INTEGRITY ASSET MANAGEMENT

Victory Integrity Small/Mid-Cap Value Fund As of September 30, 2020

Quarterly Commentary

Darling I don't know why I go to extremes
Too high or too low, there ain't no in-betweens
And if I stand or I fall
It's all or nothing at all
Darling I don't know why I go to extremes.
– Billy Joel

Everything just seems so extreme these days—politics, mask or no mask, in-person school or virtual school, economy open or closed. The market, it turns out, is not much different. So far this year, we have witnessed many extremes. The year 2019 marked the worst ten-year period since the Great Depression for small value stocks compared to small growth. This year hasn't been any better, with the Russell 2000® Growth beating the Russell 2000® Value by over 25% as of the end of the third quarter. Even more extreme has been the tech-heavy Nasdaq-100® Index, which has outperformed the Russell 2000® Value Index by over 50% year to date (53.19%, to be exact). For those keeping score at home, the difference at the end of the second quarter was a little over 40%. During the third quarter, one stock—Apple—saw its market capitalization exceed the TOTAL market capitalization of the Russell 2000®. Moreover, the market capitalization of the five largest names in the S&P 500® (AAPL, MSFT, AMZN, FB and GOOGL) is more than **five** times larger than the Russell 2000® Value.

According to Evercore ISI, this year there have been more than 600 stimulus actions implemented globally. This has increased liquidity, and that liquidity is hiding out in these top growth stocks. These stocks, in our opinion, have become the new utilities. We aren't arguing this is the tech bubble of 2000. However, given the extreme market-cap differential between just the top five stocks in the S&P 500®, we don't need a wholesale change in money flows for the value space to do well.

All that sounds pretty extreme, but what's the catalyst for change, and are there any signs of it? To paraphrase James Carville, "It's the virus, stupid." To quote him directly: "It's the economy, stupid." The two are obviously linked. The economy, so far, seems to be on a path to recovery. Perhaps the more than 600 stimulus measures are having an effect.

Furthermore, positive news on the virus should benefit value stocks. Empirical Research Partners has shown that growth stocks are negatively correlated to positive news on the virus. Conversely, value stocks are positively correlated to good virus news. In our opinion, this is a strong indication that a vaccine or the virus running its course will be good for value performance relative to growth. More importantly, we have positioned the portfolio to benefit when this rotation occurs. Our analysis shows that year-to-date, when our benchmark, the Russell 2500® Value Index, beats the Russell 2500® Growth Index, we outperformed 68% of the time.

The best performing sector of the market was consumer discretionary (+16%). Communication services and materials also outperformed. Energy was the worst performing sector (-16%). Small/mid cap growth outperformed small/mid cap value.

The Victory Integrity Small/Mid Cap Value Fund (A shares without sales charge) outperformed the Russell 2500™ Value Index benchmark for the period. Stock selection in technology, industrials, and financials led to outperformance. Security selection in consumer discretionary and communication services limited performance. Sector weights were neutral. From a style attribution perspective, higher liquidity than the benchmark was a tailwind.

Solid performance in software companies had the largest impact within technology, and Nuance Communications, Inc. (NUAN) led the way. The company produced a beat-and-raise quarter, driven by upside in both health care and enterprise segments. Not owning some of the underperformers within technology also helped, in particular not owning Ciena (CIEN), which was down 27% for the period.

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Perspecta, Inc. (PRSP) hurt performance as the company and its peers came under pressure amid concerns about COVID-19 stimulus squeezing out future government defense and IT spending.

Within industrials, security selection in building products companies was the top highlight. Accelerating housing starts and excitement about the announced merger with peer BMC Stock Holdings, Inc. (BMCH) lifted Builders FirstSource, Inc. (BLDR). Additional solid performers included Beacon Roofing Supply, Inc. (BECN), Chart Industries, Inc. (GTLS), and Quanta Services, Inc. (PWR). Beacon Roofing Supply, Inc. (BECN) benefited from accelerating housing starts, strong existing home sales, and improved shingle pricing. Chart Industries, Inc. (GTLS) reported strong quarterly results and saw improved sentiment due to its exposure to the hydrogen fuel cell market. Quanta Services, Inc. (PWR) reported quarterly upside results and raised guidance while reinstating its share repurchase program thanks to strong utility capex spending.

