Quarterly Commentary

And all that is now
And all that is gone
And all that's to come
And everything under the sun is in tune
But the sun is eclipsed by the moon
– Pink Floyd

We had to have an "eclipse" reference this month. It was either Pink Floyd or Bonnie Tyler ("Total Eclipse of the Heart"). Classic rock won out.

Anticipation of Federal Reserve interest rate policy seems to eclipse everything else in the market. The first quarter of 2024 witnessed a reversal of some of the rate-cut euphoria of Q4 2023. The Q4 2023 expectations for significant rate reductions weighed on Q4 portfolio performance. The portfolios benefitted in Q1 from some lessening of those expectations.

We are not sure when or by how much the Federal Reserve will cut interest rates. Furthermore, while not the most likely, we don't completely discount the possibility of zero cuts this year or further increases down the road. We were happy to hear Federal Reserve Chairman Powell state something we have been harping on for some time. Interest rates are not going back to pre-pandemic levels. The post-2008 interest rate environment was unique, not normal. Powell does not think it is likely that we would return to long-run rates that are in the 2% range. He also doesn't see long-term rates around the world returning to levels at or below zero.

Money-losing, long-duration equities have been a big beneficiary of ultra-low interest rates. We've written in the past about the high concentration of these companies in our value benchmarks and our significant underexposure to them. These stocks react favorably to rate reduction expectations. We continue to look for companies that meet our investment criteria and respond favorably to lower rates. We have found some investments, but not enough to completely offset our underexposure.

The upcoming Russell rebalance holds a sliver of good news. Some of the value indexes will likely see the weight of non-earners slightly decrease. Our lead risk analyst, Mike Wayton, projects that non-earners would decrease by approximately 1.6 percentage points in the Russell 2000® Value Index, by almost 1% in the Russell Midcap® Value Index benchmark, and remain roughly the same in the Russell 2500™ Value Index. The exposure will still be significant, but we will take any relief we can find.

Mike also estimates the rebalanced benchmarks will have slightly lower betas, smaller growth rates, and lower valuations. In short, they will be more value-like. The Russell rebalance is scheduled for Friday, June 28. The first official, preliminary index membership lists are expected to be released on Friday, May 24. We will have more certainty around these characteristics as well as sector weights at that time.

Here in Cleveland, we are within the path of totality of the April 8, 2024 eclipse. The last time this happened was 1806. The next occurrence will be 2444. That's about as rare as seeing near-zero to negative interest rates. We don't know if it will be 400 years before zero rates happen again, but we don't think it will be soon. As we have stated before, we believe "normal" rates could provide the catalyst to reverse the significant underperformance of small-caps vs. large-caps and value vs. growth. Time will tell. In the meantime, we will continue to apply our flexible value strategy, searching for undervalued stocks with a catalyst, keeping a close eye on the risk in our portfolios, and striving for consistent, long-term performance for our clients.

Health care and industrials were the top performing sectors in the benchmark. Utilities was the worst performing sector in the benchmark. Micro cap growth outperformed micro cap value.

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The Victory Integrity Discovery Fund (A shares without sales charge) underperformed its benchmark, the Russell Microcap® Value Index. Financials and industrials were the largest sources of contribution, mostly from stock selection. Health care was the most significant negative, largely due to our underweight allocation. Weak stock selection in technology was an additional headwind. Sector allocations were a negative due to the sizeable underweight to health care, mainly biotechs, which materially outperformed.

Within financials, an underweight to banks helped as the group underperformed after a strong rally and reduced expectations for near-term interest rate cuts. First Internet Bancorp (INBK) was a substantial positive. Better-than-expected results and outlook as net interest margins improved led to a gain of 44%. Dime Community Bancshares, Inc. (DCOM) was a notable detractor due to worries about its rent-regulated multi-family exposure. Strong consumer demand and better margins led to stellar results at EZCORP (EZPW). Our insurance holdings were a significant contributor. Heritage Insurance Holdings, Inc. (HRTG) rebounded 63% as strong results were driven by improved pricing and lower weather/catastrophe losses. Similar dynamics led to a 33% gain for HCI Group, Inc. (HCI).

Industrials were a sizeable contributor. DXP Enterprises, Inc. (DXPE) was the largest positive. It advanced 59% due to improved margins and the closure of three small acquisitions that enhance margins and growth. CRA International, Inc. (CRAI) rebounded 52% after reporting exceptional results as client activity increased. Strong execution and year-end budget flushes benefitted Willdan Group (WLDN) earnings. Interface, Inc. (TILE) rallied thanks to lower input costs, share gains, and continued debt paydown.

