USAA ULTRA SHORT-TERM BOND STRATEGY QUARTERLY COMMENTARY

USAA INVESTMENTS
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of March 31, 2022

Performance Summary

Fixed income fared poorly during Q1 as market dynamics were challenging due to Russia's invasion of Ukraine and the highest inflation readings in the past four decades, leading most to expect the Fed to rapidly tighten monetary policy. As a result, fixed income returns were negative, with widening spreads across the credit spectrum, rising interest rates, and a flattening Treasury curve. The USAA Ultra Short-Term Bond Strategy underperformed its benchmark, the Bloomberg U.S. Treasury Bellwethers 3 Month Index, for the quarter. The Strategy's longer duration and allocation to credit were the main drivers of relative performance.

Market Update & Commentary

The U.S. bond market, per the Bloomberg U.S. Aggregate Bond Index, returned -5.9% over the first quarter as, overall, bond prices fell. The Aggregate has not performed this poorly over a quarter in more than four decades. The U.S. Treasury component of the Aggregate saw a yield increase of 119 basis points (bps) to 2.4% and returned -5.6%, again on falling bond prices and because yields move inversely to price. Investment grade (IG) corporate bonds returned -7.7% on higher Treasury yields and wider credit spreads. 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. Corporate high yield performed better, declining 4.8%, due to high yield's lower sensitivity to interest rates.

	Yield (%)	Spreads (bps)			Returns (%)	
		12/31/2021	3/31/2022	Δ (+/-)	3M	1YR
Investment Grade						
U.S. Treasury	2.4	0	0	0	(5.6)	(3.7)
U.S. Aggregate	2.9	36	40	+4	(5.9)	(4.2)
U.S. Credit	3.5	87	107	+20	(7.4)	(4.2)
Corporate	3.6	92	115	+22	(7.7)	(4.2)
Aa	3.1	57	68	+11	(7.9)	(4.1)
A	3.4	74	94	+19	(7.3)	(4.3)
Baa	3.9	113	140	+27	(7.9)	(4.2)
Crossover	4.7	167	203	+36	(7.1)	(2.5)
High Yield						
U.S. Corporate High Yield	6.2	283	321	+38	(4.8)	(0.7)
Ba	5.1	194	230	+36	(5.9)	(1.5)
B	6.5	312	340	+28	(3.5)	(0.0)
Caa	9.5	555	594	+39	(3.9)	0.8
Ca-D	30.8	2,660	2,752	+92	(3.8)	(5.5)
Structured Product						
U.S. MBS	3.0	32	24	-8	(5.0)	(4.9)
ABS	2.8	38	58	+20	(2.9)	(3.1)
CMBS	3.3	68	85	+17	(5.6)	(4.5)

Corporate credit spreads widened 22 bps to 115 bps, while high yield spreads widened 38 bps to 321 bps. Though corporate investment grade and high yield credit spreads widened during the quarter, both evidenced some recovery from their widest levels of mid-March. Investment-grade rated debt (rated AAA through BBB) performed similarly, regardless of rating, but lower quality (B through CCC) high yield bonds performed better than higher-rated BB bonds.

Asset-backed securities (ABS) returned -2.9% over the first quarter. Collateralized mortgage-backed securities (CMBS) returned -5.6% on 17 bps of spread widening. Agency mortgage-backed securities (MBS) returned -5.0%, as yields on the aggregate component of US Agency MBS increased 102 bps to 3%.

Rising prices—inflation—has become the top macroeconomic concern. The February Consumer Price Index (CPI) printed at 7.9% (annualized), its biggest increase since 1982. Supply chain constraints are a lingering cause, but Russia's invasion of Ukraine (and the resulting economic sanctions) is also a factor in that it promptly drove energy prices higher—West Texas Intermediate crude oil increased over 35% (to $100/barrel) over the quarter. Prices for other commodities, such as wheat (of which Ukraine is a big exporter) to aluminum and palladium (of which Russia is a global supplier), also jumped.

A surging CPI has layered further pressure on the Fed to tame prices. The Federal Reserve increased the federal strategy target rate 25 bps in its March meeting and, at quarter's end, the market was pricing in eight rate hikes in 2022. U.S. Treasury yields saw substantial increases, particularly in the front end of the curve, flattening the Treasury curve significantly. The 2-year Treasury yield increased 160 bps to 2.34%, whereas the 10-year Treasury yield increased also, but only by 83 bps, to 2.34%, the very definition of flat.