Kinsale Capital Group, Inc. (KNSL) was the top performer within financials. Kinsale Capital Group, Inc. (KNSL) reported strong revenue growth and favorable loss experiences. In addition, the company issued equity to fund future growth. Security selection within consumer finance companies also helped, as our average holding outperformed the benchmark (20% versus 2%). Discover Financial Services (DFS) and Ally Financial Inc. (ALLY) were the highlights in consumer finance. Banks were a small contributor overall due to an underweight position. The average bank holding was down 9% as credit worries and perceptions that interest rates would remain low for an extended duration weighed on the group. Western Alliance Bancorp (WAL) was the largest detractor within the group.

Within consumer discretionary, not owning L Brands, Inc. (LB) and Penn National Gaming, Inc. (PENN) hurt, as both companies outperformed (up 112% and 138%, respectively). Of the companies that we owned, WW International, Inc. (WW), Sally Beauty Holdings, Inc. (SBH), and Kohl's Corp. (KSS) detracted. Despite progress on digital initiatives and strong user retention, quarterly results for WW International, Inc. (WW) missed expectations on weakness in their onsite studios business, which remains impacted by COVID-19. Sally Beauty Holdings, Inc. (SBH) sold off on an unexpected inventory write down and concerns that their professional supply business would be impacted by a deceleration in salon visits following a demand surge upon reopenings. A slow back-to-school selling season and a cautious second-half outlook pressured shares of Kohl's Corp. (KSS). Darden Restaurants, Inc. (DRI), PulteGroup, Inc. (PHM), and Caesars Entertainment Inc. (CZR) were positives. Shares of Darden Restaurants, Inc. (DRI) rallied on improved results as the number of closed restaurants due to COVID-19 decreased during the quarter while their off-premise business remained resilient. Homebuilders such as PulteGroup, Inc. (PHM) continued to outperform on low interest rates, strong demand, and favorable supply/demand dynamics. Following the closure of their merger with Eldorado Resorts, Caesars Entertainment Inc. (CZR) outperformed as investors shifted their attention to internet gaming and sports betting opportunities.

Stock selection in communication services detracted. Not owning Zillow Group, Inc. Class C (Z) had the largest impact, as it returned 76% for the period. Cinemark Holdings, Inc. (CNK) underperformed as theater shares lagged on lackluster box office results from new movie releases and additional movie release pushouts. Lions Gate Entertainment Corp. Class B (LGF.B) helped as the company benefited from strong library sales and limited production costs, which boosted margins and cash flow.

Utilities and energy both had modestly positive effects on performance. Our average utility holding outperformed the benchmark (+2.2% versus -1.37%). Energy was the worst performing sector in the benchmark (down 16%). Both our underweight to the sector and not owning some of the worst performing names helped. Of the names that we owned, Diamondback Energy, Inc. (FANG) was a noticeable detractor. The company underperformed as commodity price uncertainty continues to pressure the energy sector. The company also took a $2.5B impairment charge related to lower TTM commodity pricing.

The sell-off in the first quarter was rapid. We believe the recovery could come as quickly. We see a vaccine as the ultimate catalyst for a sustained reversal in market leadership. We have tilted the portfolio toward stocks that we believe will outperform as fears of the virus subside. We obviously don't know when a vaccine will be approved. However, according to the *New York Times* Coronavirus Vaccine Tracker, there are 11 vaccines in phase 3 trials. Not all the vaccines are likely to get approval, but we feel the odds are in favor of one proving effective and getting approved for use in the U.S. With the potential for a rapid rebound, we believe we need to be positioned now. We have experience with similar market extremes, and they tend to revert to the mean. We have continued our strategy discussed last quarter of smaller position sizes in companies with strong rebound potential. We believe that a value rotation is in the offing with an identifiable catalyst, and we have positioned accordingly.

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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 9/30/2020 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 9/30/2020 were: ON Semiconductor Corp. (1.4%), Medical Properties Trust, Inc (1.2%), Highwoods Properties, Inc (1.1%), STORE Capital Corp (1.1%), Assurant, Inc (1.1%), PulteGroup, Inc (1.0%), AGNC Investment Corp. (1.0%), Apartment Investment and Management Co (1.0%), Arrow Electronics, Inc (1.0%), and Sensata Technologies Holding PLC (1.0%). 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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