THRIVENT MUTUAL FUNDS

OUR VIEW

Market perspectives from Thrivent Asset Management

June 30, 2017

Equity markets around the world continued to advance in the second quarter. In the developed economies, Japan and the euro area saw the best moves upward but the latter was mostly a function of a strengthening euro versus the dollar. Economic growth is picking up in the euro area, and there does appear to be progress in Japan on the issue of corporate governance and shareholder-friendly actions like returning surplus cash on balance sheets to shareholders. U.S. stocks also advanced, led by a strong performance in the information technology and health care sectors. Growth stocks outperformed value stocks, reflecting the good results in those two sectors. These two groups have the ability to generate organic growth even in an environment of tepid economic activity. Energy shares were down in the period, while financials lagged. Both of those segments are significant in value portfolios and indexes and are dependent on cyclical growth and higher interest rates. Investors became concerned that the possibility of faster growth tied to the new administration's major policy initiatives on tax reform, infrastructure spending and regulatory relief were becoming bogged down in the legislature. The Federal Reserve followed through on their stated plan of slowly raising short-term interest rates by moving the federal funds rate target to a range of 1.00% to 1.25% in June. However, longer bond yields declined by 10–20 basis points during the second quarter, causing the yield curve to flatten. The market is skeptical of the Fed's intention to continue to raise rates much further. The credit markets continued to outperform, with longer maturity corporate bonds up 3% and high yield bonds up 2%. The continued pursuit of yield also pushed preferred stock returns up 2.5% to 3.0% during the quarter. The low volatility environment that has characterized the economy and the equity market has been even more pronounced in the bond market. Just "clipping coupons" has been the enduring characteristic of the market thus far in 2017.

● = Current quarter ○ = Previous quarter

ASSET ALLOCATION VIEWS: CURRENT OUTLOOK		Bias to Asset Class						
Asset Allocation	We remain modestly underweighted in equities. Valuations are quite full, and while first quarter earning's growth was good, it was boosted by a sharp rebound in energy and commodities sector earnings from the first quarter of last year, a factor that will diminish as this year progresses. Additionally, while the economy is growing, the expected acceleration in growth has yet to occur in the U.S.	Bonds		●				Stocks
EQUITIES								
Region	Outside the U.S. we are seeing an acceleration in economic activity that is fostering a recovery in earnings from quite depressed levels, particularly in the euro area. Japanese companies' earnings have staged a dramatic recovery as well. We are overweighted in developed foreign markets, since we feel they represent an opportunity for improved profit margins and accelerating earnings relative to the United States. Key to that expectation is continued economic growth.	U.S.				●		Int'l
Region	We are overweighted in developed markets outside the U.S. relative to emerging markets. There is a skewness in certain segments of emerging markets to commodities, particularly in places like Latin America. We are of the position that many commodity markets remain over supplied, and thus have a bias to beneficiaries of lower commodity prices or commodity importers rather than exporters.	Developed		●				Emerging
Market Cap	We remain biased to large-capitalization stocks. While small-cap and large-cap stock valuations are more in line with historical relationships (i.e., small is not expensive relative to large), there is more volatility or risk embedded in small companies. Given our modestly defensive positioning, we think it's appropriate to be more in favor of large caps in domestic portfolios.	Small				●		Large
FIXED-INCOME								
Duration	We believe the bond market has been too suspicious of the Federal Reserve resolve to continue tightening policy. Recently, the European Central Bank has also indicated it is considering its "exit strategy" from extreme accommodation. Although inflation statistics have dipped recently due to the fall in energy prices, wages are still moving up. Thus, 10-year Treasury yields at 2.0% to 2.5% range have very little room for error. Although we do not expect rates to rise dramatically, the risk/return calculus of longer duration bonds in such a low-yield environment is not favorable. Short-/intermediate-maturity bonds are currently more attractive, particularly after the surprisingly strong performance of long-maturity bonds in the second quarter.	Short		●				Long
Yield Curve	Declining inflation reports in the second quarter were a surprise, leading to a meaningfully flatter curve. We remain neutral on the curve, because it is difficult to reconcile the extremely low yields on long maturity bonds, even with the relatively sanguine recent reports on inflation. If energy prices rebound from the second quarter's weakness, the curve would steepen.	Short			●			Long

