Q1 2018 | Putnam Equity Income Fund Q&A

Temporary turmoil as tax reform encourages capex

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After a turbulent quarter for equities, could you discuss how you manage risk?

In our portfolio construction process, stock-specific analysis is key. We want to ensure that our fund holdings offer enough alpha — or upside potential — to compensate for their risks. Our analysis includes measuring the degree of risk that every position brings to the portfolio, and determining whether that risk is "paid for" — that is, properly balanced with return potential. In addition to monitoring stock-specific risk — risks that we are aware of — we also work to minimize the impact of unexpected risks so we can dampen the negative effects of market declines for investors.

In describing your approach to dividend-paying stocks, you say that you don't own "yield for yield's sake." What do you mean by this?

There is a tendency for investors to favor companies for their willingness, rather than their ability, to pay a dividend. We focus on businesses that we believe can support — and grow — their dividends. This is far more important, in my view, than simply paying a dividend for yield's sake. High-dividend-paying stocks may be easy to find, but I believe they offer less excess return potential over time. And over the past year, companies paying out high dividends have underperformed pretty dramatically.

How do you go about finding these dividend growers?

It's all about company cash flows, earnings quality, and capital allocation. We want to see a sustainable cash flow and the ability to grow a dividend over time, but we also want businesses that allocate capital to other productive uses — building a new factory, hiring new workers, or investing in innovative technologies, for example. Owning these companies that invest in the future growth of their business can enhance the fund's capital appreciation potential. Also, from a broader macroeconomic perspective, I believe that increased capital spending by more businesses — boosted by the Tax Cuts and Jobs Act — will help to extend this current economic recovery cycle.

Turning to current market topics, what are your thoughts on the tariff announcements and trade war fears that contributed to the first-quarter volatility?

From a basic macroeconomic perspective, tariffs are growth killers. They misallocate resources and can be detrimental to emerging economies, particularly those focused on raw material exports. Free trade is better for growth, as it allocates resources more efficiently across the global economy. However, I believe what we have seen so far appears to be largely political posturing, and the recently announced tariffs are not likely to have an impact on overall GDP growth in developed economies.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 3/31/18

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	–1.96%	–2.83%
1 year	11.35	6.95
3 years	8.35	7.88
5 years	11.39	10.78
10 years	9.76	7.78
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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The views and opinions expressed are those of Darren A. Jaroch, CFA, Portfolio Manager, as of March 31, 2018. 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 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 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.

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