JUNE 30, 2019

OUR VIEW
Market perspectives from Thrivent Asset Management

Summary

EQUITIES
- Equities finished the second quarter strongly to generally end the quarter in positive territory, adding to the big gains in the first quarter.
- Domestically, larger companies generally did better, with the S&P 500® Index1 up 4.3% and outperforming both mid caps (S&P MidCap 400® Index2, +3.1%) and small caps (S&P SmallCap 600® Index3, +1.9%).
- Internationally, developed markets fared better than emerging markets, with the MSCI EAFE Index4 up 3.7% vs just 0.6% for the MSCI Emerging Markets Index5.
- The middle of the quarter saw downward performance in the face of increasing trade tensions, but June saw a rally as the Federal Reserve hinted at a more accommodative monetary policy.
- Our proprietary economic measures are signaling heightened risk for economic growth across the globe. Most of the weakness appears to be from softness in the business outlook, which is likely being impacted by the uncertainty surrounding these trade disputes. However, consumer-oriented trends, like consumer spending, remain solid, suggesting that if business uncertainties are resolved, the economic outlook would be more optimistic.

FIXED-INCOME
- Fixed-income asset classes had another strong quarter as interest rates fell amid investor expectation for the Fed to ease monetary policy and eventually cut rates once again.
- The Bloomberg Barclays US Aggregate Bond Index6 was up 3.1%, while U.S. investment-grade corporate bonds performed even better, up 4.5% (Bloomberg Barclays US Corporate Bond Index7). Other fixed-income sectors, like municipal bonds, U.S. Treasuries, and high yield bonds had returns in the 2-3% range.
- The yield curve has inverted, with several different levels of short-term maturities yielding more than 10-year U.S. Treasury Bonds.
- While inverted yield curves have typically presaged an eventual recession, we aren’t yet seeing one on the immediate horizon. Furthermore, credit spreads have not been widening dramatically, which would signal concern over increasing defaults on corporate bonds.

Asset Allocation Views: Current Outlook

- We maintain an underweighting to our long-term strategic allocation to stocks.
- With S&P 500 earnings comparisons expected to be flat or negative the rest of the year and our proprietary economic models generating signals that are increasingly cautionary, we see potential challenges to U.S. markets.
- However, accommodative monetary policy and low interest rates are powerful offsets and leave us comfortable with the equity exposure we have.
The Senior Investment Team is discussing the asset classes, sectors and portfolios they oversee at a macroeconomic level. The views expressed are as of the date given unless otherwise noted.

Past performance is not necessarily indicative of future results.

The Bloomberg Barclays US Corporate Bond Index measures the performance of investment-grade debt instruments.

The S&P SmallCap 600® Index represents the average performance of a group of 600 small-capitalization stocks.

The S&P MidCap 400® Index represents the average performance of a group of 400 medium-capitalization stocks.

The S&P 500® Index is a widely followed index and is composed of 500 widely held U.S. large-cap stocks.

The Bloomberg Barclays US Aggregate Bond Index measures a wide variety of investment-grade U.S. bonds.

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

1The S&P 500® Index is a widely followed index and is composed of 500 widely held U.S. large-cap stocks.
2The S&P MidCap 400® Index represents the average performance of a group of 400 medium-capitalization stocks.
3The S&P SmallCap 600® Index represents the average performance of a group of 600 small-capitalization stocks.
4The MSCI EAFE Index measures developed-economy stocks in Europe, Australasia and the Far East.
5The MSCI EM Index measures emerging-economy stocks.
6The S&P 500® Index is a widely followed index and is composed of 500 widely held U.S. large-cap stocks.
7The Bloomberg Barclays US Corporate Bond Index measures the performance of investment-grade debt instruments.
8Credit Quality ratings are determined by credit rating agencies Moody’s Investor Services, Inc. or Standard & Poor’s Financial Services, LLC.
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Asset Allocation Views: Current Outlook (cont’d)

Equities

- We have added to our international exposure and are now generally neutral relative to strategy.
- Specifically, we've increased exposure to Europe and in emerging markets.
- Earnings growth is still depressed and relative valuations aren't a primary attraction, but estimate revisions are stabilizing, as are broader economic activity indicators.
- We find the risk/reward of regions most exposed to U.S.–China stabilization, lower rates and a weaker dollar worthy of increasing allocations and will be looking for opportunities to increase further as the year goes on.

U.S. VS. INT'L

- We continue to overweight large caps and prefer mid caps over small caps.
- Relative valuations on small caps look attractive, but earnings have been weaker than expectations while debt levels have increased.
- We expect lower profitability, higher balance sheet leverage and less operational leverage to be headwinds for small caps.
- Large caps offer greater potential for buybacks and dividends, as well as greater leverage to any improvement in international trade conditions and global growth.

MARKET CAP

- Parts of the yield curve have modestly inverted during the quarter, with three-month Treasuries outyielding 10-year Treasuries. In the past, a curve inversion has been a harbinger of a slowing economy or recession anywhere from about six months to two years out.
- This curve inversion suggests monetary policy is too tight, which is one of the primary reasons that markets have been anticipating a rate cut.
- We are now positioned for a steepening yield curve, which is common when the Fed eases.
- However, if investors increase buying long-term bonds for their extra yield, post-steepening, we will adjust accordingly.

Fixed Income

- Interest rates fell to multi-year lows during the quarter, fueled by anticipation of the Fed cutting the Fed Funds Rate, which we do expect to happen in the third quarter.
- Both the Fed and markets are reacting to signs of slowing economic growth and little inflationary pressure, despite unemployment remaining low.
- Trade tensions and political uncertainty have increased demand for "safe-haven" assets like U.S. Treasury securities, driving rates down further.
- We are maintaining a modestly long duration position to take advantage of further drops in rates, but will reduce the duration overweight if we felt the fall in rates has been overdone.

TACTICAL VS. STRATEGIC POSITION

- We are now positioned for a steepening yield curve, which is common when the Fed eases.
- However, if investors increase buying long-term bonds for their extra yield, post-steepening, we will adjust accordingly.

- Both riskier and higher quality fixed-income segments performed well in the second quarter, propelled largely by lower interest rates, which push bond prices higher. Credit spreads also decreased, helping lower quality securities.
- Accommodative monetary policy and possible rate cuts are generally supportive of credit-sensitive fixed-income assets and low yields in Treasuries and global fixed-income should also support demand for higher-yielding credit.
- Looking ahead, we are tilting slightly toward higher quality credit as we are cautious on lower-rated bonds given high debt levels and rising default risks.
- Odds of a near-term recession appear moderate, but rising. We would look to move even more toward higher quality credit on signs the economy is slowing more significantly.