Q4 2017 | Putnam Global Income Trust Q&A

Accelerating global growth supports risk-driven assets

D. William Kohli
CIO, Fixed Income
Industry since 1988

Robert L. Davis, CFA
Portfolio Manager
Industry since 1999

Michael V. Salm
Co-Head of Fixed Income
Industry since 1989

Paul D. Scanlon, CFA
Co-Head of Fixed Income
Industry since 1986

Michael J. Atkin
Portfolio Manager
Industry since 1988
(Photo not available)

Improving trends across global economies created a favorable environment for risk-driven fixed-income strategies.

The fund modestly lagged its benchmark, hampered by active currency positioning. On the plus side, corporate credit holdings aided relative performance.

We believe the acceleration in global growth seen in 2017 will likely continue in 2018, and may continue to provide a supportive backdrop for risk-driven assets.

What was the fund's investment environment like during the fourth quarter of 2017?

Improving economic growth and the continuation of a positive trend for corporate profits bolstered investor sentiment during the quarter. U.S. gross domestic product [GDP] registered two consecutive quarters of 3% or better annualized growth in the second and third quarters of 2017. Consumer spending was solid overall, as was business investment, and exports grew, reflecting a strengthening global economy. The unemployment rate reached a 17-year low of 4.1%. A closely watched measure of corporate profits — after-tax profits, without inventory valuation and capital consumption adjustments — increased 9.8% compared with a year earlier. All told, we think these trends point to a steadily growing economy ahead of the $1.5 trillion tax cut that was approved by Congress, with a portion of that amount likely to influence the economy this year.

The yield on the benchmark 10-year U.S. Treasury stayed in a fairly tight range, ending the quarter at 2.40%. Rates rose modestly across the yield curve, with short-term yields rising more than longer-term yields in anticipation of a further increase in the target for short-term rates by the Federal Reserve. In December, the Fed hiked its benchmark rate by a quarter percentage point to a range of 1.25% to 1.5%, the fifth such increase in the past two years. The central bank also reiterated its forecast for raising rates potentially three times in 2018.

In October, the European Central Bank [ECB] said it would continue purchasing government bonds into 2018, but in reduced monthly amounts. In our view, this announcement marks a milestone policy shift signaling that the ECB will follow the U.S. Fed on a path toward higher interest rates. The decision marks the beginning of the end of a policy tool the ECB adopted to stave off deflation: large-scale purchases of eurozone government bonds, known as quantitative easing.

The 19-country eurozone economy grew at an annualized rate of 2.4% in 2017's third quarter, a slowdown from the 2.6% growth rate recorded in the second quarter. Despite the third-quarter deceleration, the eurozone economy appears on course for its strongest year since 2007. Meanwhile, Japan's economy grew at an annualized pace of 1.4% in the July to September quarter, marking the country's seventh-straight quarter of growth — its longest streak since 2001.

For the first time in a decade, the world's major economies appear to be growing in sync. This parallel growth trend has been fueled by low interest rates and other stimulus measures by central banks, along with the gradual fading of crises that over the years ricocheted from the United States to Greece, Brazil, and elsewhere.

After strengthening modestly early in the quarter, the U.S. dollar weakened in November and December on doubts that the Fed will be able to maintain its pace of rate increases this year in the face of low inflation. U.S. consumer prices have stayed stubbornly weak despite other signs of economic expansion. The most recent data on U.S. inflation showed that the personal-consumption expenditures price index — the Fed's preferred price gauge — had risen at a 1.8% annual rate, still below the central bank's long-elusive 2% target. Inflation remains low in the eurozone, Japan, and most other developed economies.

Eurozone and United Kingdom government bonds were among the top performers the past three months with, for example, the Bloomberg Barclays Pan Euro Aggregate Bond Index returning 2.22% in U.S.-dollar terms. In U.S. corporate credit, investment-grade bonds modestly outpaced their high-yield counterparts.

The fund modestly lagged its benchmark, the Bloomberg Barclays Global Aggregate Bond Index, for the quarter. What detracted from relative performance?

