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Geopolitics and Inflation Drive Markets

Military conflict between the U.S. and Iran has resulted in higher oil prices due to the closure of the Strait of Hormuz. This has translated into higher inflation, above the Federal Reserve's 2% target. While the US economy has shown resilience, stable employment and growth amidst elevated inflation has resulted in big narrative shifts for monetary policy going forward.

Tactical Flexibility Matters

Risk assets continue to price in good news. Corporate credit spreads are still below long-term averages, but there is movement beneath the surface. When overall credit risk compensation is low, selectively adding yield when relative value emerges becomes especially important.

Fixed Income Overall Remains Attractive

Real yields, which are yields accounting for inflation, however, are still historically elevated The starting yield at which you invest has been a well documented indicator of the total return you receive over the life of a bond. We believe current yield levels offer fixed income investors a historically attractive entry point to boost potential future income.

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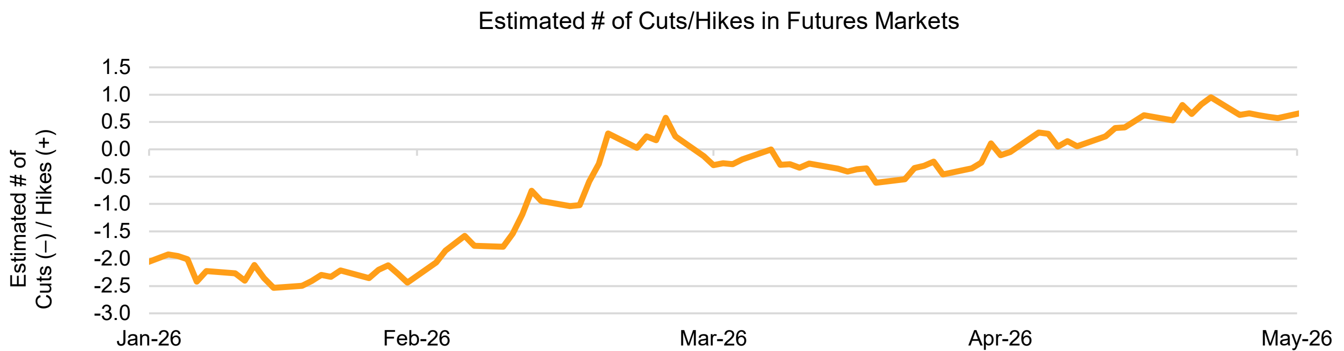
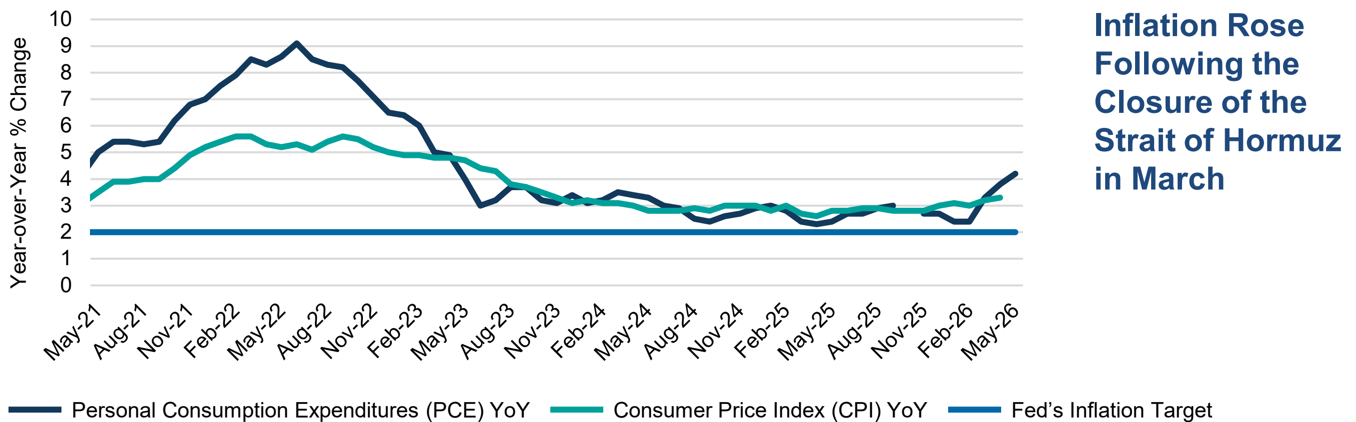
Headline Fatigue

Risk assets have faced a mix of expected and unexpected challenges in the first half of 2026: geopolitical tensions driving higher oil prices and thus driving higher inflation, evolving monetary policy expectations due to persistently elevated inflation, and AI as a source of both growth and volatility. The interconnected nature of these themes prompted swift market reactions, though headline fatigue set in across both equities and fixed income alike as the Iran conflict extended. Despite the consistently loud news cycle, fixed income credit spreads, the compensation investors receive for taking on risk relative to Treasuries, tightened throughout 1H26. While we saw some sector level movements, ex: elevated debt issuance from the AI hyperscalers resulted in brief moments of spread widening in technology and concerns about the private credit markets pushed the credit spreads of financials higher. Ultimately, these moves proved contained.

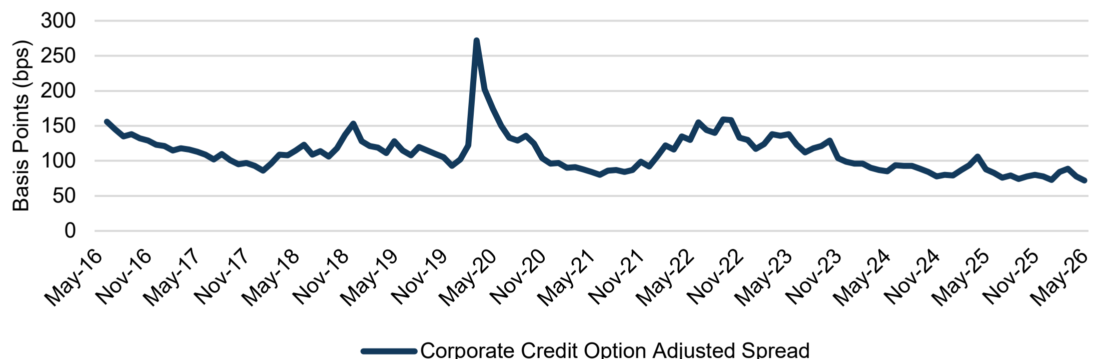
Monetary Policy Forecasting Shifted From Cuts to Hikes





Inflation Rose Following the Closure of the Strait of Hormuz in March

Credit Spreads Tightened Year to Date



Source: Bloomberg. Indexes are unmanaged and do not reflect fees and expenses. One cannot invest directly in an index.

