# USAA SHORT-TERM BOND FUND QUARTERLY COMMENTARY

USAA INVESTMENTS
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of September 30, 2021

## Performance Summary

Fixed income returns were broadly positive in the third quarter, with a flattening Treasury curve just offsetting marginally widening credit spreads. The main question on the market's mind increasingly is the extent to which inflation may be transitory and when the Federal Reserve might address it. For the remainder of 2021, we expect "carry"—the return from the yield of a bond portfolio—to be the principal driver of returns in fixed income on strong corporate fundamentals, above-trend GDP growth and the continuing global search for yield. The USAA Short-Term Bond Fund outperformed its benchmark, the Bloomberg 1-3 Year Credit Index, for the quarter. The Fund's asset allocation and credit quality positioning were the main drivers of relative performance.

## Market Update & Commentary

Fixed income returns were broadly positive during the third quarter—if, in some cases, only barely so. Investment grade credit spreads widened by 4 basis points (bps) to 84 bps, and high yield spreads widened 20 bps to 287 bps (credit spreads are the additional compensation investors require to hold securities that aren't as safe and liquid as those issued by the U.S. Treasury; widening spreads decrease returns). Offsetting the spread widening was a flattening U.S. Treasury curve, with rates in the 2- to 10-year section of the curve rising and those in the longer end falling. Lower rates generally increase the returns from issued fixed income securities.

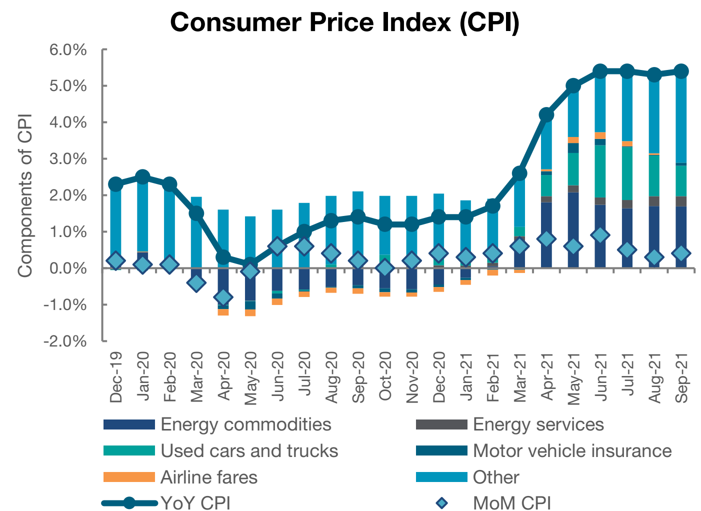
As a result, corporate high yield bonds were the strongest performer across the third quarter, followed distantly by very modest returns for the Bloomberg U.S. Aggregate Bond Index and zero returns from corporate bonds. These anemic results follow strong positive returns across all segments of fixed income during the second quarter:

| Bloomberg Index | Q3 2021 | Q2 2021 | Q1 2021 | YTD 2021 |
|---|---|---|---|---|
| U.S. Aggregate | 0.05% | 1.83% | -3.37% | -1.55% |
| U.S. Corporate | 0.00% | 3.55% | -4.65% | -1.27% |
| U.S. Corporate High Yield | 0.89% | 2.74% | 0.85% | 4.53% |
| U.S. Treasury | 0.09% | 1.75% | -4.25% | -2.50% |

*Source: Bloomberg, as of September 30, 2021.*

Late in the third quarter, the U.S. Federal Reserve ("the Fed") indicated its intent to begin tightening monetary conditions. Fed Chairman Powell communicated that inflation had already hit the Fed's target and that further progress toward full employment would justify a gradual reduction (called "tapering") in the Fed's purchases of U.S. Treasury and mortgage securities, perhaps as early as November 2021. He emphasized, though, that these purchases would taper to zero before the Fed actually began to raise rates. Specifically, Chairman Powell said there would have to be "substantial further progress" toward maximum employment.

The market has become worried, though, about wage and price inflation. So far, inflation has largely been assumed to be "transitory" in that it was induced only in certain sectors and by-passing waves of COVID-19. If inflation were to gain traction across large sectors of the economy, the market fears the Fed would be compelled to tighten monetary policy more aggressively than so far communicated. This debate may take months to settle. The Fed, while it increased its Personal Consumption Expenditures (PCE) inflation projection in September to 4.2% from its June estimate of 3.4%, still expects inflation to remain within its policy framework. Additionally, month-on-month Consumer Price Index (CPI) numbers have eased and year-on-year changes have come off peaks. On the other hand, COVID-related sectors represented approximately 60% of the August 2021 increase in the CPI, a continuation of the dynamic seen since May when these sectors contributed 72% of inflation, decreasing to 69% in June and 65% in July. That the composition of those sectors contributing to inflation appears to be trending toward more non-COVID-related sectors would seem to suggest that the economy is experiencing inflationary pressures more broadly and that these pressures may not be transitory after all.




*Source: Bloomberg, as of September 30, 2021.*

Market-based measures of inflation are supportive of higher inflation than the 2% average targeted by the Fed. The 5-year break-even rate measures the difference in yield between the nominal 5-year Treasury and the 5-year Treasury Inflation Protected Security (TIPS). This differential finished the quarter at 2.53% and ranged within a narrow band from 2.65% to 2.41% during the third quarter.

