Q3 2017 | Putnam Global Income Trust Q&A

# Corporate credit holdings drive favorable relative performance

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(Photo not available)

***The bond market continued to benefit from investor willingness to take risk in order to access higher yields.***

***The fund modestly outpaced its benchmark. Corporate- and mortgage-credit holdings aided performance, as did positions in emerging-market debt. Conversely, global interest-rate and yield-curve strategies detracted.***

***We think the Fed's gradual approach to reducing its bond portfolio may help keep rate volatility contained.***

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

The trend of elevated risk appetite continued during the third quarter.

Globally, investors grappled with geopolitical risk, highlighted by heated rhetoric surrounding North Korea's nuclear program. In the United States, Hurricanes Harvey and Irma caused suffering and economic disruption in Texas and Florida, respectively. Despite these developments, investors focused on a broader macro landscape that revealed a rising trajectory, with second-quarter U.S. gross domestic product revised upward to 3.1% and a labor market that continued to register reasonably positive gains.

The benchmark 10-year U.S. Treasury yield ended the quarter at 2.33%, slightly above where it started. The yield declined during August into early September amid heightened U.S.–North Korea tension. The yield moved higher during the remainder of September, however, as the Federal Reserve indicated that it still saw the potential for raising rates once more this year and three times in 2018.

At its mid-September policy meeting, the Fed left the target for short-term interest rates unchanged at a range of 1% to 1.25%. The central bank announced that it would begin in October to shrink its massive portfolio of Treasuries and agency mortgage-backed securities [MBS] that it accumulated after the 2008 financial crisis.

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Overseas, second-quarter growth in the 19-nation eurozone came in at a 2.6% annual rate, a faster pace than the European Central Bank [ECB] had expected at the beginning of the year. The eurozone's strength has been one of the positive surprises for the global economy this year, as it outpaced the United States in the first quarter and accelerated further in the three months ended June 30, 2017.

ECB monetary policy remains supportive, but an announcement by ECB President Mario Draghi signaled that the bank could announce a plan in October to gradually end its program of bond purchases. However, Mr. Draghi also warned that the bank's next steps would partly depend on the strength of the euro, which has surged by about 12% against the U.S. dollar since the beginning of the year.

U.S. crude oil prices rebounded in the third quarter, fueled by unexpected strong demand and signs of ebbing U.S. production. The price for a barrel of West Texas Intermediate, the U.S. crude benchmark, ended the period at $51.67, representing a 10.5% advance for the quarter.

Emerging-market [EM] debt was among the top performers of the past three months, with the JPMorgan Emerging Markets Bond Index returning 2.63%. In U.S. corporate credit, high-yield bonds outpaced investment-grade corporates as yield spreads continued to tighten.

### The fund modestly outpaced its benchmark, the Bloomberg Barclays Global Aggregate Bond Index, for the quarter. Which holdings and strategies aided relative performance?

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 helped by strong corporate earnings and investors' willingness to take risk to gain access to higher yields. The high-yield sector also benefited from a benign default backdrop.

EM debt also helped versus the benchmark, led by investments in Argentina. Argentine bonds benefited from a primary vote ahead of congressional elections in October that gave a boost to the market-friendly agenda championed by the country's president. Positions in Brazil rallied when the country's senate passed a labor reform bill in July. Holdings in Russia and Mexico also contributed.

Mortgage-credit investments provided a further boost to relative results, with non-agency residential mortgage-backed securities [RMBS] making the biggest contribution. Within non-agency RMBS, positions in pay-option adjustable-rate mortgages and prime-rate securities benefited from a generally favorable risk environment, as well as the fact that there was no new supply of these bonds coming to market.

### Which strategies detracted?

Our global interest-rate and yield-curve strategies were the primary detractors from relative results. The fund's duration — its sensitivity to interest-rate changes — was below that of the benchmark, and the portfolio was positioned to benefit if global yield curves steepened. This positioning worked against performance in July and August, as rates declined and curves flattened. Our strategy aided results in September, however, amid rising rates and a steepening yield curve in the United States, but one month's positive performance was not enough to fully offset earlier losses. Quantitative, model-driven strategies that were designed to benefit if bond yields rose in the United States and Europe placed a further drag on performance.

Our active currency strategies also detracted on a net basis. A short position in the euro and tactical positioning in the Norwegian krone hurt, as both currencies appreciated during the quarter. Long exposure to the appreciating Swedish krona contributed and partially offset the overall negative outcome of our currency positioning.

### What is your outlook for the coming months?

The Fed had signaled for months that it was planning to begin reducing its $4.5 trillion bond portfolio, and in September, announced that it would start the process in October. The Fed's plan is to allow a specific amount of securities to mature each month (or pay down, in the case of MBS): $6 billion in Treasuries and $4 billion in MBS. It would then allow the amount of maturities to increase each quarter, ultimately reaching a maximum of $30 billion per month for Treasuries and $20 billion per month for agency MBS. We expect that the Fed will reduce its holdings in a gradual and predictable manner in an effort to avoid interest-rate spikes or other market strains.

The Fed stopped adding to its investments more than three years ago, but it has been reinvesting the proceeds of maturing bonds to keep its holdings steady. These reinvestments have helped keep a lid on long-term interest rates, and letting securities mature without reinvesting could put upward pressure on rates. That said, we think the incremental nature of the plan suggests that rate volatility may be limited, at least initially.

Turning to bond yields, we think yields are too low given generally favorable global economic conditions. Although we don't believe yields are likely to rise significantly this year, partly due to strong global demand for U.S. bonds, we do think they'll be higher by the end of 2018. There are a lot of unknowns: potentially significant changes to the Fed's Board of Governors in 2018; the timing of when the ECB will begin to taper its bond-purchase program; tax reform in the United States; tighter monetary policy in other countries, such as Canada and the United Kingdom; and the ongoing potential for geopolitical flare-ups. So, while there are a variety of cross-currents that could impact the trajectory of bond yields both in the United States and overseas, we think the overall trend will be for yields to rise next year.

## Putnam Global Income Trust (PGGYX)

Annualized total return performance as of 9/30/17

| **Class Y shares** Inception 10/4/05 | **Net asset value** | **Bloomberg Barclays Global Aggregate Bond Index** |
|---|---|---|
| Last quarter | 1.96% | 1.76% |
| 1 year | 2.62 | -1.26 |
| 3 years | 1.69 | 1.30 |
| 5 years | 2.31 | 0.48 |
| 10 years | 5.12 | 3.31 |
| Life of fund | 6.57 | — |

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.

### Given this outlook, what risk strategies do you consider most attractive?

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 are 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.

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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 greater for longer-term bonds, and credit risk is 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 of the risk default, changes in government intervention, and factors related to a specific issuer or industry. These factors may also lead to periods of high volatility and reduced liquidity in the bond markets. You can lose money by investing in the fund.

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