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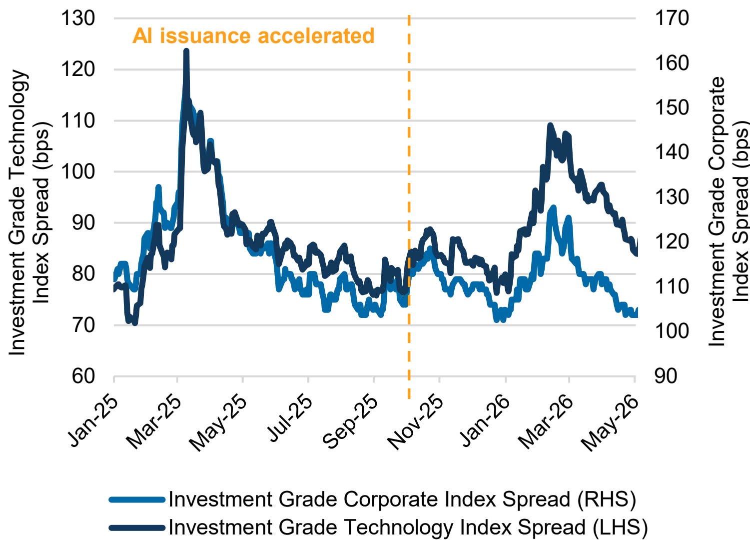

Source: Bloomberg
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Opportunities and Restraint in AI

We noted in our 2026 outlook that AI is here to stay and in the past few months we saw significant amounts of AI related debt issuance as the largest players began the work of funding their infrastructure needs.

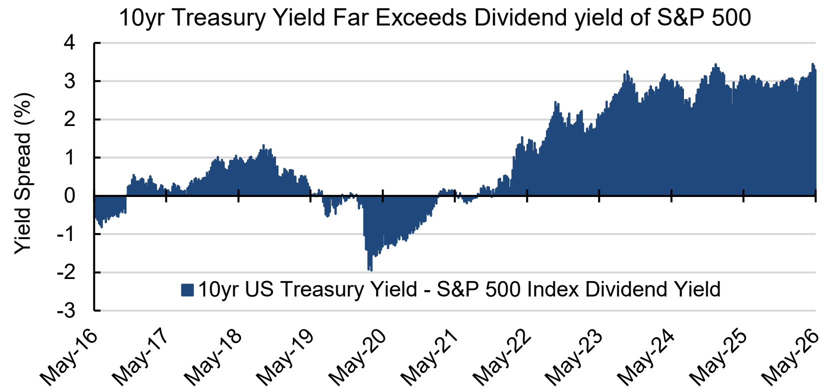
AI is forcing markets to reckon with the impacts of potential productivity gains but also question its influence on existing business models. This drove credit spread widening in the technology sector given concerns about its impact on existing software companies, particularly in February.

The range of outcomes with AI are vast and one thing we highlight as an active fixed income manager is the value of fundamental credit research. The AI related issuance boom means there is significant investable debt, but discernment between issues is key. This environment is likely to reward active credit selection over passive index exposure.

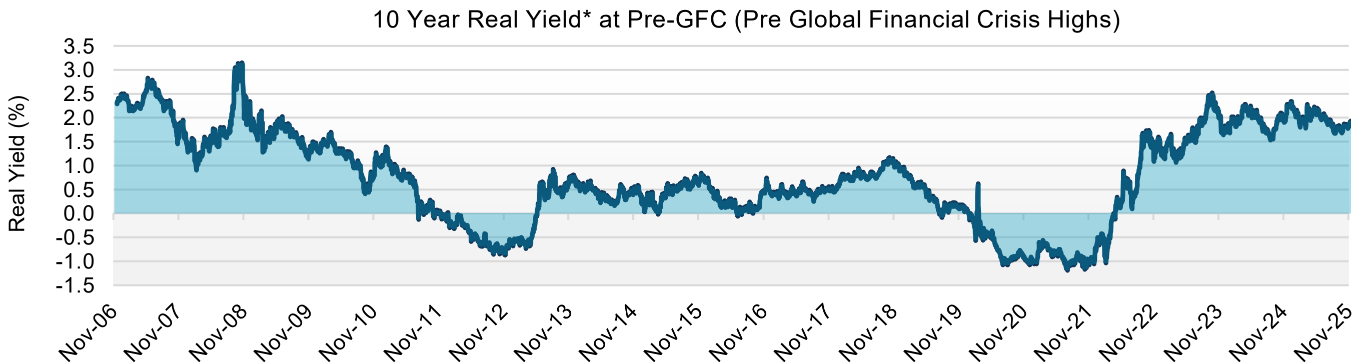
Back to 60/40?

We think fixed income is still presents an attractive opportunity for investors. From a relative value perspective, the yield on 10-year Treasury Bonds exceeds the dividend yield of the S&P 500, which in our view signals that fixed income is attractively priced relative to equities.

Real yield, which is yield in excess of inflation, is also still positive and elevated relative to history. We believe these observations present compelling reasons to revisit the traditional 60/40 portfolio that has lost some popularity in recent years.



Source: Bloomberg. * US Generic Government 10-Year Yield Index



Source: Bloomberg, *As measured by the U.S. Treasury Constant Maturity 10-Year 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.

