THRIVENT MUTUAL FUNDS

JUNE 30, 2018

OUR VIEW

Market perspectives from Thrivent Asset Management

CONTENTS

Summary

EQUITIES: The second quarter generated positive returns for all major U.S. equity indexes after a mild loss in the first quarter, but there were some sizable differences across market capitalizations. With the S&P 500 gaining in every month of the quarter, May was the strongest month as the market digested better-than-expected earnings, even after being adjusted for the 6% to 8% benefit from a lower tax rate. Organic earnings growth of around 14% resulted in S&P 500 earnings-per-share growth in excess of 20% on revenue growth of almost 9%. For the full quarter and especially in the last month, small caps were significant outperformers as the potential trade war increased investor appetite for domestic exposure, as did a stronger U.S. dollar and weaker international growth trends versus the United States. Among sectors, technology and energy were particularly strong.

FIXED-INCOME: Most fixed-income asset classes posted neutral-to-moderately-negative returns in the second quarter and first-half of 2018. Returns were impacted by continued higher interest-rates and larger credit risk premiums. Additionally, the Treasury yield curve continued to flatten with short-term interest-rates rising the most, tracking the increase in the Federal Reserve's target rate. The Fed raised rates once in the second quarter, the seventh quarter-point increase since starting to raise rates in 2015. Corporate bond returns suffered from increased yield spreads, which represent a risk premium over Treasuries for higher volatility, defaults and other risks.

In the second quarter, higher-quality fixed-income sectors generally underperformed riskier sectors, such as high-yield. Leveraged loans, high-yield corporates and preferred securities all returned around 1% in the quarter. Investment-grade corporates, however, posted a -1% return, underperforming Treasuries of similar maturity. Additionally, emerging-markets sovereign debt fell around 3.6%, in part due to concerns about rising U.S. rates and slowing global growth and trade. Municipal bonds were up roughly 1%, while high-yield municipals outperformed, rising about 3%.

Looking forward, we expect short-term rates to continue to rise and the Treasury curve to flatten with further rate increases by the Federal Reserve. We are cautious on corporate credit, but remain neutral on quality as recession risks are muted in the near-term. We also remain underweighted in emerging markets. Additionally, we expect volatility to increase within fixed-income.

● Current quarter ○ Previous quarter

Asset Allocation Views: Current Outlook

		Bias to Asset Class
Asset Allocation	We retain a small underweighting to our long-term strategic allocation to stocks, reflecting our belief that valuations and growth trends hold limited capacity to improve materially from current healthy levels. Admittedly, domestic economic resilience, margin structures and policy have proven to be longer-lasting influences than we had expected, but we consider the downside risks in the current environment of trade tensions and global slowing to hold greater downside than upside risk.	Bonds ● Stocks
EQUITIES		
Region	We have slightly widened our underweighting in international developed markets relative to the U.S., as slowing and disappointing economic measures (especially in Europe) result in moderating earnings expectations—trends exacerbated by a strong dollar and greater potential exposure to key export markets, including China. While valuations have shrunk meaningfully, and values could emerge from a stabilization of the trading environment, we think it best to get better visibility on trade before increasing exposure to the region broadly.	U.S. ●○ Int'l
Region	Given the exaggerated exposure of emerging markets to Chinese demand and the negative effects of the stronger U.S. dollar on rates and pricing, we continue to favor developed foreign markets over emerging markets—in which we expect to see relative underperformance continue in the second half after an already difficult first six months. China, in particular, remains our single biggest concern, with incremental degradation of their spending and demand trends representing the single greatest risk for emerging market economic conditions.	Developed ● Emerging