Performance in consumer discretionary was a small positive. Modine Manufacturing Company (MOD) gained 59%. It reported another strong quarter and announced an acquisition to further expand its data center exposure for HVAC systems.
Latham Group Inc. (SWIM) shares rallied 51% as expectations for Federal Reserve interest rate cuts started to be priced into the market. It makes residential vinyl pools, which are sensitive to financing costs. Conversely, Red Robin Gourmet Burgers, Inc. (RRGB), Solo Brands, Inc. Class A (DTC), and OneWater Marine Inc. Class A (ONEW) were disappointments. Red Robin Gourmet Burgers, Inc. (RRGB) reported disappointing earnings and guidance as results lagged on tough comparisons and weather disruption. Solo Brands, Inc. Class A (DTC) negatively preannounced earnings and an unexpected CEO transition. OneWater Marine Inc. Class A (ONEW) reported disappointing earnings as boat inventory levels remain elevated.

Real estate and energy were very minor positives, as our holdings slightly outperformed.

The lack of biotech ownership was the most sizeable negative in health care. The average biotech was up almost 23%, which cost us 245 basis points. RadNet, Inc. (RDNT) and Collegium Pharmaceutical, Inc. (COLL) were the main highlights. RadNet, Inc. (RDNT) reported a strong quarter, with top- and bottom-line-beating estimates driven by strong volume trends. It also reiterated upbeat guidance. Collegium Pharmaceutical, Inc. (COLL) was up 26% as results exceeded estimates.

Technology was a detractor due to weakness within software and communications equipment. In software, we did not own Cleanspark, Inc. (CLSK), a bitcoin mining company, which was up more than 92%. In communications equipment, Comtech Telecommunications Corp. (CMTL) and Lantronix, Inc. (LTRX) hurt performance. Despite news of a strategic investment, shares of Comtech Telecommunications Corp. (CMTL) lagged on the lack of a finalized debt refinancing and cautious demand commentary from communications equipment peers. Lantronix, Inc. (LTRX) issued weaker-than-expected guidance resulting from excess inventory at customers and a product pushout. Kimball Electronics, Inc. (KE) also hindered performance as demand softness coupled with changing customer production schedules and delivery date requirements pressured results. Semiconductors were a modest positive as we did not own some of the worst performers.

Performance in materials was a very minor negative. Radius Recycling Inc. Class A (RDUS) was hurt by lower scrap volumes and pricing.

Performance in communication services was about breakeven. PubMatic, Inc. Class A (PUBM) was a notable winner. It reported strong earnings and guidance, powered by growth in monetized impressions and emerging revenue streams. However, this was offset by E. W. Scripps Company Class A (SSP). Despite better-than-expected earnings results, it lagged on softer-than-expected political advertising guidance and the suspension of their preferred stock dividend payment. Cautious demand commentary from peers also contributed to the underperformance.

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All investing involves risk, including the potential loss of principal. In addition to the normal risks associated with investing, micro-cap companies may have narrower markets and be difficult to buy and sell. Micro-cap companies may have limited products or resources and may experience higher failure rates than larger, more seasoned companies. Investments concentrated in an industry or group of industries may face more risks and exhibit higher volatility than investments that are more broadly diversified over industries or sectors. The financial services industry is subject to extensive government regulation that affects the scope of their activities, the prices they can charge and capital maintenance. The industry is subject to severe competition and can be significantly affected by market conditions and activity. Investments in companies in the industrials sector may be adversely affected by changes in supply and demand for products and services, governmental regulation and changes spending policies, world events and economic conditions. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. 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 Russell Microcap® Value Index is a market- capitalization-weighted index that measures the performance of Russell Microcap® Index companies (1,000 smallest stocks in the Russell 2000® Index plus 1,000 smaller U.S.-based listed stocks) with relatively lower price-to-book ratios and lower forecasted growth values. It represents the value-oriented micro-cap segment of the U.S. equity market.

Fund holdings mentioned in the Quarterly Commentary are as of 3/31/2024 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 3/31/2024 were Brookdale Senior Living Inc (1.4%), RadNet, Inc (1.4%), Columbus McKinnon Corp (1.4%), Ichor Holdings, Ltd (1.3%), NETSTREIT Corp (1.3%), Modine Manufacturing Co (1.2%), Clearwater Paper Corp (1.2%), Interface, Inc (1.1%), DXP Enterprises, Inc (1.1%), Veeco Instruments Inc (1.1%). 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.

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