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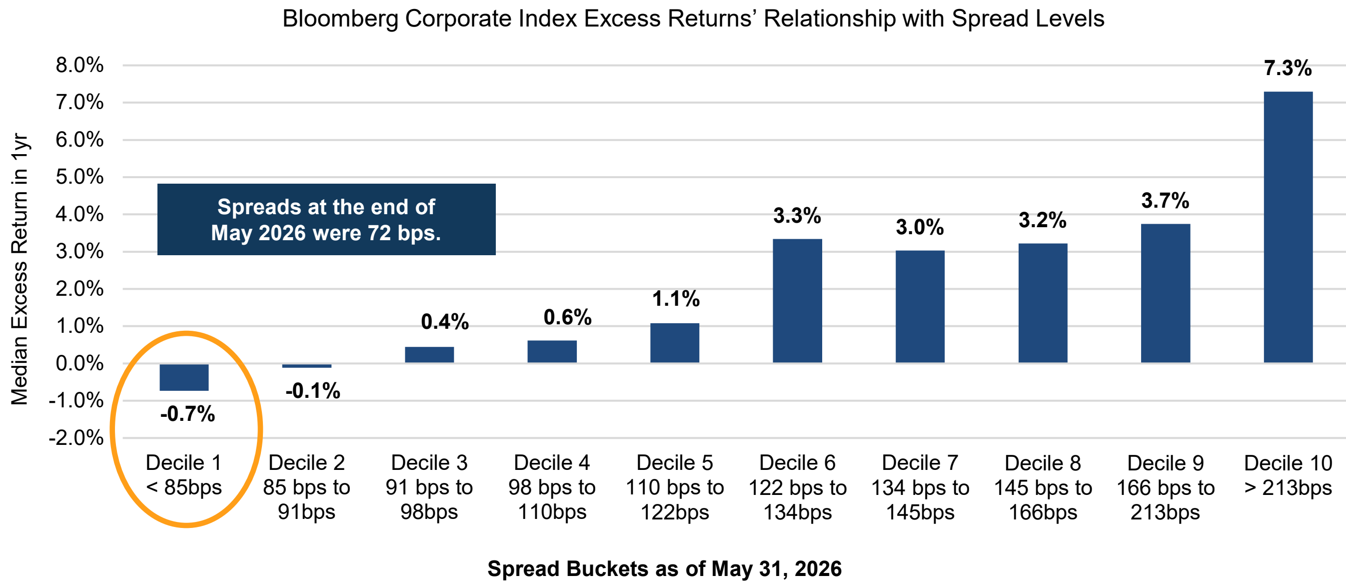
We Are Defensive Regarding Credit Risk

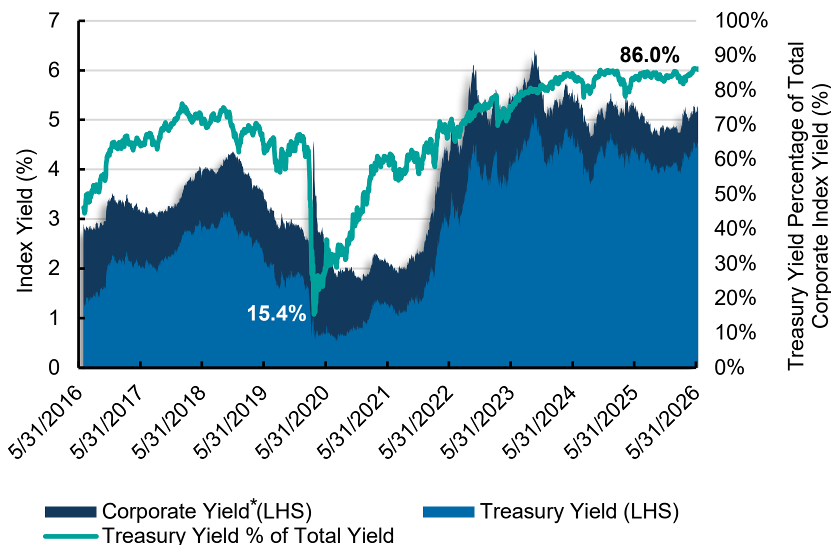
Corporate credit spreads are in the lowest decile observed over the last 25 years. Historically, when credits spreads have been in this decile, corporate bonds earned, on average, negative excess returns relative to similar duration Treasuries ("Excess Return"). This is the cornerstone of our defensive view on corporate credit. At the end of May 2026, corporate credit spreads were 72 basis points, placing them firmly in the lowest decile.



Source: Bloomberg, This analysis reviews the option adjusted spread to Treasuries of the Bloomberg Corporate Index using daily observations from 9/17/2002 through 5/31/2026. For each daily observation we look at the excess return of the Corporate index over similar duration Treasury bonds 1 year from that date. We then separated the Corporate Index spread data into deciles, where each decile bucket represents an equal percentage of daily spread observations. We then looked at what the median 1-year excess return to similar duration Treasury bonds was for each spread bucket. **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.

Steady Income Over Stretched Returns

We remain positive on our outlook for fixed income, despite our defensive positioning regarding credit risk. Elevated Treasury yields due to higher inflation has provided fixed income investors improved income opportunities. At the moment, 86% of the corporate credit index yield comes from Treasury yield – meaning the additional compensation for taking credit risk only makes up 14% of the total yield. This is high relative to history at 86% versus the 15% we saw during the COVID-19 pandemic. This supports our view that investors do not need to extend into riskier strategies to generate income and that overall, fixed income offers an attractive investment opportunity.



*Bloomberg US Corporate Bond Index

Source: Bloomberg

20260709-5733945

Credit Positioning

Overall, we remain defensively positioned within the structure of our mandates, but we see value in specific sectors like Treasuries and Asset Backed Securities. Below are our views on various asset classes with additional details regarding certain sectors on the following pages.

Forward-Looking Sector Views

Current sector views are represented by colors (green, orange, blue). Previous month sector views represented by a black dot.

SECTOR	RELATIVE VALUE	VIEW
INVESTMENT GRADE		
Treasury	OUTPERFORM	We see value in longer-term bonds with yields at or above 4.5%. Treasuries have provided relative safety and liquidity as an implicitly "risk-free" asset.
Agency MBS	OUTPERFORM	We see Agency MBS as fairly valued. Spreads tightened in January after the GSE purchase program announcement but have given back as interest rate volatility increased. We view the sector as defensive while still providing a spread to Treasuries.
Agency CMBS	UNDERPERFORM	We find Agency CMBS to offer limited relative value due to flat spreads and limited opportunities.
Corporate	UNDERPERFORM	We are defensively positioned in corporate credit. Compensation for taking on corporate credit risk is at 25-year lows.
Asset Backed Securities	OUTPERFORM	We see value as spreads are still attractive relative to short duration corporates, not looking to add to current overweight.
Commercial Mortgage-Backed Securities	MARKETPERFORM	We find CMBS to be fairly valued relative to similar corporate bonds but view the sector as a marketperform due to higher expected volatility.
Taxable Municipal Bonds	MARKETPERFORM	We are neutral in our outlook for Taxable Munis, due to limited supply.
Tax Exempt Municipals	OUTPERFORM	We see Tax-Exempt Munis as fairly valued and the historically high yields make for a strong entry point.
BELOW INVESTMENT GRADE		
High Yield Bonds	UNDERPERFORM	There has been widening in various industries which may present some opportunities. Spreads are still below levels where we would move to marketperform.
Loans	UNDERPERFORM	Loans have been experiencing some weakness. We are finding specific sectors worth exploring and leaning into our security selection capabilities.