● Current quarter ○ Previous quarter

Asset Allocation Views: Current Outlook *(continued)*

		Bias to Asset Class
Market Cap	We remain largely neutral relative to our strategic splits between large and small caps, though the valuation disparities between the two groups actually flipped after the small-cap outperformance of the second quarter, with small caps now slightly more expensive on a relative basis to large caps. The differences are not great, however, and we find the more compelling earnings growth profile of small caps over the next 12 months (helped by greater domestic exposure and more operating leverage) to be offset by their more leveraged balance sheet structures.	Small — Large
FIXED-INCOME		
Duration	We expect shorter-term interest rates to continue to rise as the Federal Reserve gradually tightens monetary policy. U.S. economic growth remains strong and inflation reached the Fed's 2% target. Additional tightening in the labor market should lead to higher wages and inflationary pressure. Also, deficit spending and the resulting increase in Treasury supply could pressure rates higher. While we expect short-term rates to rise, we do not expect longer-term rates to rise dramatically given still low global rates, slowing global growth, concerns over trade frictions, and flight-to-quality demand for Treasuries during bouts of market volatility. Overall, the risk/return of longer-duration bonds in a low-yield environment is not favorable. Floating-rate bonds and short-to-intermediate-maturity bonds are currently more attractive.	Short — Long
Yield Curve	The Treasury yield curve flattened in the first half 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 greater than longer-maturity rates, which drives the yield curve flatter. While we expect higher rate and curve volatility in 2018, we 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 the Fed slows increases in rates in response to uncertainty, such as weakening global growth and trade frictions. The curve also could steepen if markets become concerned that inflation will pick up significantly on a sustained basis. Higher deficits also pose an additional risk, as a greater supply of Treasuries could pressure rates higher at the long end of the curve.	Short — Long
Quality[1]	Performance of credit-oriented fixed-income sectors was mixed in the first part of 2018. High yield outperformed more interest-rate sensitive and high-quality sectors, such as Treasuries and investment-grade corporates. We are cautious on corporate credit but remain neutral on quality as recession risks are muted in the near-term. Fixed-income yields have increased with higher interest rates, and valuation has improved after credit spreads over Treasuries have increased. Valuation of investment-grade corporates in particular has improved, especially shorter-maturity bonds. Below-investment-grade corporate bonds (i.e., 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. 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, and have difficulty identifying fundamental reasons to be aggressive in the sector. While oil and steel markets moved higher in the second quarter (the latter due to tariff actions and fears), gold, copper and zinc moved lower—an indication of the disjointed nature of commodities markets, especially during periods of trade tension. A weaker dollar, resolution of current trade issues and the establishment of new trading relationships could lead to a more constructive environment for commodities in general, but that collective prospect seems far from imminent.	Underweight — Overweight
Currencies	Backed by the strongest developed economy in the world and a Fed committed to staying on track for further rate hikes into 2019 (while others equivocate), the dollar appreciated 4%, 5% and 6%, respectively, against the yen, euro and pound in the second quarter. While the strength of its recent advance suggests a reversion is due, the conditions remain in place for resiliency, if not further outright strength. Our relative equity exposures are consistent with this expectation.	U.S. — Foreign

Equity Sector

		Weighted Preference Under ← | → Over
Health Care	Health care stock performance, through a lens of capitalization size, has divided in 2018–more so than most sectors this year. Mid and small caps have experienced strong returns, both absolute and relative, whereas large-cap results have been modest. One influence is pharmaceuticals, which are bigger in large-cap benchmarks and have lagged. Managed health care has done well across cap ranges, as have health care facilities and health care equipment. Consistent with the market overall, growth is outperforming value. 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.	

[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
Energy	Oil prices have advanced by double digits year-to-date and by more than 50% year-over-year. OPEC's June meeting was important, with a first quota increase for this cycle. Markets fret about U.S. shale supply growth, especially with an oil price in the mid-$60s that could incent more drilling. Still, oil prices have been resilient, in part because demand growth is strong. After a poor 2017, energy equities have been among the better-performing sectors in 2018; and supply-and-demand fundamentals indicate this may continue.	
Telecom Services	Telecom services fundamentals are challenged with competition in mature 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 have hindered performance. All these factors have telecom services materially lagging benchmarks. Our sector exposure is toward underlying infrastructure support companies, providers of telecom services (e.g., fiber and towers).	
Consumer Staples	Consumer staples have struggled year-to-date. Historically, the area was viewed as stable and a place to be should markets retreat, but this view is debatable with a strong slant 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. However, most retailers are poised to benefit from tax reform more than other groups since consumers have more money to spend, which is a possible explanation as to why several retailers have performed better recently.	
Industrials	The sector comprises many industries, some economically driven, some less so. Several economically sensitive industries, like construction machinery, building materials and industrial machinery, are lagging, bringing into question macroeconomic growth forecasts. Also, the group is disproportionately impacted when trade becomes a political football. Railroads and trucking have performed well in 2018 on tight supply and pricing power. Airlines and industrial conglomerates have trailed. The global economy, trade policy and currency moves will be relevant factors impacting future performance.	
Information Technology	Tech stocks have led markets in 2018. This is true for small caps, as well as the well-known mega-cap tech stocks. "Old school traditional" tech industries, such as semiconductors and communications equipment, have also participated in the rally. Performance has not been only about Internet high-flyers. 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. 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.	
Consumer Discretionary	Industries in the consumer discretionary sector are widely diverse, as have 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. This driver has fueled several mid- and small-cap retailers that have had respectable year-to-date performance despite major online shopping competitors. Homebuilders and housewares are emphasized areas as household formation rates accelerate. Though the theme continues, those industries have lagged. Leisure travel and activities are doing well as consumers spend more disposable income on experiences than things. Media enterprises have been driven by deals in 2018, more so than by business fundamentals.	
Materials	Materials industries—and underlying commodities for many of those industries—possess unique supply/demand profiles and cycles. Still, most of the sector has performed poorly in 2018 driven by macroeconomic growth concerns and trade politics. Steel has done well, perhaps as a result of tariff protection. Fertilizers and ag chemicals was the only other industry displaying resilience. Metal and glass containers and paper packaging are two areas that have especially struggled. Economic activity is the key driver for this segment.	
Utilities	Increasing 10- and 30-year government bond yields year-to-date have resulted in underperformance for the bond-proxy utility group. Underperformance has been modest in some capitalization sizes, however, as earnings growth for some utilities segments remains solid. We remain selective at the company level and are underweighted in most portfolios.	
Financials	Reversing first quarter 2018 performance, financials are lagging year-to-date. Weakness is widespread across diversified banks, investment banking, consumer finance and most insurance categories, especially among large caps. This occurred despite bank regulatory relief and banks being given more leeway over return-of-capital to shareholders. Federal Reserve rate increases, on the one hand, can help net interest margins but, on the other hand, cause angst about nearing the end of an economic cycle. Small-cap financials have been respectable in relation to benchmarks, having performed well, both in absolute and relative terms. Consolidation has played a role driving valuation to somewhat above-average levels.	
Real Estate	Real estate investment trust (REIT) stocks have underperformed 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 more than 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.	

