MARKET COMMENTARY

INSIGHTS FROM THRIVENT ASSET MANAGEMENT

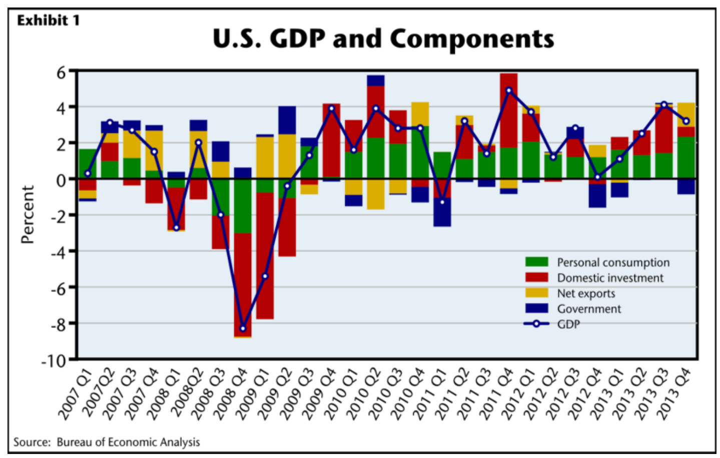
Private GDP Growth Highest in More Than Two Years

By Russell Swansen, Chief Investment Officer

The economy appears to be building a head of steam.

In its “advance estimate,” the Bureau of Economic Analysis reported last week that the private sector grew at an annual rate of 5.1% in the fourth quarter, its fastest pace in more than two years. Those gains were offset in part by a contraction in government spending, which reduced the growth rate for the economy as a whole to an estimated 3.2%. Still, that was better than the roughly 2% pace averaged over the last few years. The economic outlook remains generally positive, too, as the drag from reduced government spending is expected to diminish going forward.

All that said, these statistics are early estimates subject to revision. Over the next few months the BEA will issue, per its usual schedule, two updates to its advance estimate. The average change between its first and third estimates is +/- 0.6 percentage points. As time passes the BEA will make still further revisions to its estimates; the difference between its first estimate and these later estimates historically has averaged +/- 1.3 percentage points. We just saw a good example of how these numbers can swing so dramatically. Initially, the BEA estimated that the economy grew at a 2.8% annual rate in the third quarter of last year, but with last week’s report it revised that number to a much more robust 4.1%.



Fed Stays the Course

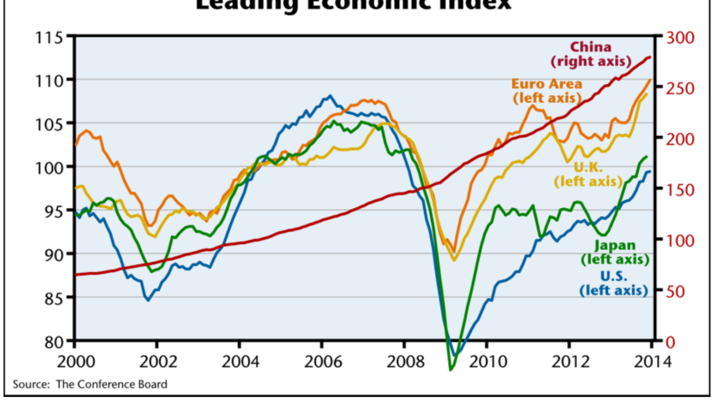
Following the January meeting of its Federal Open Market Committee, the Federal Reserve announced a second reduction in the pace of its bond-buying program but said it would continue to hold short-term interest rates near 0%. The Fed had been buying $85 billion of bonds monthly last year in a bid to keep longer-term interest rates low. It pared the amount to $75 billion per month for January and has now cut the program to $65 billion for February.

Most market observers, including us, had anticipated these moves. If anything newsworthy came from the FOMC meeting it was contained in the short written statement the Fed issued afterward, featuring slightly more optimistic language about the FOMC’s expectations for economic growth. Because the wording of these statements is often nearly identical from one meeting to the next, changes are carefully scrutinized as indicators of potential policy shifts. The latest statement suggests the Fed will continue to curb the pace of its bond purchases throughout the year but will likely not change its stance on short-term rates until 2015.

Leading Indicators

The Conference Board's Leading Economic Index for the U.S. increased a modest 0.1% in December following a jump of 1.0% in November. Conference Board economists said that despite month-to-month volatility in the final quarter of 2013 and some lingering uncertainties, the leading indicators continue to point to gradually strengthening economic conditions through spring. "Business caution and concern about unresolved federal budget battles persist," they said, "but the better-than-expected holiday season might point to sustained stronger demand and could put the U.S on a faster growth track for 2014."

Exhibit 2



Source: The Conference Board

Our own forecasting model suggests the economy will grow at a 2% to 3% annual rate over the next several months, equaling or bettering the average pace of the last few years. We expect growth in Europe and the U.K. to continue to improve as well, to a 1% to 2% rate, following a shallow but extended recession in Europe and a couple of years in which growth in the U.K. barely exceeded 0%. Japan's economy also has struggled in recent years, but we expect it to grow modestly as well. Data from China are always suspect, but what we have indicates a steady to slightly improving growth rate there, too.

The Bottom Line

The stock market's recent decline may seem at odds with the relatively good economic news, but it is not unprecedented. While the market generally follows the economy over time, it seldom moves in lockstep. The more interesting debate among many investors now centers on whether the stock market is fairly priced or overpriced. The answer depends on how one measures, but few are arguing that the market is cheap.

Fortunately, economic growth around the world appears to be accelerating, which is good for corporate earnings even if it means that longer-term interest rates in the U.S. will likely rise a bit. About half of the companies in the S&P 500 stock index have announced results for the fourth quarter, and on average their sales rose 2.2% and their earnings jumped 9.5%. We expect modestly positive returns for stocks over the coming year, and continue to favor large U.S. and European companies with global businesses.

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