THRIVENT MUTUAL FUNDS

MARCH 31, 2018

OUR VIEW

Market perspectives from Thrivent Asset Management

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Summary

After seeing exceptionally strong returns in January, major equity indexes—both domestically and internationally—finished modestly lower by the end of the first quarter. Optimism set in early in the period with the passage of the tax reform package late in 2017. Both corporate and individual tax rates were lowered, and a budget deal that included meaningful increases in federal spending passed both houses of Congress and was signed into law. Corporate earnings estimates, already robust for 2018, saw a further increase of 6–8 percentage points due to lower tax rates, bringing earnings growth expectations for 2018 to the mid- to high teens. Equity markets were extremely overbought by the end of January. A sell off occurred in early February, but stocks rallied back. They came under pressure again in March, closing the period with slightly negative returns. Much the same scenario in terms of stock prices played out overseas.

Most fixed-income asset classes posted moderately negative returns in the first quarter, impacted by higher interest rates and larger risk premiums as market volatility increased. Interest rates rose significantly early in the first quarter before stabilizing later. Additionally, the Treasury yield curve continued to flatten, with short-interest rates rising the most, tracking the increase in the Federal Reserve's target rate. The Fed raised rates once in the first quarter, the sixth quarter-point increase since starting to raise rates in 2015. The Fed also continued to shrink its balance sheet to further normalize monetary policy. Higher rates negatively impacted bond prices. Additionally, corporate bond returns suffered from increased spreads, which represent a risk premium over Treasuries for higher volatility, defaults and other risks. In the first quarter, the more interest-rate sensitive fixed-income assets produced the worst returns. Also, credit markets such as corporate bonds underperformed similar maturity Treasuries. Returns generally ranged from -1% to -3%, while leveraged loans, which pay floating interest rates, posted a slightly positive result of roughly 1.5%.

● Current quarter ○ Previous quarter

Asset Allocation Views: Current Outlook

		Bias to Asset Class
Asset Allocation	We remain underweighted to our long-term strategic allocation targets in stocks. With largely flat markets in the first quarter and the sharp increase in earnings estimates for the year, valuations have actually seen a rather sharp improvement. That said, valuations remain elevated and some level of caution is merited. The bull market in stocks and economic recovery have been in place since 2009, and while neither tends to end as a function of only time, we remain cognizant of risks—as well as opportunities—and feel a modest underweighting is still appropriate. To that end, in early April we added to our equity positions to reduce our underweighting to strategic targets, but remain below our long-term strategic targets.	Bonds —○●—— Stocks
EQUITIES		
Region	Equities in the international developed markets no longer look more attractive than domestic equities. Earnings estimates overseas have stagnated relative to strong U.S. earnings estimates as the dollar weakens and economic activity measures roll over (especially in Europe). An escalation in trade conflicts poses greater risks to most foreign developed markets due to their heavier reliance on export activity, diminishing financial prospects and suppressing investor sentiment. We feel it's appropriate to move to a more neutral position in international equities.	U.S. ——●○— Int'l
Region	Within the international allocation, we continue to favor developed markets over emerging markets. While emerging-market indexes had an outstanding performance run in 2017, much of it was a function of exceptional returns to very few stocks. We are concerned that economic activity in China is continuing to moderate and will cascade into other emerging markets. Thus, we remain overweighted in developed indexes.	Developed —●—— Emerging

