VICTORY income investors®

Active Management.
Independent Perspectives.

Serving Fixed Income Investors Since 1970.

2024 MID YEAR OUTLOOK

Preparing for the Pivot

Our 2024 Mid Year fixed income outlook is driven by four themes

> **Fixed Income is attractive in our view, both on an absolute and relative basis.** We remain defensive regarding credit risk.

> **We expect monetary policy to continue dominating the narrative**. Adding fixed income throughout the remainer of 2024 might be a better strategy than trying to precisely time the Fed's pivot.

> **Don't get distracted by election year market commentary** – sticking to a long-term strategy to achieve your investment goals is likely the best strategy.

> **Although we are defensive regarding credit positioning, we think there are a couple of pockets of opportunity.** Specifically, Asset Backed Securities (ABS) and Agency Mortgage-Backed Securities (MBS).

What's Inside

20240628-3672846

Executive Summary

Fixed income investors may benefit from higher yields as historically, fixed income returns have been highly correlated to starting yields. In our view, elevated recession risks and tighter-than-historical average credit spreads support defensive credit positioning.

	Defensive	Neutral	Aggressive
Credit Positioning	☑	☐	☐
Investment Grade	**Underperform**	**Neutral**	**Outperform**
Treasury	☐	☐	☑
Agency Mortgage-Backed Securities	☐	☐	☑
Corporate	☑	☐	☐
Loans	☑	☐	☐
Asset Backed Securities	☐	☐	☑
Commercial Mortgage-Backed Securities	☐	☑	☐
Taxable Municipal Bonds	☐	☑	☐
Tax-Exempt Municipal Bonds	☐	☑	☐
Below Investment Grade	**Underperform**	**Neutral**	**Outperform**
High Yield Bonds	☑	☐	☐
Loans	☑	☐	☐

As of May 31, 2024. The above views reflect the relative value of sectors shown based on the forward-looking return expectations over the next 12 months relative to the Bloomberg U.S. Aggregate Index.. A defensive stance in fixed income investing involves making choices that prioritize safety and stability, even if it means sacrificing some potential returns in exchange for reduced risk. It's a strategy often favored by investors seeking to protect their portfolios during periods of uncertainty or economic downturns.

Investment Grade Corporate Bonds

Investment Grade Corporate bonds are offering lower compensation (or spread), relative to history, for taking credit risk.

High Yield Corporate Bonds

High Yield Corporate bonds have experienced a rise in defaults in 2023 vs 2022, and we expect weaker earnings and wider spreads for the asset class.

Taxable Municipal Bonds

We expect credit quality for taxable municipal bonds to remain strong, however, we view other asset classes within taxable fixed income as offering better relative value.

Tax-exempt Municipal Bonds

Tax-exempt municipal bonds continue to be an attractive opportunity for tax-sensitive investors, as credit quality remains strong, and tax equivalent yields are compelling.

Securitized Debt

Residential Mortgage-Backed Securities (MBS), Asset Backed Securities (ABS), and Commercial Mortgage-Backed Securities (CMBS) may offer compelling relative value opportunities.

Money Markets

Cash currently offers compelling yields, but we think reinvestment risk is rising and intermediate duration bonds might offer better return opportunities.

For illustrative purposes only--not to be construed as investment advice or a recommendation to buy, sell or hold any security

20240628-3672846

Fixed Income is Attractive on an Absolute and Real Basis

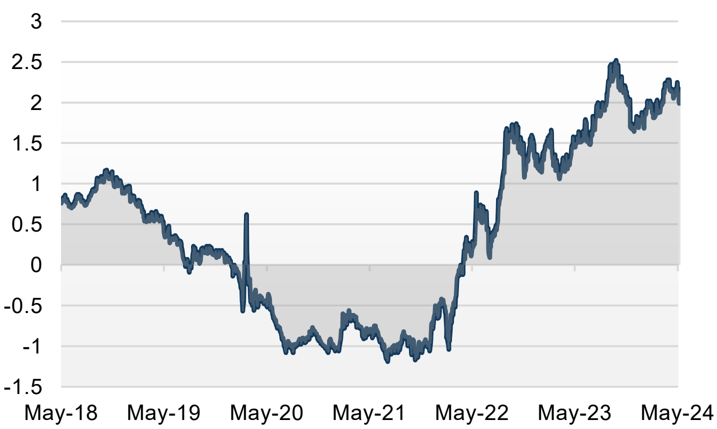
With the possibility of rate cuts on the horizon current yields may provide investors with notable room for price appreciation once the Fed begins cutting rates. **Chart 1** highlights that the current yield to worst of the Bloomberg Aggregate Index remains elevated and presents an attractive entry point for fixed income investors. Additionally, real yields, which provide a more accurate measure (as they are adjusted for inflation), are positive **(Chart 2).** This indicates to us, as fixed income investors, that bonds look attractive on both an absolute and real basis. However, it's of note that the compensation investors receive for taking on additional credit risk (the credit spread) is historically low **(Chart 3),** and we remain defensive regarding credit risk.[1] But, overall, fixed income looks attractive.

[1]Credit risk refers to the possibility that debt issuers may not be able to make principal and interest payments or may have their debt downgraded by ratings agencies.

Chart 1: Bond Yields Have Dropped From 2023 Highs But Remain at Historically High Levels

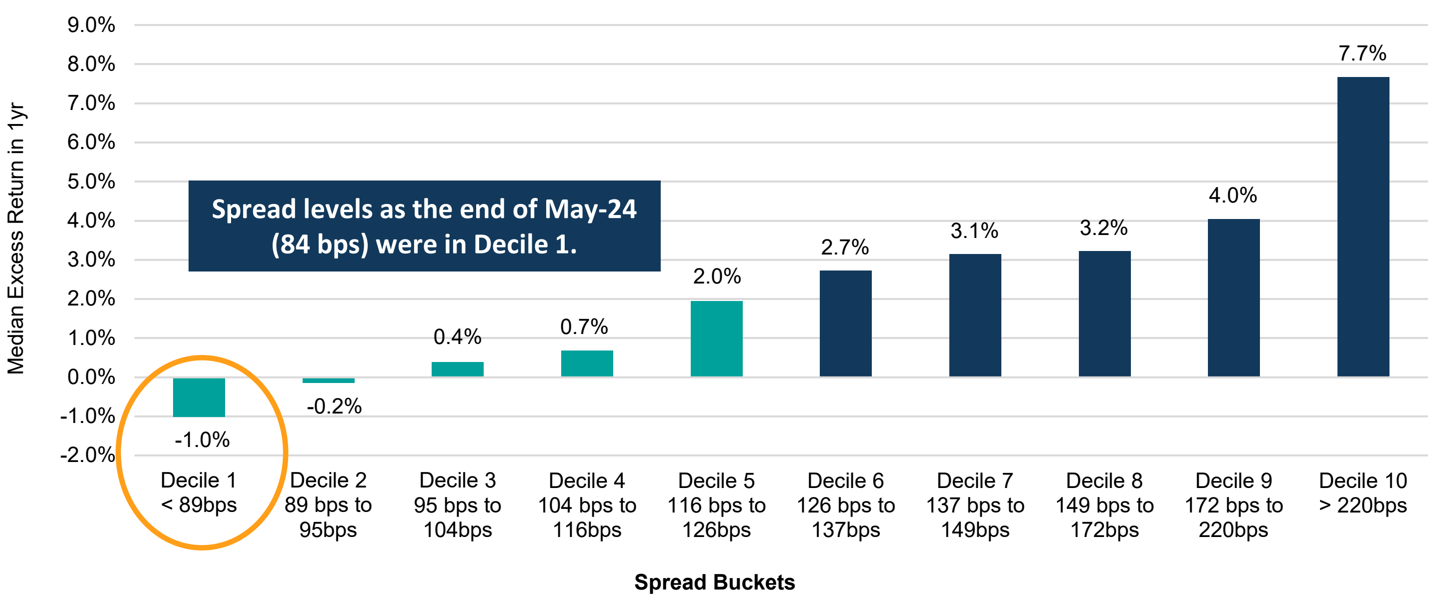
Source: Bloomberg

Chart 2: 10-Year Inflation Indexed Treasury Real Yield (%)



