THRIVENT MUTUAL FUNDS

DECEMBER 31, 2017

OUR VIEW

Market perspectives from Thrivent Asset Management

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Summary

Equities finished the year on a strong note with most major indexes, both domestically and internationally, advancing in the mid- to high-single-digit range for the quarter. For the year, returns were very strong, far exceeding our expectations at the beginning of 2017. A couple of variables likely accounted for a portion of the strong results. Global economic growth accelerated over the year as trade improved, oil prices recovered and the manufacturing sector recovered from the slump it experienced from 2014 to 2015. These items were a factor in the reacceleration in earnings growth both domestically and abroad. Inflation remained tepid, allowing interest rates to remain relatively stable and low. The stronger earnings drove some of the advance in stocks, but price to earnings ratios also saw some expansion from already elevated levels. For the quarter and the year, there were several standout asset classes. Domestically, large-caps outperformed small-caps in both time periods. Internationally, emerging markets were exceptionally strong, with small-cap Europe, Australasia and Far East (EAFE) stocks not far behind. Large-cap EAFE performed in line with large-cap U.S. stocks. The other standout domestically was large-cap growth, dominated by what are known as the FAANG stocks, i.e., Facebook, Amazon, Apple, Netflix and Google (now Alphabet). Within fixed-income, returns were modest as short- and intermediate-term interest rates rose. Returns were driven largely by income versus price, since higher rates work to lower bond prices. The yield curve flattened significantly with short rates rising the most, tracking the increase in the Federal Reserve's target rate. The Fed raised rates in the fourth quarter—the third increase of the year—and also began shrinking its balance sheet in order to further normalize monetary policy. There was little variation in returns among the major fixed-income asset classes in the quarter. Credit market returns were modest but continued to outperform Treasuries, which were flat to slightly negative. Investment-grade corporate bonds, high-yield and emerging-market bonds all returned less than 1%, while leveraged loans and preferred stocks posted returns around 1%. Municipal bonds had slightly negative returns.

● Current quarter ○ Previous quarter

Asset Allocation Views: Current Outlook

		Bias to Asset Class
Asset Allocation	We are underweighted in our long-term strategic target to equity, reflecting quite extended valuations in global equity markets. While we aren't suggesting a downturn is on the horizon, we are concerned that current equity market levels imply growth expectations that are unlikely to be realized over a longer-term investment horizon. This has been an extraordinary bull market in stocks since the financial crisis of 2008, albeit coming off an extraordinary bear market prompted by that event. That said, the economic recovery that has coincided with the market advance has been subpar by almost all fundamental economic metrics, while the market advance has been above average on a number of financial and risk metrics. We believe an underweight to long-term targets is appropriate	Bonds — Stocks
EQUITIES		
Region	The acceleration in global growth has finally taken hold with above trend growth primarily occurring outside the U.S. Valuations are elevated across the globe, but there does appear to be more opportunity for fundamental improvement in earnings outside the U.S. Margins in the US are near their cyclical highs, while in the rest of the world there is still significant opportunity for improvement. We are beginning to see that both in Europe—outside the UK—and Japan. We remain overweighted in international.	U.S. — Int'l
Region	The advance in emerging-market equities last year was quite strong, beyond what we believe to be appropriate levels given the risks in those markets. The growth in outstanding debt both at the private and regional levels has been particularly high, and the relationship between debt growth and gross domestic product (GDP) growth is deteriorating. We prefer developed market exposure over emerging markets.	Developed — Emerging
Market Cap	With the outperformance of large caps versus small in 2017, the relative valuation disparity that had been in place for a number of years has largely been corrected. Valuations are still quite high in both large- and small-cap sectors but the valuations of one sector relative to the other are in alignment with long-term norms. We have taken steps to reduce our bias, but at the margin we continue to favor large-cap because the earnings quality of large versus small still favors the former.	Small — Large

