Q2 2018 | Putnam Equity Income Fund Q&A

Fund outperforms on stock selection, tech picks

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The fund outperformed its benchmark for the quarter as well as the 1-, 3-, 5-, and 10-year periods ended June 30, 2018.

Although we have more volatility and challenges, risk is finally being properly priced into the market again.

We are beginning to see a divergence in valuations, which should present more stock selection opportunities for value investors.

We have seen more volatility and lower returns for U.S. equities in 2018 compared with last year. What is your view on market conditions?

The most notable theme for the equity market in 2018 is that risk is once again being properly priced into the market. While last year's strong returns and low volatility were welcomed by investors, in my view, those conditions were unnatural, and for many investors, risk was an afterthought. I believe that unlimited risk appetite has now developed into something far more healthy, as investors are recognizing potential risks and proceeding with more caution.

How did the fund perform in this environment?

Equity returns, particularly for value stocks, were lackluster in the second quarter, but the fund outperformed its benchmark, the Russell 1000 Value Index, for the period. I am especially pleased to report that the fund also outperformed the benchmark for the 1-, 3-, 5-, and 10-year periods ended June 30, 2018.

What contributed to the outperformance for the quarter?

Energy stocks have been among the recent performance highlights. In late 2017, we shifted the portfolio to an overweight position in the energy sector versus the benchmark. These stocks had become extraordinarily cheap, in our view, based on what we saw as attractive cash flow and earnings growth potential. While these stocks have been boosted by higher oil prices, they have also benefited from the companies' efforts to rein in spending. Investors responded positively as energy companies de-levered their balance sheets, lowered production, and reduced their capital spending.

Technology has also been helpful to performance — due to our overweight position in the sector as well as our stock selection. The fund also benefited from our decision to maintain underweight exposure to the consumer staples sector, which has struggled considerably. Recent fund performance was weakened somewhat by our stock selection in the industrial and real estate sectors.

Value stocks have continued to underperform growth stocks. As a value investor, what is your perspective on this?

Growth stocks have outperformed value stocks for the longest stretch in U.S. market history. This is surprising, and it can be challenging for funds with a value focus, but I also believe that the environment for value investors is as good as it has been in a long time. We are beginning to see a significant divergence in valuations; the difference between cheap stocks and expensive stocks has widened. This should present more stock selection opportunities for investors like us who are focused on fundamentals and valuations. We remain cautious, however, with some of the least expensive stocks. In the consumer staples sector, for example, many companies are dealing with fundamental headwinds, cost pressures, and top-line challenges, and we are avoiding these until we see a catalyst for improvement.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 6/30/18

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	2.33%	1.18%
1 year	12.18	6.77
3 years	9.13	8.26
5 years	11.19	10.34
10 years	10.26	8.49
Life of fund	10.38	—
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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As we begin the second half of 2018, how are you positioning the portfolio?

As a value investor and active portfolio manager, I remain focused on stock-specific opportunities. In positioning the portfolio, we are seeking to reduce positions in stocks that have advanced considerably and are becoming too expensive in our view. We are trimming these in favor of stocks that have underperformed and offer what we believe to be more attractive valuations.

The views and opinions expressed here are those of the portfolio managers as of June 30, 2018, 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. 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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