Q2 2020 | Putnam High Yield Fund Q&A

High yield rallies strongly following coronavirus scare

Paul D. Scanlon, CFA
Co-Head of Fixed Income
Industry since 1986

Norman P. Boucher
Portfolio Manager
Industry since 1985

Robert L. Salvin
Portfolio Manager
Industry since 1986

High-yield bonds advanced nearly 10% during the past three months, rebounding from an extreme but short-lived period of risk aversion in March.

The fund's favorable positioning in chemicals contributed the most versus the benchmark. Conversely, below-benchmark exposure to the rebounding energy sector detracted.

Despite considerable uncertainty, 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 June 30, 2020?

The fund's class Y shares returned 9.64%, performing in line with the 9.69% result of the benchmark JPMorgan Developed High Yield Index.

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

Following its partial recovery in late March, the asset class continued to rebound in April on hopes that massive government stimulus efforts would be enough to offset the near-term economic fallout from the coronavirus pandemic. The market rally continued in May, aided by an easing of coronavirus restrictions and additional policy support. These developments reinforced investors' view that global economic activity had bottomed and would begin to recover, albeit gradually.

The pace of the high-yield recovery slowed in June. Investors weighed the potential for more support from the U.S. Federal Reserve, along with better-than-expected economic data, against an accelerating rate of coronavirus infections in certain parts of the country. Market participants worried that the possibility of a second wave of infections could slow progress toward the economy reopening.

During June, the capital markets continued to reopen to high-yield issuers at a record clip. New-issue volume totaled $61.5 billion for the month, which was the most active month on record. On the demand side, high-yield mutual funds and exchange-traded funds [ETFs] took in $47.7 billion during the 12-week period ending June 17. However, this record pace of inflows stalled by the middle of June.

For the quarter as a whole, high-yield bonds performed in line with high-yield bank loans. Reflecting renewed investor demand for risk, both asset classes handily outperformed the broad investment-grade fixed-income market.

Within the JPMorgan index, all cohorts posted gains, led by a 31% retracement in the energy group, following last quarter's -40% return. Automotive [+14%], gaming, lodging & leisure [+11%], chemicals [+10%], and retail [+10%] also registered strong advances. Conversely, broadcasting [+3%], cable & satellite [+4%], transportation [+5%], and utilities [+5%] notably lagged the fund's benchmark. From a credit-rating perspective, lower-quality debt generated the highest gains, rallying back from the oversold levels reached amid the flight from risk that occurred in March.

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

On the plus side, favorable overall positioning in chemicals, along with security selection in technology and financials, added the most value versus the benchmark. On the downside, an underweight allocation in energy more than offset strong bond selection in that sector. Lower-than-benchmark exposure to the automotive sector also detracted on a relative basis.

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

We have a moderately constructive outlook overall. The biggest risk on the horizon is the still-to-be-determined impact of the coronavirus pandemic on economic growth, corporate earnings growth, and cash flows.

That said, except for the energy sector, we have a fairly positive intermediate-term view on corporate fundamentals and the market's supply-and-demand backdrop. Also, even though high-yield spreads retightened somewhat 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 coronavirus. In addition to energy, we are monitoring the impact on 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 increasing risk of defaults or credit-rating downgrades.

As for supply/demand dynamics, new issuance of high-yield debt resurfaced in April and, as noted above, remained strong through quarter-end. On a year-to-date basis through June, new-issue volume totaled $218.4 billion, a 55% increase over the same period in 2019. On the demand side, high-yield funds [mutual funds and ETFs] saw inflows of $31.9 billion year to date versus $18.8 billion in the first half of 2019. Overall, a resurgence in new-issue supply is being met by renewed demand.

From a valuation standpoint, the average spread of the fund's benchmark rose 3.65 percentage points during March to about 9.5 percentage points over Treasuries. This was the highest spread level since early 2016 and was well above the 20-year average of 6.1 percentage points. The benchmark's average yield spiked to 10% during this time. As of period-end, spreads had tightened to 7.2 percentage points over Treasuries and the benchmark's yield was at 7.6%. In our view, spreads at this level continue to offer a broad range of attractive relative-value investment opportunities. Moreover, we think the market's yield remains compelling in the face of much lower global yields.

In addition to coronavirus, risks to our outlook include price volatility in oil and other commodities, policy missteps by global central banks, and heightened geopolitical tension.

Putnam High Yield Fund (PHAYX)

Annualized total return performance as of 6/30/20

Class Y shares Inception 12/31/98	**Net asset value**	**JPMorgan Developed High Yield Index**
Last quarter	9.64%	9.69%
1 year	–0.64	–2.02
3 years	2.83	2.69
5 years	3.81	4.49
10 years	5.91	6.74
Life of fund	7.17	—

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 June 30, 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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