Source: Bloomberg

Chart 3: Bloomberg Corporate Index Excess Returns' Relationship with Spread Levels

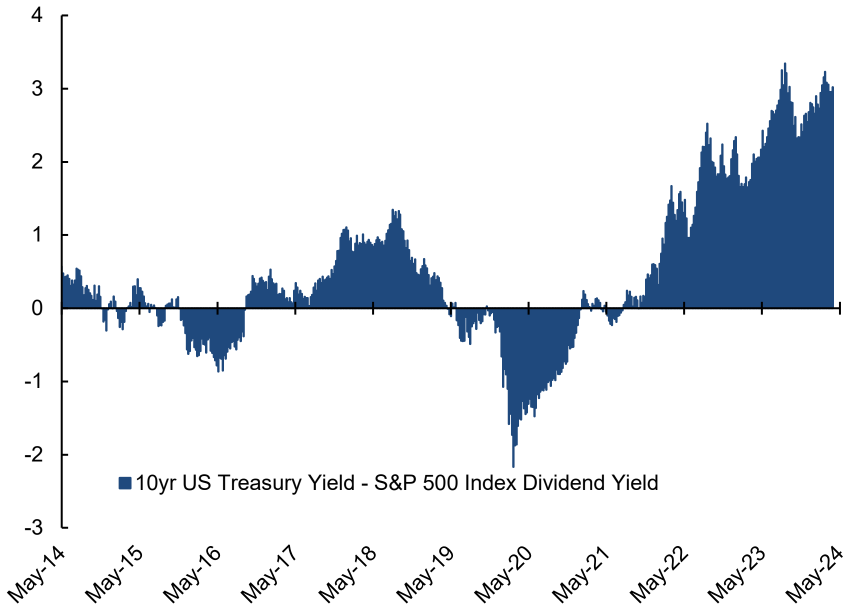


Source: Bloomberg

Past performance is no guarantee of future results. Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

20240628-3672846

Chart 4: 10-Year US Treasury Yield Minus S&P 500 Index Dividend Yield



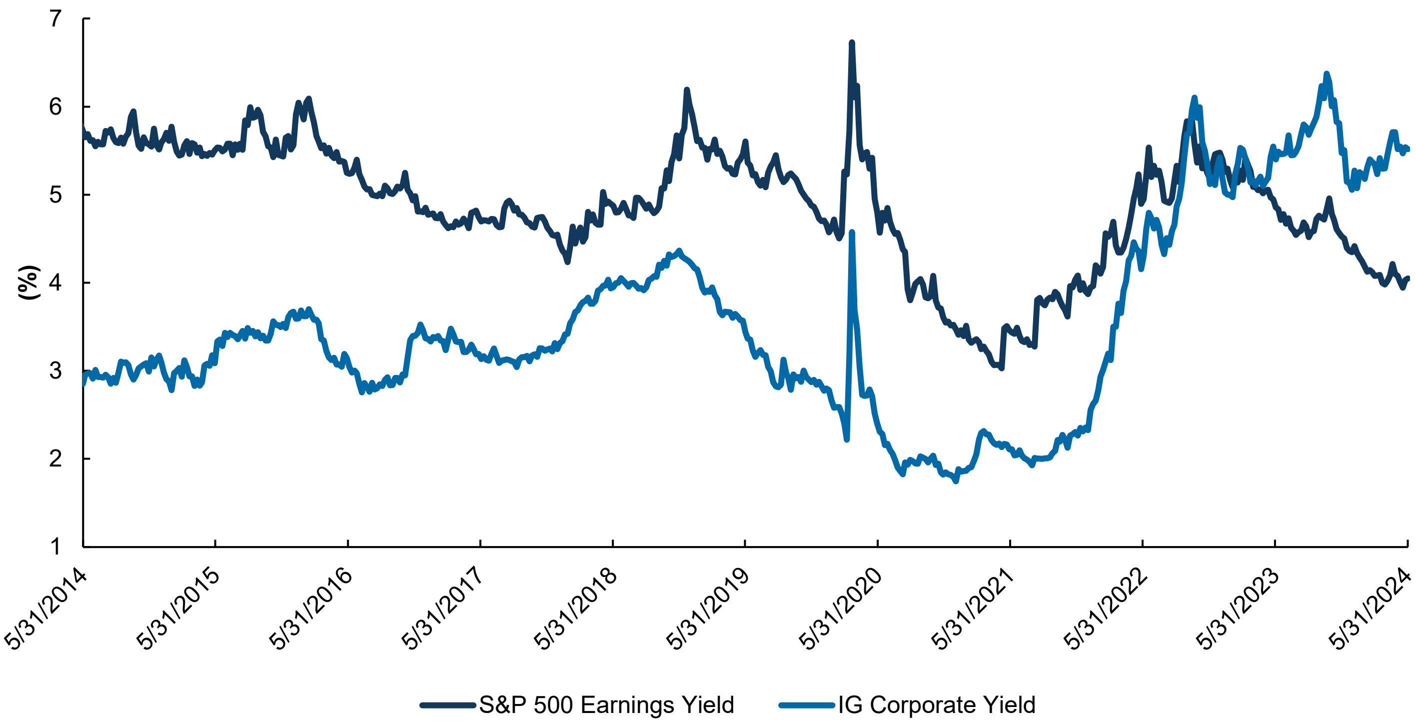
Source: Bloomberg

Past performance is no guarantee of future results. Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

Relative Valuation Looks Attractive

Fixed income looks attractive relative to equities. We looked at two valuation metrics to consider the valuation of Treasury bonds and investment grade bonds versus the S&P 500 index. The yield on the 10-year U.S. Treasury currently exceeds the *dividend* yield on the S&P 500. Which, in our view, indicates bonds are cheap **(Chart 4)**. This view is further supported by comparing the yield on investment grade U.S. corporate bonds to the earnings yields on the S&P 500. As is demonstrated in **Chart 5**, the yield on investment grade corporates has surpassed the *earnings* yield on the S&P 500.

Chart 5: Investment Grade Corporate Yields Exceed Equity Earnings Yield



Source: Bloomberg. "IG Corporate" is represented by the Bloomberg Corporate Index.

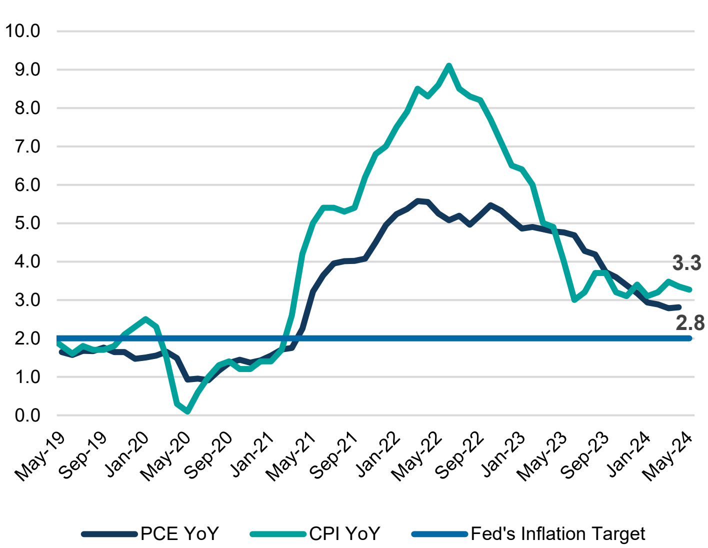
Past performance is no guarantee of future results. Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

20240628-3672846

Monetary Policy Still Dominates the Narrative, Lower Rates on the Horizon?

