Integrity Asset Management

Victory Integrity Mid-Cap Value Fund As of September 30, 2018

Quarterly Commentary

"It's de ja vu all over again"
Yogi Berra

As 2018 has unfolded, we can't help but notice the similarities to 2016. Certainly, some of our relative performance issues have been the same: Size, cyclicality and rate sensitivity. Although not this quarter, our larger-than-benchmark market cap has been a drag on performance as it was in 2016 (for small and small/mid cap value). The Russell 2000 Value Index remains top quintile (20th percentile). This trend accelerated in April with an influx of money into small cap ETFs. Furthermore, like 2016, the market has embraced safety over valuation and consistency over expected return. The market, in our opinion, is buying insurance against an economic downturn – insurance we now find too expensive.

We wrote last quarter that we had reduced some of the portfolio's cyclicality and rate sensitivity. This likely helped our relative performance this quarter. However, in contrast to last quarter where we didn't see compelling valuation differentials, discounts are now looking more interesting. Investor skepticism regarding where we are in the economic cycle and the length of the recovery has resulted in relative performance differences looking very interesting in some cyclicals. We have decided to slowly start adding more cyclicality back into the portfolio. The extreme performance difference between cyclical and non-cyclical equities is illustrated below.

Past performance is no guarantee of future results.
Cyclicals (represented by CYCL) are stocks whose success varies with the seasonal or economic cycle.
Defensives (represented by DEFS) are stocks that are either stable or a market outperformer during an economic contraction.
Source: FactSet and Goldman Sachs Global Investment Research

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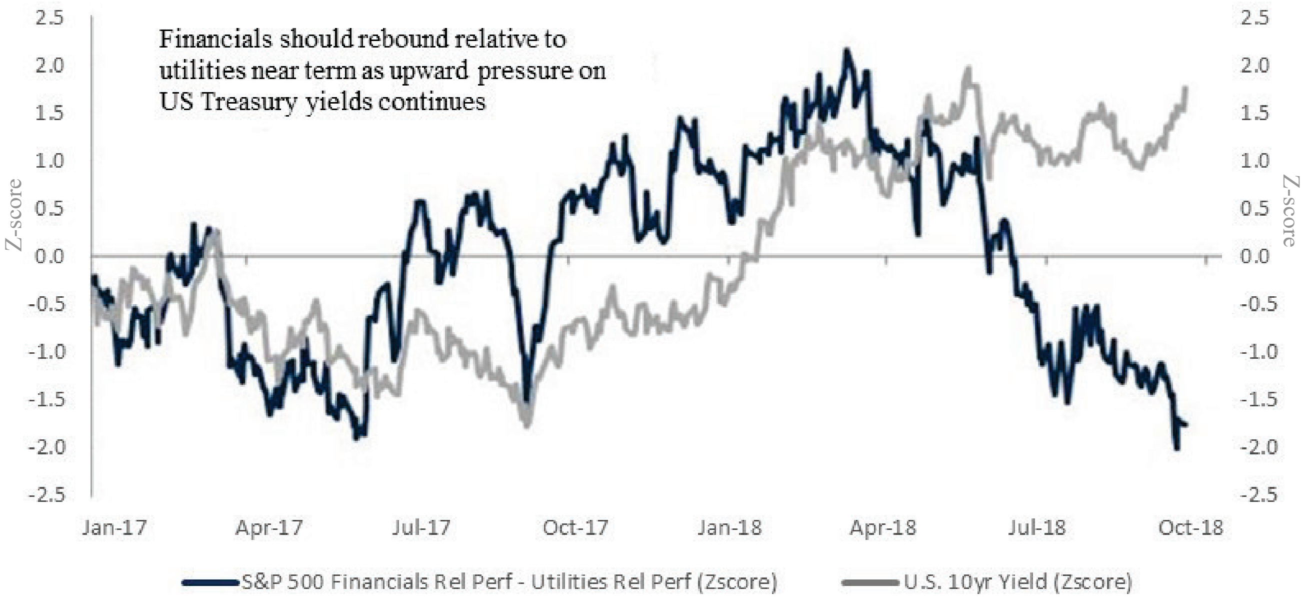
Moreover, the poor performance of banks relative to utilities, also illustrates the market's desire for safety over valuation.



Past performance is no guarantee of future results.
Z-score is a numerical measurement of a value's relationship to the mean in a group of values
Source: ISI and Goldman Sachs Global Investment Research

We don't think our thesis is without risk. The cycle is extended. Rates are rising. We are in the middle of a trade war. Midterm elections are coming in November. There is a lot to be concerned about, and one day this cycle, like all cycles, will end. Trees don't grow to the sky, as the saying goes. That said, we don't see the signs of an impending recession. It's hard to find the extreme excesses that precede a recession. Business capital expenditures have just begun to grow after 10+ years of sub-par performance. It seems premature to pronounce the cycle dead. We could be wrong, but historically we have bet along with valuation. To move to a very conservative position would require, in our opinion, paying prices where the only reward would be recession, and then it would come in the form of less negative returns relative to the benchmark. The best performing sector of the market was telecommunication services. Industrials and health care also outperformed. Materials was the worst performing sector and consumer staples also lagged. 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. Stock selection in consumer discretionary, health care and materials were the key positives. Stock selection in industrials was the most significant negative. Selection in consumer staples was a very minor negative. Sector weights were neutral to performance.