● Current quarter ○ Previous quarter

Asset Allocation Views: Current Outlook *(continued)*

FIXED-INCOME		Bias to Asset Class
Duration	We expect interest rates to continue to rise as the Federal Reserve and other central banks gradually tighten monetary policy from extreme levels adopted in the wake of the financial crisis. Also, we expect improved global economic growth to move rates higher. U.S. inflation has continued to be subdued, but tightening in the labor market should lead to higher wages and eventually greater inflation. Although we do not expect rates to rise dramatically, the risk/return of longer duration bonds in a low-yield environment is not favorable. Short- and intermediate-maturity bonds are currently more attractive.	Short — Long
Yield Curve	The Treasury yield curve flattened significantly in 2017. Increases in the federal funds target rate typically impact shorter-term interest rates greater than longer-maturity rates, which drives the yield curve flatter. While we expect rate and curve volatility to increase from 2017, we also expect the flattening trends to continue over time as the Federal Reserve raises rates in response to a stronger economy and tightening labor market. Long term, increased inflation, strong growth and higher deficits could pressure rates higher at the long end of the curve.	Short — Long
Quality[1]	Credit-oriented sectors in the fixed-income market, particularly investment-grade corporate bonds, remain relatively attractive. Strong demand for yield from domestic and foreign buyers has supported investment-grade corporates. This sector should continue to outperform Treasury bonds. However, absolute yields are exceptionally low relative to inflation. Below-investment-grade corporate bonds offer more yield, but appear fair at best from a valuation perspective given their greater default and volatility risks.	High — Low
Region	Emerging-market bonds performed strongly in 2017, propelled by a synchronized improvement in global growth and trade, along with still accommodative global monetary policy. Continued growth and moderate inflation should benefit emerging markets. However, after recent strong performance, emerging-markets debt valuations have richened. At the same time, the low yields of developed market bonds, particularly in Europe, leave them more exposed to price declines should interest rates rise significantly. As always, sovereign credit selection remains critical given the political and economic challenges faced by some emerging-market credits.	Developed — Emerging
COMMODITIES AND CURRENCIES		
Commodities	We are underweighted in commodities. Prices have rallied back to multi-year highs recently on the back of the pickup in global economic growth but are still well below peaks seen earlier in the cycle. China remains the marginal consumer of most commodities and growth there is expected to slow. At some point India will likely play a larger role in the global commodity demand cycle, but we are well early on that outlook.	Underweight — Overweight
Currencies	The dollar is overvalued relative to the major global currencies, but less so than a year ago owing to a sharp recovery in the euro and British pound and a more modest yen rally. We are relatively neutral as the valuation distortions in major currencies has largely dissipated	U.S. — Foreign

Equity Sector

		Weighted Preference Under ← | → Over
Health Care	Health care stocks performed well in 2017, especially in the managed health care and health care equipment industries. Small- and mid-cap stocks outperformed their large-cap brethren, the opposite of what occurred for the broad market. Similarly, unlike the market where growth far outdistanced value benchmarks, that dynamic was closer to equivalent in this sector. Both those points are consistent with the fact that health care industries and companies have unique characteristics. Pharmaceuticals lagged and portfolios were underweighted this area. Drug pricing concerns remain, with pressure from both commercial and government payers. Our focus remains on finding sector participants that derive growth from volume and new product innovation.	
Energy	Oil-linked equities dramatically lagged oil price changes and the broader stock market in 2017 despite sharply declining crude inventories. Looking forward, the risk to $40 oil has diminished substantially, driven by robust global demand, OPEC discipline and possibly a political risk premium. OPEC agreed to continue to withhold 1.5 million barrels per day of supply through year-end 2018. A clear exit strategy at that point is not known, but does provide time for another year of demand growth to absorb additional OPEC barrels. In the long-run, the industry will move toward long-term marginal cost that is higher than $55 per barrel.	
Telecom Services	Fundamentals remain challenged with continued competition in ever-maturing wireless, broadband and video markets among traditional providers, with continued investment exacerbated by emerging cloud-based services that continue to penetrate the traditional consumer and commercial customer bases. Sector exposure is tilted to agnostic underlying infrastructure companies, like fiber and towers, that support the providers of actual services. Telecom services stocks could see support by those favoring defensive characteristics of recurring cash flow and high dividend yields, if concerns about an aging economic cycle increase. In addition, positive tax law changes and an improved regulatory environment could spur higher earnings, capital returns and interest in these stocks.	
Consumer Staples	Traditional retailers continue to face headwinds from declining mall traffic and market share losses to e-commerce retailers, as well as incremental expenses associated with developing their own e-commerce systems. Most retailers, however, are poised to benefit from tax reform more than other groups, both directly and indirectly, as consumers will have more money to spend. Still, we have positioned away from retail square footage, in general. Outside of retail, other industries–including packaged food, soft drinks and tobacco—also struggled. There lacks a compelling argument why this should reverse in 2018.	

