Q2 2018 | Putnam Global Income Trust Q&A

Fund strategies partly offset challenging global conditions

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(Photo not available)

Increased global trade and political tensions created a challenging market environment in the second quarter.

Currency allocations and mortgage-credit holdings aided the fund's relative performance. Conversely, emerging-market debt and U.S. corporate credit detracted.

We think U.S. growth may strengthen in the months ahead, but we are monitoring trade policy and emerging-market economies.

Not FDIC insured | May lose value | No bank guarantee

What was the fund's investment environment like during the second quarter of 2018?

The period was marked by a continued flattening of the U.S. Treasury yield curve, along with increased global trade tensions.

The yield on the benchmark 10-year Treasury reached a nearly seven-year high of 3.11% on May 17 before mounting concerns about trade issues and slower global growth drove investors to the relative safety of government debt. Longer-dated yields were also held in check by continued strong demand for long-term U.S. bonds from pension funds, insurance companies, and international investors. As a result, the 10-year yield ended the quarter at 2.85%, only modestly higher than where it began the period.

Short-term yields rose more than longer-term yields during the quarter, reflecting market activity related to Federal Reserve policy. The Fed increased its target for short-term rates to 1.75% to 2.00% at its June policy meeting, the second hike this year and the seventh in the past three years. We think the central bank is likely to raise rates twice more in 2018, and possibly once or twice in 2019.

As the year has progressed, the Treasury yield curve has continued to flatten. It is possible that the curve may invert at some point, meaning short-term yields would be higher than longer-term yields. Historically, an inverted yield curve has been an accurate forecaster of recession. This time, however, we think there may be different dynamics at work. The massive amount of longer-term Treasuries that the Fed purchased during the years that it was attempting to stimulate economic growth are still being held on the central bank's balance sheet. This has created a scarcity in the supply of longer-term Treasuries, which is being met by robust demand. As a result, we think demand for long-term debt is having a greater influence on the curve than the pace of Fed rate hikes. We view this as a more benign backdrop that is less indicative of near-term recession.

On the trade front, at the end of May, the Trump administration announced tariffs on steel and aluminum imported from the European Union, Canada, and Mexico. It then applied tariffs to $50 billion in Chinese imports to the United States, a move that was designed to punish China for unfair trade practices. President Trump escalated the trade conflict with China in mid-June, asking his administration to identify a new list of $200 billion in Chinese goods that would be penalized with tariffs. The Chinese government immediately threatened to retaliate with its own equivalent tariffs on U.S. goods. The president has also threatened to impose tariffs on global automobile imports. As of quarter-end, investors remained on edge as to the full scope of President Trump's global trade offensive.

The fund posted a negative return but outpaced its benchmark, the Bloomberg Barclays Global Aggregate Bond Index, for the quarter. Which holdings and strategies aided relative performance?

Our currency allocation was the top relative contributor this period. Against the backdrop of a strengthening U.S. dollar, our lower-than-benchmark allocations to several currencies that weakened versus the dollar — the Swedish krona, the British pound, the Japanese yen, and the New Zealand dollar — proved advantageous. Tactical positioning in the euro also aided our currency strategy.

Our mortgage credit holdings provided a further notable boost versus the benchmark, led by commercial mortgage-backed securities [CMBS]. Our long exposure to the BBB-rated tranche within the CMBX — an index that references a basket of CMBS issued in a particular year — benefited from reduced investor concern about the performance of regional shopping malls. Investors now believe mall-related uncertainties are unlikely to materially hamper the CMBS market.

Our interest-rate and yield-curve strategies modestly aided relative results. A shorter-than-benchmark duration in the United States benefited our strategy during April as bond yields rose. However, this gain was pared over the balance of the quarter as yields modestly receded. In May, a political crisis in Italy sparked a selloff in peripheral eurozone debt, and weighed on our position in Greek government bonds. In June, however, our holdings in Greece rebounded, along with eurozone debt generally, as Italy's president expressed openness to the possibility of forming a coalition government supported by the country's two large antiestablishment parties

What about detractors?