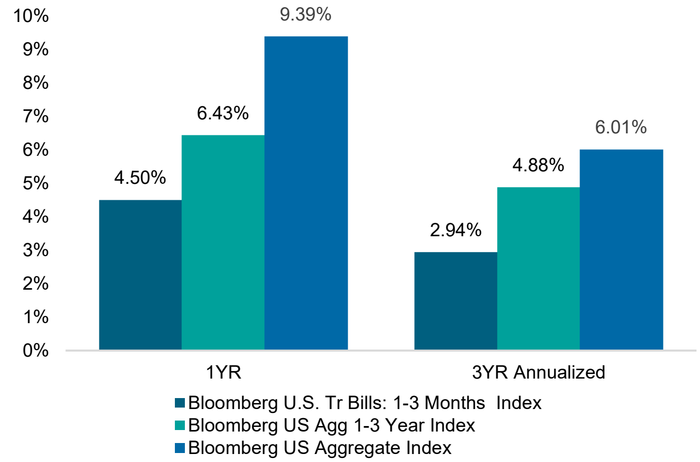
The Fed has kept rates at restrictive levels since July of 2023, but there have been signals of economic softening and moderating inflation, see **Chart 6**, that have influenced the forecasts for rate cuts for the remainder of 2024. These forecasts have dramatically fluctuated over the last year, see **Chart 7**, and might not be a reliable indicator of the Fed's future actions. However, should the trends in economic data continue and demonstrate sufficient economic slowdown there is an increased chance that investors will see one to two cuts this year. There is historical evidence that shows extending duration during the pause between the last hike and first cut could be a beneficial strategy, see **Chart 8**.

Chart 6: Moderating Inflation, Still Above Target



Source: Bloomberg

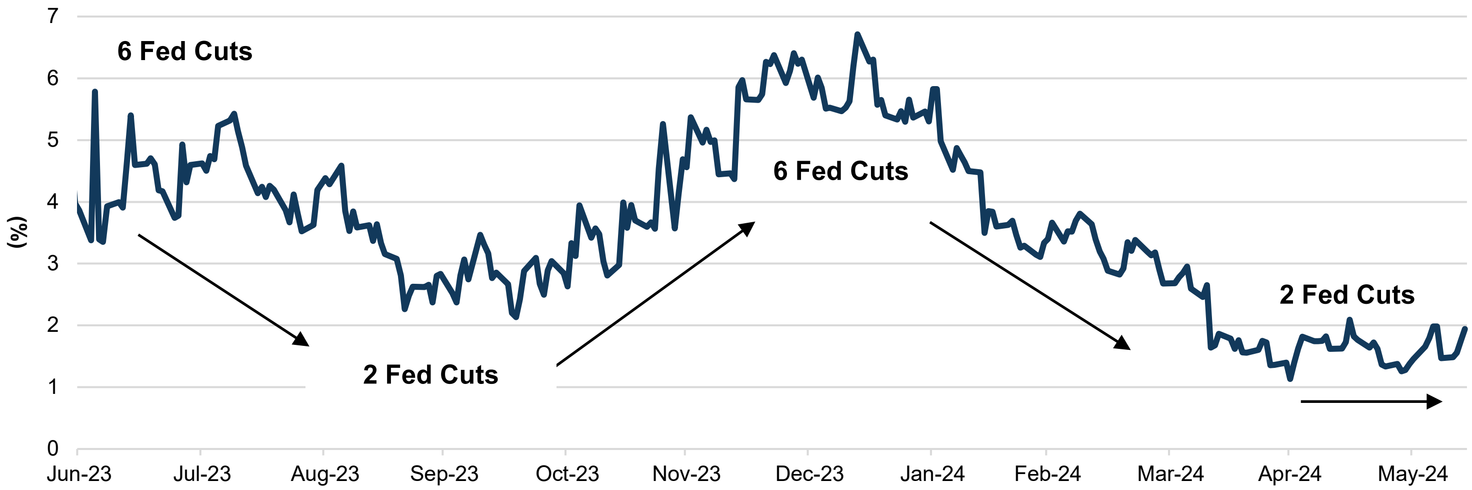
Chart 8: Returns Following the Last Rate Hike



Source: Bloomberg, Shows returns for the past 4 rate hiking cycles (Since 1984)

Past performance is no guarantee of future results. Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

Chart 7: Market Pricing of Fed Cuts in 2024 is Volatile; Precisely Timing the Pivot is Proving Difficult



Source: Bloomberg

These charts signal, in our view, a higher likelihood of an easing of monetary policy over the next 12 to 24 months. While the Fed will likely require consistent data trends to bolster their path forward, we see little chance that, this year being an election year, impacting the decision-making process.

20240628-3672846

Investing in an Election Year

It's that time again. 2024 is a big year for elections abroad and at home and, in our view, investors should be wary of the riptide of recommendations they bring. Political affiliation can lead to drastically different consumer sentiment, as indicated by **Chart 9**, and we advise some caution on how political bias may impact investment strategies. **Chart 10** highlights the historical returns for the various asset classes throughout multiple election cycles – which suggests that political leadership does not have an outsized impact on performance. With these points in mind, we believe that remaining loyal to your long-term strategy amidst the noise is a worthwhile practice.

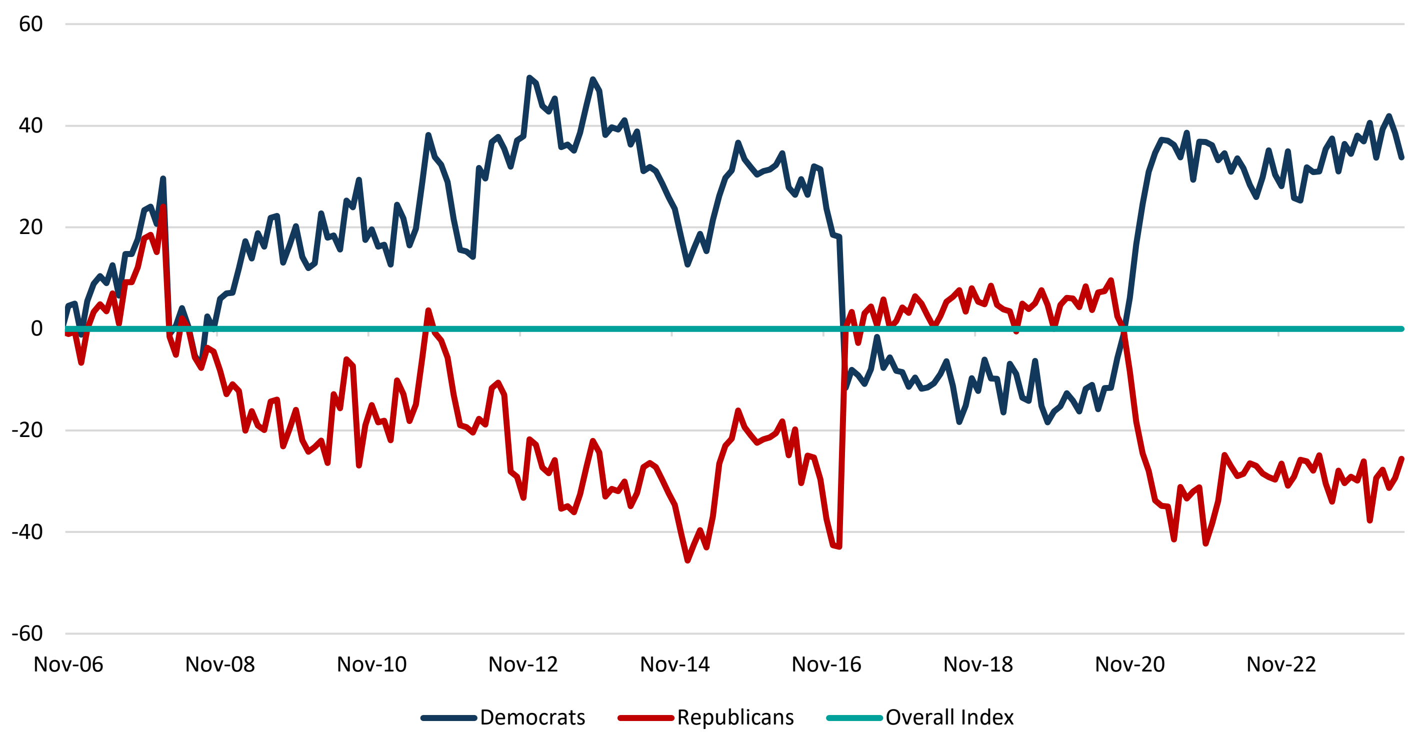
Chart 10: Annualized Investment Return and GDP Growth by Presidential Party

