Victory Investment Grade Convertible Securities Strategy Quarterly Commentary

VICTORY income investors

As of December 31, 2024

Executive Summary

- After handily outperforming stocks in the third quarter, investment grade convertible returns were more subdued during the final quarter. For the quarter, the ICE BofA Investment Grade U.S. Convertible 5% Constrained Index (the "Constrained Convertible Index") (VX5C) declined 0.25%, while the ICE BofA Investment Grade U.S. Convertible Index (the "Unconstrained Convertible Index") (VXA1) slipped 1.75%.
- The Victory Investment Grade Convertible Securities Strategy (the "Strategy") underperformed the Constrained Convertible Index (VX5C) and outperformed the Unconstrained Convertible Index (VXA1) in the fourth quarter.
- Historically, convertible returns have closely matched or even exceeded equity returns over the long term, with lower volatility.
- We believe that investment grade convertibles are well positioned in a period of economic uncertainty. With stock valuations at elevated levels, the yield and defensive characteristics of convertibles could become increasingly important.

Market Review

Convertibles participated in the stock market gains in 2024 with the ICE BofA Investment Grade U.S. Convertible 5% Constrained Index (the "Constrained Convertible Index") (VX5C) posting a 11.59% total return, compared to the S&P 500® Index return of 25.02 %, for an equity participation rate of 46%. Both stocks and convertibles easily bested the Bloomberg U.S. Aggregate Total Return Index ("Bloomberg Aggregate") return of 1.25 %.

Again, led by mega-cap technology names, stocks continued to prosper in 2024, with the S&P 500® Index posting its best back-to-back gains since the late 1990s. Stocks began the year with a modest rise in January, but gains accelerated in February as both Meta and Nvidia spiked after reporting blockbuster earnings, thus setting the tone for much of the year. The S&P 500® Index closed the first quarter up over 10%, its best first quarter since 2019. Inflation concerns and weaker-than-expected GDP growth pressured markets in April, but stocks quickly continued their upward trajectory after Apple announced a large stock buyback and Nvidia released another colossal earnings report. Not all earnings reports were positive, however, as Nike fell 20% late in June on disappointing results. The S&P 500 returned 15.29% in the first half, but returns were very narrow as evidenced by the fact that the group of stocks nicknamed the "Magnificent Seven" – Alphabet (Google), Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla – accounted for approximately 60% of the gains. Equity markets continued to climb in the third quarter as leadership shifted and the narrow return profile experienced in the first half began to broaden out. Progressively falling inflation data and stronger GDP reports bolstered stocks during the quarter. Notable in the third quarter, the Federal Reserve (the Fed) began an easing cycle by cutting the federal funds rate by a half point, surprising some prognosticators who predicted only a quarter-point cut. The Fed ultimately cut rates a further quarter-point in November and December as well.

Stocks fell on the first day of the fourth quarter after Iran sent missiles into Israel. They quickly rebounded, however, spurred on by a positive start to the earnings season, with several large banks reporting good results. As October progressed earnings reports became decidedly mixed, with a balance of positive and negative surprises. Just as it looked like October would be another up month, markets nosedived on the last day as several tech companies, including Meta and Microsoft, relayed disappointing outlooks. Investors reacted positively to the November election results, believing that the prospect of lower taxes and reduced regulation would propel stocks higher. Equities first started moving up on election day, before climbing sharply after the results became known. Stocks rolled over mid-month, retracing nearly half their recent gains as strong retail sales and hawkish comments out of the Federal Reserve reduced hopes of a December rate cut. However, they soon turned upward again, drifting higher for the balance of November. Despite the quarter-point Fed rate cut, stocks fell in December, giving back a good portion of November's election rally. The November 5.87% S&P 500® Index gain was followed by a 2.39% loss in December, which still left returns up a stellar 25.02% on the year.

Like in 2023, equity returns were again quite narrow in 2024. Whereas the "Magnificent Seven" accounted for nearly 60% of 2023 S&P 500® Index returns, they accounted for approximately 53% of returns in 2024. Total return would have been 11.75% in 2024 without the "Magnificent Seven" contribution. Also like in 2023, S&P 500® Index returns were most narrow in the first half of the year before broadening out during the second half.

Fourth Quarter Convertibles

After handily outperforming stocks in the third quarter, investment grade convertible returns were more subdued during the final quarter. For the quarter, the ICE BofA Investment Grade U.S. Convertible 5% Constrained Index (the "Constrained Convertible Index") (VX5C) declined 0.25%, while the ICE BofA Investment Grade U.S. Convertible Index (the "Unconstrained Convertible Index") (VXA1) slipped 1.75%. The Financials sector contributed the most to returns, followed by Consumer Discretionary. The Utilities, Real Estate, and Industrials sectors subtracted from returns. Top individual index performers included Apollo Global, Booking Holdings, and Ares Management. Bottom performers included NextEra Energy, Uber Technologies, Wells Fargo, and Meritage Homes. For the year, the Constrained Convertible Index (VX5C) returned 11.59% and the Unconstrained Convertible Index (VXA1) returned 9.96%.

