Q3 2017 | Putnam Equity Income Fund Q&A

Opportunities increase for value stocks and cyclical sectors

Darren A. Jaroch, CFA
Portfolio Manager
Industry since 1996

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

There may be more opportunities among value stocks today than we have seen since the global financial crisis.

In areas such as energy and industrials, many fundamentally strong companies with exposure to key growth trends are trading at below-market multiples.

If earnings growth remains strong, I believe equities can continue their advance through the close of 2017.

Throughout 2017, we have discussed the U.S. political environment and its effect on the equity market. What is your perspective today?

Investors have shown a remarkable ability to brush off macroeconomic issues in 2017. Recently, this has included developments related to the Trump administration. At the same time, the post-election exuberance we saw earlier this year has all but disappeared. The equity market has mostly given back the gains that occurred immediately after the presidential election — those so-called "Trump trade" rallies, primarily in cyclical sectors. Many areas of the market that spiked dramatically in anticipation of corporate tax reform, for example, are now lower than they were pre-election. The good news for the months ahead may be that any progress from Washington, no matter how minor, could have a significant positive effect on the equity market. For example, a tax cut, which I believe is possible and is more likely than tax reform, could provide a nice boost for cyclical stocks.

U.S. equities continued to deliver gains, but performance was still dominated by a narrow group of stocks. What does this mean for investors going forward?

In many ways, it seems like we have a directionless market, with a hodgepodge of sectors outperforming at various times. One persistent theme, however, has been the considerable outperformance of growth stocks over value stocks. While it is not unusual for the styles to diverge, there has been a dramatic bifurcation this year. For the most part, all growth-related factors have been driving stocks — return on equity, earnings growth, and top-line growth. Stocks with the highest price-to-earnings [P/E] multiples have outperformed the lowest P/E stocks consistently throughout 2017. Also notable in the third quarter was weakness in cyclical stocks, especially in the financials sector, where banks and other institutions continued to be challenged by low interest rates.

In my view, there may be more opportunities among value stocks today than we have seen since the global financial crisis — and not simply because they have underperformed. As we assess the macroeconomic and earnings environment, we find the most relative value in cyclical sectors. Cyclicality is quite inexpensive today, and this is where we will focus much of our research in the closing months of 2017.

In areas such as energy and industrials, many fundamentally strong companies with exposure to key growth trends are trading at below-market multiples. However, the sector that stands out most is financials. With improving global macroeconomic trends, I believe financial stocks are among the most attractively valued.

How are market conditions affecting your positioning of the fund's portfolio?

While I am pleased with the year-to-date performance of the fund, I am also looking carefully at areas of potential risk among the holdings. I may trim positions in stocks that could be vulnerable to corrections simply because they are priced for perfection. By this I mean that they have performed so consistently, and expectations have risen so high, that investors may overreact to the slightest sign of weakness. These types of companies are still fundamentally strong in my view, but I may trim them in favor of stocks that have underperformed, may be less vulnerable to disappointment, and offer more attractive valuations.

With the market's extended advance and elevated valuations, are you concerned about a correction?

I am less concerned about a correction today than I was earlier in the year. One reason for my more sanguine view is the level of coordinated global growth we are seeing. In addition to an improving U.S. economy, we have better-than-expected macroeconomic data coming from markets overseas, including Europe and Japan, as well as positive earnings estimate revisions from most regions.

Earnings are certainly a contributor to my bullish view. For a second consecutive quarter, earnings growth for S&P 500 companies has exceeded expectations. I believe this has contributed greatly to the equity market rally, in part by helping investors to look past macroeconomic risks and other distractions and focus on strong fundamentals. In the months ahead, this raises the pressure on businesses as investors focus on future profitability, top-line growth, and prospects for deregulation and taxes. However, if earnings growth remains strong, I believe equities can continue their advance through the close of 2017.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 9/30/17

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	5.16%	3.11%
1 year	18.08	15.12
3 years	9.00	8.53
5 years	13.79	13.20
10 years	7.85	5.92
Life of fund	10.40	—

Total expense ratio: 0.69%

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.

The views and opinions expressed are those of Darren A. Jaroch, CFA, Portfolio Manager, as of September 30, 2017. They 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 prices may fall or fail to rise over time for several reasons, including general financial market conditions and factors related to a specific issuer or industry. 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.

This material is for informational and educational purposes only. It is not a recommendation of any specific investment product, strategy, or decision, and is not intended to suggest taking or refraining from any course of action. It is not intended to address the needs, circumstances, and objectives of any specific investor. Putnam, which earns fees when clients select its products and services, is not offering impartial advice in a fiduciary capacity in providing this sales and marketing material. This information is not meant as tax or legal advice. Investors should consult a professional advisor before making investment and financial decisions and for more information on tax rules and other laws, which are complex and subject to change.

A world of investing.®

Putnam INVESTMENTS

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 | One Post Office Square | Boston, MA 02109 | putnam.com

TL020 308123 10/17