Average Annualized Return	Republican	Democrat	Average
Average GDP % Change From Previous Year	2.69%	2.93%	2.81%
Bloomberg U.S. Aggregate Index	9.21%	3.91%	6.56%
Bloomberg Corporate Index	9.87%	4.65%	7.26%
Bloomberg Municipal Index	7.71%	4.80%	6.25%
S&P 500 Index	8.04%	11.91%	9.97%

Source: Bloomberg, Bureau of Economic Analysis. Performance calculated since Index Inception, GDP since 1976.

Past performance is no guarantee of future results.
Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

Chart 9: Consumer Sentiment Starkly Differs by Political Party



Source: Bloomberg: University of Michigan Consumer Sentiment Index

20240628-3672846

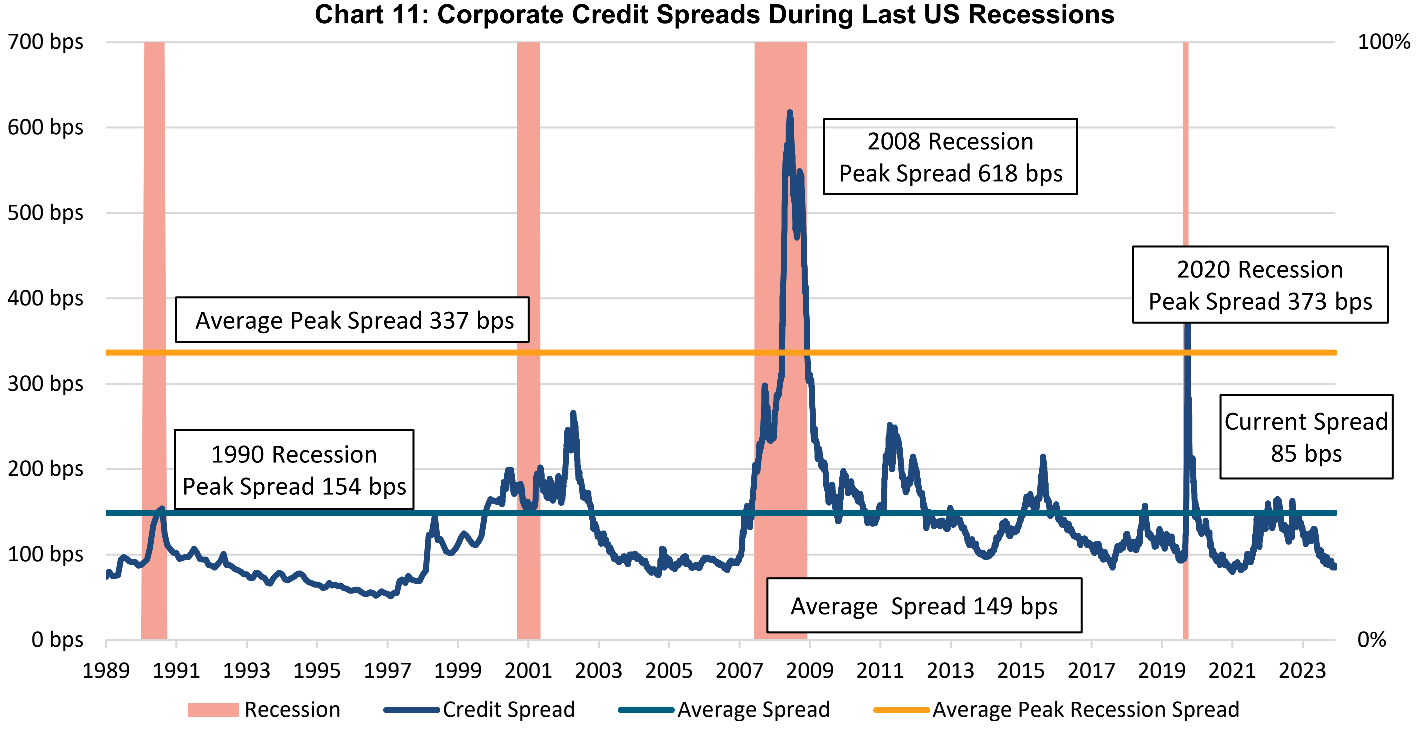
Investment Grade Corporate Bonds

The economic backdrop for 2024 has remained quite resilient. Corporate earnings have continued to surprise to the upside and beat consensus estimates. Profit margins remain strong due in part to companies being able to pass on higher prices, even if volumes have slightly declined. Real GDP has held up, but with the cumulative effect of widespread price increases beginning to take its toll on consumers, real GDP is forecasted to decrease in the latter half of the year. Nonetheless, economists' consensus estimate for a recession has dropped to 30%. The market does seem to be expecting a slower economy. Although there are some mixed signals, some historically accurate signals of a slowing/recessionary economy include the inverted yield curve, which has been negative since November 2022 (as measure by the 10-year Treasury minus the 3-month T-Bill). Also, the Conference Board Leading Economic Index has fallen 9.8% from October 2022 to April 2024. Finally, as mentioned, the consumer is beginning to show some weakness, with credit card debt at a near historically high of $1.3 trillion as of April, and delinquencies beginning to increase. All these indicators signal the likelihood of a slowing economy over the next 12 to 24 months and risk to corporate earnings.

Against this backdrop, the Federal Reserve System has remained vigilant in its fight against inflation. After peaking at 9.1% in June 2022, CPI has dropped to 3.3% in May 2024. This remains higher than the Fed's target of 2%, which has led to the markets' expectation of a "higher for longer" Fed funds rate. Indeed, at the end of 2023, the market expected the Fed to begin cutting rates in March and had priced in seven full cuts by the end of 2024. Fast forward to the end of May, and now the first cut is expected in November, and only two full cuts are priced into early 2025.

Many corporate issuers are entering this period of economic uncertainty on the tailwinds of strong earnings and relatively healthy balance sheets. The significant stress in the banking sector last year appears to have passed, but there remains mounting pressure on other sectors such as commercial real estate. Thus far this year, Investment Grade Corporate credit spreads peaked at 104 basis points in January and have retraced back to approximately 84 basis points at the end of May. The current spread level is lower than 2023 year-end levels by 14 bps.

Chart 11: Corporate Credit Spreads During Last US Recessions



Credit spread is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury. Basis point "bps" is 1/100th of a percentage point.