Treasury yields initially fell and credit spreads widened on a "risk-off" reaction to the invasion. But, by March 14, investment grade corporate credit spreads had peaked for the quarter and Treasury yields had resumed their climb such that, by quarter-end, they were well above yields before the invasion as inflationary concerns returned to the fore. In all likelihood, these same concerns will prove to be most important for the rest of 2022.

1The yield on the Bloomberg Credit Index vs. the Yield on the Bloomberg Treasury Index. The current multiple is higher than the 40-year average

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Portfolio Performance & Positioning

The Strategy under performed its benchmark index, the U.S. Treasury Bellwethers 3 Month Index, for the quarter ended March 31, 2022. The Strategy returned -1.16% (net of fees) compared to the benchmark return of 0.04%. During the first quarter, rising U.S. Treasury rates and wider credit spreads resulted in losses across the entire investment grade spectrum. Rates in the front-end of the yield curve were hit harder than the long-end as the Treasury yield curve underwent a bear flattening. The 2-year Treasury yield increased by a stunning 160 basis points in the quarter vs. 83 basis points for the 10-year Treasury. For perspective, that was the biggest move in the 2-yr Treasury since 1984. Credit spreads widened for about 8 weeks in a row to start the quarter only to gap out even more after Russia invaded Ukraine. Spreads tightened in the back half of March, recovering some from their widest point. The Bloomberg 1-3 Year U.S. Aggregate Index lost 0.23% for the quarter, impacted by rising rates and 13 basis points of credit spread widening.

Industry outflows pressured short paper with front-end selling being the cheapest funding option to meet redemptions or extend duration in attractive new issues. Front-end off-the-run paper was acutely illiquid and suffered the worst price declines. We expect rate volatility to continue as the Fed seeks to tame inflation running at a 40-year high with a heightened sense of urgency. The market has priced in atypical 50 basis point rate increases in each of the next two meetings with expectations for continued tightening thereafter until the Fed reaches its neutral target.

Holdings across each of the credit rating categories had negative returns in the quarter. The Strategy did benefit from its large cash and cash equivalents position as that dampened some of the rate and spread volatility, plus returns there increased after the Fed raised rates by 25 basis points at its March meeting. The Strategy's biggest relative outperformers were its investments in media & entertainment, cable & satellite, P&C, and aerospace & defense sectors. Each of these had a positive return. The largest relative detractors were in healthcare, asset-backed securities, other industrial, finance companies, and gaming.

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

Contributors

- Best performers were media & entertainment, cable & satellite, P&C, and aerospace & defense within corporates, technology and capital goods within bank loans, agency within government related, non-agency commercial mortgage-backed securities, and equipment asset-backed securities within structured product.
- Sector performance was strongest in media & entertainment.
- The Strategy's large cash and equivalents position was a contributor to performance.

Detractors

- Healthcare, asset-backed securities, other industrial, finance companies, and gaming had the lowest overall industry returns.
- Returns in every rating category were negative for the quarter with AAA-rated securities performing the best.
- Longer duration than the benchmark had was a major detractor of performance.

Performance

Average Annual Returns (%) asof March 31, 2022

USAA Ultra Short -Term Bond Composite	QTD	YTD	1-YR	3-YR	5-YR	10-YR	Since Inception (November 2010)
Gross of Fees	-1.01	-1.01	-0.22	2.33	2.44	2.18	2.20
Net of Fees	-1.16	-1.16	-0.82	1.72	1.84	1.58	1.60
Bloomberg U.S. Treasury Bellwethers 3 Month Index	0.04	0.04	0.06	0.81	1.14	0.65	0.58
FTSE 3-month T-bill Index	0.03	0.03	0.06	0.76	1.09	0.60	0.54

Past performance cannot 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 fee). 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.

Investing involves risk, including loss of principal.

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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 Ultra Short-Term Bond Fixed Income Composite includes all institutional and retail portfolios invested in high-quality securities, the interest of which is excludable from gross income for federal income tax purposes (referred to herein as "tax-exempt securities"), with remaining maturities of 397 days or less. During normal market conditions, at least 80% of the composite portfolio will consist of tax-exempt securities. In addition, during normal market conditions, at least 80% of the composite portfolio annual net investment income will be tax-exempt and excludable from the calculation of the federal alternative minimum tax ("AMT") for individual taxpayers. The strategy aims to deliver high current income consistent with preservation of principal. The composite creation date is July 2019. The benchmark of the composite is the FTSE 3 Month U.S. Treasury Bill Index.

The FTSE 3-Month U.S. T-Bill Index measures monthly return equivalents of yield averages that are not marked to market and consists of the last three three-month Treasury bill issues. 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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