INTEGRITY ASSET MANAGEMENT

Victory Integrity Small/Mid-Cap Value Fund | As of June 30, 2018

Quarterly Commentary

"Fasten your seatbelts; it's going to be a bumpy night."
All About Eve

We are entering a very interesting and complicated backdrop for the markets and the global economy with uncertainties from monetary policy, cracks in the synchronized global growth story, and escalating global trade tensions. Additionally, the yield curve continues to flatten, credit spreads are moving higher and the dollar has strengthened. Lastly, emerging markets stocks are correcting and commodity prices have become more volatile. Since our last communication, we have become more conservative in our outlook. Previously, we believed that cooler heads would prevail in the global trade disputes, however, tariffs have been enacted or threatened to be enacted globally and markets are adjusting to these uncertainties. Companies from General Motors, Campbell Soup and Harley Davidson, to name a few, are starting to feel the effects of the trade wars.

As we stated last quarter, we had begun to take some interest rate sensitivity out of the portfolios due to Federal Reserve interest rate increases and the resulting yield curve flattening. That said, we are not quite at the point of capitulation in the more interest rate sensitive groups. As the quarter progressed, we began to shift the portfolios to a more neutral position as the trade tensions increased more than we had predicted and the yield curve continued to flatten. We decreased weights in financials and industrials, while increasing weights in REITs and utilities. The portfolios are still tilted towards a growing economy, however, with this back drop we felt it prudent to position the portfolio in this manner. The best performing sector of the market was energy while industrials lagged. Small-mid value outperformed small-mid growth.

The Victory Integrity Small/Mid Cap Value Fund (A shares without sales charge) underperformed the Russell 2500™ Value Index benchmark for the period. Stock selection in energy, financials, industrials, materials, and consumer discretionary were the largest detractors to performance. Consumer staples, real estate, and health care were modest positives for the quarter. Sector weights were negative as an underweight to real estate and an overweight to industrials hurt. Higher market capitalization and lower momentum were large style headwinds. Flows into small cap ETFs were very sizeable and led to lower market cap stocks outperforming. According to Jefferies, the average Small/Mid cap value fund lagged by 250 basis points.

Ultra Petroleum (UPL, 0.00%), HollyFrontier Corp (HFC, 0.66%), and RSP Permian (RSPP, 0.00%) were the largest detractors within energy. In addition to the western gas differentials blowing out due to better weather, Ultra Petroleum Corp (UPL, 0.00%) released disappointing results on one of its horizontal wells. We exited the position. We bought HollyFrontier Corporation (HFC, 0.66%) late in the quarter and missed out on performance achieved earlier in the period. RSP Permian, Inc. (RSPP, 0.00%) is being acquired by CXO in a stock deal. The acquirer stock price has been pressured, which has pressured RSP Permian, Inc. (RSPP, 0.00%). Delek US Holdings (DK, 0.67%) was a top performer. The refiner has the largest percentage throughput exposure to Permian-priced crudes and should benefit with Permian differentials widening and not expected to reverse course until mid-2019.

Within financials, Ally Financial (ALLY, 1.87%), MGIC Investment Corp (MTG, 0.00%) and Stifel Financial Corp. (SF, 0.68%) hurt performance. Investor consternation over exposure to lower credit quality auto borrowers have outweighed solid results and a strong capital return story for Ally Financial (ALLY, 1.87%). MGIC Investment Corporation (MTG, 0.00%) succumbed to deteriorating pricing pressure which was evident across the entire mortgage insurance complex. Stifel Financial Corp (SF, 0.68%) sold off along with other interest rate sensitive stocks.

Security selection in industrials hampered performance. Mixed guidance and uncertainty around the impact of the French CICE tax credit changes sparked a sell off in ManpowerGroup, Inc (MAN, 0.00%). Concerns that truckload pricing and demand have already peaked pressured Knight-Swift Transportation Holdings Inc. Class A (KNX, 0.82%). Huntington Ingalls Industries, Inc. (HII, 0.97%) underperformed as the company cut long-term EBIT margin guidance due to a younger program/delivery mix over the next two years.

Quarterly Commentary

In materials, Alcoa (AA, 0.00%) and Summit Materials, Inc (SUM, 0.00%) detracted. Alcoa (AA, 0.00%) suffered from volatility in aluminum and alumina prices due to trade war rhetoric. While we like the fundamental backdrop, the volatility in the trade market has forced us to exit the position. A sell-off post-earnings due to poor weather and reliance on a back half weighted year hampered Summit Materials, Inc. Class A (SUM, 0.00%). We exited the position.

Wyndham Destinations, Inc. (WYND, 0.69%) and Dana Incorporated (DAN, 0.49%) limited performance within consumer discretionary. Wyndham Destinations, Inc. (WYND, 0.69%) succumbed to profit taking and investor rotation as they completed the spin-off of their hotel assets. Dana Incorporated (DAN, 0.49%) fell on concerns over tariffs and increased steel costs pressuring earnings. Macy's (M, 0.60%) helped offset performance as the company had a beat and raise quarter benefitting from better demand, tight inventory control, and strategic initiatives.