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ASSET ALLOCATION VIEWS: CURRENT OUTLOOK (CONTINUED)		Bias to Asset Class						
Quality[1]	Credit-oriented sectors in the fixed-income market, particularly investment-grade corporate bonds, remain relatively attractive. However, this is taking place in an environment where absolute yields continue to be exceptionally low relative to inflation. As long as foreign central banks continue with their programs of buying corporate bonds, this sector will continue to outperform Treasury bonds. After a tremendous rally this year, below-investment-grade corporate bonds now appear fair, at best, from a valuation perspective.	High			●			Low
Region	With evidence of a synchronized improvement in global growth, accompanied by still expansive global monetary policy, emerging-market bonds have been strong performers. We believe this outperformance relative to high-quality bonds can continue due to the fact that global fixed-income investors are still underexposed to this area. Sovereign credit selection remains very critical however, given the political and economic challenges faced by some large emerging-market credits such as Brazil and Russia.	Developed				●		Emerging
COMMODITIES AND CURRENCIES								
Commodities	We remain biased against the commodity sector and economies that are dependent on higher prices. We did have an overweight exposure to energy shares in 2016 but closed that trade in the first quarter of 2017. While we have seen a sharp rise in select commodities, we believe it has little basis in improving fundamentals for the sector and so we remain on the sidelines.	Under-weight		●				Overweight
Currencies	The dollar is over-valued versus other major currencies. That said, monetary policy in the U.S. is still more restrictive than that of the other major currency blocks like the euro, yen or British pound and interest rates in the U.S. remain relatively high. In both Japan and Europe, there are still many sovereign bonds trading at negative yields, while the U.S. yield curve—albeit at low levels of interest rates—is still at positive levels. Should central bankers in those economies become more restrictive, there would be an increased likelihood of rallies in those currencies. In the near term we think that unlikely, but we are monitoring the situation closely.	U.S.			●			Foreign

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EQUITY SECTOR: CURRENT OUTLOOK		Strength of Preference Underweight ◀ Neutral ▶ Overweight				
Health Care	Health care has materially outdistanced broad market indexes in 2017, especially in mid- and small-capitalization ranges. Breadth has been excellent with all categorizations within the sector advancing more than the market. Health care equipment, health care facilities and managed health care segments have posted particular strength, despite uncertainty out of Washington D.C. Drug pricing concerns remain, with pressure from both commercial and government payers driving lower price increases. Our focus is finding group participants that derive growth from volume and new product innovation to counter pricing pressures in areas with numerous alternatives and little differentiation. We have decreased exposure to pharmaceuticals. Regarding health care services, a benign utilization environment, improving corporate employment levels, and a more favorable set-up for Medicare-related business has resulted in an overweighting toward managed care stocks in several portfolios.			●	○	
Energy	Energy stocks have performed dismally in 2017 and have given back all relative gains achieved in 2016. Global oil demand growth remains solid, but growing U.S. supply has proven to be the main concern. Markets fear that a ramping in U.S. production will short circuit the current upcycle in activity and price. Our view is fundamentals are decent and this cyclical industry will have better days ahead as companies have paltry profitability at mid-$40s oil price levels. Investors have rewarded growth in this sector, but should shift focus to profitability and returns on capital employed.				●	
Telecom Services	Telecom services have materially trailed benchmarks across all capitalization ranges in 2017, as was the case during most of 2016. Competitive intensity and capital intensity across the sector is rising while pricing power is eroding. This is a recipe for continued underperformance for the sector. Competitive pressures continue to be felt from nontraditional cloud-based service providers and cable multiple-system operators, including the potential foray into wireless services for the latter. The ability to execute needed consolidation could face regulatory pushback and, without structural change, this will continue to be a sector to avoid. We remain cautious with zero exposure in many strategies.		●			
Consumer Staples	Depending on the benchmark, consumer staples have returns around in-line to slightly lagging so far in 2017. Variation among industries, which themselves have unique dynamics, has been significant. Tobacco, soft drinks and household products have performed fairly well, whereas retailers have not. We have, in general, positioned away from retail square footage. We prefer global staples companies with significant emerging-market exposures to leverage scale and volume growth. Small caps offer the best opportunities, especially companies providing better-for-you, natural and organic products.		●			
Industrials	Industrials, especially in large-capitalization ranges, have good results compared to the market in 2017, with breadth across many diverse industries in the sector. This is interesting given a backdrop of mediocre economic growth. Railroads and industrial machinery have outperformed, which are two areas of focus in Thrivent portfolios. Airlines and trucking have reversed their first quarter lagging performance, outperforming in the second quarter. Deep cyclicals have done well, with the market discounting future improvement in economic activity. We remain well-diversified across the many industries within this sector—industries that possess their own unique cycles, catalysts and valuations.			●		

