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 technology. Real estate and energy were the worst performing sectors. Mid growth outperformed mid value.

The Victory Integrity Mid-Cap Value Fund (A shares without sales charge) outperformed the Russell Midcap® Value Index for the quarter. Positive relative performance came from technology and financials. Consumer discretionary was a minor positive. Stock selection in materials was a modest detractor. Sector weights were a positive due to an overweight to technology, the best performing sector, and an underweight to real estate, the worst performing sector. Higher momentum and larger earnings growth were positive style attributes.

Within technology, an overweight to semiconductors and good stock selection helped drive performance. Microsemi (MSCC, 0.00%) and ON Semiconductor (ON, 0.61%) were the main highlights. Microsemi (MSCC, 0.00%) announced they would be acquired. ON Semiconductor (ON, 0.61%) delivered solid results driven by end-market demand in auto, industrial, and cloud markets. Outside of semiconductors, CACI International (CACI, 0.67%) was a strong performer. It beat and raised its fiscal year guidance on the back of a book-to-bill greater than 1x with future revenue at the same or better margins.

In financials, XL Group (XL, 0.00%) and E*TRADE (ETFC, 1.40%) were the most significant contributors. XL Group (XL, 0.00%) agreed to be acquired. A small accretive acquisition of retail brokerage accounts (from Capital One), along with improved asset gathering and retail trading activity, were key highlights for E*TRADE (ETFC, 1.40%).

Consumer discretionary was helped by some of our retail holdings. Macy's (M, 1.04%) and Kohl's (KSS, 0.80%) were up about 20%. Macy's (M, 1.04%) posted better than expected results as it benefited from favorable weather, lean inventories, and disciplined promotional activity. Kohl's (KSS, 0.80%) outperformed after preannouncing better than expected holiday comps and raising their earnings guidance. Conversely, TEGNA (TGNA, 0.91%) fell as advertising spend started the year weaker than expected.

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Stock selection in materials was a modest source of weakness. Carpenter Technology (CRS, 0.64%) fell due to tepid guidance, and capacity constraints in its supply chain raised concerns on its ability to leverage anticipated volume growth. Albemarle (ALB, 0.00%) sold off on investor fears over upcoming lithium supply expansions and their impact on pricing.

Health care was hurt by Patterson Companies (PDCO, 0.00%), which missed earnings estimates and lowered guidance. Patterson Companies (PDCO) continues to see softness in its dental business and sluggish trends within consumables and equipment. This was offset by better selection elsewhere, most notably Encompass Health (EHC, 0.89%). It increased 16% as home health and hospice continue to show strong growth trends.

Performance in industrials was neutral overall. Trucking and logistics were positives, offset by airlines and machinery. Old Dominion Freight Line (ODFL, 0.84%) advanced 12% thanks to a favorable environment for demand and pricing. Strong freight markets with higher free cash flow guidance helped XPO Logistics (XPO, 0.72%). Alaska Air Group (ALK, 0.00%) did not demonstrate any gains in passengers despite capacity additions, while also talking up heightened competition in certain markets. Navistar (NAV, 0.66%) fell as investors have become skeptical of sales and margin improvements with the Class 8 market nearing records.

Within energy, good stock selection in exploration and production (E&P) was offset by weak selection in equipment and services. Avoiding owning some of the worst performing E&P stocks helped. A weak quarter due to customer mix and weather, further compounded by capex increases due to faster attrition of equipment, hurt RPC, Inc. (RES, 0.66%). We still believe pressure pumpers will see increasing prices as the year progresses. Weak results due to weather and higher capex guidance for the first quarter negatively affected U.S. Silica (SLCA, 0.79%), but we still believe it is the best positioned sand name available.

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.

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Past performance does not guarantee future results.

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Fund holdings mentioned in the Quarterly Commentary are as of 3/18/2018 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: SunTrust Banks, Inc. (1.5%), Perrigo Co. Plc (1.4%), Fifth Third Bancorp (1.4%), E*TRADE Financial Corp. (1.4%), %), L3 Technologies, Inc. (1.4%), Ally Financial Inc. (1.4%), PacWest Bancorp (1.3%), American Financial Group, Inc. (1.2%), Duke Realty Corp. (1.2%), and Lincoln National Co. (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. Fund holdings are as of quarter-end and may change at any time.

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