Our currency strategies worked against relative performance this quarter. Our positioning was hampered by lighter-than-benchmark exposure to several currencies that strengthened versus the U.S. dollar, most notably the euro. An overweight allocation to the Norwegian krone was another negative, as this currency weakened relative to the greenback.

Which holdings and strategies aided performance versus the benchmark?

Our corporate credit holdings were the primary contributor for the period. An overweight allocation to investment-grade debt and a modest out-of-benchmark position in high-yield bonds were aided by a continuation of the positive trend in corporate earnings and an improving U.S. economy. The high-yield sector also continued to benefit from a benign default backdrop.

Mortgage-credit investments also notably helped versus the benchmark, led by positions in mezzanine commercial mortgage-backed securities [CMBS]. Our holdings of cash bonds performed well. Additionally, our long exposure to the BBB-rated tranche within the CMBX — an index that provides access to CMBS issued in a particular year — recovered in November and December following weakness in prior months.

An allocation to agency credit-risk transfer securities [CRTs] provided a further boost to relative results. The sector rebounded from an August-to-September selloff driven by hurricanes in Texas and Florida, as investors concluded that initial damage fears were overblown. Furthermore, CRTs continued to benefit from strong overall demand, as investors continued to embrace the sector's relatively high yields backed by robust collateral and rising residential real estate prices.

Our global interest-rate and yield-curve strategies were a modest contributor this period. The fund's duration — its sensitivity to interest-rate changes — was below that of the benchmark, which aided performance as rates rose slightly across all but the longest-maturity portion of the curve. Internationally, results were mixed, as continued solid performance from our holdings of Greek government bonds was offset by negative results from curve-positioning strategies in other countries.

What is your outlook for the coming months?

We believe the acceleration in global growth seen in 2017 will likely continue in 2018, but with significant changes in its components. We think U.S. GDP may strengthen somewhat from its recent level, but we also think growth in Europe and Japan may improve relative to the United States as 2018 unfolds. As a result, we think the euro and possibly the yen may strengthen versus the dollar later in the year. Meanwhile, the United Kingdom may be headed toward a softer version of Brexit as a consequence of recent developments in the country's efforts to separate from the European Union. Overall, we expect reasonably solid global growth, continued policy tightening by the Fed, relatively benign inflation, and a generally supportive environment for risk-driven assets. We also think bond yields may continue to drift higher over the course of 2018 as rate normalization continues.

In our view, the Fed will be a key focus of investor attention in 2018, especially during the first half, as a new chair takes office and new governors join the Federal Open Market Committee. While we don't anticipate significant policy changes under the new Fed chair, we do see the potential for miscommunication as the market adjusts to the tone and language of a new leader.

Putnam Global Income Trust (PGGYX)

Annualized total return performance as of 12/31/17

Class Y shares Inception 10/4/05	Net asset value	Bloomberg Barclays Global Aggregate Bond Index
Last quarter	0.77%	1.08%
1 year	7.52	7.40
3 years	2.39	2.02
5 years	2.21	0.79
10 years	5.02	3.09
Life of fund	6.54	—

Total expense ratio: 0.96%

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.

How are you positioning the fund in light of this outlook?

We think prepayment risk remains attractive because relatively tight mortgage-lending standards may continue to curb refinancing activity. We also like interest-only securities structured from reverse mortgages, given their stable prepayment profile and attractive spreads.

Within corporate credit, high-yield valuations are not as attractive as they were a year ago, but continue to look fair to us, in light of our positive outlook for corporate fundamentals, the U.S. economy, and default trends.

Within mortgage credit, we think commercial mortgage-backed securities could benefit from employment growth, low interest rates, and a continuation of the current economic expansion. While we expect some degree of losses related to regional malls, we're also encouraged by the fact that many malls are attempting to repurpose their space to attract new types of tenants. We believe the non-agency RMBS market continues to be supported by an improving housing market and shrinking supply. We continue to like agency credit risk-transfer securities on the basis of fundamentals and underlying collateral, but have become more cautious from a valuation perspective.

The views and opinions expressed are those of the portfolio managers as of December 31, 2017, 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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