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Putnam INVESTMENTS

Q1 2017 | Putnam Global Income Trust Q&A

Fund outperforms amid supportive global backdrop

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(Photo not available)

Riskier fixed-income categories continued to perform well amid a generally favorable investment environment.

The fund outperformed its benchmark, led by mortgage-credit strategies. Holdings of corporate credit — both investment grade and high yield — also notably contributed. Conversely, active currency strategies hampered relative performance.

Global economic activity appears to be strengthening, and inflation levels are beginning to rise. Given this backdrop, it is possible that the Federal Reserve may raise rates at a faster pace than the market is currently anticipating.

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

The environment was generally supportive for riskier assets. During January and February, investors were optimistic about the potential for tax cuts and increases in infrastructure and defense spending under the Trump administration. Later in the quarter, however, a failed effort to repeal the Affordable Care Act triggered uncertainty about the administration's ability to get its tax-reform and fiscal-stimulus plans passed by Congress.

Economic data in both the United States and globally were positive overall. In particular, fourth-quarter U.S. gross domestic product [GDP] was revised upward from a 1.9% to a 2.1% annual rate, according to the Commerce Department. This follows growth of 3.5% in the third quarter. In February, the Federal Reserve's preferred inflation gauge, the Personal Consumption Expenditures Price Index, rose 2.1% from a year earlier, the first time inflation exceeded the central bank's target in nearly five years. The jobless rate in the 19-country eurozone declined to 9.5% in February, the lowest level since 2009.

As expected, the Fed increased its target for short-term interest rates by a quarter percentage point to a range of 0.75% to 1% at its mid-March policy meeting. Fed Chair Janet Yellen expressed confidence in the economy and reaffirmed that the central bank may implement two more increases this year. The benchmark 10-year Treasury yield rose from late February through mid-March in anticipation of the Fed's move, then fell, ending the quarter at 2.39%, slightly below where it began the year.

After reaching a 14-year high in early January, the U.S. dollar declined by 3.5% for the quarter, as investors grew more cautious on the currency amid uncertainties surrounding the Trump administration's policy platform.

U.S. crude oil prices stayed above $54 per barrel for most of the quarter, but fell in early March after weekly data showed a record inventory buildup. This concern eased somewhat later in the month, and oil prices rose to end the period at $50.60 on the New York Mercantile Exchange.

Within this environment, emerging-market [EM] debt and high-yield corporate bonds outpaced U.S. Treasuries on a duration-adjusted basis, while performance within the mortgage-backed sector was mixed.

The fund finished ahead of its benchmark, the Bloomberg Barclays Global Aggregate Bond Index. Which holdings and strategies fueled its relative performance?

Our mortgage-credit strategies were the top relative contributor, led by holdings of mezzanine commercial mortgage-backed securities [CMBS]. Early in the period, our positions in CMBS that were issued before the 2008 financial crisis performed particularly well. However, gains from the sector were pared in February when headlines concerning retail store closures prompted some investors to express a bearish view on certain parts of the CMBS market due to the sector's exposure to retail properties. Although we agree that retailers face challenges amid evolving shopper preferences and a shift from traditional brick-and-mortar to online commerce, we believe the CMBS held by the fund have enough credit protection to withstand the changes that are occurring in retail.

Elsewhere within mortgage credit, holdings of non-agency residential mortgage-backed securities across various subsectors also aided the fund's relative performance.

An overweight allocation to investment-grade corporate credit, and a modest out-of-benchmark position in high-yield bonds, also provided a notable boost to performance, despite modest spread widening in March [bond prices decline as yield spreads widen]. Positive sentiment toward both sectors was fueled by investor expectations that economic growth could potentially accelerate if the Trump administration is successful at implementing tax cuts and more-robust fiscal policy. Relatively stable global oil prices also provided a tailwind. Within investment-grade credit, overweight exposure to the financials sector proved particularly advantageous. Banks and other financial institutions performed well amid higher interest rates and the potential for a more favorable regulatory environment under the new administration.

