Q4 2020 | Putnam Equity Income Fund Q&A

Strong quarter for value stocks and a solid year for the fund

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How did the fund perform in the fourth quarter?

For the quarter, the fund underperformed its Russell 1000 Value benchmark. However, it outperformed the benchmark for the 1-, 3-, 5-, and 10-year periods ended December 31, 2020.

The fourth quarter was a notable one for value stocks. Can you explain?

Although growth stocks once again trounced value for 2020 overall, we began to see a rotation into value stocks late in the year. Value started outperforming growth in September, and in November, the Russell 1000 Value Index delivered its highest-ever monthly return, handily outperforming its Russell 1000 Growth Index counterpart. The value leadership took a dramatic turn on a single day — November 9 — when Pfizer announced impressive efficacy results for its COVID-19 vaccine trials. On that day, the S&P 500 Index's value stocks outperformed its growth stocks by the biggest margin in records going back to 1993, according to Dow Jones Market Data.

Do you believe value stocks can continue to outperform?

Key ingredients for a prolonged value rally are some inflation and modestly higher interest rates. While the 10-year Treasury yield is still a long way from where it was at the start of March 2020, a look at some non-U.S. markets provides perspective. China, for example, has largely returned to a more normal growth trajectory, and has seen interest rates return to their pre-pandemic levels. We believe this is a preview of what we're likely to see in developed markets that are currently still grappling with the pandemic.

Among the biggest headwinds for value stocks in 2020 were sharp declines in inflation expectations, interest rates, and bond yields. We expect a reversal of this in 2021. Inflation is likely to pick up as spending and demand resumes — both from consumers and from businesses that had held back on capital expenditures due to the pandemic.

What areas of the value universe are poised for improvement?

The financials sector, which was the epicenter of earnings uncertainty in 2020, is now fertile ground for a rally, in our view. This is the case for bank stocks especially, which underperformed the S&P 500 by about 35% in 2020. Going into 2021, banks should be able to outperform based on technical drivers alone — the potential for inflation and higher interest rates. Throughout 2020, historically low rates put pressure on net interest margins — the difference between interest earned and interest paid on loans and deposits. Also, in 2020, banks took an unprecedented level of reserves against their loan books in anticipation of loans that could go bad over the next couple of years. In 2021, we'll get visibility on the adequacy of those reserves, which will provide a floor for earnings expectations.

As we enter 2021, what is your outlook?

The news of an effective COVID-19 vaccine had a profound effect on investor sentiment. Suddenly, the idea of leaving our homes for shopping, dining, travel, and entertainment felt like a distinct possibility. While the pandemic has been a financial hardship for many, there are also many households that have built up significant savings in 2020. As we enter 2021, we see considerable demand for leisure spending as well as more assets in savings accounts that are ready to be deployed.

There will be debate over whether multiple waves of the COVID-19 pandemic will result in more permanent economic damage. So far, the market has looked fully past that, anticipating a return to normal in the second half or final quarter of 2021. We have the prospect of herd immunity, pent-up demand from consumers who are eager to go out and spend their savings, and the potential for more fiscal stimulus for those who are struggling.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 12/31/20

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	15.58%	16.25%
1 year	6.07	2.80
3 years	8.30	6.07
5 years	11.46	9.74
10 years	11.70	10.50
Life of fund	10.35	—
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. 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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