For illustrative purposes only—not to be construed as investment advice or a recommendation to buy, sell or hold any security. The views expressed are those of Victory Income Investors as of the date noted and are subject to change. The 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 potentially reduced risk. It's a strategy often favored by investors seeking to protect their portfolios during periods of uncertainty or economic downturns.

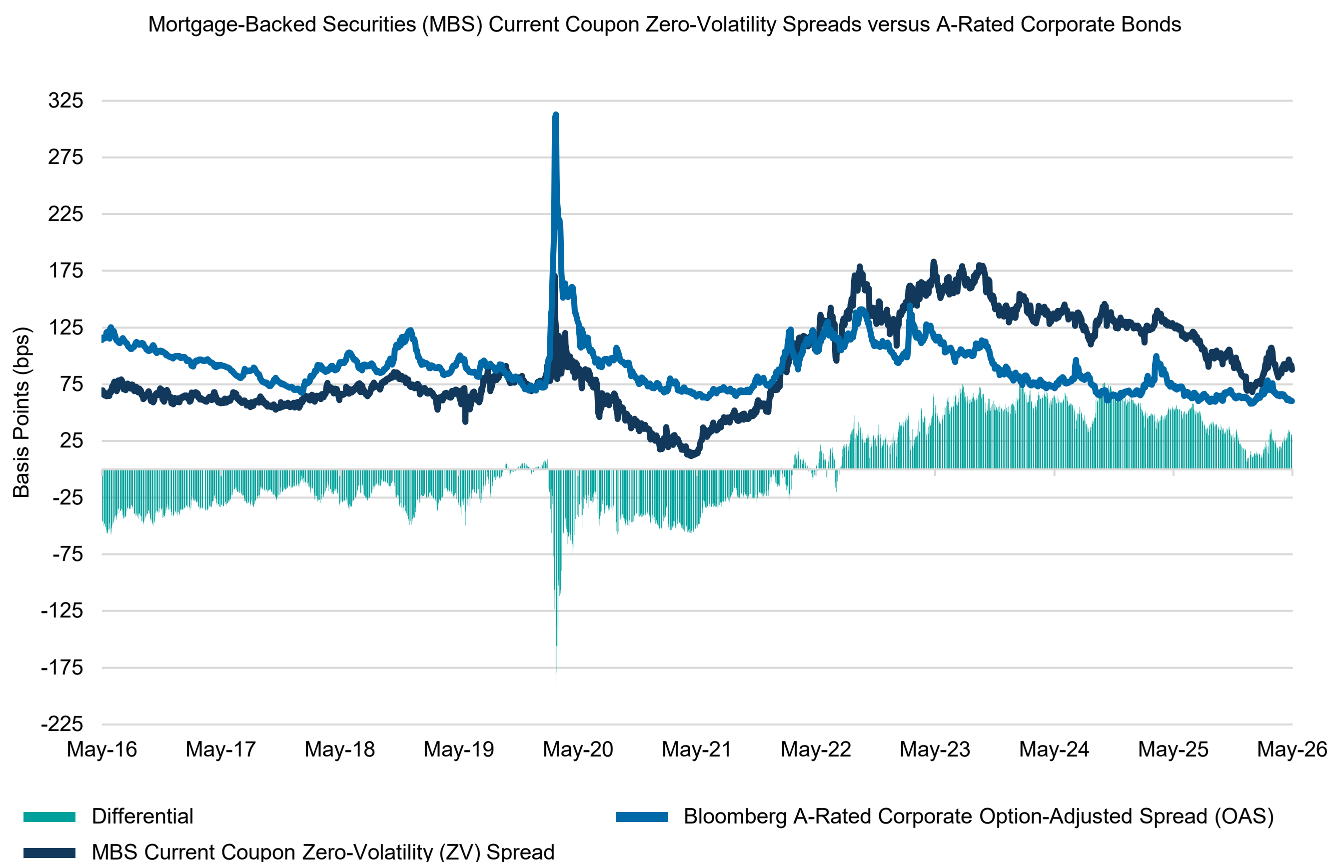
20260709-5733945

Residential Mortgage-Backed Securities (MBS)

> We expect Agency MBS to Market Perform in the second half of 2026. MBS spreads tightened significantly in January after the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) announced they would buy $200 billion of MBS in 2026. However, spreads leaked wider since then and still look wide on both a nominal and Option-Adjusted Spread (OAS) basis vs. how they historically trade vs. corporates.

> The supply/demand imbalance which caused MBS spreads to widen over the last few years is expected to continue rightsizing in 2026. We expect MBS spreads to tighten or remain rangebound as bank demand continues to slowly return to the market. That extra demand from banks will be partially offset by increased supply from money managers, who are historically overweight MBS, and will sell into spread tightening.

> Within MBS we prefer higher coupons which offer attractive yields relative to corporates in both fast and slow prepayment scenarios.



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.