Performance in consumer discretionary was led by our media holdings and Royal Caribbean Cruises Ltd. (RCL). TEGNA, Inc. (TGNA) and Cinemark Holdings, Inc. (CNK) were up double digits. TEGNA, Inc. (TGNA) announced the accretive acquisition of two stations and raised their guidance for political advertising. Cinemark Holdings, Inc. (CNK) rallied on strength of the domestic box office and good uptake of their subscription offering. Royal Caribbean Cruises Ltd. (RCL) posted better than expected earnings, raised the midpoint of their annual guide, and noted 2019 bookings are pacing ahead of 2018.

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Molina Healthcare, Inc. (MOH) and Encompass Health, Inc. (EHC) were the largest contributors within health care. A management turnaround at Molina Healthcare, Inc. (MOH) led to strong results and raised guidance driven by an improved margin outlook. Capital structure improvements continue as debt has been reduced by $493M this year. Encompass Health, Inc. (EHC) enjoyed solid volume growth in the IRF segment, improvements in bad debt and better clinical collaborations which led to strong results. Home Health & Hospice also showed solid growth rates.

Allegheny Technologies Incorporated (ATI) and not owning some of the worst performing metals and mining stocks were positives within materials. Allegheny Technologies Incorporated (ATI) had impressive quarterly results and success in winning spot jet engine forging business as competitors struggle to meet demand. Flat rolled business continues to be guided to their $100M EBIT goal for 2019.

Performance in technology was a very minor positive. Notable positives included Nuance Communications, Inc. (NUAN) and Ciena Corporation (CIEN). Nuance Communications, Inc. (NUAN) increased their share buyback authorization and provided positive comments on the ongoing business review. Ciena Corporation (CIEN) delivered solid earnings results driven by broad based demand for optical capacity. Microchip Technology Incorporated (MCHP) clipped performance as it lowered guidance due to an inventory correction at recently acquired Microsemi and demand weakness.

Owens Corning (OC) and Knight-Swift Transportation Holdings Inc. Class A (KNX) were the biggest culprits in industrials. Owens Corning (OC) suffered from poor quarterly results and fears that inflation and lack of storm demand will cause margin compression in its roofing business. Knight-Swift Transportation Holdings Inc. Class A (KNX) missed earnings expectations because of an underperforming unit and suggested that a turnaround may be more protracted. This was somewhat offset by Huntington Ingalls Industries, Inc. (HII) which was up 18%. It benefitted from solid quarterly performance and continued positive comments from the government regarding Navy fleet expansion.

Consumer staples was negatively impacted by US Foods Holding Corp. (USFD) which missed earnings and announced a large acquisition to improve geographic range.

Overall performance in financials was a slightly negative. We had some modest outperformance within insurance led by Arthur J. Gallagher & Co. (AJG). It has benefitted from rising P&C pricing and its accretive acquisition strategy. However, this was outweighed by declines in Synovus Financial Corp. (SNV) and E*TRADE Financial Corporation (ETFC). Synovus Financial Corp. (SNV) announced a large bank acquisition that effectively ended the possibility of it being a near-term seller, which many investors believed to be the case. E*TRADE Financial Corporation (ETFC) was weighed down by pricing concerns as Fidelity introduced 0% fee ETFs and JP Morgan announced free commission trades.

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Past performance does not guarantee future results.

Risks Associated with Investing in the Fund: The Fund invests in smaller and medium-sized company stocks, which are more volatile and less liquid than larger, more established company securities. Value-based investments are subject to the risk that the broad market may not recognize their intrinsic value. 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.

Indexes Defined The Russell Midcap® Value Index measures the performance of those Russell Midcap® companies (approximately 800 of the smallest securities in the Russell 1000® Index, which includes the 1,000 largest stocks by market capitalization in the Russell 3000® Index, an index of the top 3,000 U.S. stocks by market capitalization covering 98% of the U.S. equity investable universe) with higher composite value scores. The S&P 500® Index is a widely recognized capitalization-weighted index that measures the performance of the large-capitalization sector of the U.S. stock market. You cannot invest directly in an index. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns.

Fund holdings mentioned in the Quarterly Commentary are as of 9/30/2018 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 9/30/2018 were: PPL Corporation (1.5%), Zimmer Biomet Holdings, Inc. (1.4%), L3 Technologies, Inc. (1.4%), Laboratory Corporation of America Holdings (1.4%), Host Hotels & Resorts Inc (1.3%), Camden Property Trust (1.4%), Huntington Ingalls Industries, Inc. (1.3%), HCP, Inc (1.3%), Ally Financial Inc. (1.2%), and Welltower, Inc (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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