[1] Credit Quality ratings are determined by credit rating agencies Moody's Investor Services, Inc., or Standard & Poor's Financial Services, LLC.

● Current quarter ○ Previous quarter

Equity Sector *(continued)*

		Weighted Preference Under ← | → Over
Industrials	The sector provided strong returns, with strength across many diverse industries including aerospace and defense, construction machinery and railroads. The primary driver was increasing evidence as the year progressed regarding synchronized global economic expansion. Forecasts call for continued respectable worldwide real and nominal growth in 2018 that is supportive for the sector. Benefits from a weaker dollar for this internationally leveraged sector should continue, at minimum on a year-over-year basis even if the dollar is flat versus other currencies from this point.	
Information Technology	Tech stocks had a very strong year in 2017. More important,, appreciation was driven primarily by earnings growth, not multiple expansion. The cyclical backdrop may be problematic as growth rates and margins reach peak levels, though growth remains above that of the market overall and 2018 chief information officer spending surveys are encouraging. Mergers and acquisitions could continue. Semiconductor and electronics continue to provide long-term secular growth opportunities via Internet of Things, industrial automation, the cloud, and artificial intelligence/machine learning trends. Communications equipment could see an improvement in fundamentals with service provider infrastructure projects emerging, like 5G and "fiber deep" (i.e., the trend in which cable providers push digital technologies closer to customers to provide better service), driven by broadband competition and following a pause in spending due to service provider acquisitions. Tax law may assist the sector via repatriated offshore cash being used for material share repurchases.	
Consumer Discretionary	Industries in the consumer discretionary sector are widely diverse, as has been equity performance across those industries. Companies should benefit from increased consumer disposable income as a result of lower personal income tax rates, growing employment and increases in worker average hourly earnings. Home improvement retail is relatively well positioned. Homebuilders and housewares are emphasized areas as household formation rates accelerate. Leisure travel and activities are doing especially well as consumers spend more disposable income on experiences than things. Media is challenged, given a number of pressures, including an explosion in the number and quality of content choices from nontraditional suppliers, fewer people willing to pay for TV subscriptions, and reallocation of advertising to online, but firms are enacting structural change, including mergers and aquisitions, to better position for the future. Corporate tax reform will impact companies in this sector differently as some industries, like media and cable, pay relatively high rates of corporate income tax while other industries, such as cruise lines, already pay very little corporate income tax.	
Materials	The sector performed near to modestly above benchmarks in aggregate, but as is always the case, divergence at the industry level existed because materials industries and commodities possess unique supply/demand profiles and cycles. Chemicals and industrial metals did well. Precious metals did not. Global economic growth should be supportive broadly looking into 2018 where sector forecasted earnings growth is of the highest among all sectors.	
Utilities	An increase in the 10-year government bond yield, in combination with changes to the federal income tax code, have resulted in underperformance for the utility group in the most recent quarter, as well as underperformance on a year-to-date basis. Changes in the tax code do not positively impact utilities as they do many other industries. While the earnings growth outlook for the utility group remains solid, we are underweighted in most portfolios due to valuation considerations.	
Financials	Optimism regarding renewed economic growth driven by tax reform lifted bank stocks, offsetting some of the headwind from a flatter yield curve. Net interest margins have benefited modestly from higher short-term rates, but loan growth remains subdued. Investment bank trading desk activity has decelerated as market volatility remains low. Bank regulatory relief remains probable, however, and banks are being given more leeway over return of capital to shareholders. Fundamentals for the insurance sector are improving with expectations for a better property casualty pricing environment, while valuations remain at historical averages. Brokers and exchanges have a more balanced outlook because fundamentals are stable while valuations have increased, and in many instances are above historical averages.	
Real Estate	Real estate investment trust (REIT) stocks appear attractive after having underperformed the general equity market in 2017. Rising short-term interest rates and tax reform, which does not provide a marginal benefit to REITs have been the primary reasons for underperformance this year. With a dividend yield of approximately 4%, and mid-single-digit expected earnings growth in 2018, REITs have the potential to provide a satisfactory total return in the coming year. The segments we continue to favor are data centers and industrial driven by digital storage, cloud development and e-commerce. Class A malls are also attractive after having underperformed in 2017. Finally, we think the apartment sector will continue to perform well as job growth and new household formation continues to fuel strong demand for housing.	