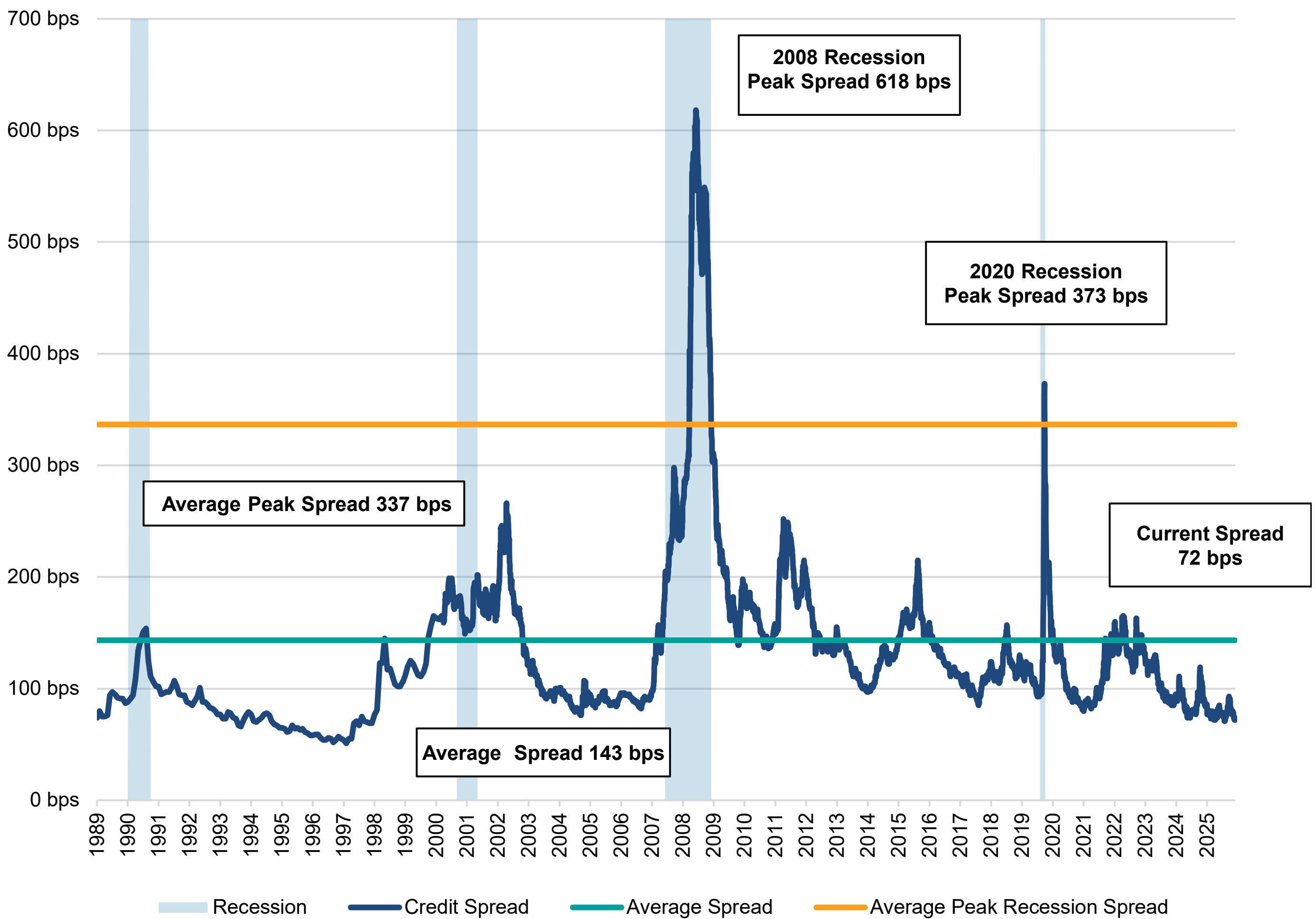
20260709-5733945

Investment Grade Corporate Bonds

> In our view corporate profit margins and balance sheets are in good overall condition and have the capacity to support additional capital expenditures, shareholder returns and M&A.

> We see recession probability as low and we believe investment grade spreads remain very tight by historical comparison. These factors contribute to an outlook for increased corporate issuance in 2026, driven in part by increasing AI related capital expenditures.

> A more certain trade environment could also encourage debt funded capital expenditures. While all in corporate yields remain attractive, the historically low spread environment warrants a cautious and selective approach to credit risk.



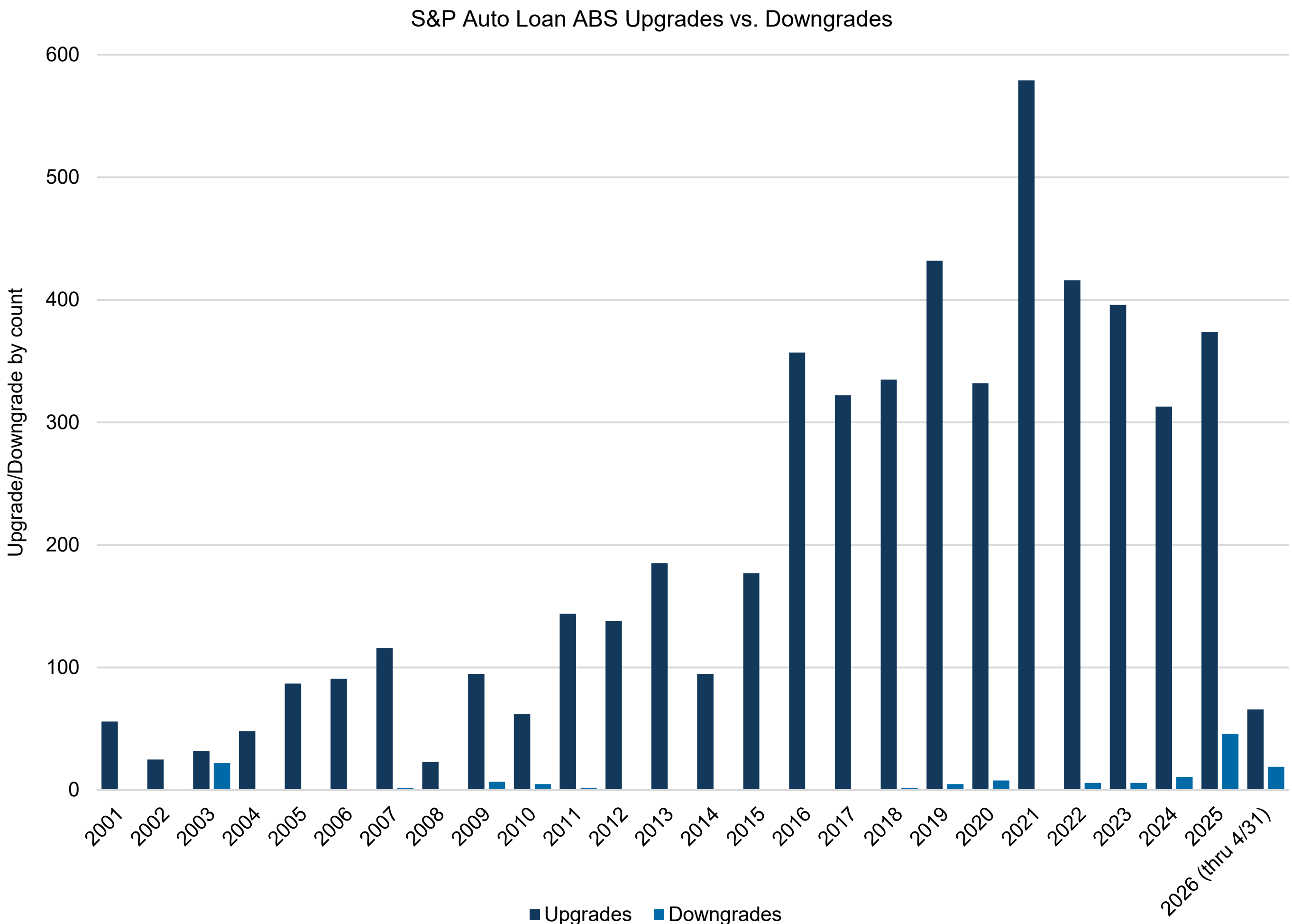
Credit spread is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury.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