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

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EQUITY SECTOR: CURRENT OUTLOOK (CONTINUED)		Strength of Preference Underweight ◀ Neutral ▶ Overweight				
Information Technology	Information technology (IT) sector strength continued in the second quarter. Strength has been widespread across many Internet service, software and hardware categories. As cloud computing and mobile begin to mature, the winners are becoming increasingly clear while emerging areas in the Internet-of-Things, artificial intelligence (AI), edge computing and new software paradigms, such as containers and serverless, will offer new opportunities, first in semiconductor and hardware areas and eventually in software and Internet. AI has been a theme in data center computing and is seen as a catalyst for a change in edge computing architectures as those applications become smarter. The other accelerating theme is electronic content growth in automotive driven by the growing popularity of electric vehicles and advanced driver assistance systems, with the potential for autonomous driving vehicles to catalyze another leg of growth in the future. Mobile is moving toward cyclical growth from secular, though the Apple iPhone cycle has been a driver of outperformance in Apple's ecosystem. Security spending will continue to grow within IT budgets, as will investment in analytics and big data as technologies mature. In the second half of 2017, the potential for cash repatriation is a catalyst for tech stocks, which carry a disproportionate amount of the cash held overseas by U.S. companies in both absolute terms and as a percentage of market cap.				●	
Consumer Discretionary	Performance across the many industries in the consumer discretionary sector has been diverse. Homebuilders, cruise lines, Internet retail, cable and satellite, and hotels have done well, while apparel retailers, department stores, autos and auto parts companies have not. We have exited auto parts retail positions as the group will be "Amazoned" sooner than thought. Home improvement retail is relatively well positioned. Growing employment and accelerating increases in average hourly earnings for workers is driving consumer ability to spend on discretionary items. Homebuilders and housewares are emphasized areas as household formation rates accelerate. Leisure travel is doing especially well as consumers spend more disposable income on experiences than on things. Cruise and theme park operators are clear beneficiaries of this change in consumer behavior. Media continues to be 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 some reallocation of advertising to online and out of TV. Brands create barriers-to-entry, and many portfolios are invested in some of the best-known global brands.			●		
Materials	Despite far from robust economic indicators, materials have performed in-line to slightly-better-than benchmarks. Chemicals, both diversified and specialty, paper packaging and metal and glass containers are industries of particular strength and are favored in portfolios. Steel and aluminum have been notable laggards. Each commodity possesses its own supply-and-demand drive cycle, which we'll monitor closely. Conversely, economic growth impacts the entire sector. Equity returns year-to-date would indicate the economy is doing better than consensus believes.			●		
Utilities	With 10-year government bond yields declining year-to-date, utilities have reversed the underperformance we witnessed late last year. Performance has been respectable across electric utilities, independent producers, renewables and water utilities. Less political pressure after the November election—particularly with regard to coal mining and coal burn by utilities—may also factor in. Nonetheless, we remain underweighted in most portfolios based on challenged fundamentals.		●			
Financials	The optimism regarding changes in the political and economic landscapes for financials that was witnessed late in 2016 has not continued during the first half of 2017. The yield curve is flattening and net interest margins are static, which is the opposite of many expectations. A modest economy has not driven greater capital markets activity, especially in fixed-income, currencies and commodities, and loan growth is slowing. Credit concerns are increasing for credit cards and autos. This, however, is creating opportunities to purchase consumer finance franchises at attractive valuations where credit concerns are overly discounted. Bank regulatory relief does appear probable and will, over time, help bank return on equity, a key input to bank valuations. Our focus, regardless of macroeconomic change, remains on the best franchises with value.				●	
Real Estate	Real estate investment trust (REIT) stocks have modestly underperformed the general equity markets in 2017. Nonetheless, REITs have provided a positive return this year supported by the unexpected decline in 10-year U.S. Treasury yields and a steady fundamental outlook. REIT dividend yields are currently attractive, in our view, at around 4.0%. We have greater-than-benchmark weightings in property sectors with strong fundamentals such as data centers, industrials and apartments. We have less-than-benchmark exposure in the most interest-rate sensitive property sectors that include health care and net lease REITs. Retail property REITs have significantly underperformed other property sectors in 2017 due to retail store closings and increasing competition from Internet sales. However, valuations appear attractive at significant discounts to net asset value. Therefore, we maintain our above-benchmark exposure in Class A mall REITs and equal weight exposure in shopping center REITs.			●		