Outside the United States, investments in EM debt continued to be a productive part of the portfolio. During the quarter, positions in Brazil and Mexico added the most, partly helped by stable oil prices and persistent investor demand for high-yielding securities. Brazil's bonds also received a boost when the country's central bank cut its benchmark interest rate by more than investors were expecting, as Brazil continues its efforts to recover from a deep recession.

How did your interest-rate and yield-curve positioning fare this period?

Our global "term structure" strategies also notably contributed versus the benchmark, led by our non-U.S. positioning. We continued our efforts to de-emphasize interest-rate risk by keeping the portfolio's duration — a key measure of interest-rate sensitivity — below that of the benchmark, mainly in Europe. This strategy proved advantageous as rates in Europe rose, particularly in the United Kingdom. The fund was also helped by positions in the U.K. and continental Europe that were designed to benefit from changes in the expected inflation rates in those regions. Meanwhile, the fund's U.S. duration was relatively close to that of the benchmark.

Our holdings of Greek government debt were a slight positive. The country's bonds rose on increased investor optimism that the securities might eventually be included in the European Central Bank's bond purchase program.

How did active currency strategies influence performance?

Our currency strategies detracted from relative results. Most major currencies appreciated versus the U.S. dollar, so our lower-than-benchmark exposure to various currencies hurt. Specifically, short positions in the Japanese yen, the euro, and the South Korean won worked against the fund's relative performance. Long exposures to a number of currencies, including the Mexican peso, Australian dollar, and Swedish krona, proved modestly beneficial and provided a partial offset to the overall negative impact of our currency positioning.

What is your outlook for the coming months?

As we look at the world today, we see economic activity picking up and inflation levels beginning to rise. Higher commodity prices appear to be working their way into final prices, which is leading to fairly persistent pricing pressures in the United States and elsewhere. In our view, global economies appear to be normalizing, and we think this is particularly true in the United States. Given this normalization, we think the level of interest rates remains too low.

Within this environment, we think the Fed's tone has changed somewhat. For some time now, the central bank has emphasized that its policy was data-dependent — particularly data related to employment and inflation levels. After years of employing stimulative monetary policy in an effort to ward off deflation, the Fed has now shifted its focus to inflation. This new phase of monetary policy is driven by a central bank that is becoming more concerned with the possibility that the economy could outperform forecasts. Consequently, we do expect the Fed to increase rates at least twice more this year, and these increases could occur sooner than the market is currently forecasting.

We are also monitoring developments that would signal the possible spread of global populism, such as the outcome of the presidential election in France. If the populist candidate there were to win, it could spark volatility as the market attempts to calibrate the effects of another populist president leading a major global economy.

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

Our non-U.S., quantitatively driven, underweight duration strategies have moved the fund's total duration further below that of its benchmark. We also extended our strategy of seeking to capitalize on potentially steeper global yield curves. We think this overall positioning could benefit the fund if interest rates continue to trend higher in 2017.

Putnam Global Income Trust (PGGYX)

Annualized total return performance as of 3/31/17

Class Y shares Inception 10/4/05	**Net asset value**	**Bloomberg Barclays Global Aggregate Bond Index**
Last quarter	2.44%	1.76%
1 year	3.45	-1.90
3 years	0.68	-0.39
5 years	2.24	0.38
10 years	5.23	3.34
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.

We plan to continue seeking opportunities in corporate and mortgage credit that we believe offer relative value. Within those market areas, we continue to have a constructive outlook for investment-grade bonds, based on what we think is a generally favorable fundamental and technical backdrop for the asset class. We also continue to like CMBS due to the attractive spreads available there.

Lastly, we expect to maintain a sufficient cash allocation to provide a cushion against bouts of market volatility, as well as any disruptions in the market's supply/demand environment.

The views and opinions expressed are those of the portfolio managers as of March 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 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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