● Current quarter ○ Previous quarter

Fixed-Income Sector

		Weighted Preference Under ← | → Over
High-Yield	High-yield has been one of the best performing fixed-income sectors year-to-date. Its lower duration and higher yields have helped insulate it from the increase in interest rates. Solid U.S. economic growth should support the market for the remainder of the year. We remain concerned that high-yield is trading relatively expensive when compared to Treasuries and other fixed-income sectors.	
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 neutral weighting to agency mortgages as mortgage spreads versus Treasuries have widened past historical averages. Longer term, the supply and demand picture for agency MBS will become more challenging as supply is increasing at the same time the Fed is slowing its reinvestment of paydowns. More net supply will need to be absorbed by money managers at cheaper valuations.	
Corporates	We are cautious on investment-grade corporate bonds but remain neutral given improved yields and valuation. Corporate fundamentals remain solid, supported by strong earnings. Market technicals, however, have been weak with reduced buying from foreign and domestic investors. Higher rates have hurt total returns. Longer-term, high-debt levels are a concern, especially if the economy were to slow significantly. Also, absolute returns of corporate bonds remain susceptible to declines in a rising interest rate environment.	
Non-U.S. Dollar	The dollar strengthened in the second quarter, and was up moderately for the first half of the year. We expect continued dollar strength. The Federal Reserve is raising short-term interest rates, which should help to support the dollar as the interest-rate differential with other major developed markets increases (short-term capital flows usually go to countries with relatively higher short-term interest rates). Also, global growth has moderated while the U.S. economy remains strong. The dollar also benefits during bouts of global instability, such as the recent turmoil in emerging markets. Overall, we see little value in trying to capture additional return through non-U.S. dollar currencies.	
Emerging Markets	Emerging-market bonds posted poor returns to start 2018 amid higher U.S. rates, a stronger dollar and increased concerns over slowing growth and trade outside the U.S. Idiosyncratic factors in key countries such as Argentina, Brazil and Turkey also contributed to weakness. While valuations have improved significantly with higher yields, we remain cautious on emerging-market debt until the dollar and rates stabilize along with global growth. Higher rates and a strong dollar make repaying U.S. dollar-denominated debt more difficult for many emerging-market countries, which have seen debt levels increase significantly in recent years.	
Inflation Protected	Treasury Inflation Protected Securities (TIPS) outperformed (nominal) coupon-bearing Treasuries in the first half of 2018 as market concerns over inflation increased and energy prices moved up. TIPS remain attractive relative to conventional Treasury bonds. While TIPS are not good for current income, they remain useful as a diversifier in an overall portfolio strategy because they provide modest "insurance protection" against an unexpected rise in inflation.	
Treasury/ Agency	We remain underweighted in Treasuries. Solid 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. Risks to this view include a slowdown in global growth, the impact of increased trade protectionism and increased market volatility driving a flight-to-quality rally in Treasury yields.	
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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