Fixed-Income Sector

		Weighted Preference Under ← | → Over
High-Yield	Solid economic growth and declining default rates should continue to provide support for the high-yield market. With spreads at their tightest levels this economic cycle and some upward pressure on interest rates, we expect returns in the low single digits for 2018. Causing some concern is several industries such as retail, health care and telecommunications that are experiencing significant challenges.	
Securitized Assets	Nonagency residential mortgage-backed securities (RMBS) continue to be an attractive sector given the yield advantage versus comparable sectors, dwindling supply, and fundamental support of a strong housing market. Many sectors within nonagency RMBS also are expected to perform better if interest rates move higher. We also favor collateralized loan obligations (CLOs) for the yield pickup versus other securitized products and corporate bonds. Additionally, CLOs have floating-rate coupons that benefit from Federal Reserve rate increases.	
Agency Mortgages	Low interest rate volatility and solid demand from investors has suppressed agency mortgage-backed securities (MBS) yield spreads relative to Treasury securities to narrow levels similar to past periods. We recommend a modest underweight as we expect the yield spread versus Treasuries to widen in 2018 if interest rate volatility moves higher and the Federal Reserve reduces its reinvestment in agency MBS.	

● Current quarter ○ Previous quarter

Fixed-Income Sector *(continued)*

		Weighted Preference Under ← | → Over
Corporates	We recommend a moderate overweight in investment-grade corporate bonds given the additional yield pickup over U.S. Treasuries and other high-quality fixed-income sectors. Corporate fundamentals remain solid, supported by strong earnings. Additionally, the U.S. investment-grade corporate market has been supported by strong inflows driven in part by attractive yields compared with other developed markets globally. Corporate bond prices, however, remain susceptible to declines in a rising interest rate environment.	
Non-U.S. Dollar	After a surprisingly weak performance through most of 2017, the dollar remained relatively range-bound in the fourth quarter. The Federal Reserve has been raising short-term interest rates, which helps to support the dollar (short-term capital flows usually go to countries with relatively higher short-term interest rates). Tax reform and solid economic growth also should work to support the dollar. But stronger global growth—particularly in Europe—is likely to lead other central banks to adopt less accommodative monetary policies, supporting currencies such as the euro. Overall, we see little value in trying to capture additional return through non-dollar currencies.	
Emerging Markets	Emerging-market bonds posted very strong returns in 2017. An improving global economic backdrop with synchronized growth across major regions benefits emerging-markets debt, along with investor demand for incremental yield. However, valuations are rather high following strong returns, leading to a neutral weighting of the sector.	
Inflation Protected	Treasury Inflation Protected Securities (TIPS) performed relatively poorly for much of 2017 as inflation statistics moved lower. More recently, energy prices have moved up and inflation appears to be gradually strengthening. TIPS appear attractive relative to conventional (nominal) coupon-bearing Treasury bonds. TIPS are not good for current income, but remain useful as a diversifier in an overall portfolio strategy because they provide modest protection against an unexpected rise in inflation.	
Treasury/ Agency	We remain underweighted in Treasuries. Continued economic growth, rate increases by the Federal Reserve, and an expected rise in inflation should combine to pressure interest rates higher. Other higher income sectors continue to look more attractive in this still low-yield environment.	
Municipals (tax-sensitive)	We recommend a moderate overweight in munis for higher marginal tax bracket investors. The threat in the U.S. House of Representatives' tax proposal of repealing the tax exemption for private activity bonds, while not ultimately passed into law, caused issuers to rush to market before 2017 ended. This had the effect of moving what likely would have been new issuance in 2018 into 2017, leaving the new issue calendar sparsely populated to start 2018. Additionally, January is typically one of the largest reinvestment months, boosting demand as the year begins. The tax reform act that passed into law does disallow advance refunding of tax-exempt bonds (another hit to supply), as well as taking itemized deductions for state and local taxes greater than $10,000 (which is likely to produce more demand for muni bonds in higher tax states, despite the lower marginal income tax rates). Consequently, the muni market will likely see a significant supply/demand imbalance, favoring current bondholders. One counterweight is that the tax law also makes it less appealing to corporations (typically banks, property and casualty insurance companies) to hold tax-exempt securities, given the decrease in the corporate tax rate.	

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