20260709-5733945

Asset-Backed Securities (ABS)

- We expect ABS to Outperform for the second half of 2026. The gap between ABS and short corporate bond spreads has narrowed but remains wide relative to the longer-term history.
- We focus on the subsectors of the ABS market that have proven to be high in the consumer's payment hierarchy or have demonstrated durability through multiple cycles, such as auto loans, credit cards, and equipment. Conversely, we tend to avoid the more esoteric subsectors of ABS market that have weaker structural features and have not proven their resilience through multiple cycles, such as unsecured "fintech" consumer lending and solar ABS.
- These ABS structures have the added benefit of de-leveraging over time which makes ABS a good defensive play and results in predictable upgrades as deals season.



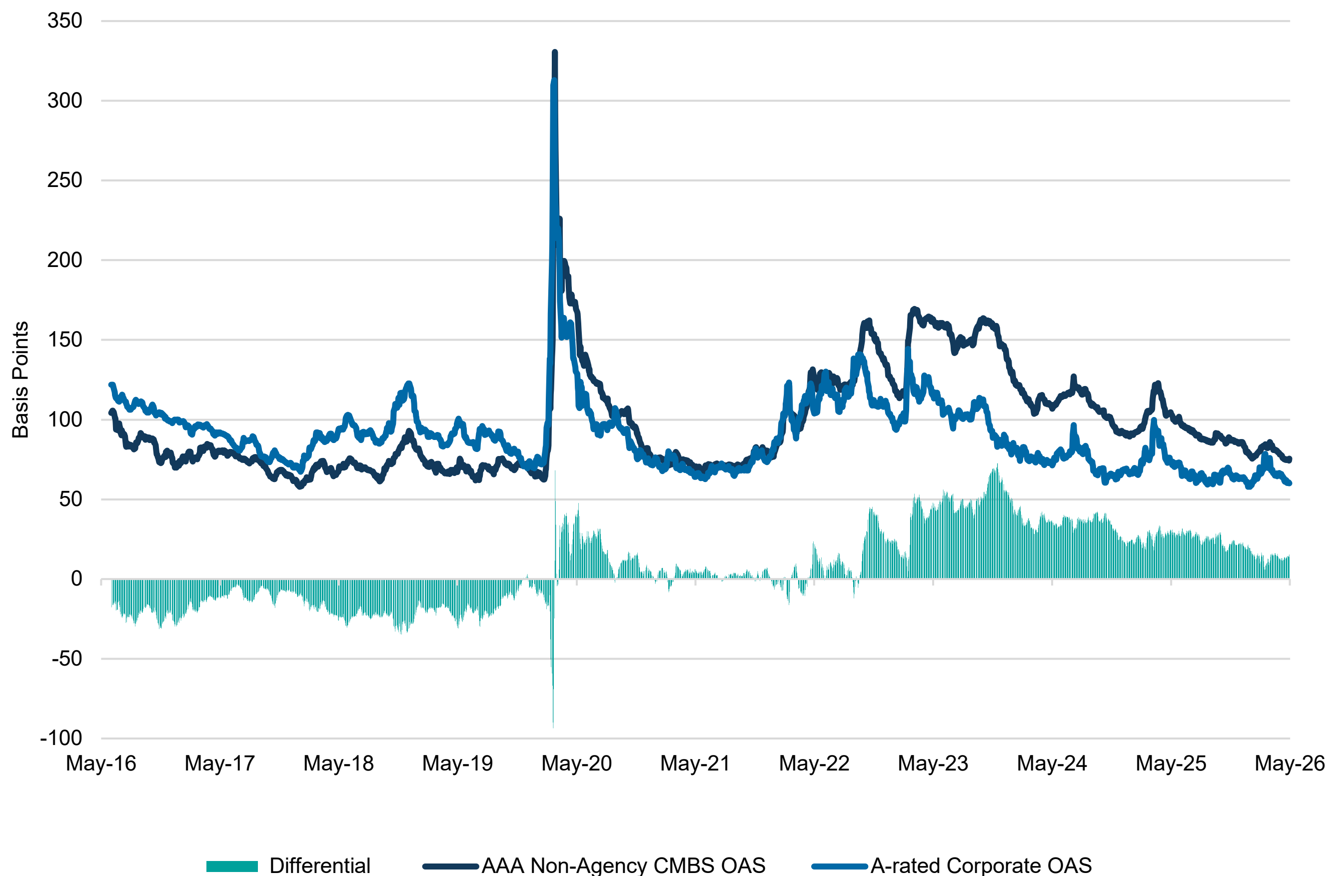
As of October 31, 2025

Source: S&P

20260709-5733945

Commercial Mortgage-Backed Securities (CMBS)

