Putnam INVESTMENTS

Q1 2017 | Putnam International Equity Fund and Putnam Europe Equity Fund Q&A

Non-U.S. stocks make a strong advance

Simon Davis
Co-Head of Equities
Industry since 1988

Non-U.S. stocks performed well in the first quarter as global growth surprised on the upside.

We found undervalued opportunities among U.K. stocks, European cyclicals, and Japanese exporters.

High expectations for policy change in the United States will continue to expose markets to the risk of policy disappointment.

Non-U.S. equity performance was generally strong in the first quarter. What drove the markets?

Non-U.S. stock markets surged upward in the first quarter. Emerging-market equities gained roughly 12%, European stocks rose by more than 7%, and Japanese stocks were lifted by nearly 5%. Fuel for this broad-based advance came in part from the post-U.S. election rally and expectations of U.S. fiscal stimulus, but also from better-than-expected global economic data and the prospects of continued benign monetary policy in Europe, the United Kingdom, and Japan.

Did you have any notable sector or country preferences in either of the funds you manage?

In both Putnam Europe Equity Fund and Putnam International Equity Fund, I continued our traditional focus on identifying attractive individual stocks rather than on making bets on sectors or countries. While the portfolios generally showed a preference for technology, consumer cyclicals, and U.K.-based stocks during the period, these exposures were largely a consequence of our fundamental research-based stock selection decisions.

In the United Kingdom, in particular, we believed that many stocks reflected a pricing in of worse outcomes for Brexit than are likely, in our view. For us, that meant undervalued opportunities in the United Kingdom were relatively easy to find during the first quarter.

I would also mention that since the second half of 2016, we had already begun to re-emphasize stocks that exhibited more attractive valuations by our metrics. This renewed focus on value opportunities helped relative performance in both Putnam Europe Equity Fund and Putnam International Equity Fund in the first quarter.

How did the U.K. economy perform, given the overhang of pending Brexit negotiations?

The United Kingdom's plan to depart the European Union has yet to be felt as a headwind in the U.K. economy. That said, we note that U.K. consumers are in a worse place today than they were a year ago as higher inflation has collided with relatively stagnant wages. However, as I mentioned, we currently see a variety of compelling valuation opportunities in the United Kingdom. This was particularly the case in consumer discretionary companies that are not exclusively reliant on domestic U.K. demand — especially companies whose management has indicated a willingness to return value to shareholders through share buybacks and other measures.

What are your thoughts on European stocks? Is political risk still driving the market?

The improved economic backdrop in Europe in the fourth quarter of 2016 led to better year-end corporate earnings results — and, we expect, it may lead to bigger earnings surprises in the months ahead. A wide variety of companies in Europe's cyclical industries, as well as in the financials sector, should benefit from domestic economic recovery and reflation, and we expect that European exporters will continue to benefit from foreign exchange dynamics and relative economic stability in China and the emerging markets.

As we have discussed in prior quarters, politics in Europe continue to pose a threat to the integrity of the European Union and, by extension, may cause volatility in markets. The weak performance of Geert Wilders — the "Dutch Trump" — and his populist Freedom Party in the Netherlands' mid-March general election gives some cause for optimism on this front. And yet, the imminent French presidential elections pose the next risk for markets in a busy political calendar.

What are your thoughts on prospects for Japanese equities?

We continue to regard investing in Japanese equities as a highly sensitive play on the global economic recovery. Unlike the United States or Europe, domestic demand in Japan is not strong enough to drive a sustained economic recovery that could meaningfully impact the government's high debt levels. In the absence of strong domestic demand, Japan must look to external demand to help drive economic growth. For this reason, among others, we continue to believe the exporting sector holds some of the more interesting near-term opportunities for investors in Japanese stocks.

China in early 2017 seems like far less of a risk to global markets than China in early 2016. What are your thoughts on China's economic stability?

China has posted a series of better-than-expected economic results, which helped boost global markets in 2016 and into the first quarter of 2017. We think China maintains a clear interest in keeping the semblance of economic stability in advance of the 19th National Congress of the Chinese Communist Party, which will occur in the fall of this year. At this event, we can expect to see emerge the next lineup of China's national leadership under Xi Jinping. After applying significant stimulus, China has more recently been dialing back some of the excesses in its economy, particularly in the financial and real estate sectors. In general, the risk here is that a structured slowdown could cool the economy — and hence global demand — more than the markets or policymakers anticipate.

What is your outlook for non-U.S. markets?

We continue to find significant value in international markets, particularly among developed-market stocks. The global economy is performing modestly better than expected, and we expect this to continue.

On the basis of this view, we think that investors considering their options would find fixed-income assets to be relatively overpriced and U.S. equities relatively expensive alongside many non-U.S. stocks. In the United States, there is a real risk that President Trump may not be able to deliver on tax reform, infrastructure spending, and deregulation — precisely those policy features responsible for driving expectations upward since the election. In addition, the negative potential of protectionist trade measures, if these are adopted in the pursuit of new bilateral trade agreements, is also a risk that may come back to worry markets in the months ahead.

We remain cautious with respect to the emerging markets, which we think could suffer as a result of rising U.S. interest rates and a stronger U.S. dollar. Current account deficits in countries such as Turkey, Indonesia, and Brazil, while reduced, continue to make these countries vulnerable to capital outflows. As a general rule, we will remain highly selective in our efforts to invest in attractively valued franchises across the emerging markets.

Putnam International Equity Fund (POVYX)

Annualized total return performance as of 3/31/17

Class Y shares Inception 7/12/96	**Net asset value**	**MSCI EAFE Index (ND)**
Last quarter	7.91%	7.25%
1 year	9.56	11.67
3 years	-0.24	0.50
5 years	6.09	5.83
10 years	0.49	1.05
Life of fund	7.25	4.95
Total expense ratio: 1.07%		

Putnam Europe Equity Fund (PEUYX)

Annualized total return performance as of 3/31/17

Class Y shares Inception 10/4/05	**Net asset value**	**MSCI Europe Index (ND)**
Last quarter	7.88%	7.44%
1 year	7.31	9.76
3 years	-1.31	-1.51
5 years	7.16	5.63
10 years	1.40	0.70
Life of fund	7.67	7.52
Total expense ratio: 1.07%		

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

Recent performance may have benefited from one or more legal settlements.

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 (International Equity Fund class A inception, 2/28/91, and Europe Equity Fund class A inception, 9/7/90), 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 MSCI EAFE Index (ND) is an unmanaged index of equity securities from developed countries in Western Europe, the Far East, and Australasia.

The MSCI Europe Index (ND) is an unmanaged index of European equity securities.

You cannot invest directly in an index.

The views and opinions expressed are those of Simon Davis, Co-Head of Equities and Portfolio Manager, as of March 31, 2017. They are subject to change with market conditions and are not meant as investment advice.

Consider these risks before investing: International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Investments in small and/or midsize companies increase the risk of greater price fluctuations. Investments in a single region may be affected by common economic forces and other factors. In addition, events in any one country within the region may impact the other countries or the region as a whole. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. 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. Stock prices may fall or fail to rise over time for a variety of reasons, including general financial market conditions and factors related to a specific issuer or industry. You can lose money by investing in the funds.

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Putnam Investments | One Post Office Square | Boston, MA 02109 | putnam.com

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