Investments in emerging-market debt worked against relative performance this quarter. Uncertainty surrounding upcoming elections in Brazil hampered the performance of that country's debt. Bonds issued by the government of Argentina also underperformed as the country's currency depreciated sharply, prompting Argentina's central bank to raise its policy interest rate by about 13 percentage points.

Positions in investment-grade and high-yield corporate bonds were a further dampener on the fund's performance. Corporate yield spreads widened in May amid heightened market volatility triggered by trade tensions. Corporate bond prices also fell in anticipation of large bond sales to fund mergers and acquisitions by major firms in communications-related industries.

What is your near-term outlook?

We think second-quarter U.S. economic growth may be stronger than the 2% annualized rate reported for the first quarter. In May, an inflation measure closely watched by the Fed hit the central bank's target of 2% for the first time in six years, a sign that the economy is on more solid footing after a long run of relatively slow growth. Inflation readings over the past three months suggest the Fed's long battle with weak inflation could finally be drawing to a close. It appears to us that a strong labor market is beginning to push wages up and robust economic growth will increasingly squeeze slack out of the economy.

Globally, we are focused on developments related to international trade and also on the performance of emerging-market economies.

After a decade of borrowing by emerging-market governments and companies, dollar-denominated bonds in developing economies are coming under increasing pressure as U.S. interest rates rise, trade tensions ratchet higher, and the U.S. dollar strengthens. A stronger dollar makes it more difficult for countries with large amounts of dollar-denominated bonds to repay that debt as it matures.

The dilemma now facing policy makers in less-developed countries is whether to try to keep pace with the Federal Reserve as it raises interest rates. Higher rates could help stem capital outflows from emerging markets, but could also crimp domestic growth.

Given this outlook, what market sectors do you find to be most attractive?

We continue to favor mortgage credit, prepayment risk, and corporate credit, but are taking a somewhat more conservative approach than previously. We are doing this by purchasing securities with shorter durations while also seeking greater credit protection by investing at more senior levels in a deal's credit structure.

As for emerging markets, we have sought to manage risk by reducing exposure to markets that tend to be more volatile, such as Russia. Beyond that, we plan to continue focusing on select investment opportunities that we believe offer value, rather than taking broad exposure to the sector.

Putnam Global Income Trust (PGGYX)

Annualized total return performance as of 6/30/18

Class Y shares Inception 10/4/05	**Net asset value**	**Bloomberg Barclays Global Aggregate Bond Index**
Last quarter	-2.06%	-2.79%
1 year	1.94	1.36
3 years	2.77	2.58
5 years	2.41	1.50
10 years	4.68	2.58
Life of fund	6.41	—

Total expense ratio: 0.97%

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 6/1/87), 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 Bloomberg Barclays Global Aggregate Bond Index is an unmanaged index of global investment-grade fixed-income securities. You cannot invest directly in an index.

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Consider these risks before investing: International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed investments carry the risk that they may increase in value when interest rates decline and decline in value when interest rates rise. The fund invests in fewer issuers or concentrates its investments by region or sector, and involves more risk than a more broadly invested fund. The fund's policy of concentrating on a limited group of industries and the fund's non-diversified status, which means the fund may invest in fewer issuers, can increase the fund's vulnerability to common economic forces and may result in greater losses and volatility. Bond investments are subject to interest-rate risk (the risk of bond prices falling if interest rates rise) and credit risk (the risk of an issuer defaulting on interest or principal payments). Interest-rate risk is generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds. Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. Unlike bonds, funds that invest in bonds have fees and expenses. Bond prices may fall or fail to rise over time for several reasons, including general financial market conditions, changing market perceptions (including perceptions about the risk of default and expectations about monetary policy or interest rates), changes in government intervention in the financial markets, and factors related to a specific issuer or industry. These and other factors may lead to periods of high volatility and reduced liquidity in the fund's portfolio holdings. You can lose money by investing in the fund.

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