Source: Bloomberg Corporate Index, U.S. Recession Indicator (National Bureau of Economic Research)

Past performance is no guarantee of future results.

20240628-3672846

High Yield Corporate Bonds

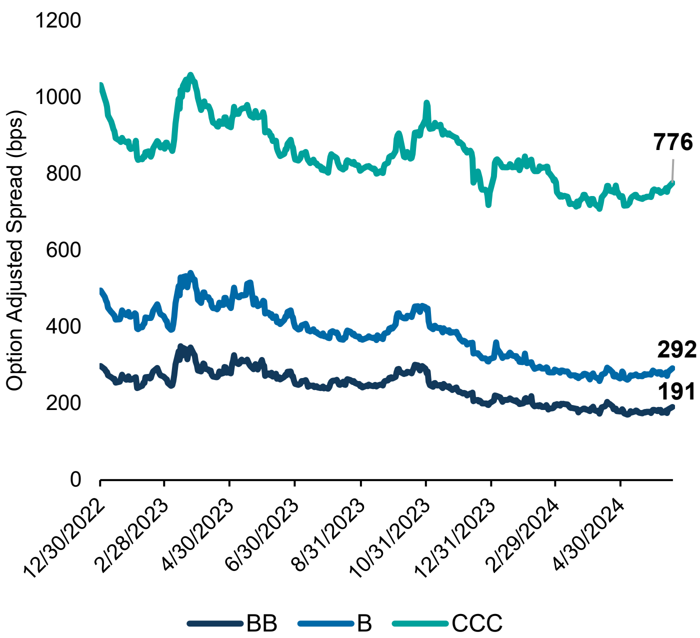
Year to date, returns for the high yield and leveraged loan markets were positive as the uncertainty of 2023's banking and geopolitical issues settled into a quieter backdrop with stronger-than-expected economic indicators and corporate earnings. While this has been positive for performance, high yield spreads are close to their all-time tights, and volatility is likely to increase into this year's election.

Single-B credit spreads have continued to tighten in the first half of the year, starting the year at 317 bps, tightening to lows of 258 in April, but then widening a bit to end at 292 as of June 17th **(Chart 12).**

High yield and leveraged loans have both experienced a rise in defaults. The default rate for leveraged loan issuers, for example, rose to 5.93% in 2024 from 5.82% at the end of 2023 as shown in **Chart 13**, and there is mounting pressure on a few sectors of the high yield market, such as media and commercial real estate.

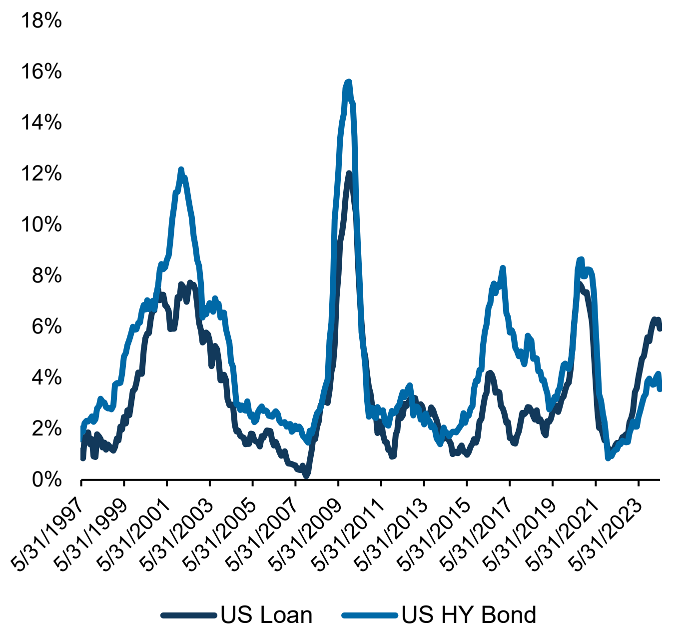
Heading into the second half of 2024, we believe that earnings will weaken, spreads will widen (in particular in the lower-rated high yield and leveraged loan issuers), and the default rate will continue to gradually rise. While the credit quality of the high yield index has slightly fallen, most of the deterioration in quality comes from bonds being upgraded to investment grade. In the second half of 2024, we anticipate that more bonds will be downgraded to high yield ("fallen angels") than upgraded to investment grade ("rising stars") which should reverse the trend and add quality names to the high yield universe.

Chart 12: High Yield Spreads



Source: Bloomberg. Indices represented are Bloomberg BB US High Yield Index, Bloomberg B US High Yield Index and Bloomberg CCC US High Yield Index.

Chart 13: US Leveraged Loan vs HY Bond Default Rates



Source: Moody's

High Yield bonds, aka junk bonds, are bonds that pay higher interest rates because they have lower credit ratings (below BBB) than investment-grade bonds. As such, High Yield credit spreads correlate inversely with credit rating, lower credit ratings generally have higher average credit spreads.

Past performance is no guarantee of future results.
Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

20240628-3672846

Municipal Bonds

Starting yields for municipal bonds, which we view as a good predictor of long-term returns, remain high. These elevated yields have continued to provide a very attractive potential entry point for investors, particularly on a tax-equivalent basis. The runway for this entry has extended beyond our previous expectations, although we expect this to level off at some point.

Municipal credit spreads have tightened steadily through 2024 so far, to a level meaningfully tighter than even just this time last year. Flows within the municipal market have been slightly positive so far this year; however, flows could change quickly depending on the future path of interest rates. The market is generally expecting an interest rate cut later this fall, followed by multiple cuts next year.

As we head into the second half of 2024, we expect municipal credit quality to remain relatively strong. Broadly speaking, municipal bond issuers received significant federal stimulus during the recent pandemic (as well as during the post-pandemic environment) and have maintained these elevated levels of reserves in many cases. At this point credit quality remains strong and default rates remain low.