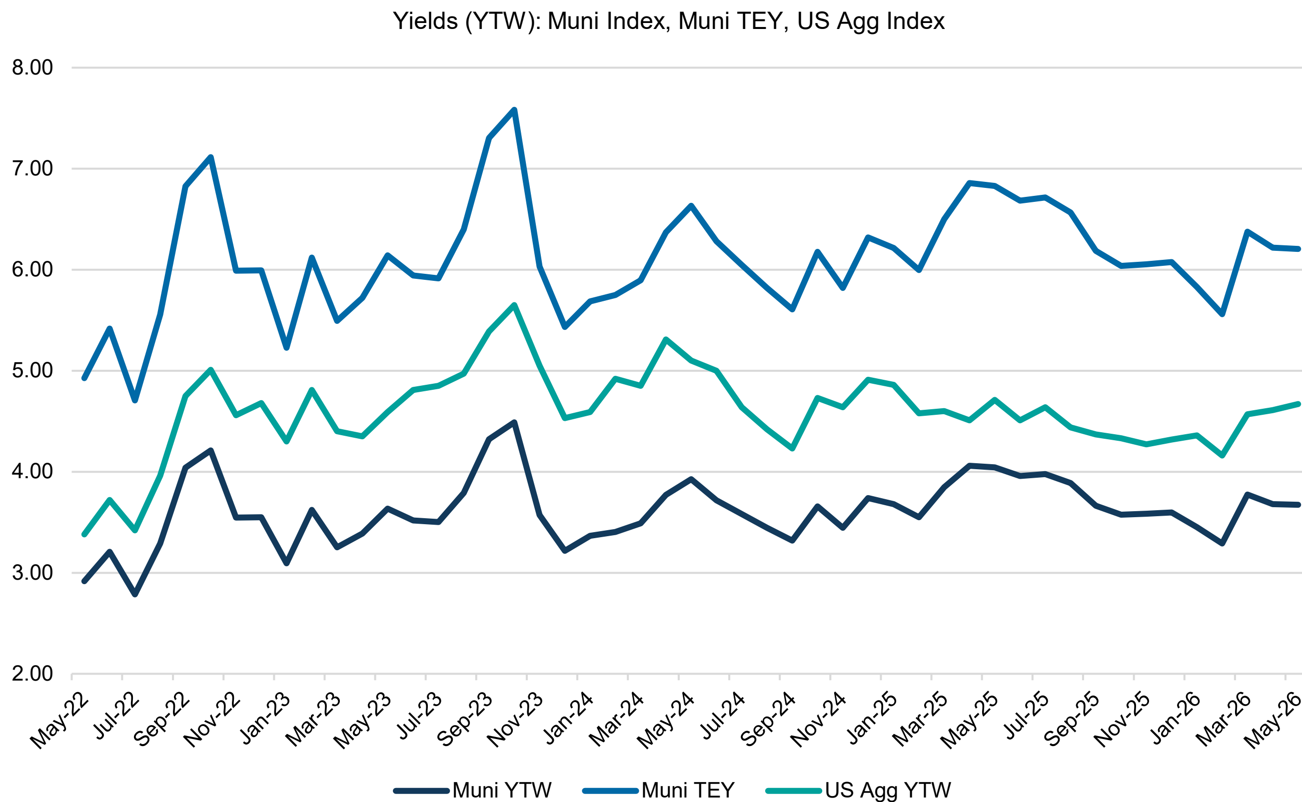
- We expect CMBS to Market Perform in the second half of 2026. The gap between CMBS and corporate bond spreads remains wide relative to the pre-COVID relationship.
- Despite this wider spread relationship for CMBS relative to corps, we temper our CMBS outlook to Market Perform due to the tendency for CMBS to trade with a high beta to corporate spreads, which are near cyclical tights.
- Within CMBS we prefer Single Asset Single Borrower (SASB) vs. Conduit CMBS. SASB allows an investor to pick their spots by property type, location, and sponsor vs. conduit CMBS which is a diverse pool with a little bit of everything (the good and the bad).



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

Municipal Bonds

- Starting yields for municipal bonds, which we view as a good predictor of long-term returns, remain high. Although these elevated yields have declined slightly since their peak in recent years, they continue to offer an attractive entry point for investors, in our view, particularly on a taxable-equivalent basis. At the end of May 2026, the yield on the Bloomberg Municipal Bond Index was 3.67% which is a taxable-equivalent yield of 6.21% (in the highest tax bracket). This compares quite favorably to the 4.67% yield of the Bloomberg U.S. Aggregate Bond Index (taxable) for the same time period.
- Despite some volatility in the market, we expect municipal credit quality to remain relatively strong. Heading into the second half of 2026, we anticipate overall stability for the municipal sector as a whole. Credit quality for the industry is bolstered by historically strong levels of reserve funds, on average.
- Between elevated yields, strong credit quality and low defaults rates, we continue to view municipal bonds as a solid option for portfolio diversification.



*Tax Exempt Yield

Source: Bloomberg. Indices represented are the Bloomberg Municipal Index and the Bloomberg US Aggregate Index.
The TEY (Tax-exempt yield) is calculated for the highest tax bracket (40.8%).

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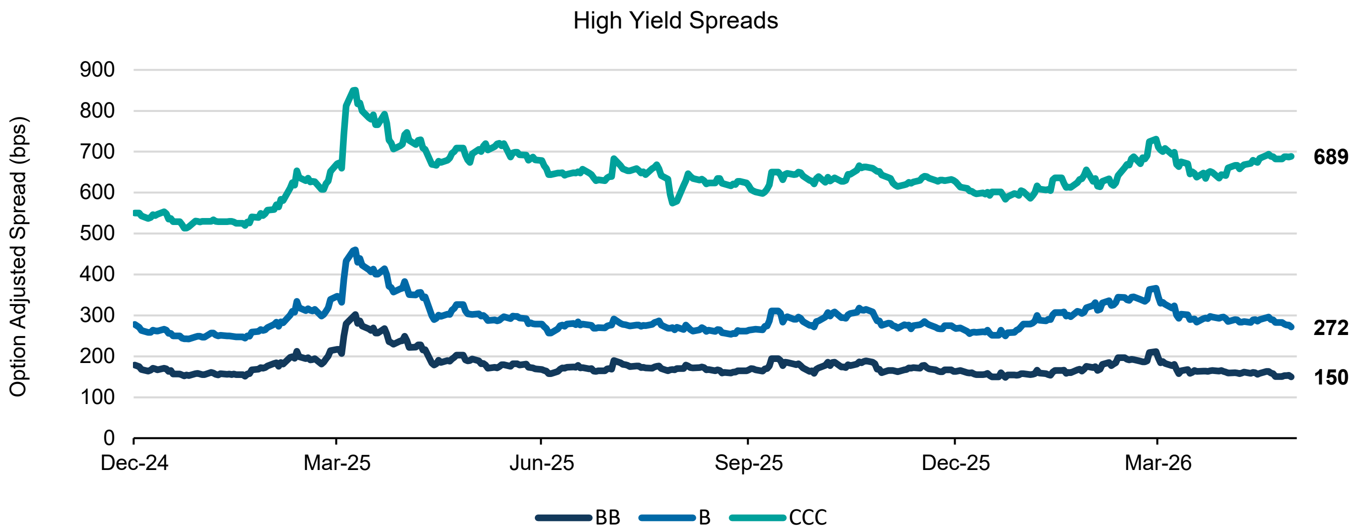
20260709-5733945