Current quarter Previous quarter

Asset Allocation Views: Current Outlook *(continued)*

		Bias to Asset Class
Market Cap	Absolute valuations for all indexes remain elevated, but relative valuations between small- and large-cap stocks are now more closely aligned with long-term averages. Thus a heavy skew toward one or the other is not warranted. There has been unusual pressure on profit margins in the small-cap arena and leverage in those companies is high, so we do remain a bit underweighted to long-term strategic targets.	Small Large
FIXED-INCOME		
Duration	We expect shorter-term 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. Global economic growth remains solid. U.S. inflation has picked up, although it has yet to move higher on a sustained basis. However, tightening in the labor market should lead to higher wages and, eventually, greater inflation. Although we do not expect longer-term rates to rise dramatically, the risk/return of longer-duration bonds in a low-yield environment is not favorable. Short- to intermediate-maturity bonds are currently more attractive.	Short Long
Yield Curve	The Treasury yield curve flattened in the first quarter of 2018 as the Federal Reserve continued to raise its target interest rate. Increases in the federal funds target rate typically impact short-term interest rates more than longer maturity rates, which drives the yield curve flatter. While we expect higher rate and curve volatility in 2018, we also expect the flattening trends to continue over time as the Fed raises rates in response to a strong economy and tightening labor market. The curve could steepen, however, if markets become concerned that inflation will pick up significantly on a sustained basis. Higher deficits also pose an additional risk, since higher debt levels and a greater supply of Treasuries could force rates higher at the long end of the curve.	Short Long
Quality[1]	Credit-oriented sectors in the fixed-income market remain attractive relative to Treasuries and other higher quality fixed-income assets. Yields have increased with higher interest rates, and valuation has improved after spreads over Treasuries increased in the first quarter of 2018. Valuation of investment-grade corporates appears more attractive, especially for shorter-maturity bonds. Below-investment-grade corporate bonds (such as high yield) offer more yield, and corporate fundamentals remain solid. High-yield valuation, however, appears fair at best given the greater default and volatility risks.	High Low
Region	Emerging-market bonds offer attractive yields, but valuation remains relatively rich. Additionally, higher interest rates remain a key risk to returns. 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. U.S. yields look attractive on a relative basis to other developed markets. Sovereign credit selection remains critical given the political and economic challenges faced by some emerging-market credits.	Developed Emerging
COMMODITIES AND CURRENCIES		
Commodities	We remain underweighted in commodities. There was a rally in the space last year with the recovery in oil and better growth in China in the first half of 2017, but that momentum is easing. Further dollar weakness might be a catalyst for a bump up in commodity prices, but we don't think the fundamentals support sustained better pricing.	Underweight Overweight
Currencies	The euro appears to be fair against the dollar, while the pound and the yen are undervalued. Our international exposure in equities captures that valuation disparity. Because of this, we remain neutral in direct currency exposures.	U.S. Foreign

Equity Sector

		Weighted Preference Under ← | → Over
Health Care	Health care stocks have displayed mixed performance so far in 2018. Small-cap health care is ahead of relevant benchmarks, but large-caps are underperforming. Managed health care is lagging, but health care equipment is outdistancing even general indexes. Consistent with the market overall, growth is outperforming value. The sector has political risk and is not leveraged to a strong economy. Mergers and acquisitions have been a noteworthy feature of the sector in 2018 as companies position for a competitive future. Health care industries and companies have unique idiosyncrasies. Our focus remains on finding sector participants that derive growth from volume and new product innovation.	
Energy	Energy stocks began the year briskly, but lost momentum, and for the quarter ranked near the worst performing sectors, as was true in 2017. This happened despite an oil price that is up about 10% year-to-date and 20% year-over-year. OPEC's commitment to cut production remains strong, as does demand growth. Markets are worried about U.S. shale supply growth, especially with an oil price in the mid-$60s that could incent more drilling. We continue to select stocks based on unique characteristics, rather than making dramatic commodity calls.	
Telecom Services	If concerns about an aging economic cycle increase, fundamentals are challenged with competition in ever-maturing wireless, broadband and video markets among traditional providers. New competition in emerging cloud-based services is penetrating traditional consumer and commercial customer bases. As high-yielding bond proxies, higher interest rates in 2018 has hindered performance. 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.	

[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
Consumer Staples	Staples have materially lagged year-to-date. Historically, the area was viewed as stable and a place to be should markets retreat, but this view is debatable with power tilting toward distribution and away from brands. Underperformance is not solely in retail, but also in household products, packaged foods, tobacco, brewers and soft drinks. Traditional retailers continue to face headwinds from declining mall traffic and market share losses to e-commerce retailers. 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, in general, we have positioned away from retail square footage.	
Industrials	The sector is lagging benchmarks, slightly, in the first quarter of 2018. Aerospace and defense and trucking have performed above average. Airlines and industrial conglomerates have trailed. 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 on. Several economically sensitive industries, like construction machinery, are lagging despite good macroeconomic data. Investment spending could trend higher.	
Information Technology	Tech stocks have retained strength into 2018 and have the best year-to-date returns. The same is true for small caps, as well as the well-known mega-cap tech stocks. Importantly, appreciation has been driven primarily by earnings growth, not multiple expansion. We remain keenly focused on the cyclical backdrop that may become problematic as growth rates and margins reach peak levels, though growth remains above that of the market overall and chief information officer spending surveys are encouraging. Semiconductor and electronics continue to provide long-term secular growth opportunities via the 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, driven by broadband competition.	
Consumer Discretionary	Industries in the consumer discretionary sector are widely diverse, as has been equity performance across those industries. Internet and direct marketing retail has driven 2018 returns in large-cap portfolios. 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. Though the theme continues, those industries have lagged this year. Leisure travel and activities are doing 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.	
Materials	The sector lagged broad benchmarks year-to-date, which is curious, given upward revisions in global GDP rates. Divergence existed at the industry level as materials industries and commodities possess unique supply/demand profiles and cycles. Steel did well, perhaps as a result of proposed tariff protection, but aluminum did not. Global economic growth should be supportive where sector forecasted earnings growth is one of the highest among all sectors.	
Utilities	Sharp increases in 10- and 30-year government bond yields year-to-date has resulted in underperformance for the bond-proxy utility group. The earnings growth outlook for utilities remains solid, though we remain selective at the company level and are underweighted in most portfolios.	
Financials	Fed policy normalization, higher interest rates and tax reform have fueled good sector returns in the first quarter of 2018. Loan growth may reaccelerate, and volatility helps investment banking and exchange businesses. Bank regulatory relief remains probable, 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.	
Real Estate	Real estate investment trust (REIT) stocks have continued to underperform general equities in 2018. Rising short-term interest rates are a headwind for REITs, and tax reform reduced corporate tax rates with no commensurate benefit for companies structured as REITs. However, REITs may provide value at current prices with a dividend yield of over 4%, and mid-single-digit earnings growth expected in 2018. In addition, REIT equities are currently trading at a discount to net asset value above their historical average. The sectors that we continue to favor are data centers, cell towers and industrial property driven by digital storage, mobile communication and e-commerce. We also believe the apartment sector is attractively valued and will benefit from continued job growth and a reduction in new construction over the course of this year.	

