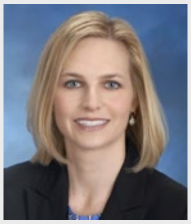
4Q/2017 UMP COMMENTARY

Fourth Quarter Update for USAA Managed Portfolio Shareholders



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USAA Investment Management Company

UMP TACTICAL ALLOCATION

AS OF 12/31/2017

ASSET CLASS	CHANGE	MOMENTUM	DISCRETIONARY
US Large	—		
US Small	—		
International Developed	—	✓	✓
Emerging Market	—	✓	✓
Treasury	—		
Investment Grade Credit	—		
High Yield	—		
Emerging Market Debt	—		
Cash	—		

Global equities finished 2017 on a strong note, propelled by stronger economic growth and low inflation. U.S. stocks were also aided by the substantial corporate tax cut signed into law at year-end.

Emerging market stocks returned 7.5% for the fourth quarter and nearly 38% for the full year. Non-U.S. developed markets, led by Europe, returned 4% in 4Q and 25.6% for the year, while U.S. large caps picked up 7% and 22% for the respective time periods.

USAA Managed Portfolios (UMP) maintained tactical allocations to international developed markets and emerging markets throughout the quarter, based on momentum (continuation of existing market trends) and our discretionary models, which consider fundamental valuations, macro conditions and market sentiment.

MARKET OVERVIEW

Synchronized gross domestic product (GDP) growth among global economies was a key contributor to investor optimism in 2017, and data suggests that this trend can continue to lift markets in 2018 as well. Adding to the buoyant markets outlook for the coming year were a couple of significant events in December — key central banks signaling that they plan to keep monetary policy on the loose side, and a dramatic tax cut for U.S. corporations.

A pick-up in U.S. economic growth in the second and third quarters spurred some worry that the Federal Reserve might accelerate its pace of interest-rate increases in 2018 — such a shift would likely disrupt both stock and bond markets. While the Fed went ahead with a mid-December rate hike, it said a lack of inflationary pressure takes away the need to rush rates higher. Central banks for the Eurozone, Japan and China echoed the sentiment.

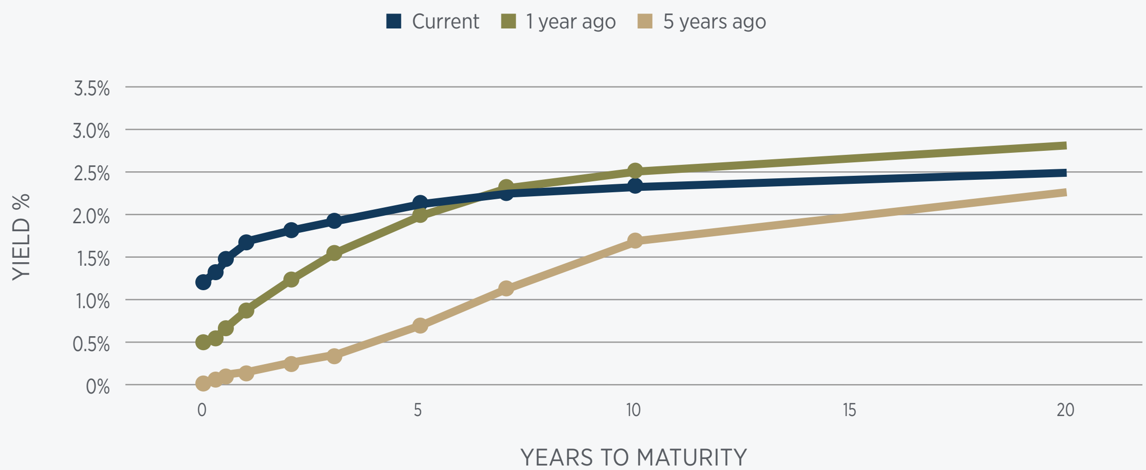
The Fed controls rates for short-maturity Treasuries, but the bond market determines rates for longer-term debt securities. Figure 1 shows how the Treasury yield curve flattened in 2017, with front-end yields (shorter maturities) rising sharply in response to Fed hikes but the back end remaining fairly constant. It appears investors judged that the risk of owning longer-dated bonds in a rising-rate cycle (falling prices) was outweighed by the reward of higher income.

A flat yield curve creates concern because it could eventually lead to an inverted yield curve — short-term rates exceeding longer-term rates. Every recession in the past half-century has been preceded by an inverted yield curve, though not every inversion has later resulted in a recession.

