INTEGRITY ASSET MANAGEMENT

Victory Integrity Small/Mid-Cap Value Fund As of September 30, 2019

Quarterly Commentary

Cloudy With a Chance of Meatballs
(2009)

This past quarter had more twists and turns than a roller-coaster ride at Cedar Point (FUN). Volatility was the word of the quarter. We had a little bit of everything—the bombing of a Saudi Aramco oil field, the opening of the impeachment inquiry into Donald Trump, plunging global interest rates, a violent sell-off in August followed by a deep value micro-cap rally to start September, strains in the repo market, the continued saga of the U.S.-China trade war, and a yield curve that has bounced in and out of inversion.

As we enter this upcoming earnings season with the backdrop of slowing global growth and global manufacturing in a recession, we are expecting a tremendous amount of volatility. We are planning to use this volatility opportunistically to tilt the portfolio a little more cyclically. With global interest rates declining and a solid U.S. jobs market, we feel this could be an interesting time to tactically add a modest amount of exposure to smaller cyclical companies as their valuations become more attractive. While smaller/micro companies have underperformed year to date, we are mindful of the potential tailwind for these companies if we are not going off a cliff. All of this is predicated on our belief that the U.S. will not go into a recession and that global economies, while weak, are bottoming. Historical recession indicators (beyond the inverted yield curve) are not evident, such as surging oil prices, spiking initial unemployment claims, and widening of credit spreads, and there are no obvious bubbles to unwind. The best performing sector of the market was real estate (+6.9%). Utilities and consumer staples also outperformed. Energy was the worst performing sector (-17.5%). Health care and communication services also underperformed. 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 materials, financials, utilities, and industrials detracted from performance. Security selection in energy and health care helped performance. Sector weights were a minor negative as our underweight to real estate (the best performing sector) hurt. From a style perspective, higher market capitalization was a tailwind, while higher beta than the benchmark detracted.

Chemical companies hurt performance within materials. Orion Engineered Carbons SA (OEC) cut guidance due to weaker than anticipated global auto production and raw material inflation. Concerns about exposure to Chinese auto sales weighed on Ingevity Corporation (NGVT). Cleveland-Cliffs Inc. (CLF) detracted, as the company underperformed due to declining global iron ore prices. U.S. Concrete, Inc. (USCR) was a bright spot, as the company benefited from favorable third quarter weather trends for construction work and volumes.

Security selection in banks was the largest detractor within financials. Our average bank holding underperformed the benchmark (-4.9% vs. -1.0%). Eagle Bancorp, Inc. (EGBN) was a notable detractor. The company announced it was under investigation stemming from accusations of illegal behavior from a former consultant of the company. Assurant, Inc. (AIZ) was a positive contributor, as strong earnings and increased synergies from The Warranty Group acquisition helped.

Utilities were the second-best performing sector (+6.4%), and our underweight was a slight headwind. In addition, we missed owning a couple of the top-performing utility companies, as our average holding underperformed (2.3% vs. 6.4%).

Meritor, Inc. (MTOR), EnerSys (ENS), and Timken Co. (TKR) were the largest detractors within industrials. Meritor, Inc. (MTOR) fell as fears over the end of the Class 8 truck cycle and continued tariff concerns weighed on the stock. EnerSys (ENS) continued poor execution on an ERP (enterprise resource planning) implementation and experienced weakening demand. Timken Co. (TKR) reduced 2019 guidance for slower sales and earnings growth due to macro concerns. Old Dominion Freight Line, Inc. (ODFL) helped as the company continued solid execution despite a slowdown within industrial markets.

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Energy was a positive contributor thanks to avoiding some of the worst performing energy names (McDermott International, down 79%, for example). Our average energy holding outperformed the index (-6.6% vs. -17.5%). Diamondback Energy, Inc. (FANG) was a notable detractor given the commodity backdrop.

Security selection in health care was aided by not owning biotechnology companies and by avoiding pharmaceutical companies that underperformed. Our average health care holding outperformed the index (-0.2% vs. -9.8%). Perrigo Co. Plc (PRGO), up 18%, was our top contributor. Magellan Health, Inc. (MGLN) limited performance. The announced retirement of their CEO & chairman reduces their takeout potential as was previously rumored. In addition, the company saw some delays in NY rates, which lowered health care earnings.

Consumer staples and technology were slight positives. Performance Food Group Co. (PFGC) was the top performer in consumer staples, as the company delivered strong earnings along with the announcement of an accretive acquisition. SYNNEX Corp. (SNX), MACOM Technology Solutions Holdings (MTSI), and Anixter International Inc. (AXE) were highlights in technology. Strength in their distribution segment resulted in a beat-and-raise quarter for SYNNEX Corp. (SNX). Cost-cutting drove improved profitability in the quarter for MACOM Technology Solutions Holdings (MTSI). Anixter International Inc. (AXE) reported strong earnings as they continue to benefit from their exposure to utility spending. Conduent, Inc. (CNDT) limited performance as the company provided disappointing guidance on continued execution issues and weak new business bookings. The company also suspended their CEO search and announced a strategic review.

Real estate was a narrow negative. Our aforementioned underweight offset positive security selection. Americold Realty Trust (COLD) benefited from robust supply/demand dynamics within their cold storage segment. Lower interest rates, along with solid results and continued leasing progress, led to outperformance for SITE Centers Corp. (SITC). Lower interest rates and the defensive nature of triple net REITs aided STORE Capital Corp. (STOR).

Security selection within consumer discretionary slightly detracted from performance. Shares of Adtalem Global Education Inc. (ATGE) were pressured by mixed enrollment trends and growing concerns that a Democratic presidency would increase regulatory scrutiny of the for-profit educators. Dana Inc. (DAN) reduced top-line guidance due to sluggish end markets. Aramark (ARMK) aided performance as news of an activist taking a position and the retirement of the CEO following a spate of mis-executions boosted shares.

With visibility very limited, maybe the 2009 movie title *Cloudy With a Chance of Meatballs* describes this market environment perfectly, as we never know what’s coming next! However, with an easing global interest rate environment, a solid U.S. consumer, global economies that appear to be bottoming, negative investor sentiment, and the possibility of a China trade deal/truce, this could certainly set up a more positive economic backdrop.

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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 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 9/30/2019 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 9/30/2019 were: Duke Realty Corp. (1.7%), STORE Capital Corp (1.5%), Camden Property Trust (1.5%), American Financial Group, Inc (1.5%), AGNC Investment Corp, (1.4%), Quanta Services, Inc. (1.4%), Leidos Holdings, Inc (1.2%), Apartment Investment and Management Co (1.3%), Highwoods Properties, Inc (1.3%), and Voya Financial, Inc. (1.3%). 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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