Chart 14: Municipal vs US Aggregate vs Tax Equivalent Yield

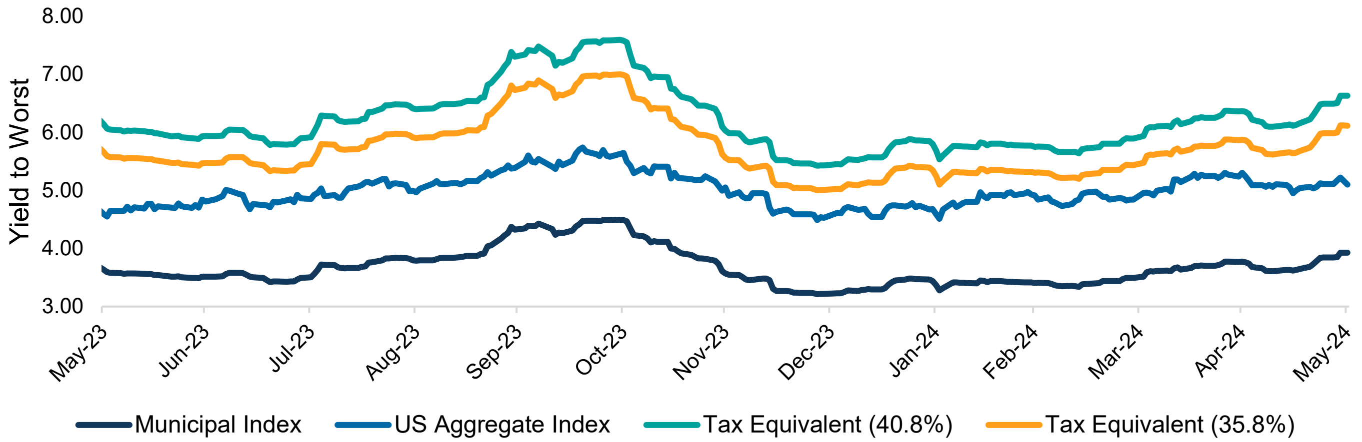
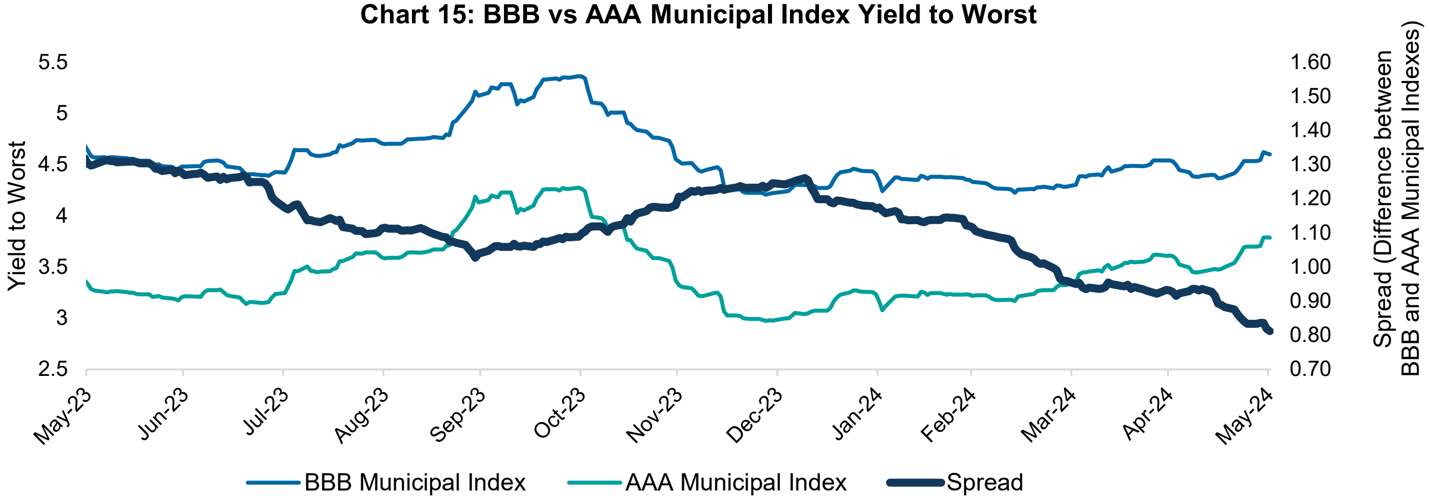


Chart 15: BBB vs AAA Municipal Index Yield to Worst



Source: Bloomberg. Indices represented are the Bloomberg Municipal Index, the Bloomberg US Aggregate Index, Bloomberg Municipal BBB Index, and Bloomberg Municipal AAA Index.

Past performance is no guarantee of future results.
Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

20240628-3672846

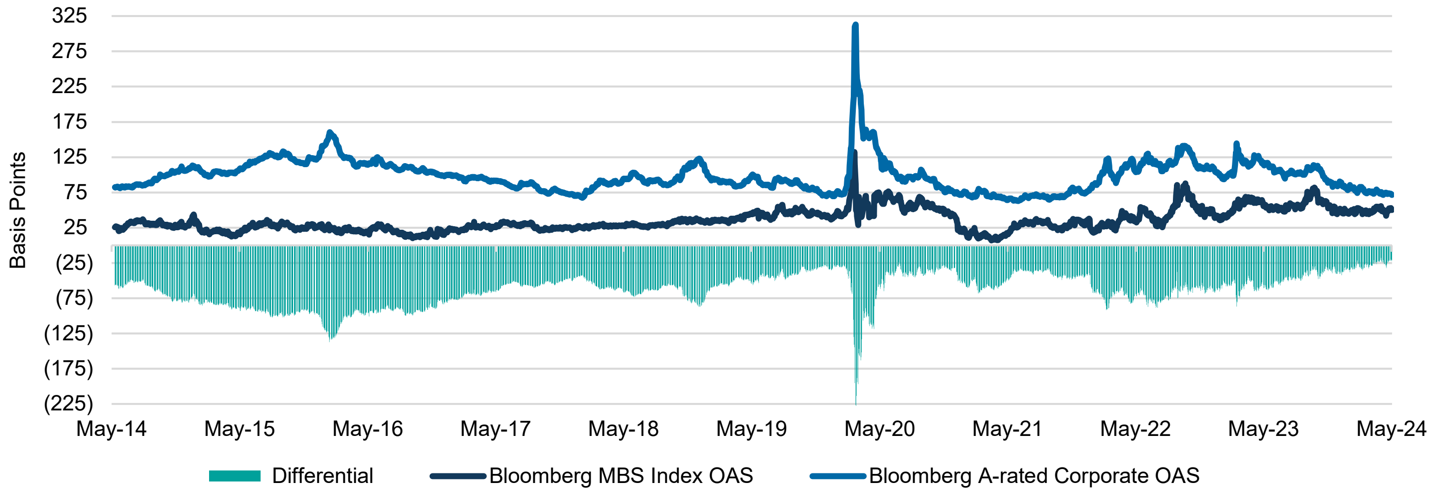
Residential Mortgage-Backed Securities (MBS)

As we head into the second half of 2024, we think Agency MBS has the potential to outperform.

Historically we have not liked the risk/reward profile of MBS because we did not believe the spreads offered by MBS provided adequate compensation for its poor call protection (negative convexity). Over the last several years spreads have been tight in the MBS market because large segments of the MBS buyer base are "non-economic" buyers. The three largest non-economic buyers of MBS have been: 1) banks, which buy MBS due largely to capital requirements and regulatory reasons, 2) the Fed, which purchased large amounts of MBS as economic stimulus due to the Global Financial Crisis (GFC) and the Covid Pandemic, and 3) index funds, which purchase MBS to match the issuance-weighted indices like the Bloomberg Aggregate Index.

Coming out of the pandemic and the Fed's zero interest rate policy, banks had significant holdings of low coupon MBS and other securities they purchased during the pandemic. As rates rose in 2022 and 2023, many banks found themselves significantly underwater on a large portion of their securities portfolios which reduced their demand for securities. As individuals and companies have moved deposits to larger banks and banks took other actions to improve their balance sheets, there has been a partial unwinding of the supply/demand imbalance and some banks have now become net buyers of MBS. MBS also has the added benefit of offering both attractive relative value as compared to single-A corporate bonds, and it represents a defensive sector for investors as we get later in the economic cycle.

Chart 16: MBS vs. A-Rated Corporate Bonds



Banks and the Fed stepped away as net buyers of MBS in 2022 and 2023. With the two largest non-economic buyers still not in the market fully, spreads have remained wide as money managers, who are relative value buyers, require wider spreads to step in as the largest source of MBS demand.

We think the risk/reward continues to be in favor of incrementally adding to MBS. We particularly like the Ginnie Mae part of the MBS market given its zero percent risk weighting for banks amid continued uncertainty around potential regulatory changes under the new Basel Endgame proposal.

Source: Bloomberg. The Bloomberg MBS OAS is the OAS of the Bloomberg MBS Index. The A-rated Corporate OAS is the OAS of the Bloomberg A-rated Corporate Index.

Past performance is no guarantee of future results.
Indexes are unmanaged and do not reflect fees and expenses; One cannot invest directly in an index.