New convertible issuance was strong in 2024, with 112 new issues during the year raising $88.6 billion. While most convertible issues are unrated, 17 of the new issues were rated investment grade and added to the Constrained Convertible Index (VX5C). This comes after a very strong year of issuance in 2023 as well.

Portfolio Performance

The Victory Investment Grade Convertible Securities Strategy (the "Strategy") underperformed the Constrained Convertible Index (VX5C) and outperformed the Unconstrained Convertible Index (VXA1) in the fourth quarter. Absolute performance was led by the Financials and Consumer Discretionary sectors. Utilities and Industrials subtracted the most from performance, although the Real Estate and Information Technology sectors also declined. Relative performance was helped by an underweight in Utilities and an overweight in Consumer Discretionary. Relative performance was hurt by an overweight in Information Technology and by negative security selection in Financials and Industrials. Top performing individual convertibles included Apollo Global, Booking Holdings, and Expedia Group. Bottom performers included NextEra Energy, Parsons Corp., and Uber Technologies.

Portfolio Characteristics

We strive to invest in high-quality convertibles with attractive underlying common stocks. We structure our portfolios by spreading our holdings across the three types of convertibles: 1) equity-sensitive, high-delta convertibles; 2) total return, middle-of-the-road convertibles;

and 3) fixed income-oriented convertibles. This structure provides a balance between upside participation during good markets and downside protection during bad markets.

The holdings in the Strategy portfolio have an average current yield of 2.9%, a delta (sensitivity to common stock) of 46%, and an average credit rating of BBB. The Constrained Convertible Index (VX5C) yields 3.3% and has a delta of 46% and an average credit rating of BBB. The holdings are diversified across all economic sectors. Compared to the Constrained Convertible Index (VX5C), we maintain an overweight in the Consumer Discretionary, Health Care, Information Technology, and Industrials sectors. We maintain an underweight in the Utilities and Real Estate sectors. We maintain approximately neutral exposure to other sectors.

Buys and Sells

During the fourth quarter, we initiated positions in new issue convertible bonds from Capital Southwest and Digital Realty. Capital Southwest is a Texas-based business development company (BDC) providing debt and equity capital to a variety of companies. Digital Realty is a REIT specializing in technology-related properties. We also initiated a position in a new issue mandatory convertible preferred from alternative asset management company Ares Management. We continued to add to Uber Technologies, which received its first investment grade rating in August. We swapped portions of both NextEra Energy and Parsons Corp. for similar issues with longer maturities. We eliminated our position in a Barclays bond exchangeable into Visa Inc. Finally, we trimmed positions in Booking Holdings, Euronet Worldwide, and Southwest Airlines.

Outlook

We believe that investment grade convertibles are well positioned in a period of economic uncertainty. With stock valuations at elevated levels, the yield and defensive characteristics of convertibles could become increasingly important.

Reported U.S. economic growth has exceeded expectations in 2024, and we expect continued expansion in 2025 as well. The Bureau of Economic Analysis (BEA) pegged third quarter GDP growth at 3.1%, up from the 3.0% and 1.6% growth reported in the second and third quarters, respectively. The latest Bloomberg survey of economists shows a forecast of 2.7% real GDP growth for all of 2024, slowing to 2.0% in 2025.

Economic growth and robust tech results are pushing up S&P 500® Index earnings. Bloomberg's survey of strategists indicates a median S&P 500® Index EPS forecast of $269 in 2025, putting the index at close to 22 times earnings based on its year-end closing level of 5882. Healthy earnings growth could drive returns in 2025; however, elevated valuation levels may limit upside gains. A repeat of the stellar returns experienced over the past two years appears unlikely.

Inflation, which has been a primary concern, has been trending lower although November's Consumer Price Index reading of 2.7% was an uptick over the previous month. Recent evidence of sticky inflation, economic strength, and anticipated policy impacts has reduced the number of likely Fed rate cuts in 2025. We do expect, however, that inflation rates will continue to decline modestly and that the Fed easing cycle will continue into 2025.

We remain neutral on stock market prospects, believing markets will continue to be volatile. Stock returns broadened out in the second half of the year from the very narrow technology-driven returns of the first half. We believe that a broader market would be good for convertible relative performance. The equity sensitivity of convertibles as measured by delta remains on the conservative side, which could enhance downside protection.

Historically, convertible returns have closely matched or even exceeded equity returns over long periods, with lower volatility. In general, convertibles have tended to underperform stocks in bull markets, outperform stocks in bear markets, and provide competitive returns in normal markets. In addition, their lack of perfect correlation to either the stock or the bond market makes them a worthy addition to balanced portfolios.