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FIXED-INCOME SECTOR: CURRENT OUTLOOK		Strength of Preference Underweight ◀ Neutral ▶ Overweight				
High-Yield	Declining default rates and the relatively healthy corporate balance sheets of high-yield issuers continue to support the high-yield market. At current trading levels, we believe there is limited room for further price appreciation. The market appears fairly rich, trading at these levels or better only a small percentage of the time over the last several market cycles.			●		
Securitized Assets	Nonagency residential mortgage-backed securities (RMBS) continue to offer attractive loss-adjusted yields relative to other sectors and are supported by a strong housing market. Many sectors within nonagency RMBS offer yields that are competitive to corporate bonds, but have less price risk if interest rates move higher. We also favor collateralized loan obligations (CLOs) for the relative spread offered versus comparable sectors, and CLOs offer floating-rate coupons that benefit from Federal Reserve rate increases.				●	
Agency Mortgages	The additional yield offered by agency mortgage-backed securities (MBS) relative to Treasury securities is near long-term averages. We recommend a modest underweight as we expect the yield differential versus Treasuries to increase over the second half of the year as the Federal Reserve begins tapering MBS and U.S. Treasury purchases.		●			

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FIXED-INCOME SECTOR: CURRENT OUTLOOK (CONTINUED)		Strength of Preference Underweight ◀ Neutral ▶ Overweight				
Corporates	We recommend a neutral allocation to investment-grade corporates. Investment-grade corporate bonds appear fully valued versus the long-term average. Corporate debt levels have risen, but fundamentals generally remain solid. 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. While neutral overall, we prefer investment-grade corporates over U.S. Treasuries given the additional yield pickup.			●		
Non-U.S. Dollar	The dollar has been surprisingly weak during the first half of 2017, particularly given the Federal Reserve has been the only major central bank to raise short-term interest rates (short-term capital flows usually go to countries with relatively higher short-term interest rates). As other global economies appear to be improving—particularly Europe—capital is flowing to those economies, apparently at the expense of the relative value of the dollar. At these levels, the dollar seems rather oversold, particularly given the still unstable nature of global geopolitics. As such, we see little value in trying to capture additional return through non-dollar currencies.		●			
Emerging Markets	Emerging-market bonds have been a strong area of performance in 2017. Given an improving global economic backdrop and the ongoing trend of investor demand for incremental yield, we remain modestly overweighted in the sector.				●	
Inflation Protected	Treasury Inflation Protected Securities (TIPS) have performed relatively poorly during the first half of 2017 as inflation statistics have moved lower due to falling energy prices. (Interestingly, TIPS are very correlated to oil prices.) TIPS now look reasonable, particularly relative to conventional (nominal) coupon-bearing Treasury bonds. We are neutral on the area overall. TIPS are not good for current income, but remain better used as a diversifier in an overall portfolio strategy because they provide modest "insurance protection" against a surprising rise in inflation.			●		
Treasury/ Agency	Although longer maturity Treasuries performed reasonably well in the second quarter, they remain locked in a 2.0% to 2.5% yield trading range. Other higher income sectors continue to look more attractive in this still low-yield environment. We remain underweighted in the sector.		●			
Municipals (tax-sensitive)	With the exception of the longest maturities, munis look richly valued compared to U.S. Treasury securities. The muni yield curve is steeper than that of U.S. Treasuries, which creates the long-end value. The supply and demand technicals look supportive through the summer months. Credit spreads in general have narrowed. Absolute yields are lower than they were six months ago, but higher than they were 12 months ago. The policy risks emanating from Congress seem to have receded, but the Federal Open Market Committee continues on the path to "normalizing" rates and shrinking the balance sheet. Recent comments from the head of the European Central Bank indicate more confidence in the European economy and, by inference, less need for such generous monetary accommodation. And through it all, the U.S. economy keeps chugging along. Munis are still a decent option for fixed-income investors in higher tax brackets, but there may be better options for those in lower tax brackets.		●	○		

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