronger and can help absorb approximately $24 billion of the shortfall. In addition, the LAO says the Legislature has the option to reduce spending on schools and community colleges, adding another $17 billion to the shortfall. The LAO also mentions there are other options like reducing one-time spending that could generate another $10 billion. However, if the Legislature uses all of its tools to reduce the current shortfall, then it will have fewer options to address budget deficits going forward. The state will need to increase revenues and/or reduce expenditures. During the fourth quarter of 2023, California's GDP grew by an annual rate of 3.1% versus the US GDP growth of 3.4%. California's fiscal outlook remains vulnerable to economic performance.

We will continue to monitor the overall performance of the state; however, we continue to view the state as AA- with a stable outlook. The state currently maintains strong ratings of Aa2 with negative outlook by Moody's, AA- with stable outlook by S&P, and AA with stable outlook by Fitch Ratings.

Victory New York Bond Fund

The State of New York continues to benefit from a sizable and diverse economic base which includes New York City, a center for world trade and culture. Economic growth has occurred at a modest pace that trails the nation. GDP growth, although improving, compares unfavorably to the U.S. as whole, coupled with the state's employment increasing steadily but still below pre-pandemic highs. Longer-term uncertainty is noted as hybrid work-from-home schedules could cause an economic challenge for commercial real estate demand, especially in New York City. Population for New York has declined but remains substantial at approximately 19.6 million. New York has a history of maintaining consistent financial performance, in large part due to an institutionalized multi-year budgeting process which includes quarterly adjustments. Although the fiscal 2025 budget was not passed prior to the April 1 deadline, an agreement between the Governor and Legislature has now been reached. Financial performance remains steady, including an anticipated fiscal 2024 operating surplus, while only a modest use of reserves may be required to offset fiscal 2025 spending. A robust cash balance effectively provides financial strength and further mitigates uncertainty related to potential funding needs for migrant assistance and the Metropolitan Transportation Authority, which has encountered operating difficulties since the pandemic.

General obligation bonds are rated a strong Aa1 (stable) by Moody's, AA+ (stable) by Standard & Poor's, and AA+ (stable) by Fitch.

Victory Virginia Bond Fund

The Commonwealth of Virginia has stabilized after the economic and fiscal impact felt from the COVID-19 pandemic. According to the February 2024 preliminary data, unemployment in Virginia is at 3.0%, roughly the same as last quarter's revised rate of 3.1%. Labor force participation in the Commonwealth is at its highest rate since the beginning of the pandemic. The unemployment in the U.S. is higher, at 3.8%, and has been in a 3.4%–3.9% range for the last 24 months (April 2022–March 2024).

Growth of the GDP slowed down slightly during the fourth quarter of 2023 versus the previous quarter. Virginia's GDP grew 3.4% (annualized) vs. the previous quarter's 4.2% annualized growth, the same GDP growth rate of the U.S., ranking Virginia 25th by state. The sector that experienced the most GDP growth in Virginia during the quarter was the retail trade sector. The largest contraction in GDP statewide during the quarter was in the federal civilian sector.

Fiscal 2024 year-to-date results affirm the Commonwealth's solid financial position. Virginia's general fund revenue collections were $17.8 billion for the period July 2023–February 2024, a 6.3% increase over prior year revenue collections for the same period. Virginia has $16.3 billion in cash and investments available as of February 2024 (57% of the 2024 general fund budget). In addition, Virginia's pension burden is one of the lowest in the nation in terms of state GDP.[7] Moody's Investors Service determined that Virginia has a low pension risk based on FY 2022 data.

We continue to view the underlying credit quality of Virginia as exceptionally strong. Presently, Virginia remains rated AAA by Fitch, Moody's, and Standard & Poor's.

Standardized Performance: March 31, 2024

Average Annual Returns (%)

Victory California Bond Fund	Ticker	Inception Date	Q1 2024	1 Year	5 Year	10 Year	Since Inception	Expense Ratio Gross	Expense Ratio Net
Fund Shares	USCBX	08/01/89	-0.07	3.82	1.54	2.76	4.97	0.59	0.59
A Shares, without sales charge	UXABX	08/02/10	-0.21	3.63	1.27	2.50	3.40	0.97	0.89
A Shares, with sales charge (max. 2.25%)	UXABX	08/02/10	-2.44	1.28	0.82	2.26	3.23	0.97	0.89
Institutional Shares	UCBIX	06/29/20	-0.06	3.97	–	–	0.56	0.59	0.51
Bloomberg Municipal Bond Index	–	–	-0.39	3.13	1.59	2.66	–	–	–
Bloomberg Municipal Bond - California Exempt Index	–	–	-0.42	3.15	1.60	2.68	–	–	–