Investment Performance (%)

Average Annual Returns as of December 31, 2024

Victory Investment Grade Convertible Securities Strategy	Inception Date	Q4 2024	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Victory Investment Grade Convertible Securities Strategy (Gross)	1/1/87	0.01	11.04	11.04	3.01	6.68	8.14	8.37
Victory Investment Grade Convertible Securities Strategy (Net)	1/1/87	-0.13	10.44	10.44	2.44	6.11	7.56	7.73
ICE BofA Investment Grade U.S. Convertible 5% Constrained Index (VX5C)	–	-0.25	11.58	11.58	3.74	6.10	8.31	–
ICE BofA Investment Grade U.S. Convertible Index (VXA1)	–	-1.75	9.95	9.95	2.37	4.97	8.39	–

Past performance does not 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. The composite net-of-fees returns shown reflect gross performance less actual investment management 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.

Top 5 Contributors (%)	Contribution to Absolute Return
Apollo Global Management Inc Mandatory Conv Pfd Registered Shs Series A	1.1
Booking Holdings Inc. 0.75% 01-may-2025	1.0
Expedia Group, Inc. 0.0% 15-feb-2026	0.2
Barclays Bank Plc 0.0% 18-feb-2025	0.1
Southwest Airlines Co. 1.25% 01-may-2025	0.1

Top 5 Detractors (%)	Contribution to Absolute Return
NextEra Energy, Inc. 4.6 % Equity Units Cons of Deb 01.09.27 + 1 PC 01.09.25	-0.4
Uber Technologies, Inc. 0.875% 01-dec-2028	-0.3
Parsons Corporation 0.25% 15-aug-2025	-0.3
Wells Fargo & Company 7.5 % Non Cum Perp Conv Pfd Registered Shs A Series L	-0.3
Meritage Homes Corporation 1.75% 15-may-2028	-0.3

Top Ten Holdings	% Rep. Account
Booking Holdings Inc. 0.75% 01-may-2025	6.6
Bank of America Corp 7.25 % Non Cum Perp Conv Pfd Registered Shs Series L	5.2
Apollo Global Management Inc Mandatory Conv Pfd Registered Shs Series A	5.0
Wells Fargo & Company 7.5 % Non Cum Perp Conv Pfd Registered Shs A Series L	4.9
Ford Motor Company 0.0% 15-mar-2026	4.4
Expedia Group, Inc. 0.0% 15-feb-2026	4.0
NextEra Energy, Inc. 4.6 % Equity Units Cons of Deb 01.09.27 + 1 PC 01.09.25	3.7
Envista Holdings Corporation 1.75% 15-aug-2028	3.5
Southwest Airlines Co. 1.25% 01-may-2025	3.3
Uber Technologies, Inc. 0.875% 01-dec-2028	3.3
Total	44.0

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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 Victory Investment Grade Convertible Securities Composite includes all accounts, except wrap fee paying accounts, invested in investment grade convertible securities with a minimum convertible commitment goal of 70%-90%. The composite creation date is 1Q93 and the composite inception date is January 1987.

The benchmark of the composite is the ICE BofAML Investment Grade US Convertible 5% Constrained Index (VX5C). Prior to 12/1/2017, the benchmark was the ICE BofAML U.S. Convertible - Investment Grade Index (VXA1). The ICE BofAML Investment Grade US Convertible 5% Constrained Index (VX5C) is a market-capitalization weighted index of domestic corporate convertible securities, with all positions capped at 5% of market value. Bonds and preferred stocks must be convertible only to common stock, ADR's or cash equivalent and have a market value of at least $50 million. Composed of Coupon, OID, or zero-coupon convertible bonds rated by Moody's and/or S&P with an average rating of Baa3/BBB- or higher. The ICE BofAML U.S. Convertible - Investment Grade Index (VXA1) is a market capitalization-weighted index of domestic corporate convertible securities. Bonds and preferred stocks must be convertible only to common stock, ADR's or cash equivalent and have a market value of at least $50 million. Composed of Coupon, OID, or zero-coupon convertible bonds rated by Moody's and/or S&P with an average rating of Baa3/BBB- or higher. 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. Prior to September 2023, the name of this composite was the INCORE Investment Grade Convertible Securities.

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.

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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 top contributors and detractors are presented to illustrate examples of the portfolio's investments and may not be representative of the portfolio's current or future investments.

Victory Capital Management Inc. (VCM) is a diversified global investment advisor registered under the Investment Advisers Act of 1940 and comprised of multiple investment franchises: Integrity Asset Management, Munder Capital Management, NewBridge Asset Management, RS Investments, Sophus Capital, Sycamore Capital, Trivalent Investments, Victory Income Investors (formerly USAA Investments, a Victory Capital Investment Franchise); the VictoryShares & Solutions Platform, THB Asset Management and New Energy Capital Partners. Munder Capital Management and Integrity Asset Management became part of the Victory Capital GIPS firm effective November 1, 2014; RS Investments and Sophus Capital effective January 1, 2017; Victory Income Investors, effective July 1, 2019; THB Asset Management, effective March 1, 2021, and New Energy Capital effective November 1, 2021. Effective September 1, 2023, INCORE Capital Management is no longer part of the firm definition.

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