**Not FDIC Insured • May Lose Value • No Bank Guarantee**



20211015-1870483

## Outlook

The pace of the Fed's tapering, when the Fed will begin raising rates and the extent and from which sectors inflation may emerge will engage the market's attention for months to come. Our view is that positioning a portfolio on inherently uncertain inflation and interest rate forecasts is an unreliable way to generate consistent fixed income returns. Our approach to managing fixed income is unchanged through the interest rate cycle and consists of managing to a stable duration target while focusing on credit selection and industry positioning to generate alpha. We believe this method should generate strong returns no matter when, whence, or whatever the cause of inflation.

Looking ahead, and despite credit spreads being at or near their all-time lows, we expect continued support for credit through the second half of 2021 on solid corporate fundamentals and strong demand for yield. We believe this environment is ideal for active managers in that it offers greater opportunity for credit selection across credit quality buckets, sectors and asset classes.

## Portfolio Performance & Positioning

The Fund outperformed its benchmark index, the Bloomberg 1-3 Year Credit Index, quarter to date ending September 30, 2021. The Fund share class returned 0.15% (before fees) compared to the benchmark return of 0.14%. The largest contributors to relative performance were the Fund's positions in corporate bonds. These bonds posted strong performance as the risk markets continued to benefit from a return to normal economic activity, the approval of multiple COVID-19 vaccines and the passing of a fiscal stimulus package. Security selection within these categories was also a meaningful contributor. Security selection within the Fund's off-benchmark exposure to high yield bonds, specifically BB-rated securities, as well as BBB-rated bonds, strongly benefited our performance. Our positions in cash, Treasuries, asset backed bonds, taxable municipal bonds and food and beverage were detractors from performance. During the quarter, our sector allocations were generally unchanged.

See the table below for more information on average annual returns.

## Contributors

- Allocation and Selection added 22 bps of outperformance. Duration subtracted a modest 3 bps from performance.
- Within the corporate sector, outperformance was driven by industrials.
- Within the corporate sectors, the greatest outperformance came from aerospace and defense, consumer cyclical services, midstream, diversified manufacturing and CMBS.
- An overweight to BBB and high yield credit and an underweight to A and higher rated credit were the largest credit rating position drivers of performance.

## Detractors

- Certain sectors detracted from performance during the quarter. Underperformance came from cash, Treasuries, bank loans, food and beverage, and other industrials.

## Standardized Performance: September 30, 2021

Average Annual Returns (%)

| USAA Short-Term Bond Fund | Ticker | Inception Date | Q3 2021 | 1 Year | 5 Year | 10 Year | Since Inception | Expense Ratio Gross | Expense Ratio Net |
|---|---|---|---|---|---|---|---|---|---|
| Fund Shares | USSBX | 06/01/93 | 0.15 | 2.78 | 2.77 | 2.47 | 3.85 | 0.52 | 0.52 |
| A Shares, without sales charge | UASBX | 08/02/10 | 0.09 | 2.56 | 2.57 | 2.24 | 2.22 | 0.74 | 0.73 |
| A Shares, with sales charge (max. 2.25%) | UASBX | 08/02/10 | -2.21 | 0.30 | 2.11 | 2.01 | 2.01 | 0.74 | 0.73 |
| Institutional Shares | UISBX | 08/01/08 | 0.27 | 2.97 | 2.87 | 2.59 | 3.26 | 0.42 | 0.42 |
| R6 Shares | URSBX | 12/01/16 | 0.29 | 3.01 | – | – | 3.21 | 0.45 | 0.39 |
| Bloomberg 1-3 Year Credit Index | – | – | 0.14 | 0.92 | 2.40 | 2.18 | – | – | – |

**Past performance does not guarantee future results. The performance quoted represents past performance and current performance may be lower or higher. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. To obtain performance information current to the most recent month-end, visit www.vcm.com.** Returns include reinvestment of dividends and capital gains. Performance for periods greater than one year is annualized. Fee waivers and/or expense reimbursements were in place for some or all periods shown, without which, fund performance would have been lower. Net expense ratio reflects the contractual waiver and/or reimbursement of management fees through November 30, 2021.

20211015-1870483

**Carefully consider a fund's investment objectives, risks, charges and expenses before investing. To obtain a prospectus or summary prospectus containing this and other important information, visit www.vcm.com/prospectus. Read it carefully before investing.**

Not all share classes are available to all investors.

**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. 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.

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.

**The Bloomberg 1–3 Year Credit Index** measures the performance of investment grade corporate debt and sovereign, supranational, local authority and non-U.S. agency bonds that have a remaining maturity of at least one year and less than three years.

Index returns are for illustrative purposes only and do not represent actual Fund performance. Index performance does not reflect management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. **Past performance does not guarantee future results.**

Victory Capital means Victory Capital Management Inc., the investment adviser of the Victory Capital mutual funds and USAA Mutual Funds. Victory Capital mutual funds and USAA Mutual Funds are distributed by Victory Capital Services, Inc. (VCS), member FINRA, an affiliate of Victory Capital. Victory Capital and its affiliates are not affiliated with United Services Automobile Association or its affiliates. USAA and the USAA logos are registered trademarks and the USAA Mutual Funds and USAA Investments logos are trademarks of United Services Automobile Association and are being used by Victory Capital and its affiliates under license.

©2021 Victory Capital Management Inc.

V20.134 // 3Q 2021 USAA Short-Term Bond Fund COM

VictoryCapital®