Performance Food Group Company (PFGC, 0.84%) and Lamb Weston Holdings, Inc. (LW, 1.02%) were the top performers within consumer staples. Performance Food Group Company (PFGC, 0.84%) benefitted from strong movie concession sales. Lamb Weston Holdings, Inc. (LW, 1.02%) benefitted from tight capacity within the potato industry.

DDR Corp (DDR, 1.72%) and Kimco Realty Corporation (KIM, 1.06%) were highlights within real estate. Solid earnings results and stabilization in retail fundamentals led to the rebound in both DDR Corp (DDR, 1.72%) and Kimco Realty Corporation (KIM, 1.06%).

Encompass Health Corporation (EHC, 1.29%), Molina Healthcare, Inc. (MOH, 0.87%), and Magellan Health, Inc. (MGLN, 0.75%) were the top contributors within health care. Encompass Health Corporation (EHC, 1.29%) outperformed on continued volume strength and improved growth from the move into home health. Molina Healthcare, Inc. (MOH, 0.87%) was strong as the company made progress toward their long term 1.5 – 2.0% margin target and earnings were well above expectations for the first quarter. We bought Magellan Health, Inc. (MGLN, 0.75%) intra-quarter on a pullback. The company rallied on the prospects of stronger earnings from new contract wins in Virginia to offset the lost Florida Medicaid business.

Technology had one notable contributor and detractor. Synaptics Inc. (SYNA, 0.51%) led the way within technology as the company confirmed that they are engaged in merger discussions with Dialog Semiconductor. Flex Ltd. (FLEX, 0.00%) underperformed following another quarter of execution issues and profitability pushouts with a new program ramp.

The contrarians in us would very much love to bet against the increasingly consensus view that we are heading for an all-out global trade war as corporate profits are solid, interest rates are still low, the consumer is strong, the regulatory environment is pro-business and valuations are palatable in some groups. Unfortunately, the eventual outcome of the trade tensions are binary, and the markets have not completely discounted the impacts of a full-blown trade war. Hence, we are very cognizant that we are always one tweet away from global tensions being alleviated or escalated. However, we fear some real damage has already been done from the rhetoric and the first round of tariffs. Bottom line, it's going to be a very volatile market this summer, but hopefully cooler heads can prevail and markets can refocus on fundamentals.

VictoryFunds®

Quarterly Commentary

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 2500™ Value Index measures the performance of those Russell 2500™ Index companies (approximately 2,500 of the smallest securities 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. 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 6/30/2018 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 6/30/2018 were: Ally Financial Inc. (1.9%), PacWest Bancorp (1.8%), DDR Corp. (1.7%), Synovus Financial Corp. (1.7%), American Financial Group, Inc (1.4%), Camden Property Trust (1.3%), Encompass Health Corp (1.3%), Zions Bancorporation (1.2%), American Campus Communities (1.2%) and Duke Realty Corp. (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.

The information in this article is based on data obtained from recognized services and sources and is believed to be reliable. Any opinions, projections or recommendations in this report are subject to change without notice and are not intended as individual investment advice. The securities highlighted, if any, were not intended as individual investment advice. A complete list of all recommendations of security selection is available by request for the previous 12 months. Furthermore, Victory Capital Management Inc., and its affiliates, as agents for their clients, and any of its officers or employees, may have a beneficial interest or position in any of the securities mentioned, which may be contrary to any opinion or projection expressed in this report.

SHARES OF THE FUND MAY BE SUBJECT TO SALES CHARGES AND OTHER FEES. AN INVESTOR SHOULD CONSIDER THE FUND'S INVESTMENT OBJECTIVES, RISKS, AND CHARGES AND EXPENSES CAREFULLY BEFORE INVESTING OR SENDING MONEY. THIS AND OTHER IMPORTANT INFORMATION ABOUT THE INVESTMENT COMPANY CAN BE FOUND IN THE FUND'S PROSPECTUS. TO OBTAIN A PROSPECTUS, PLEASE CALL 1-800-539-FUND OR VISIT WWW.VCM.COM. PLEASE READ THE PROSPECTUS CAREFULLY BEFORE INVESTING.

THE FUNDS ARE DISTRIBUTED BY VICTORY CAPITAL ADVISERS, INC. ("VCA"), MEMBER FINRA AND SIPC. VICTORY CAPITAL MANAGEMENT INC., AN AFFILIATE OF VCA, IS THE INVESTMENT ADVISOR TO THE FUNDS AND RECEIVES A FEE FROM THE FUNDS FOR ITS SERVICES.

V17.054 // 2Q 2018 INTGY SMID Cap Val Fund COM

VictoryFunds®