USAA HIGH INCOME FUND QUARTERLY COMMENTARY

USAA INVESTMENTS
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of June 30, 2020

Market Commentary

High-yield corporate bonds staged a dramatic recovery during the second quarter, leading a rally in the U.S. fixed income market. The asset class benefited from increased investor risk appetite, which was supported by substantial monetary and fiscal stimulus from the federal government as well as the phased reopening of the U.S. economy. To counter the economic fallout of the new coronavirus (COVID-19) and to keep the credit markets functioning, the U.S. Federal Reserve ("the Fed") instituted a series of supportive facilities for commercial paper, corporate bonds, and asset-backed securities. It also began buying high-yield bond exchange-traded funds (ETFs) under its secondary market corporate credit facility, putting upward pressure on the prices of the ETFs' underlying bonds. Additionally, the Fed held the target federal funds rate near zero, which helped to keep borrowing costs low. The Fed's actions, along with fiscal relief spending from Congress, boosted investor sentiment.

Reflecting the improvement in sentiment, high yield credit spreads (yield differentials between high-yield bonds and investment-grade bonds of comparable maturity) narrowed during the second quarter. (Spreads are generally considered an indication of risk; the narrower the spread, the smaller the perceived risk.) High yield credit spreads based on the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Bond Index (the Index) ended the quarter at 627 basis points, though this was still wide relative to the long-term average of 508 basis points. (A basis point is 1/100th of a percentage point.)

Improved credit conditions and corporations' desire for liquidity led to a deluge of new corporate bond issuance. The high-yield corporate bond market saw $55.6 billion in new issuance between January 1 and June 26, with June the most active month on record, according to JP Morgan.

High-yield leverage ratios – the amount of debt a high-yield company has compared to its equity/capital – were near all-time highs at the end of the second quarter, according to Bloomberg Intelligence. Meanwhile, the number of credit downgrades by credit ratings agencies outpaced the number of upgrades. Some weakly positioned companies were downgraded from investment grade to high yield ("fallen angels"), while certain high-yield companies defaulted on their debt. Among well-known Index constituents with default activity during the second quarter were Hertz, J.C. Penney, J. Crew, Neiman Marcus, and Chesapeake Energy. The energy sector had the most defaults, followed by retailing. Moody's Investors Service calculated that the trailing 12-month corporate high-yield default rate in the U.S. doubled from 3.1% in May 2019 to 6.4% in May 2020.

In the U.S. Treasury market, yields on shorter- and longer-term maturities rose slightly during the second quarter, while those on maturities from one year to 10 years fell. The yield on a 30-year Treasury rose six basis points. Yields on two-, three-, five-, and 10-year Treasuries dropped seven, 11, eight, and four basis points, respectively.

In this environment, high-yield corporate bonds performed as expected, with their returns falling in between stocks and intermediate-term bonds. Historically, high-yield securities tend to perform between stocks and high-quality bonds, generally with less volatility. The best-performing industries in the Index were energy related, including exploration and production, midstream pipelines, and refining. Energy companies benefited from higher crude oil prices; the price of West Texas Intermediate increased $9.18 to $39.27 per barrel during the quarter. The worst-performing industries in the Index were airlines, transportation services, and aerospace/defense.

Fund Performance and Positioning

During the second quarter, the USAA High Income Fund outperformed its benchmark index.

The Fund benefited from corporate credit selection, highlighted by investments in metals and mining, utilities, autos, and homebuilding names. Also adding to relative performance were out-of-index positions in bank loans, equities, and emerging markets bonds, all of which outperformed the Index. These positive results were offset somewhat by an underweight in the energy sector and to a lesser extent, credit selection across the energy universe. The Fund's performance was also hurt by its allocation to and selection of investments in financial companies, mainly insurance companies. A cash position, investments in high yield ETFs (which were held in lieu of cash), and a small number of mortgage-backed securities also dampened the Fund's relative returns. During the quarter, we added to the Fund's position in "fallen angels" and invested in attractive opportunities from the new issue calendar. After a strong rally in May, we reduced the portfolio's investments in riskier credits.

To identify potentially attractive investment opportunities, we continued to work with our in-house team of credit analysts. This team helps us evaluate each potential investment individually, rather than on the basis of thematic trends. We seek ideas where our fundamental understanding of the credit risk is different than the market, building the portfolio bond-by-bond through fundamental bottom-up analysis. Our credit analysts review all securities considered for purchase and assign their own independent credit rating. They continuously monitor every holding in the Fund.

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Consider the investment objectives, risks, charges and expenses of the USAA Mutual Funds carefully before investing. To obtain a prospectus or summary prospectus containing this and other information visit www.usaa.com/prospectus. Read it carefully before investing.

Investing involves risk, including potential loss of principal. There is no assurance the objective(s) will be met. A fund's performance may be affected by risks that include those associated with nondiversification, non-investment grade debt securities, high-yield/high-risk securities, undervalued or overlooked companies, investments in specific industries or countries and potential conflicts of interest. Additional risks to a fund may also include, but are not limited to, those associated with investing in foreign securities, emerging markets, initial public offerings, real estate investment trusts (REITs), derivatives, short sales, commodity-linked investments and companies with relatively small market capitalizations. Each fund has different risks. Please see a prospectus for more information about risks, fund holdings and other details.

Diversification neither assures a profit nor eliminates the risk of experiencing investment losses.

The opinions are as of the date noted and are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

Discussion based on the fund share class. Other classes have different performance characteristics.

Some income for tax-exempt investments may be subject to state or local taxes or the federal alternative minimum tax.

Holdings, if any, are subject to change without notice and should not be considered purchase recommendations.

Victory Capital Management does not give financial, tax or legal advice, and nothing contained herein should be construed as such advice.

An index is unmanaged and not available for direct investment; therefore, its performance does not reflect the expenses associated with the active management of an actual portfolio.

As of July 1, 2019, Victory Capital Management Inc. is the investment advisor for USAA Mutual Funds.

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