FIGURE 1

FED HIKES PUSHING UP SHORT RATES, BUT NOT LONG END

U.S. TREASURY YIELD CURVE



Source: Thomson Reuters Datastream as of 11/2017

The corporate tax rate reduction from 35% to 21% stands to provide a sizable boost to cash flow and bottom-line results, as will the low one-time tax on profits now held overseas. The big question now is how much more upside is available for stocks after the sharp run-up in the fourth quarter, as the tax cut was being shaped, approved and signed into law — the Standard & Poor's 500 gained 7% in the three-month period.

In our view, how long the benefit lasts depends more on how companies choose to spend their windfall. The market is signaling that it wants more capital expenditures, which have been modest during the post-Great Recession recovery.

Recent market analysis shows that, since the start of 2016, the companies with the highest capital spending have seen their share prices rise twice as fast as the most prolific share repurchasers. But companies are not likely to increase capex unless they can look ahead and see more customers, regardless of how much extra cash they have on hand.

Consumer confidence and spending are now at multi-year highs, almost certainly due in large part to the planned cut in individual tax rates. However, the payoff from capex tends to come with a lag, so corporations would have to be confident that the economic upswing is long lasting.

PORTFOLIO MANAGEMENT

The biggest contributor to relative performance in the fourth quarter was our focus on U.S corporate bonds over Treasuries, which benefited from stronger economic growth and investors seeking higher income in a low-rate environment. This particularly helped our more conservative portfolios in comparison to their benchmarks. Our investments in non-U.S. developed markets generated positive relative returns. Our tilt toward value stocks detracted from performance.

For the full year, corporate bonds also led the way while U.S. small caps and value lagged. We were well rewarded in 2017 for our patience in sticking with emerging markets, which broke out after several rough years. Developed market stocks also helped, and our tactical shifts during the year added to performance relative to a passive stock-bond investment mix. Our allocation to alternative investments yielded a positive return for the year, though as expected, they did not keep up with 2017's growth-driven stock market.

From a manager research and selection standpoint, changes were made in certain large cap mutual funds and equity ETFs used in some models. All managers are subject to ongoing due diligence, and choosing to replace a manager is purposely rare to limit portfolio disruption. However, we implemented these changes to better align with our investment philosophy along with our goal of delivering performance over the long term.

Our key themes heading into 2018:

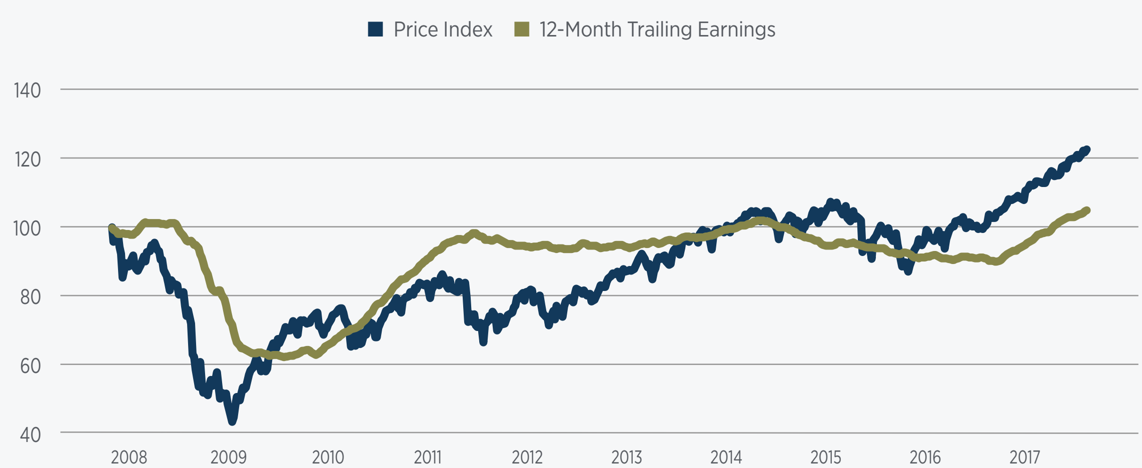
U.S. Corporate Bonds

The same macro trends driving stocks have benefited credit, particularly high-yield bonds. Volatility has been picking up for high-yield given worries that very tight spreads may soon widen. Tight spreads, however, can last for prolonged periods. We think economic growth and improving corporate earnings could support credit. High-yield has also tended to fare well in rising-rate environments due to their higher coupons.

