Q1 2019 | Putnam Equity Income Fund Q&A

Striking a balance amid uncertainty

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We are aiming for a portfolio with less market sensitivity, as we could encounter more turbulence in the months ahead.

We do not believe a recession is imminent, but it may be a higher probability than it was six months ago.

The first quarter brought quite a change in market conditions. What is your perspective on this?

The equity market rebounded in dramatic fashion in the first three months of 2019. That was to be expected given the enormous shift in sentiment in the fourth quarter. There was so much fear in the market in the final months of last year, and we believe the negativity was a bit too extreme. However, we also believe there is some logic to the defensiveness that remains in the market today. We are later in the economic cycle, there are quite a few headwinds out there, and expectations for earnings growth have declined significantly.

How did the fund perform in the first quarter?

The fund's performance rebounded along with the market, but it slightly underperformed the benchmark for the quarter overall. In our analysis of quarterly performance, we found that the defensive aspects of the portfolio continued to work very well and generally outperformed the more cyclical holdings.

After those two very different quarters, how are you positioning the portfolio?

We are looking to strike more of a balance between defensive and cyclical stocks. For most of 2018, we had already been moving away from our pro-cyclical bias and trimming stocks that we believed had become too expensive. We sought opportunities in more classic value sectors and those that might be less vulnerable in a market decline.

We continue to make these adjustments, but it can be challenging. Stocks of companies that are viewed as high quality and defensive have been the best performers over the past six months. As a result, we believe quality and defensiveness have become very expensive. In some cases, we need to take "quality at any price" to get an appropriate balance of cyclical and defensive stocks in the portfolio. We are aiming for a portfolio with less market sensitivity, as we could encounter more turbulence in the months ahead.

What sectors are you favoring, and where are you more cautious?

We have increased the fund's exposure to utilities, although it remains underweight relative to the benchmark. We have reduced exposure to technology, although it remains an overweight position. Financials is another area where we are more cautious. We are especially concerned about regional banks, which tend to be pressured by the flat yield curve.

In our research, we are reexamining what I consider to be "hyper-cyclical" areas of the portfolio — sectors such as basic materials and industrials. Here, we are shifting to a greater focus on quality, seeking to add more stable, traditional companies with strong balance sheets. We are not changing our overall investing approach or philosophy, but we are seeking more downside protection.

What are some risks and opportunities for value investing today?

The market has priced in, as an almost near certainty, a favorable resolution to the U.S.–China trade conflict. We have yet to see a resolution, and any setbacks with this situation could be quite disruptive for equity markets. Another key risk is a continued global economic slowdown. Many market observers believe we have reached the end of this growth cycle and are heading toward a recession. Others believe we are entering a mid-cycle slowdown.

We do not believe a recession is imminent, but it may be a higher probability than it was six months ago. If investors become too preoccupied with the risks, as they did in the fourth quarter, it could become self-fulfilling. The economy could tip under the weight of the negative sentiment.

However, there are reasons to be optimistic. I am encouraged by the fact that individual stock correlations have come down. This is a sign that investors are not trading based on broad themes, but rather are focusing on fundamental strengths of individual companies. The difference between the most expensive and the cheapest stocks has widened. This is helpful for our investment approach, as active research of business fundamentals begins to matter more.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 3/31/19

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	11.83%	11.93%
1 year	4.88	5.67
3 years	11.53	10.45
5 years	8.19	7.72
10 years	14.58	14.52
Life of fund	10.24	—
Total expense ratio: 0.66%		

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 6/15/77), 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.

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Consider these risks before investing: Value stocks may fail to rebound, and the market may not favor value-style investing. Income provided by the fund may be reduced by changes in the dividend policies of, and the capital resources available at, the companies in which the fund invests. Stock values may fall or fail to rise over time for several reasons, including general financial market conditions, changing market perceptions, changes in government intervention in the financial markets, and factors related to a specific issuer, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund's portfolio holdings. You can lose money by investing in the fund.

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