Q3 2018 | Putnam Equity Income Fund Q&A

Strong quarter offers hints of potential rotation to value

Darren A. Jaroch, CFA
Portfolio Manager
Industry since 1996

Walter D. Scully, CPA
Assistant Portfolio Manager
Industry since 1996

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

I believe the ingredients for a value rebound have been in place for a few years and that value outperformance is on the horizon.

We see potential in financials, as interest rates have increased, but stocks in the sector have not yet advanced in response.

What can you tell us about market conditions in the third quarter?

U.S. stocks were the best performers across global equity markets, and U.S. growth stocks outperformed value stocks yet again. Two investor concerns became more pronounced in the third quarter: the U.S.–China trade conflict and rising interest rates.

The best-performing sectors were health care and industrials, and there was a hint of defensiveness in the market again. The fund outperformed its benchmark, the Russell 1000 Value Index, for the quarter as well as for the 1-, 3-, 5-, and 10-year periods ended September 30, 2018.

What is your view on the global trade conflict and its impact on financial markets?

I believe, as many market observers do, that the impact of the tariffs on macroeconomic growth will be limited. However, there are individual industries and stocks that will feel some pain. We have already seen evidence of this in some stocks that have performed poorly. As you would expect, they are in areas such as autos, semiconductors, and commodities, which are closely tied to global trade and the consequences of higher tariffs. Conversely, we have seen strength from industries that are believed to be immune from trade conflict, such as health care, railroads, airlines, and retail pharmaceuticals. Among these groups, U.S. stocks tended to be an investor preference as economic growth remained healthy in the United States.

Although we cannot yet determine the outcome of these trade and tariff issues, I believe the concerns are largely priced into the equity market. The risk is that a resolution takes longer than expected and that the conflict takes a more serious toll on businesses and their supply chains.

What contributed to the fund's outperformance for the quarter?

I did not make any significant shifts in holdings, and it was a bit of a challenge to find new investment ideas for the portfolio. However, as an active manager, I am pleased to report that the fund's outperformance was primarily due to stock selection rather than sector allocation. On a sector basis, our underweight position in health care dampened performance somewhat. After an extended period of underperformance, health care was the top-performing sector by far in the third quarter, due partly to its defensive qualities and its relative immunity to the trade conflict. For the fund, stock selection highlights were in the utilities, consumer discretionary, and technology sectors. Technology was the top-contributing sector of the portfolio, led by our holdings in Microsoft and Apple. In utilities, our holdings in California utilities outperformed significantly. They were boosted by the passage of a California law aimed at preventing bankruptcy from wildfire-related lawsuits.

Can you provide an update on your views on the performance of growth versus value?

Growth stocks have outperformed value stocks for one of the longest stretches in U.S. market history. However, I continue to believe the ingredients for a value rebound have been in place for a few years and that value outperformance is on the horizon. Also, on difficult market days in the months ahead, the defensive qualities of value stocks may prove beneficial.

When looking at growth versus value, it is important to consider how we define these terms. Benchmark indexes can be very limiting since they are backward looking. Our approach is based on prospective value, in which we use forward-looking research to analyze valuations. What we consider to be a value or growth — in a sector or an individual stock — can change regularly based on our expectations for the businesses. This is why it's important to look outside our benchmark for opportunities.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 9/30/18

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	6.53%	5.70%
1 year	13.64	9.45
3 years	14.63	13.55
5 years	11.62	10.72
10 years	11.44	9.79
Life of fund	10.48	—
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.

The Russell 1000 Value Index is an unmanaged index of those companies in the large-cap Russell 1000 Index chosen for their value orientation. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. You cannot invest directly in an index. There are no guarantees that a company will continue to pay dividends.

What is your outlook as we enter the fourth quarter?

I expect equities will be challenged with increased volatility in response to the trade conflict and rising interest rates. Interestingly, as rates have increased, stocks in the financials sector have not yet advanced in response. This is unusual, and we consider this an area of opportunity in the months ahead.

The views and opinions expressed here are those of the portfolio managers as of September 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.

For informational purposes only. Not an investment recommendation.

Request a prospectus or summary prospectus from your financial representative or by calling 1-800-225-1581. The prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

Putnam Retail Management

Putnam Investments | 100 Federal Street | Boston, MA 02110 | putnam.com

TL020 313478 10/18