FIGURE 2

SYNCHRONIZED GLOBAL GROWTH PROVIDING EARNINGS LIFT

MSCI ALL-COUNTRY WORLD INDEX, PRICE VS. EARNINGS



Note: Chart rebased to 100 as of 12/11/2007 | Source: Thomson Reuters Datastream
The MSCI All Country World Index is designed to measure large- and mid-cap equities across 23 developed market and 24 emerging market countries. The index covers approximately 85% of the global investable equity opportunity set.

Developed Markets

We have long been constructive on non-U.S. developed market stocks on a relative valuation basis. Heading into 2018, this conviction is reinforced by strengthening global GDP that could help the export-led economies of the Eurozone and Japan — Figure 2 shows that corporate profits (green line) globally are following share prices (blue line) upward. The likely continuation of accommodative monetary policy may also add to the tailwind.

Emerging Markets

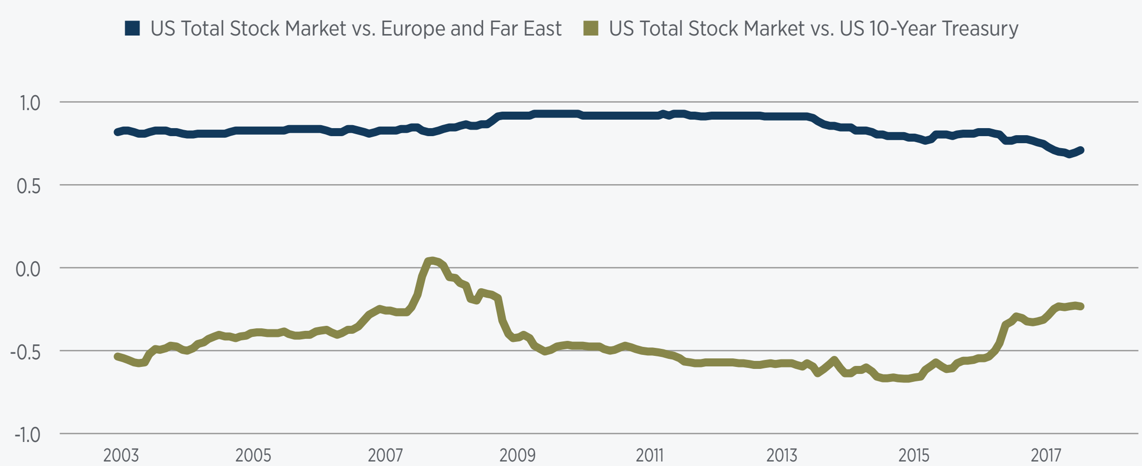
Even after a stellar 2017, we believe emerging market stocks offer long-term investment appeal. They are inexpensive relative to developed markets on a valuation basis, and their earnings growth is projected to rise faster than that of DMs over the next two years. History suggests that EM performance trends can play out over multi-year periods, and we are still early in the current upswing.

2017 was an outstanding year for equities — even the also-ran indexes, styles and sectors managed to post double-digit total returns. At times like this, investors sometimes get swept up in the euphoria and lose sight of the long-term benefits of a well-diversified portfolio.

FIGURE 3

DIVERSIFIED PORTFOLIO CONTINUES TO OFFER BENEFITS

ROLLING 5-YEAR CORRELATION AS OF 12/14/17



Source: Thomson Reuters Datastream

Even as short-term interest rates rise, we believe bonds have a role to play for most investors as a diversification tool — a way to offset some of the risk of equities, regardless of geography. The blue line in Figure 3 shows the consistently strong correlation between the total stock markets of the U.S. and non-U.S. developed markets — when one is up, the other tends to go up as well (and vice versa).

The green line shows a negative correlation between the total U.S. stock market and the 10-year Treasury — when stocks fall in value, bonds tend to rise. For the past few years, both stocks and bonds moved in the same direction—much of this can be attributed to loose money globally that has helped keep a lid on interest rates. We would expect this dynamic to be disrupted by monetary tightening from the Fed and eventually by other key central banks as well.

As always, our guidance to members is to remain focused on the long-term investment plan into which you have put so much thought. For those USAA Managed Portfolio (UMP) shareholders who may be uneasy about market risk in general or have concerns about current asset-class allocations, we suggest consulting with a USAA advisor.

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