Q2 2020 | Putnam Equity Income Fund Q&A

Addressing uncertainties with a balanced portfolio

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At the midpoint of 2020, there is a considerable disconnect between the markets and the economy.

Market conditions remained volatile in the second quarter. How did the fund perform?

The fund delivered a solid return for the quarter and outperformed its Russell 1000 Value benchmark. We are pleased to report that the fund also outperformed its benchmark for the 1-, 3-, 5-, and 10-year periods ended June 30, 2020.

Performance was helped by a balanced portfolio that contained a mix of cyclical and defensive holdings. In addition, we remained focused on the fundamentals of individual businesses rather than on macroeconomic or sector trends. This portfolio construction helped prepare the fund for the continued uncertainty and market volatility.

How have value stocks fared in this year's turbulence?

Coming into 2020 and through the steep declines in March, value stocks continued to underperform growth stocks. This is understandable given the severe market downturn and business shutdowns brought on by the COVID-19 pandemic. Value stock benchmarks tend to have a much higher level of cyclicality. The largest value sectors include financials, energy, real estate, and industrials, which are also the most sensitive to macroeconomic shifts. Not surprisingly, when the market quickly priced in a recession in response to the COVID-19 crisis, value stocks took it on the chin.

In the second quarter, however, we saw value begin to outperform growth. Leadership has alternated as the market tries to determine the longer-term impact of the crisis. If the first-quarter downturn was a quick hit and we see a resumption of normalcy, more cyclical stocks should do well. However, if the health crisis has a longer-duration impact on growth and GDP, the less cyclical stocks, in areas such as technology and health care, are likely to be the stronger performers.

For the financials sector in particular, 2020 has been difficult. What is your perspective on the sector as we look ahead to the second half of the year?

With its high sensitivity to the macro economy, this sector has certainly struggled. The pain has been particularly acute for banks, as lower interest rates pressure net interest margins — the difference between interest earned and interest paid on loans and deposits. Also, as the economy entered a recession, concerns grew about lower borrowing rates. Credit card use, for example, plummeted as the COVID-19 crisis escalated.

The other issue for financials relates to investor sentiment and memories of the 2008/2009 global financial crisis. Financials were at the epicenter of that crisis, in which irresponsible lending and leverage exposed insufficient capital levels and caused systemic failures. However, coming into 2020, the financials sector was in considerably better shape than it was in 2008. Today, U.S. banks are very well capitalized as a result of much stricter regulation, and they are part of the solution to today's crisis, rather than the cause, as they were in 2008. In the final weeks of the quarter, performance in the sector improved, in part because banks are playing an essential role in transmitting Federal Reserve and Treasury policy into the markets. There is no concern in the market around capital levels, and the largest U.S. banks are maintaining their dividends, unlike many of their global peers.

What is your outlook for the coming months?

At the midpoint of 2020, there is a considerable disconnect between the markets and the economy. The news on the macroeconomic front is bleak, yet the market seems to believe that the damage from the shutdown will be temporary. At the same time, government and central bank stimulus has been immediate, massive, and global. The Federal Reserve is not planning to raise interest rates before late 2022, and many investors seem to believe there will be no price to pay for the stimulus. There will be consequences at some point, and that is why we remain focused on our risk control and portfolio construction strategies.

Our goal, as always, is to prepare the fund for a range of scenarios with a balanced structure for the portfolio. We plan to maintain a mix of cyclical and defensive holdings, investing in our best ideas with a focus on the fundamentals of the businesses.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 6/30/20

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	17.54%	14.29%
1 year	–1.68	–8.84
3 years	5.61	1.82
5 years	6.42	4.64
10 years	12.00	10.41
Life of fund	10.00	—

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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The views and opinions expressed here 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: 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. 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. 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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