Q3 2020 | Putnam Equity Income Fund Q&A

Cyclical stocks rebound, but uncertainties remain

Darren A. Jaroch, CFA
Portfolio Manager
Industry since 1996

Lauren B. DeMore, CFA
Assistant Portfolio Manager
Industry since 2002

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The next few months will likely bring a lot of uncertainty, and our goal is to prepare the fund for a range of scenarios.

How did the fund perform in the third quarter?

For the first time in several quarters, the fund underperformed its Russell 1000 Value benchmark. However, it outperformed the benchmark for the 1-, 3-, 5-, and 10-year periods ended September 30, 2020.

How was the investing environment in the quarter? What has changed since mid-year?

While growth benchmarks continued to trounce their value counterparts, we did start to see a different group of sectors leading the market. Cyclical sectors such as consumer discretionary, materials, and industrials outperformed stocks in less cyclical areas. Notable exceptions among cyclicals were financials and energy. The only sector posting a loss in the third quarter was energy, which declined more than 20% despite steady oil prices. Technology stocks also took a breather in the quarter. In value indexes, technology was the second-worst performing sector for the quarter.

In your view, what caused this sector rotation?

When you consider the backdrop and sentiment, it becomes clear why cyclicals started to outperform. Throughout the summer, investors began to look past the COVID-19 crisis, they saw progress in combatting the pandemic, cases had declined, and economies began to open up. As expectations grew for a sustained economic recovery, investors turned to those cyclical sectors that had been struggling throughout the first half of 2020.
It is worth noting that this pro-cyclical stance took a somewhat dramatic turn toward the end of the quarter as we saw resurgences of COVID-19 cases globally and new shutdowns in some economies.

The financials sector, a significant component of the value universe, continued to struggle in the third quarter. What is your perspective on the sector today?

While most cyclical sectors have already priced in an economic recovery, financial and energy stocks have not, and they have underperformed rather dramatically. However, we continue to view financial stocks, particularly those of banks, as an attractive investment opportunity. Banks are trading at historically low valuations, yet we believe they offer strong balance sheets and are very well capitalized as a result of much stricter regulation since the 2008 financial crisis. We acknowledge that in order for the performance of these stocks to improve, we probably need to see higher interest rates and a slight steepening of the yield curve. If the market prices in a normalized macroeconomic environment at some point in 2021, it is likely that banks would participate in that recovery as investors recognize how inexpensive these assets are.

What were some bright spots in the quarter?

The strong U.S. housing market was beneficial for a number of holdings in our portfolio. Tight inventory, low mortgage rates, and fiscal stimulus have all boosted the housing industry. In addition, home improvement spending has increased, particularly by consumers in higher income brackets, who generally have not experienced job losses to the extent that lower-income consumers have.

Another positive trend, in our view, is consumer savings. The U.S. personal savings rate hit a record high of 33% in April, according to the Bureau of Economic Analysis. Although not as high today, it remains elevated at around 15%. This could mean that consumers may be able to spend and help drive the economy while we wait for a new stimulus plan.

As we enter the final months of 2020, what is your outlook?

The cyclical rally that we saw for most of the quarter has stalled over the past couple of weeks. Investors are trying to determine when — or even whether — economic conditions will normalize. The next few months in particular will bring a lot of uncertainty, which in turn, is likely to result in market volatility. Among the issues distracting investors are rising numbers of COVID-19 cases, a possibly contentious U.S. presidential election, uncertainty about the timing of a COVID-19 vaccine, and debate around a new stimulus package from Congress.

Rather than trying to predict the next headline and the market reactions to it, we continue to focus on longer-term trends. We are working to determine which changes are temporary and which may be permanent and to take advantage of mispricings across all sectors. Our goal, as always, is to prepare the fund for a range of scenarios with a balanced structure for the portfolio. We plan to maintain a mix of cyclical and defensive holdings, investing in our best ideas with a focus on the fundamentals of the businesses.

Putnam Equity Income Fund (PEIYX)

Annualized total return performance as of 9/30/20

Class Y shares Inception 10/1/98	**Net asset value**	**Russell 1000 Value Index**
Last quarter	4.31%	5.59%
1 year	–0.08	–5.03
3 years	5.33	2.63
5 years	9.15	7.66
10 years	11.10	9.95
Life of fund	10.04	—
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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Putnam Investments | 100 Federal Street | Boston, MA 02110 | putnam.com

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