FUND COMMENTARY

Honing the competitive edge of Thrivent Large Cap Value Fund

By Gene Walden, Senior Finance Editor | 07/26/2022

To stay sharp during the long, frigid Minneapolis winters, Kurt Lauber, Thrivent Large Cap Value Fund Senior Portfolio Manager, hits the ice for a local men's hockey league, pushing the puck and indulging his unsatiable penchant for competition. He picked up hockey in 2004 – the same year he joined Thrivent.

In one particularly raucous game, Lauber found himself matched up in a face-off refereed by a former National Hockey League pro from the old Minnesota North Stars. "We were just killing each other out there even though we all had to go to work the next day," recalls Lauber. Amused by Lauber's over-the-top competitive zeal, the former NHL enforcer looked at him just before he dropped the puck and joked, "Does anyone see any scouts in the stands?"

That competitive fire has been with Lauber his entire life. He took up boxing as a student at the University of Notre Dame and worked his way up to campus champion. Later, he focused that disciplined training on earning his black belt in Shorin-Ryu karate. During one recent winter, he skated six miles pulling a sled with all his provisions into the Boundary Waters wilderness along the Canadian border – where temperatures may drop to 30 or 40 degrees below zero – and pitched a tent for five crisp days of camping and ice fishing.

So, it's no surprise that Lauber, the father of five children – all hockey players – takes that same intensity into his job as manager of **Thrivent Large Cap Value Fund** (**TLVIX**). The Fund recently received a 4-Star Overall Morningstar Rating™ out of 1,145 funds in the Large Value category, as well as for the three-year, five-year, and 10-year performance periods (out of 1,145 funds, 1,077 funds, and 779 funds, respectively, as of June 30, 2022). (Morningstar ratings are calculated based on risk-adjusted return.)

Turning the tide

Lauber, who has managed Thrivent Large Cap Value Fund since 2013, believes that value stocks could be poised for a lengthy breakout after a long period of underperformance. "Value stocks have gotten a bad reputation over the past 10 years primarily because growth has done so well. If you look at the Russell Large Cap Growth universe, growth stocks have outperformed value stocks by about 6% per year from the Great Financial Recession of 2008 through the COVID recession."

Economic circumstances fueled that outperformance, he explains. "From the financial crisis to the COVID recession, growth stocks did well because interest rates, inflation, and economic growth were low, and the companies that could deliver growth, such as technology, did very well."

But, as Lauber points out, value stocks often tend to reverse that trend after disruptive periods in the market. "What people don't remember is going back to the Dot.com recession that began in 2001, value actually outperformed growth by about 5% from 2001 to 2008."

Prior to the market crash in 2001, technology stocks became overvalued, which precipitated the sell-off. "We had too much capital chasing too few ideas," explained Lauber. "It really took 10 years for the growth stock segment to recover. At the same time, value did very well."

Although fears of recession from efforts by the Federal Reserve (Fed) to slow demand and temper inflation are having a negative impact on both investment styles, Lauber believes value stocks could experience another resurgence over the next few years. "Value stocks started to get some love over the two years since the bottom of the COVID recession. The Russell 1000 Value Index has beaten the Russell 1000 Growth Index by about 12% – or 6% per year."

Going forward, Lauber believes the conditions may continue to be favorable for value stocks. "It really depends on the economy. Right now, we have high inflation and interest rates that are moving higher. Industries within the value universe, such as financials, materials, energy, and industrials, tend to do better with a little inflation but also depend on good economic growth. And in this cycle, we're not seeing the excesses that we had leading up to the Great Financial Crisis, which should also bode well for value stocks once inflation comes under control."

Stock selection process

While value stocks were outperforming growth stocks over the past two years, Thrivent Large Cap Value Fund actually managed to outperform the Russell 1000 Value index by more than 10% during the two-year period through the first half of 2022. The key to that success, explained Lauber, was the Fund's stock selection process, which focuses on determining which stocks are likely to outperform market expectations of company returns in the years ahead.

