

Q1 2019 | Putnam Emerging Markets Equity Fund Q&amp;A

# Emerging markets rally on dovish Fed, trade talks



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Industry since 1993

*The Fed's U-turn on rates makes emerging markets less vulnerable to the dollar.*

*As fears of China-U.S. trade war ebb, investors piled into emerging markets.*

*Our largest country allocations include Saudi Arabia, Hong Kong, and the Philippines.*

## **What was the market environment during the first quarter of 2019?**

Emerging-market equities rallied during the quarter, buoyed by the Fed's pivot on interest rates, expectations that China's economy will regain its footing, and the surge in energy prices. The Fed left short-term rates unchanged at its March meeting and signaled little appetite for raising them again this year. China and the United States, the world's two largest economies, are looking to reach a tentative trade agreement. Any truce will provide some reassurance to markets and lift an important economic cloud.

The improving backdrop drove the year-to-date rally in riskier assets. President Trump and Chinese President Xi Jinping are expected to sign a trade deal in the coming weeks. China remains an anchor for many emerging markets because of its trade and financial links. The Fed's shift in monetary policy has also opened the door for interest-rate cuts in some developing economies. India's central bank lowered rates for the second time in two months in April to buoy the slowing economy. A weaker U.S. dollar has also propelled many emerging-market currencies higher and eased pressure on their current account deficits. In 2018, an appreciating dollar had pushed up debt servicing costs for emerging-market companies that had borrowed in the greenback.

We were defensively positioned through the quarter. The majority of our fund's outperformance came from bottom-up stock selection, specifically opportunities in China's clean technology companies that focus on domestic growth and that are less affected by macroeconomic factors. The benchmark MSCI Emerging Markets Equity Index (ND) finished the quarter up 9.92%.

### How did the fund perform?

Putnam Emerging Markets Equity Fund outperformed its benchmark, the MSCI Emerging Markets Equity Index, for the quarter. The fund rose 11.12%. Our stock picks in different sectors and countries drove most of the performance, followed by country allocations. Our sector allocations, currency strategy, and cash holdings were negative contributors.

### What strategies detracted from return?

#### What strategies helped?

From a country perspective, underweight allocations in India, South Korea, and Hong Kong relative to the benchmark contributed most to returns. But an overweight allocation in Australia, an out-of-benchmark position in Argentina, and an underweight allocation in Thailand detracted most from performance. Our stock selections were strongest in India, China, and the Philippines and weakest in Thailand, Argentina, and Malaysia.

In terms of sectors, positions in financials, energy, and consumer staples were the top contributors to performance. Utilities, materials, and consumer discretionary, however, detracted most from results. Regarding currency, out-of-benchmark exposures to the Argentine peso and the U.S. dollar hurt results.

### What is the outlook for the second quarter and for 2019?

The outlook for emerging-market economies appears more constructive in 2019. Trade tensions between China and the United States are easing, the Fed is unlikely to raise rates this year, and China is taking steps to manage its economic slowdown. Emerging-market stocks are also more attractively valued following the sell-off in 2018. We believe this provides an opportunity for active managers to drive outperformance through superior stock picking.

But there are risks on the horizon. Global growth continues to slow, and political risks loom in some emerging economies, including India and

South Africa. Both countries hold elections in 2019. And there is uncertainty about the ultimate outcome of U.S.-China trade negotiations. Political developments in Europe, including a disorderly Brexit, will also affect financial market movements this year. Considering these uncertainties, we believe our top-down macroeconomic approach — which complements our bottom-up company research — is more important than ever for an investment strategy focused on finding attractive opportunities.

As of quarter-end, the fund's largest active country allocations included Saudi Arabia, Hong Kong, and the Philippines. The fund had the biggest underweight positions in South Korea, China, and South Africa. We are overweight in consumer staples, financials, and industrials and underweight in materials, information technology, and communication services. We favor countries that have strong domestic markets, high investment, reformist agendas, and those that are developing strategies and brands for intellectual property.

### Putnam Emerging Markets Equity Fund (PEMYX)

Annualized total return performance as of 3/31/19

Class Y shares Inception 9/29/08	Net asset value	MSCI Emerging Markets Index [ND]
Last quarter	11.12%	9.92%
1 year	-11.21	-7.28
3 years	11.19	10.68
5 years	4.10	3.68
10 years	8.30	8.94
Life of fund	4.28	5.46

Total expense ratio: 1.58%

What you pay: 1.07%

"What you pay" reflects Putnam Management's decision to contractually limit expenses through 12/30/19.

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](http://putnam.com). 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 MSCI Emerging Markets Index (ND) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. You cannot invest directly in an index.

The views and opinions expressed are those of Daniel J. Graña, CFA, Portfolio Manager of Putnam Emerging Markets Equity Fund, as of March 31, 2019. They are subject to change with market conditions and are not meant as investment advice.

**Consider these risks before investing:** International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Investments in small and/or midsize companies increase the risk of greater price fluctuations. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. 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. Stock prices may fall or fail to rise over time for several reasons, including general financial market conditions, changing market perceptions, changes in government intervention in the financial markets, and factors related to a specific issuer, industry or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund's portfolio holdings. From time to time, the fund may invest a significant portion of its assets in companies in one or more related industries or sectors, which would make the fund more vulnerable to adverse developments affecting those industries or sectors. You can lose money by investing in the fund.

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