USAA SHORT-TERM BOND STRATEGY
QUARTERLY COMMENTARY

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 Strategy outperformed its benchmark, the Bloomberg 1-3 Year Credit Index, for the quarter. The Strategy'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.

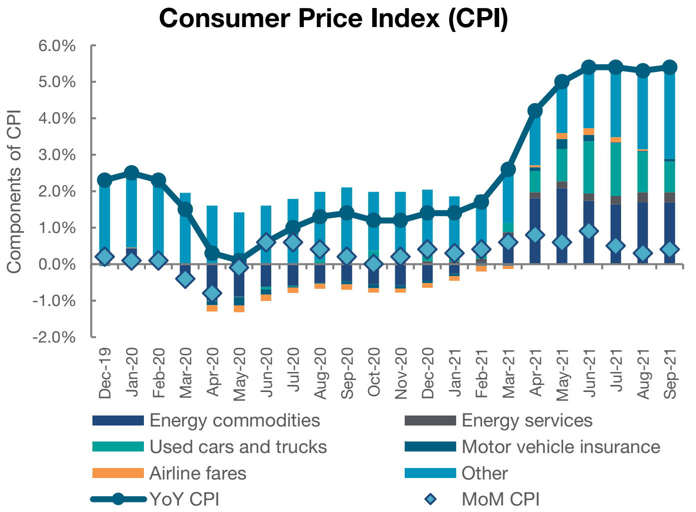
As a result, corporate high yield bonds were the strongest performer across the third quarter, followed distantly by very modest returns for the Bloomberg U.S. Aggregate Bond Index and zero returns from corporate bonds. These anemic results follow strong positive returns across all segments of fixed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

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 Strategy outperformed its benchmark index, the Bloomberg 1-3 Year Credit Index, quarter to date ending September 30, 2021. The Strategy returned 0.28% (before fees) compared to the benchmark return of 0.14%. The largest contributors to relative performance were the Strategy'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 Strategy'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.

Performance

Average Annual Returns (%) as of September 30, 2021

USAA Short-Term Bond Strategy	QTD	YTD	1-YR	3-YR	5-YR	10-YR	Since Inception (July 1993)
Gross of Fees	0.28	1.70	3.32	4.31	3.35	3.08	4.43
Net of Fees	0.15	1.30	2.78	3.75	2.77	2.47	3.83
Bloomberg 1-3 Year Credit Index	0.14	0.35	0.92	3.31	2.40	2.18	3.26

Past performance does not guarantee future results. Performance returns for periods of less than one year are not annualized. Returns include reinvestment of dividends and capital gains. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Net-of fees returns are calculated by deducting 1/12 of the highest tier of the standard fee schedule in effect for the period noted (the model feel). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equity to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found on Part II of its Form ADV.

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The holdings and sector diversification are presented to illustrate examples of the portfolio's investments and may not be representative of the portfolio's current or future investments. Holdings are as of a point in time and may change at any time.

The USAA Short-Term Bond Fixed Income Composite includes all institutional and retail portfolios invested primarily in a broad range of debt securities that have a dollar-weighted average portfolio maturity of three years or less. The debt securities in which the composite portfolio may invest include, among others, obligations of U.S., state, and local governments, their agencies and instrumentalities; mortgage- and asset-backed securities; corporate debt securities; repurchase agreements; and other securities believed to have debt-like characteristics. The strategy aims to deliver high current income without undue risk to principal. Portfolios in the composite will invest primarily in investment-grade securities, but also may invest in below investment-grade securities, which are sometimes referred to as high-yield or "junk" bonds. High yield bonds carry increased levels of credit and default risk and are less liquid than government and investment grade bonds. The composite creation date is July 2019. The benchmark of the composite is the Bloomberg 1-3 Year Credit Index.

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. The index does not incur fees and expenses and is not available for direct investment.

Index returns reflect the reinvestment of dividends and capital gains but do not include advisory fees, transaction costs, or other expenses. One cannot invest directly in an index.

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Supplemental information. Performance prior to July 1, 2019, is that of USAA Asset Management Company prior to acquisition by Victory Capital. The prior performance information of the strategy is based on a single representative pooled fund, and managed by the same team from the previous employer. Performance composite results for the periods following June 30, 2019 have followed the performance reporting polices set forth by Victory Capital.

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