Q4 2018 | Putnam Global Income Trust Q&A

Fund underperforms amid increasing risk aversion

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Diminishing risk appetite weighed on a wide range of market sectors in the fourth quarter, although government-related bonds posted gains.

Positions in corporate and mortgage credit detracted from relative performance, while global interest-rate positioning modestly contributed.

In light of pervasive market volatility during 2018's fourth quarter, we think the Federal Reserve may pause its rate-hiking cycle.

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

Investor sentiment became sharply risk-averse during the quarter and market volatility spiked. A confluence of factors, including the ongoing U.S.-China trade dispute and concern about slowing global economic growth led to a sharp downturn in risk assets.

Within this environment, credit-sensitive securities declined as yield spreads widened. U.S. high-yield bonds underperformed emerging-market [EM] debt for the quarter, but returned -2.1% for the year, meaningfully ahead of the -5.3% result generated by EM debt on a U.S.-dollar basis.

U.S. Treasuries and other government securities were a bright spot in the fourth quarter, as yields fell substantially and prices rose. The yield on the benchmark 10-year U.S. Treasury ended the year at 2.69% after hitting a seven-year high of 3.24% in early November. Short-term yields also declined, maintaining a positive spread between shorter- and longer-term Treasury rates. Part of the decline in yields occurred as Federal Reserve officials took a more dovish tone, and a softening in U.S. housing and business investment data became apparent.

Against this backdrop, intermediate-maturity U.S. Treasuries delivered a total return of 3.7%, as measured by the ICE BofAML 7-10 Year U.S. Treasury Index, while the broad Bloomberg Barclays U.S. Aggregate Bond Index gained 1.6%. Foreign sovereign bonds also registered positive performance, with the FTSE World Government Bond Index returning 1.8% in U.S.-dollar terms.

As expected, the Fed raised its target for short-term interest rates to a range of 2.25% to 2.5% at its December 2018 policy meeting. However, the Fed reduced its forecast for 2019 rate hikes from three to two, stating that future rate increases will be "data dependent" — language that commits the Federal Open Market Committee (FOMC) to a response without committing them to a specific path. In our view, it appears that the Fed is becoming less sure about how fast it will need to act or how far it will need to go. To us, it seems clear that the central bank needs to assess how the economy is holding up under the rate increases it has already made.

For the quarter, the fund posted a modestly negative return and lagged its benchmark, the Bloomberg Barclays Global Aggregate Bond Index. Which holdings and strategies detracted from relative performance?

Our corporate credit holdings — primarily investment-grade bonds — were the biggest detractor versus the benchmark. The asset class struggled amid negative investor sentiment, trade uncertainty, and a sharp drop in oil prices. A small allocation to high-yield credit also worked against performance for similar reasons.

Our mortgage-credit strategies also hampered relative performance this quarter. The fund's exposure to commercial mortgage-backed securities via CMBX — an index that references a basket of CMBS issued in a particular year — hurt results as the index's average yield spread widened substantially. [The prices of credit-sensitive securities decline as yield spreads widen.]

Elsewhere, our currency allocation was a further modest detractor on a net basis. Long positions in the Norwegian krone and the Australian dollar were the primary culprits as these currencies weakened considerably versus the U.S. dollar. Underweight exposure to the Japanese yen was another negative because this currency appreciated relative to the U.S. dollar. Positive results from a short position in the euro — which also declined against the U.S. dollar — partially offset the overall negative impact of our currency allocations.

What impact did EM debt have on results?

EM debt was another moderate dampener versus the benchmark, primarily due to positions in Argentina and Mexico. Investor risk aversion and weakening economic data hurt our holdings in both countries. Political uncertainty in Mexico sparked by comments from the country's incoming president also dented our investments there.

What about relative contributors?

Our global interest-rate positioning modestly helped. Later in the quarter, the fund's duration outside the United States was greater than that of the benchmark. This strategy generated positive performance as global yields declined amid the broad-based movement away from risk and toward the relative safety of government securities and cash.

What is your near-term outlook?

For some time, we have held the view that the Fed was attempting to normalize interest rates, and that it would continue to raise its target for short-term rates as long as the markets seemed to be accommodating these increases. Given the volatility that pervaded markets in the fourth quarter, we now think the Fed is likely to pause, perhaps until the second half of 2019.

U.S. gross domestic product [GDP] — the broadest measure of goods and services produced throughout the country — expanded at a 4.2% annual rate in the second quarter of 2018 and 3.4% in the third quarter. Real interest rates [adjusted for inflation] rose meaningfully during the second half of 2018. We think higher real rates will dampen economic growth somewhat. Also, as growth in China is affected by trade discussions with the United States, we think this will also have a slowing effect on U.S. growth. As a result, while we believe U.S. GDP growth will remain positive over the next year, we think it is likely to slow to a range of 2% to 3%.

Given this outlook, how are you positioning the fund?

We continue to favor mortgage credit, prepayment risk, and corporate credit. However, because we are in the later stages of both the economic and credit cycles, we are taking a somewhat more conservative approach than previously. We are doing this by purchasing securities with less price sensitivity to changes in yield spreads. We're also investing in more-seasoned mortgage-backed bonds which we believe may be less sensitive to any weakness in real estate markets.

As a result of the downturn in asset prices in the fourth quarter, yields are higher across many market sectors. Consequently, we think this may give us the ability to generate greater income in the portfolio.

Putnam Global Income Trust (PGGYX)

Annualized total return performance as of 12/31/18

Class Y shares Inception 10/4/05	**Net asset value**	**Bloomberg Barclays Global Aggregate Bond Index**
Last quarter	–0.52%	1.20%
1 year	–2.12	–1.20
3 years	2.55	2.70
5 years	1.51	1.08
10 years	6.51	2.49
Life of fund	6.26	—

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.

The ICE BofAML 7-10 Year U.S. Treasury Index is an unmanaged index that tracks the performance of the direct sovereign debt of the U.S. Government having a maturity of at least seven years and less than 10 years.

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The Bloomberg (BBG) Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities.

The FTSE World Government Bond Index (WGBI) measures the performance of fixed-rate, local-currency, investment-grade sovereign bonds. You cannot invest directly in an index.

The views and opinions expressed are those of the portfolio managers as of December 31, 2018, are subject to change with market conditions, and are not meant as investment advice. All performance and economic information is historical and is not indicative of future results.

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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