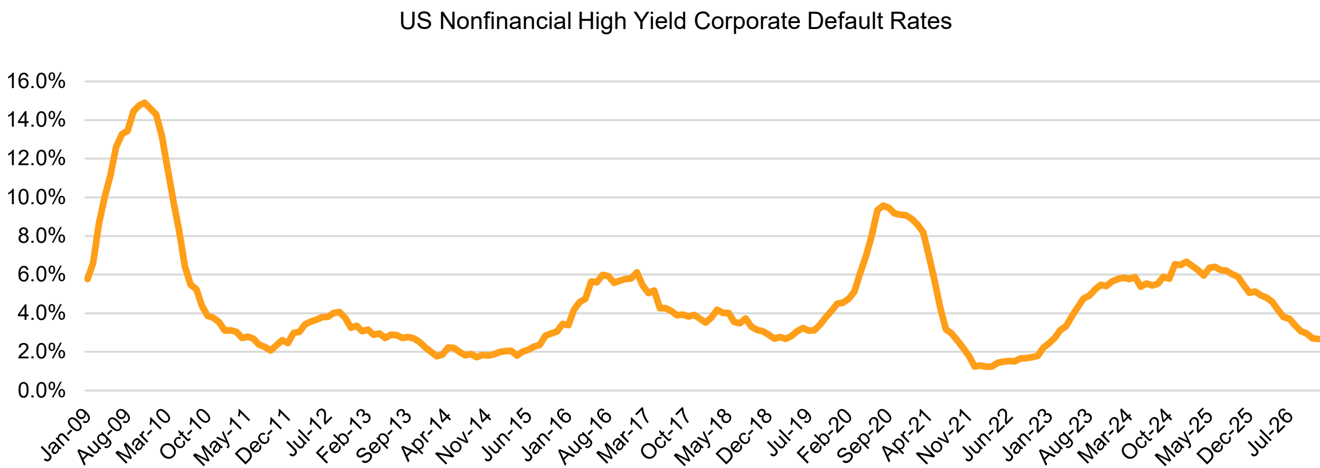
High Yield Corporate Bonds

> Year-to-date, both the high yield and leveraged loan markets have delivered positive returns, despite significant volatility surrounding the war in Iran. As tensions escalated, spreads widened and risk sentiment deteriorated quickly — a stark reminder of how rapidly market conditions can shift.

> While volatility has largely stabilized, ongoing geopolitical uncertainty and its effects on monetary and fiscal policy keep the potential for disruption elevated.

> In light of these conditions, we believe it remains prudent to maintain a disciplined, patient, and opportunistic approach in selecting our investment opportunities.





Source: Moody's

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

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.

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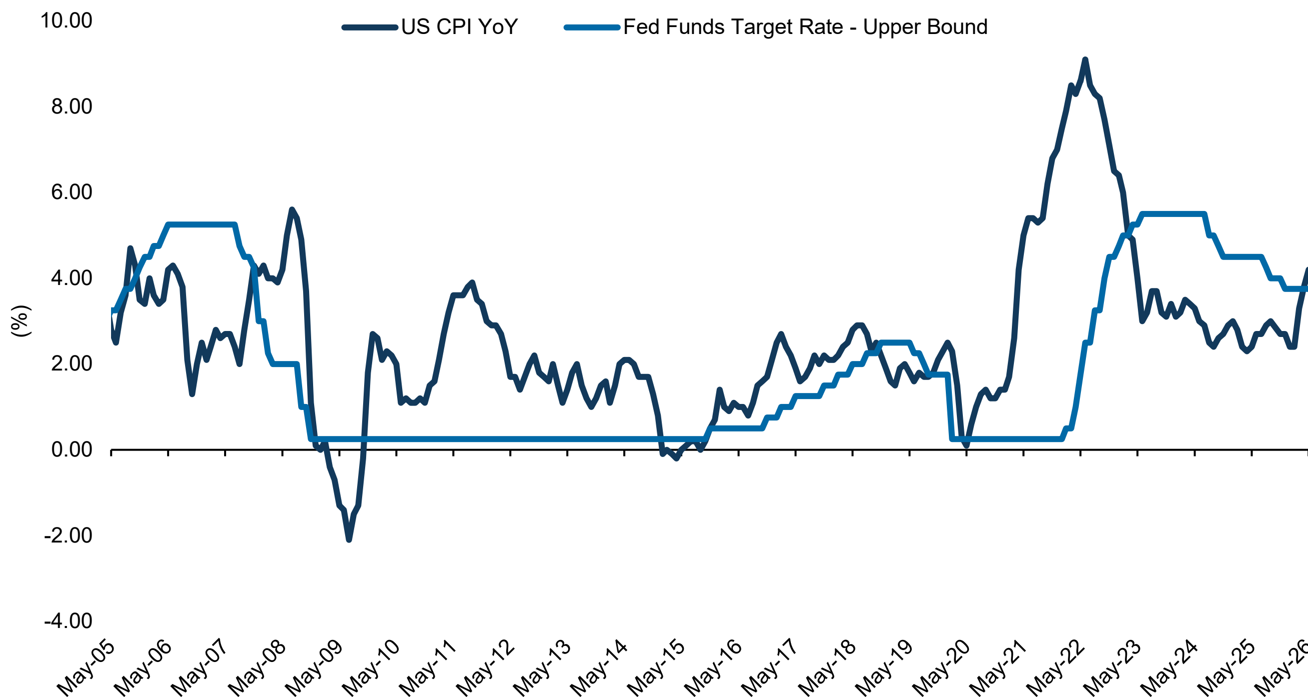
Money Markets

- We believe money market rates face an uncertain path in the coming months. Though market participants generally expected rates to decline during 2026, persistent above-target inflation has called those views into question.
- With record inflows, money market funds have remained a popular investment choice due to their history of stability, safety and very short duration. These three factors persist and have been a feature of money market funds for decades regardless of the direction of interest rate movements. However, we would caution against an excessive overweight in money market funds.
- Despite their relative attractiveness, longer-duration fixed income has historically outperformed money markets when rates have declined. 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.
- Interestingly, as of April 2026, the year-over-year headline CPI inflation reading exceeded money market rates.



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

20260709-5733945

Disclosures

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

Fixed income securities are subject to interest rate, inflation, credit, prepayment, 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.

Option Adjusted Spread (OAS) is a sophisticated bond valuation metric that measures the yield spread of a fixed-income security over a risk-free benchmark after removing the value of embedded options. This measurement provides a cleaner assessment of credit and liquidity risk by isolating the compensation investors receive for these factors alone.

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.

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.

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