INTEGRITY ASSET MANAGEMENT

Victory Integrity Discovery Fund As of March 31, 2018

Quarterly Commentary

Should I stay or should I go now?
Should I stay or should I go now?
If I go, there will be trouble
And if I stay it will be double
So come on and let me know
— The Clash

Since we re-used a quote last quarter, why not make it two-in-a-row? The "should I stay or go" quote refers to a couple of things that could be the source of both the market's consternation and the direction of our decisions, depending on the outcome. We have tariff tantrum vs. rate shock. It's like the movie *Batman v Superman* – not very good. It's hard to pinpoint exactly what has caused the market turmoil, and like most things, it's likely a combination. To cut to the chase: If it's tariffs we are a buyer, if it's rates, we are a bit more cautious.

Looking at the concerns over tariffs and a trade war, to quote a line from *Batman v Superman*: "If I wanted it, you'd be dead already." (Good stuff, right? #Oscar snub?) If Trump really wanted a trade war and Smoot-Hawley type tariffs, we would have them already. Things could escalate from here. That is a risk, but we think cooler heads prevail, and that the threat of tariffs is a bargaining ploy. The myriad of exemptions (steel tariffs, for example) is evidence of that. The announced steel tariffs resulted in a sell-off in a number of steel-dependent industrials. We have used that sell-off to add some new companies to the portfolios and to add to some existing positions. Our assumptions are: no trade war and the ability to pass through at least some of the input price increases. Companies (both public and private) to which we have spoken have confidence that they can pass on some of the price increase. Given the significant sell-off in some of these names, we think we have unearthed some good risk/reward opportunities. The best performing sector of the market was health care. Telecommunication services, real estate, and energy were the worst performing sectors. Micro growth outperformed micro value.

The Victory Integrity Discovery Fund (A shares without sales charge) underperformed its benchmark, the Russell Microcap® Value Index, due to stock selection in health care, real estate and consumer discretionary Stock selection in energy was a positive. Sector weights were a sizeable headwind. We were underweight biotech, one of the best performing industry groups, and we were overweight real estate, which underperformed.

Health care was the most sizeable negative, costing us about 80 basis points. Not owning any biotechs was the primary impediment. The average biotech stock was up almost 15%, and this cost us 109 basis points. Capital Senior Living (CSU, 0.68%) was negatively impacted by the high uptick in reported flu cases, which should result in a decline in occupancy across the senior living industry. This will continue to be a headwind until flu activity moderates. Conversely, Addus HomeCare (ADUS, 1.54%) was the largest positive contributor, as it announced two deals that were viewed as near-term positives. Also, a CMS proposal to include coverage of some in-home support services helped.

Real estate detracted due to stock selection and an overweight to the group. Cedar Realty Trust (CDR, 0.74%) was our worst performer, as rent concessions and higher expenses led to reduced guidance for the year.

Consumer discretionary was weighed down by our media holdings, Gray Television (GTN, 1.02%) and Entravision Communications (EVC, 0.35%). Advertising spend started the year weaker than expected at Gray Television (GTN, 1.02%). Additionally, investors were disappointed that there were no acquisitions following last quarter's equity raise. Entravision Communications (EVC, 0.35%) declined, as it gave quarterly guidance for television advertising revenues pacing down double digits and radio revenues pacing down high single digits. Within retail, Kirkland's (KIRK, 0.67%) was a detractor. Although it preannounced sales that exceeded expectations, it experienced margin compression that led to lower guidance. Ruth's Hospitality Group (RUTH, 1.05%) and Marcus Corp. (MCS, 1.09%) were bright spots. Ruth's Hospitality Group (RUTH, 1.05%) reported strong earnings, offered solid 2018

guidance, and increased the dividend by 22%. Positive traffic and improving spending trends have benefited the high-end segment. Marcus (MCS, 1.09%) continues to take market share and outperform industry box office trends due to theater remodels and stronger offerings. Revenues have been trending higher as well in the hotel/resort segment.