20240628-3672846

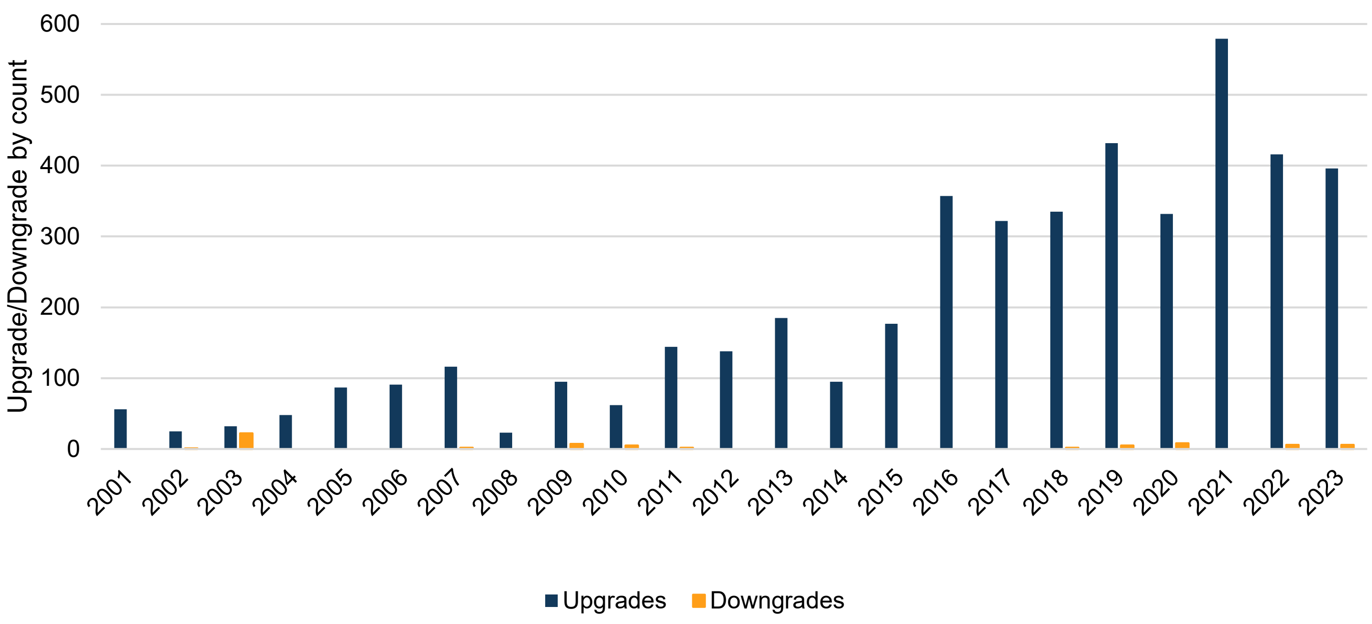
Asset-Backed Securities (ABS)

As we head into the second half of 2024 with a defensive posture, we continue to think ABS has the potential to outperform other sectors of the fixed income market over the remainder of the year. We favor ABS because it provides attractive spread pickup relative to short duration corporate bonds and because the ABS structures we buy have defensive characteristics and tend to get upgraded over time as they deleverage. As a bonus, because ABS is almost exclusively a short duration product, an inverted yield curve provides ABS with an attractive yield pickup over the longer duration Bloomberg US Aggregate index.

We continue to closely monitor the state of the consumer and the impact an economic downturn could have on the ABS market. However, the parts of the ABS market that we focus on have robust structures with substantial credit enhancement and have been able to withstand severe recessions like the Global Financial Crisis (GFC) and Covid. With overall corporate spreads near multi-year tights, we favor these ABS structures because they de-leverage over time which can make ABS a good defensive play and can result in predictable bond ratings upgrades as deals season.

We prefer the parts of the ABS market that have demonstrated durability through multiple cycles and/or have proven to be high in the consumer's payment hierarchy, providing an extra "margin of safety." These sectors include ABS backed by auto loans, credit cards, and equipment that is essential to the borrower's business. Conversely, we tend to avoid the more esoteric parts of the ABS market that have weaker structural features and/or newer parts of the market that have not proven their resilience through multiple cycles. The subsectors of the ABS market that fall into these categories include unsecured "fintech" consumer lending, music royalties, solar ABS, and container ABS.

Chart 17: S&P Auto Loan ABS Upgrades vs. Downgrades



Source: S&P

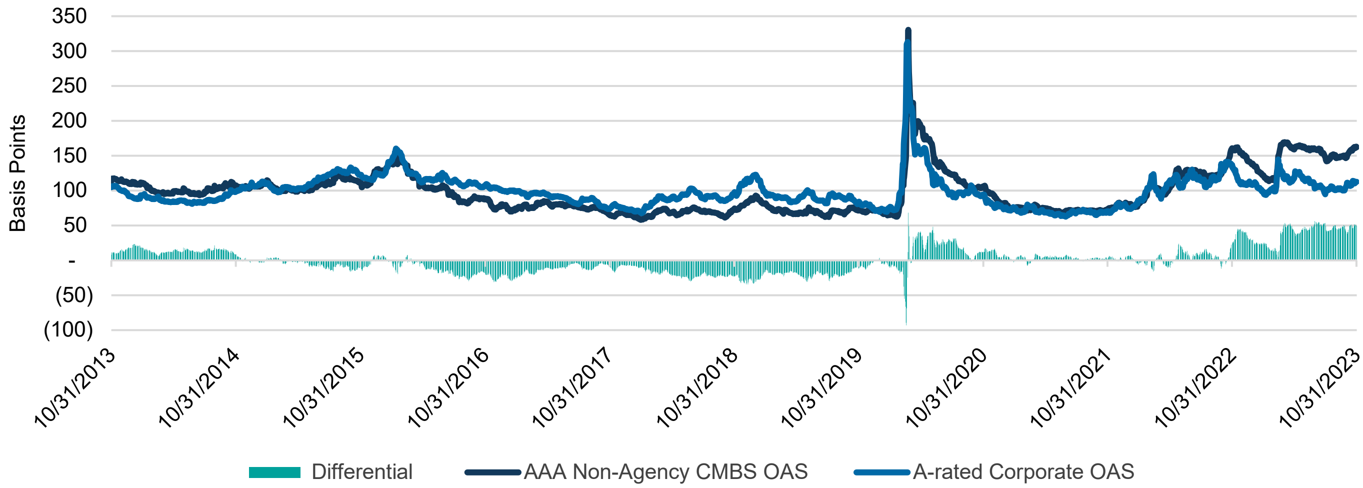
20240628-3672846

Commercial Mortgage-Backed Securities (CMBS)

After strong outperformance in the first half of 2024, we moved to a neutral stance on CMBS for the remainder of the year. CMBS significantly outperformed corporate bonds in the first half of the year with excess returns of +3.02% for the Non-Agency CMBS Index vs. +1.39% for the Corporate Index. While we still think CMBS has the potential to outperform in the second half of 2024, we think downside risks have increased and as a result we are more cautious and recommend moving to a more defensive, up in quality bias within CMBS. As we get later in the economic cycle, overall spread volatility is likely to increase and CMBS tends to trade with more spread beta than other fixed income sectors. We also think commercial real estate (CRE) refinancing issues and continued negative headline risk could cause CMBS spreads to trade with more downside volatility.

Commercial real estate (CRE) was constantly in the headlines the past 24 months due to struggles from higher interest rates, tighter lending standards, and Covid's acceleration of the bifurcation of the "haves and have nots," particularly within the office sector. Market sentiment around the combination of those three factors caused CMBS spreads to significantly widen relative to corporate bonds during 2023. In the first half of 2024, some of that underperformance reversed and CMBS outperformed corporate bonds as the fear and greed pendulum had swung too far in the direction of fear. We recommend investors continue to own CMBS but focus on an up in quality portfolio. Security selection will be paramount.