Victory New York Bond Fund	Ticker	Inception Date	Q1 2024	1 Year	5 Year	10 Year	Since Inception	Expense Ratio Gross	Expense Ratio Net
Fund Shares	USNYX	10/10/90	-0.14	4.29	1.35	2.38	4.92	0.71	0.67
A Shares, without sales charge	UNYBX	08/02/10	-0.30	4.17	1.17	2.17	2.74	0.99	0.86
A Shares, with sales charge (max. 2.25%)	UNYBX	08/02/10	-2.52	1.81	0.71	1.94	2.57	0.99	0.86
Institutional Shares	UNYIX	06/29/20	-0.22	4.15	–	–	0.57	0.70	0.61
Bloomberg Municipal Bond Index	–	–	-0.39	3.13	1.59	2.66	–	–	–
Bloomberg Municipal Bond - New York Exempt Index	–	–	-0.73	3.21	1.48	2.56	–	–	–

Victory Virginia Bond Fund	Ticker	Inception Date	Q1 2024	1 Year	5 Year	10 Year	Since Inception	Expense Ratio Gross	Expense Ratio Net
Fund Shares	USVAX	10/10/90	0.20	3.81	1.21	2.38	4.70	0.56	0.55
A Shares, without sales charge	UVABX	08/02/10	0.15	3.59	0.97	2.13	2.71	0.85	0.79
A Shares, with sales charge (max. 2.25%)	UVABX	08/02/10	-2.08	1.26	0.51	1.90	2.54	0.85	0.79
Institutional Shares	UVAIX	06/29/20	0.21	3.87	–	–	0.37	0.57	0.51
Bloomberg Municipal Bond Index	–	–	-0.39	3.13	1.59	2.66	–	–	–
Bloomberg Municipal Bond - Virginia Index	–	–	-0.49	2.93	1.37	2.38	–	–	–

Past performance does not guarantee future results. The performance quoted represents past performance and current performance may be lower or higher. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. To obtain performance information current to the most recent month-end, visit *www.vcm.com.* Fee waivers and/or expense reimbursements may have been in place for some or all periods shown, without which Fund performance would have been lower. Returns include reinvestment of dividends and capital gains. Performance for periods greater than one year is annualized. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an unmanaged index. Investing involves risk including loss of principal. Net expense ratio reflects the contractual waiver and/or reimbursement of management fees through June 30, 2024.

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Carefully consider a fund's investment objectives, risks, charges and expenses before investing. To obtain a prospectus or summary prospectus containing this and other important information, visit www.vcm.com/prospectus. Read it carefully before investing.

Not all share classes are available to all investors.

All investing involves risk, including the potential loss of principal. Fixed income securities are subject to interest rate, inflation, credit and default risk. Because the Funds each invest primarily in tax-exempt securities of the states in each of their names, they are more vulnerable to unfavorable economic, political and regulatory changes affecting issuers in each of those respective states. Some income may be subject to local taxes and could be declared taxable and/or subject to the federal alternative minimum tax (AMT) if federal or state tax laws change. The bond market is volatile. Bonds and bond funds will decrease in value as interest rates rise and vice versa. Credit risk refers to the possibility that debt issuers may not be able to make principal and interest payments or may have their debt downgraded by ratings agencies. 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 opinions are as of the date noted and are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

The Bloomberg Municipal Bond Index is considered to be generally representative of investment-grade municipal issues having remaining maturities greater than 1 year and a national scope.

The Bloomberg U.S. Aggregate Bond Index measures the investment grade, USD-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS and CMBS.

The Bloomberg Municipal Bond – California Exempt Index is an unmanaged index considered representative of California investment-grade municipal bonds.

The Bloomberg Municipal Bond – New York Exempt Index is an unmanaged index considered representative of New York investment-grade municipal bonds.

The Bloomberg Municipal Bond – Virginia Index is an unmanaged index considered representative of Virginia investment-grade municipal bonds.

The Bloomberg U.S. Universal Index is an index that represents the union of the U.S. Aggregate Index, U.S. Corporate High-Yield Index, Investment Grade 144A Index, Eurodollar Index, U.S. Emerging Markets Index and the non-ERISA eligible portion of the CMBS Index. The index covers USD-denominated, taxable bonds that are rated either investment-grade or below-investment-grade.

The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills and STRIPS are not included.

Index returns are for illustrative purposes only and do not represent actual Fund performance. Index performance does not reflect management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. **Past performance does not guarantee future results.**

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