Energy was a small positive due to stock selection as we owned Mammoth Energy Services (TUSK, 0.57%), which was up 63%. This was partially offset by an overweight to the group, which lagged. Mammoth Energy Services (TUSK, 0.57%) was the top performer thanks to strong earnings led by infrastructure construction work in Puerto Rico, and it has more than $500 million in backlog. Sanchez Energy (SN, 0.49%) and Smart Sand (SND, 0.08%) were disappointments. Slightly lower production guidance and rotation away from energy companies with higher leverage were headwinds for Sanchez Energy (SN, 0.49%). Smart Sand (SND, 0.08%) reported results that missed estimates, as the company had additional costs associated with increases in production capacity. Also, first quarter guidance was below analysts' estimates.

Technology was neutral to performance. Calix (CALX, 0.95%) and Rudolph Technologies (RTEC, 0.79%) were solid performers. Calix (CALX, 0.95%) was up 13% as investors are looking forward to longer-term revenue drivers, including a product roll-out with Verizon. Rudolph Technologies (RTEC, 0.79%) rose 15%, as it offered a strong first quarter outlook on broad product strength (Gen-6 OLED and new Metrology products). Conversely, Ultra Clean Holdings (UCTT, 0.67%) retraced recent gains after it announced an equity offering in January.

Other notable positives included DXP Enterprises (DXPE, 0.96%), HCI Group (HCI, 0.86%) and Haynes International (HAYN, 1.08%). A resurgence in key end markets (industrial, oil and gas) led to better than expected revenues that should continue at DXP Enterprises (DXPE, 0.96%). HCI Group (HCI, 0.86%) has benefited from an earnings rebound after a challenging 2017 hurricane season. Improving end-markets and better pricing led to continued financial progress at Haynes International (HAYN, 1.08%).

If the market believes the Federal Reserve is going to have to aggressively raise rates, that's a harder battle to fight. The rapid flattening of the yield curve is a sign that this is the case. The correlation to interest rates of our portfolios and the benchmarks has increased significantly in the last month or so. Opposing this perception is trickier than fighting market beliefs around rising input costs and pricing power. We will find out in a quarter or two whether we were right or wrong about pricing assumptions. Admittedly, interest rates will eventually become a problem. The question is when. If we fight rate perceptions too long, eventually we will be wrong. We are certainly not Fed forecasters. However, we do find it hard to believe that after a decade of trying to revive growth and inflation, the Fed is going to kill the first buds that they see. That said, we do have a large degree of interest-rate sensitivity in the portfolio. Our underweight to utilities and REITS in favor of banks and capital markets worked well last year, and the valuation discrepancies have mostly been reversed. To that end, we have modestly worked those relative exposures down.

We still think that economic growth in the U.S. and worldwide is solid and that there is a lot of cash earning subpar returns. As we wrote last quarter, we see this as a potential catalyst to move the market higher. Despite removing some of our interest rate bet in the face of a less steep yield curve, we continue to position the portfolio for a stronger growth environment.

Past performance does not guarantee future results.

Risks Associated with Investing in the Fund: The Fund invests in smaller company stocks, which are more volatile and less liquid than larger, more established company securities. A substantial portion of the Fund's assets is invested in the financial sector, whose performance can be significantly negatively impacted by economic downturns and changes in government regulation and interest rates. The Fund may invest up to 25% of its assets in foreign securities, which involve additional risks due to currency fluctuations, economic and political conditions, and differences in financial reporting standards. Performance and after-tax returns can be significantly impacted by the Fund's investments in Initial Public Offerings (IPOs), which may involve short-term trading. We cannot, however, ensure that the Fund will obtain IPOs.

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Fund holdings mentioned in the Quarterly Commentary are as of 3/31/2018 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 3/31/2018 were: Addus HomeCare Corporation (1.5%), EZCORP, Inc. Class A (1.3%), Heritage Financial Corporation (1.3%), Covenant Transportation Group, Inc. Class A (1.2%), Carrols Restaurant Group, Inc. (1.2%), First Bancorp (1.2%), NexPoint Residential Trust Inc. (1.1%), TriCo Bancshares (1.1%), United Financial Bancorp Inc (1.1%), and Marcus Corporation (1.1%). 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. Fund holdings are as of quarter-end and may change at any time.

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