Fixed-Income Sector

		Weighted Preference Under ← | → Over
High-Yield	Solid earnings growth and debt reduction have supported the high-yield market during this time of increased volatility in the equity markets. Default rates have continued to decline despite increased stress in the retail, health care and telecommunications industries. Spreads have widened a bit as the Fed continues to increase interest rates and fears of a trade war increase. We expect returns in the low single digits for 2018.	
Securitized Assets	Nonagency residential mortgage-backed securities (RMBS) continue to be an attractive sector given strong fundamental support from rising home prices and a shrinking supply of bonds. Many sectors within nonagency RMBS have floating rate coupons that adjust higher as short-term rates rise. We also favor collateralized loan obligations (CLOs) for the yield pickup versus other securitized products and corporate bonds. CLOs also have floating-rate coupons that benefit from Federal Reserve rate increases.	
Agency Mortgages	We recommend a modest underweighting to agency mortgages as a worsening supply/demand imbalance through the spring and summer months is expected to pressure mortgage spreads wider versus Treasuries. More net supply will need to be absorbed by money managers at cheaper valuations as the Fed's reinvestment of paydowns wanes. Other investors, such as banks and overseas investors, are unlikely to be large investors in agency MBS at current spread levels given more attractive investment opportunities outside the sector.	

● Current quarter ○ Previous quarter

Fixed-Income Sector *(continued)*

		Weighted Preference Under ← | → Over
Corporates	We recommend a moderate overweighted position 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 and tax reform. Additionally, valuation of investment-grade corporates looks attractive on a relative basis within fixed-income. Absolute returns of corporate bonds, however, remain susceptible to declines in a rising interest rate environment.	
Non-U.S. Dollar	The dollar weakened moderately to start 2018, but has since been range-bound. The Federal Reserve has been raising short-term interest rates, which should help 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 global growth has picked up, which is likely to lead other central banks to adopt less accommodative monetary policies, supporting currencies such as the euro. Additionally, concerns over the U.S. budget and current account deficits present a headwind to the U.S. dollar. Overall, we see little value in trying to capture additional return through non-dollar currencies.	
Emerging Markets	Following strong returns in 2017, emerging-market bonds posted weaker returns to start 2018. Higher rates and inflation along with concerns about an increase in trade protectionism helped drive moderately negative returns. Emerging-market debt returns remain vulnerable to higher rates in addition to a strong U.S. dollar. While yields are attractive, valuations remain relatively rich on a long-term basis.	
Inflation Protected	Treasury Inflation Protected Securities (TIPS) performed well on a relative basis to start 2018 as market concerns over inflation increased and energy prices moved up. TIPS appear attractive relative to conventional (nominal) coupon-bearing Treasury bonds. While TIPS are not appropriate for current income, they remain useful as a diversifier in an overall portfolio strategy because they may 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 gradual 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 maintain our modest overweighting in munis for higher marginal tax bracket investors. New issue supply is down significantly from the pace in 2017, while the Muni/Treasury yield ratio indicates that valuation is attractive, and overall credit quality remains good. The economy is growing and the labor market is healthy—both of which are supportive for tax revenues. Counterweights to these positives are the Fed's intentions to continue to raise short-term rates, inflation moving higher in response to an economy at full employment, and the decrease in institutional demand for municipals caused by lower corporate tax rates. When there is credit stress, it is often related to unfunded pension obligations.	

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