Chart 18: CMBS vs. A-Rated Corporate Bonds



Source: Bloomberg. Indices represented are the Bloomberg Non-Agency Investment Grade CMBS: AAA Total Return Index (I31070US) and the Bloomberg A-rated Corporate Index

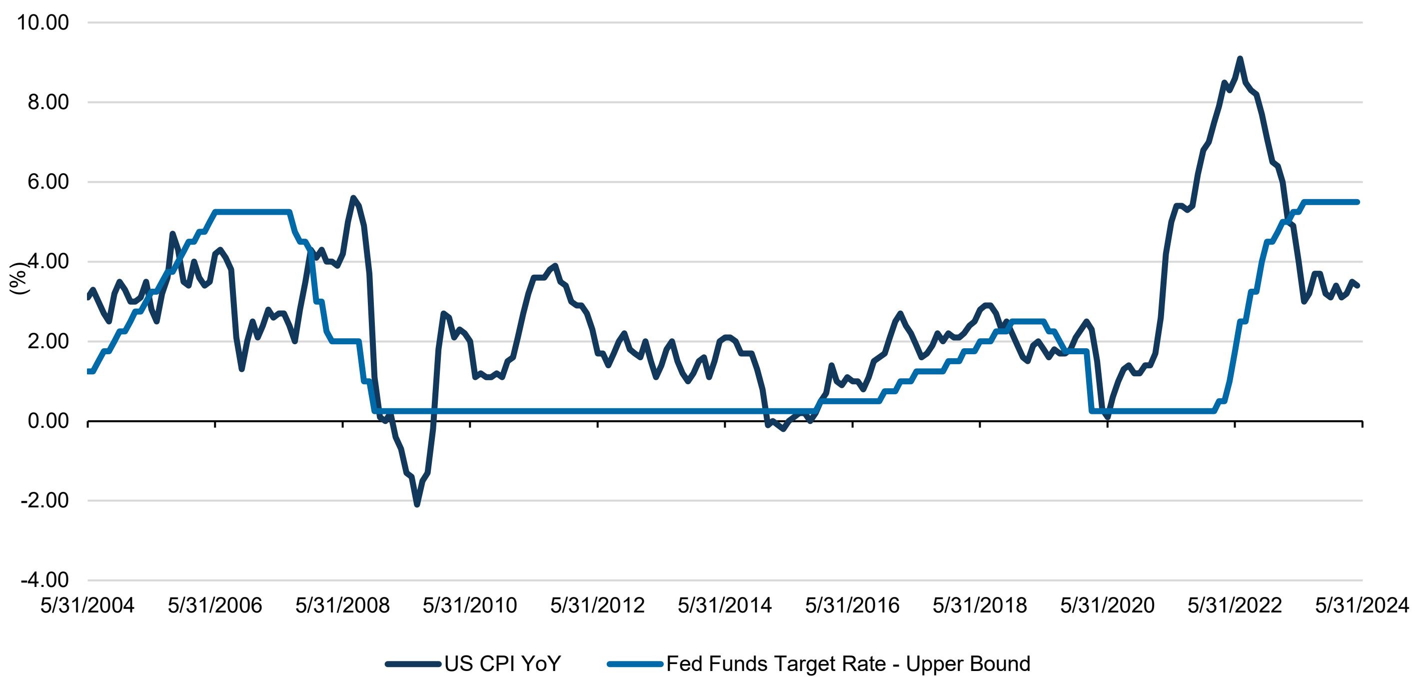
While the office sector will continue to face headwinds, we think trophy properties in dynamic office markets like New York will have a story that unfolds similarly to the initial overly bearish concerns about shopping mall retail several years ago. The consensus opinion on malls several years ago was "the death of all malls" due to the growth of ecommerce. But what actually happened is the best malls thrived at the expense of the lower quality properties. Retailers eventually pivoted to use their most productive brick-and-mortar stores to complement their ecommerce strategy. A strategy focused on the highest quality properties owned by sponsors with deep pockets was a winning strategy for retail and we think it will be a winning strategy for the office sector in dynamic markets like New York, though it will take years to play out. We are more cautious on lower quality office properties and office markets that have tenant bases skewed heavily towards tech or that are struggling with crime/safety issues. Investors should focus on deals at leverage points that are financeable at higher rates and that can withstand a potential economic downturn where property prices and cash flows could further decline.

20240628-3672846

Money Markets

Money market funds have proven to be a popular asset class this year. After a series of FOMC rate increases that began in 2022 money market yields now hover around 5%, and investors have responded by pouring money into them, resulting in over $6 trillion currently being held in the sector. For the time being, cash is seen as an attractive alternative to risk assets thanks to competitive yields, but will that hold? While it's difficult to know with certainty the direction of the Fed's course going forward, we do know that inflation has begun to moderate but it is still above the Fed's 2% target. This means that further rate hikes can't be ruled out entirely. However, it's hard to imagine that the Fed's next move wouldn't be a rate cut if inflation begins to ebb significantly or the economy enters a downturn. In terms of forward guidance, the Fed has stated that it "will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."

Chart 19: Fed Funds vs. CPI



Source: Bloomberg

U.S. CPI: The Consumer Price Index measures the monthly changes in prices paid by U.S. consumers. The Bureau of Labor Statistics calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.

Fed Funds Target Rate – Upper Bound: Shows the upper limit of the federal funds target range established by the Federal Open Market Committee

Our current assessment of the cash sector is that it offers stability, security and very short duration. These three factors persist and have been a feature of money market funds for decades. What can be more transient is yield since this is determined by current market rates.

Since shorter term instruments pay better now, should investors keep a significant portion of their fixed income holdings in a money market funds? History tells us that longer-duration fixed income outperforms money markets as rates decline. This is because money markets require continuous repurchase of securities since they mature within days or weeks of issuance in most cases. This requirement to reinvest proceeds is called "reinvestment risk" and is an inherent risk in all short-term instruments. Longer term bonds, in contrast, do not face immediate reinvestment risk because they mature over the course of years and their prices can appreciate with falling rates. While we are constructive on the cash sector for the remainder of 2024, we would caution against an excessive overweight in money market funds.

20240628-3672846

Disclosures

All investing involves risk, including the potential loss of principal.

Fixed income securities are subject to interest rate, inflation, credit and default risk. The bond market is volatile. Bonds and bond funds will decrease in value as interest rates rise and vice versa. Credit risk refers to the possibility that debt issuers may not be able to make principal and interest payments or may have their debt downgraded by ratings agencies. High yield securities may be more volatile, be subject to greater levels of credit or default risk, and may be less liquid and more difficult to sell at an advantageous time or price than higher-rated securities of similar maturity.

Mortgage-backed securities (“MBS”) and asset-backed securities (“ABS”) are subject to credit, prepayment and extension risk and may react differently to changes in interest rates than other bonds. Small movements in interest rates may quickly and significantly reduce the value of certain MBS and ABS.

The value of your investment is also subject to geopolitical risks such as wars, terrorism, environmental disasters, and public health crises; the risk of technology malfunctions or disruptions; and the responses to such events by governments and/or individual companies.

R-squared is a statistical measure that represents the percentage of a fund’s or security’s movements that can be explained by movements in a benchmark index.

Credit spread is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury.

Yield to Worst (YTW) is the lowest possible yield received on a bond, absent default.

Dividend Yield is total cash dividends paid as a percent of market capitalization at the end of the period. The yield for the index is the total of all dividends paid over twelve months divided by the total market capitalization.

This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding, or a recommendation of, any security or market sector, but as an illustration of broader themes.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness.

Advisory services offered by Victory Capital Management Inc., an SEC-registered investment advisor. 15935 La Cantera Pkwy., San Antonio, TX 78256.

V21.069 // VINC Mid Year Outlook PRES

20240628-3672846