"The most important lesson I've learned as a fund manager," said Lauber, "is to do deep, fundamental work on names from the bottom up and to understand that good-return companies deserve higher valuations – and to find those returns that are not reflected in the stock price. That's the best way to add alpha.

"If investors expect really good returns and the valuations already reflect that, there's no opportunity," he added. "We believe the best opportunity comes from finding companies that can deliver very good future returns that people aren't expecting."

To identify those types of companies, Lauber focuses on components of return on invested capital: the ratio of sales-to-capital (capital turnover) and the ratio of operating profit to sales (margin). "The growth investors are just looking at the sales side of it. They just look at how big the market could be. We care about that, but we also care about the capital that is actually being put in to generate that sale and the profitability of every incremental sale."

To identify detailed future returns, he asks Fund analysts to rank companies on operating performance, valuation, and catalysts. The team focuses on the industry or company dynamics that could alter the sales landscape and impact future returns. "We're looking for the key performance indicators that are going to unlock value. Since the stocks we're analyzing usually come with lower expectations, we have to identify a catalyst that could change those expectations. Is it a product? Is it management? Is it the cycle? What's going to unlock that value?"

They apply this strategy to stocks within every sector rather than focusing on chasing favorable sectors, Lauber explained. "We can go plus or minus any sector, but we're looking for these dislocations within each sector that lower our risk and provide greater opportunity."

Once they've crunched the numbers and identified potential investments, they talk to management and do a deeper dive on the companies before making the final decision on whether to add those stocks to the portfolio.

When to sell

Determining which stocks to sell can be a much more straight-forward process. "Basically, we sell when we're uncomfortable with the valuation, we sell when we're uncomfortable with operating performance, and we sell the entire position when we're uncomfortable with both. That's the good sell.

"The bad sell," he adds, "is when you find your investment thesis is violated right at the quarter's end, at the same time as everybody else, because it immediately impacts the price of the stock. You have to have a clear thesis and a discipline of selling when the thesis is broken, and the best-case scenario is to make that assessment and make your move before anyone else does."

Where are we in the market cycle?

Pinpointing where the market is in the current cycle has proven particularly challenging due to the wide range of global and domestic economic issues that factor into the equation. High inflation, war in Ukraine, the boycott of Russia, China's zero-tolerance COVID policy, commodity shortages, and lingering supply chain issues all play into the market's volatility. Compounding the problem has been the Fed's efforts to tame inflation.

"What makes it worse from the Fed's perspective," explained Lauber, "is that the economy is in very good shape." He pointed out that corporate and consumer balance sheets are solid, wage growth has been good, and the labor market is strong. Because all are good indicators of a healthy economy, "it makes it even harder for the Fed to fight inflation," said Lauber. "They have to try even harder to tighten the money supply and raise rates."

While many are concerned about an extended bear market and the possibility of a recession, Lauber counters that “I could paint a different picture where supply chains start to open up, high commodity prices start to come down, and inflation starts to level off. Then, if China starts stimulating its economy, that could improve global economic growth, and things could be a little better than people expect.”

Lauber must take all of those factors into consideration in selecting stocks for the Fund. “What we're looking for are those stocks that are affected by that confusion or being priced like we're going into recession, stocks that provide the opportunity for improved returns but with low expectations for that possibility.” With many stocks down 20 to 40% from their highs, the list of names that offer strong upside potential as the economy recovers continues to grow.

“When valuation spreads compress and more companies have similar valuations, then it becomes very important to look at the operating factors and really lean on the analysts to use their framework to decrease the number of names. It's not always intuitive. You really have to look at the history of how each individual stock and each sector has been impacted by macro factors. What we like to do in the value stock space is to try to determine what is different in this cycle. Then we have to determine which industry or which company is going to be better off when the economy begins to recover.”

The key is to identify those companies before the rest of the market catches on. And that passion for beating the competition to the punch is a trait that’s baked into Lauber’s DNA.

See more on **Thrivent Large Cap Value Fund**

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