Q4 2020 | Putnam High Yield Fund Q&A

# High yield advances amid supportive risk environment


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***High-yield bonds rose by more than 6% in the fourth quarter, fueled by strong demand for higher-yielding securities.***

***Positioning in broadcasting, housing, and cable & satellite contributed the most versus the benchmark. Conversely, positioning in energy, along with underweight allocations in transportation and gaming, lodging & leisure, detracted.***

***We have a moderately constructive intermediate-term view on the market's fundamental environment and supply-and-demand backdrop.***



### How did the fund perform for the three months ended December 31, 2020?

The fund's class Y shares gained 5.79%, trailing the 6.47% return of the benchmark JPMorgan Developed High Yield Index.

### What was the market environment like for high-yield bonds during the fourth quarter of 2020?

The quarter began on a positive note, rebounding from a pullback in September. Hopes for a COVID-19 vaccine and additional fiscal stimulus led to a modest gain in October.

The high-yield market rallied strongly in November, gaining about 4% for the month. Encouraging vaccine news bolstered investor optimism about the strength of the economic recovery in 2021. The U.S. election outcome — a Biden victory and what appeared at the time would be a divided Congress — also boosted market sentiment. The asset class continued to rally in December amid increasing positivity about economic growth in the New Year.

Oil was a major focus early in the year amid significant price volatility. During the fourth quarter, crude oil prices rose steadily to finish at $48.52 per barrel. For the full year, however, oil prices declined by about 20%.

Reflecting consistent investor demand for risk, high-yield bonds outpaced high-yield bank loans, investment-grade corporate bonds, and the broad investment-grade fixed-income market for the quarter overall.

Within the JPMorgan Index, all cohorts posted gains, led by energy [+12%], broadcasting [+9%], and transportation [+9%]. Conversely, telecommunications, cable & satellite, and paper & packaging were among the weakest performing groups, with each returning about 4% and trailing the index. From a credit-rating perspective, lower-quality debt generated the highest gains, signaling increased risk appetite on the part of investors and demand for higher yields.

### What factors had the biggest influence on the fund's relative performance?

Favorable overall positioning in broadcasting, housing, and cable & satellite added the most value versus the benchmark. On the downside, positioning in energy, along with lower-than-benchmark exposure to transportation and gaming, lodging & leisure, detracted on a relative basis.

### What is your outlook for the high-yield market over the coming months?

As we move into 2021, we have a moderately constructive view overall. Although we expect the ongoing global health crisis to affect the high-yield market, we have a fairly positive intermediate-term outlook for corporate fundamentals and the market's supply-and-demand backdrop. Also, even though high-yield spreads retightened following their sizable widening in March, we think valuations remain relatively attractive. [Spreads are the yield advantage high-yield bonds offer over comparable-maturity U.S. Treasuries.]

From a fundamental perspective, we are closely watching sectors vulnerable to the disruption caused by the pandemic. We are monitoring the impact on energy, gaming, lodging & leisure, retail, and several other cohorts. Within these groups, we are focusing on the health of issuers' balance sheets and liquidity metrics, as well as the risk of defaults or credit-rating downgrades.

The U.S. high-yield default rate ended the quarter at 6.76%, fueled by defaults among energy issuers. Excluding the energy sector, the default rate was a more modest 4.46%, although this was still above the long-term average of 3% to 3.5%. Given expectations for a widely distributed COVID-19 vaccine, we believe the default rate will decline this year.

As for supply/demand dynamics, net new issuance of high-yield debt [net of issuance for refinancing purposes] totaled $152.7 billion in 2020, up 63% from net issuance of $93.3 billion in 2019. On the demand side, high-yield funds [mutual funds and exchange-traded funds] experienced inflows totaling $44.3 billion in 2020, a substantial increase from the $18.8 billion that entered the asset class in 2019. We believe high-yield funds will continue to attract inflows in 2021, although perhaps not to the degree we saw in 2020.

From a valuation standpoint, the average spread of the fund's benchmark tightened to about 4.4 percentage points over U.S. Treasuries as of period-end, below the long-term average of six percentage points. After tightening from March's extremely wide level, high-yield spreads compressed further on recent vaccine news. The benchmark's yield was at 4.71% as of December 31, a record low. Optimism over continued government stimulus and vaccine distribution drove bond prices higher and yields lower. Despite tighter spreads and lower yields, we think the market's yield and overall total return potential remain attractive in the face of much lower global yields.

### How was the fund positioned as of December 31?

Relative to the benchmark, the portfolio had overweight exposure to the higher-quality segment of the market and an underweight allocation in lower-quality bonds. From an industry perspective, we favored cable & satellite, utilities, housing/building products, and broadcasting.

## Putnam High Yield Fund (PHAYX)

Annualized total return performance as of 12/31/20

| **Class Y shares** Inception 12/31/98 | **Net asset value** | **JPMorgan Developed High Yield Index** |
|---|---|---|
| Last quarter | 5.79% | 6.47% |
| 1 year | 5.91 | 5.34 |
| 3 years | 5.28 | 5.63 |
| 5 years | 7.63 | 8.48 |
| 10 years | 5.99 | 6.95 |
| Life of fund | 7.38 | — |

Total expense ratio: 0.77%

Returns for periods of less than one year are not annualized.

*Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or a loss when you sell your shares. Performance assumes reinvestment of distributions and does not account for taxes. For the most recent month-end performance, please visit putnam.com. Class Y shares before their inception are derived from the historical performance of class A shares (inception 3/25/86), which have not been adjusted for the lower expenses; had they, returns would have been higher. For a portion of the periods, this fund may have had expense limitations, without which returns would have been lower. Class Y shares are generally only available for corporate and institutional clients and have no initial sales charge.*

The JPMorgan Developed High Yield Index is an unmanaged index of high-yield fixed-income securities issued in developed countries. You cannot invest directly in an index.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of December 31, 2020, are subject to change with market conditions, and are not meant as investment advice.

**Consider these risks before investing:** The value of investments in the fund's portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general economic, political, or financial market conditions; investor sentiment and market perceptions; government actions; geopolitical events or changes; and factors related to a specific issuer, geography, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund's portfolio holdings. Lower-rated bonds may offer higher yields in return for more risk. Bond investments are subject to interest-rate risk (the risk of bond prices falling if interest rates rise) and credit risk (the risk of an issuer defaulting on interest or principal payments). Interest-rate risk is generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds (a significant part of the fund's investments). Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. Unlike bonds, funds that invest in bonds have fees and expenses. Our investment techniques, analyses, and judgments may not produce the outcome we intend. The investments we select for the fund may not perform as well as other securities that we do not select for the fund. We, or the fund's other service providers, may experience disruptions or operating errors that could have a negative effect on the fund. You can lose money by investing in the fund.

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