

# Rates are slowly rising:

Ideas that may help with tougher investment reviews ahead.

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# What sponsors and participants are seeing



July 16, 2013

“Top fund managers were blindsided by U.S. bond market carnage”



June 4, 2013

“Bond investors should heed rising interest rates. Bonds have been destroying savings in college funds, 401(k) funds, IRAs, and retirement nest eggs”



July 7, 2013

“Savvy investors should take note of slowly rising interest rates”

# The impact of rising rates

<b>Period of rising rates</b>	<b>Change in yield on 10-year Treasury bond</b>	<b>Barclays U.S. Aggregate Bond Index return</b>	<b>U.S. 10-year Treasury return</b>
11/30/09 to 12/28/09	64 bps (3.20 to 3.84)	-1.67%	-4.94%
10/7/10 to 12/15/10	115 bps (2.38 to 3.53)	-3.03%	-8.48%
10/3/11 to 10/27/11	62 bps (1.80 to 2.24)	-1.25%	-5.09%
2/27/12 to 3/26/12	34 bps (1.92 to 2.26)	-0.72%	-2.66%
7/24/12 to 8/16/12	39 bps (1.44 to 1.83)	-1.19%	-3.40%
8/31/12 to 9/14/12	31 bps (1.57 to 1.88)	-0.66%	-2.70%
10/2/12 to 10/18/12	22 bps (1.64 to 1.86)	-0.35%	-1.80%
12/6/12 to 12/18/12	25 bps (1.59 to 1.84)	-0.69%	-2.19%
1/23/13 to 2/1/13	18 bps (1.86 to 2.04)	-0.60%	-1.54%
5/2/13 to 5/28/13	54 bps (1.63 to 2.17)	-1.75%	-3.82%
6/14/13 to 6/25/13	46 bps (2.14 to 2.60)	-2.23%	-4.01%

Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities. You cannot invest directly in an index. Past performance is not indicative of future results. Performance of the Putnam funds will differ.

# Recent Casey Quirk Report

- “But the storm clouds are already here. Individual and defined contribution investors are most exposed: They hold \$5 trillion in fixed income, and are not prepared for losses in this part of their portfolio.”
- “U.S. investors facing uncertain bond markets will shift \$1 trillion of assets from traditional fixed-income products to next generation debt strategies”
- “Successful fixed-income asset managers will be highly active and benchmark agnostic, offer broad capabilities, provide modern risk management, and rely on integrated sector teams.”
- “Establish a thought leadership position around next generation debt management.”

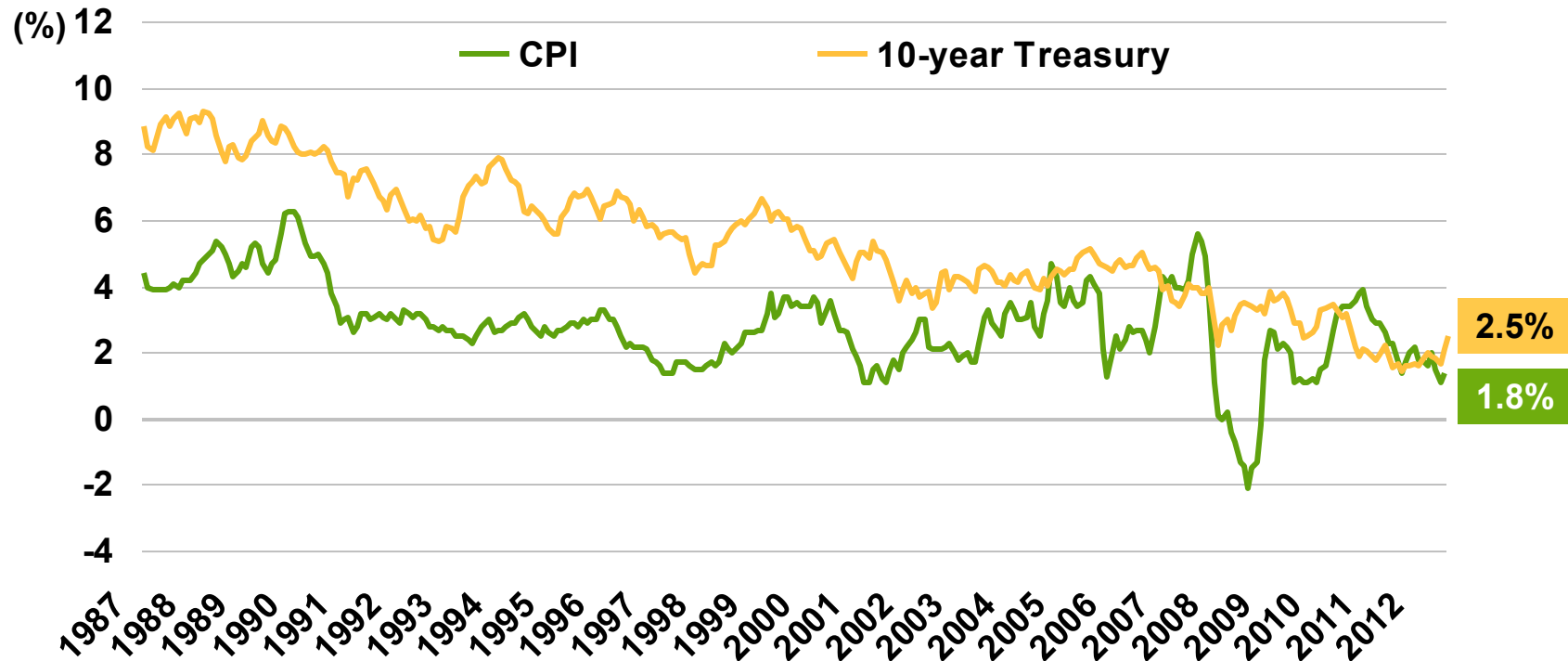
Source: Casey Quirk, “When the Tide Turns: Building Next Generation Fixed Income Managers,” May 2013.

# Fixed Income overview

- Investors may need to re-think the approach to investing in fixed income
  - We believe the thirty-year rally in bonds is approaching the end, and traditional benchmarks (and strategies) could leave investors exposed to interest-rate risk
  - Global growth is diverging, offering greater opportunities
- Spreads continue to look attractive on a historical basis despite the recent rally
  - Many attractive opportunities exist for those investors who look outside the benchmark
  - Improving economic conditions, strength in the housing market, continued deleveraging at the household and corporate level, etc., are all positives

The views and opinions expressed are those of the speaker, are subject to change with market conditions, and are not meant as investment advice.

# 10-year Treasury and inflation



**Average yield: 5.4%**

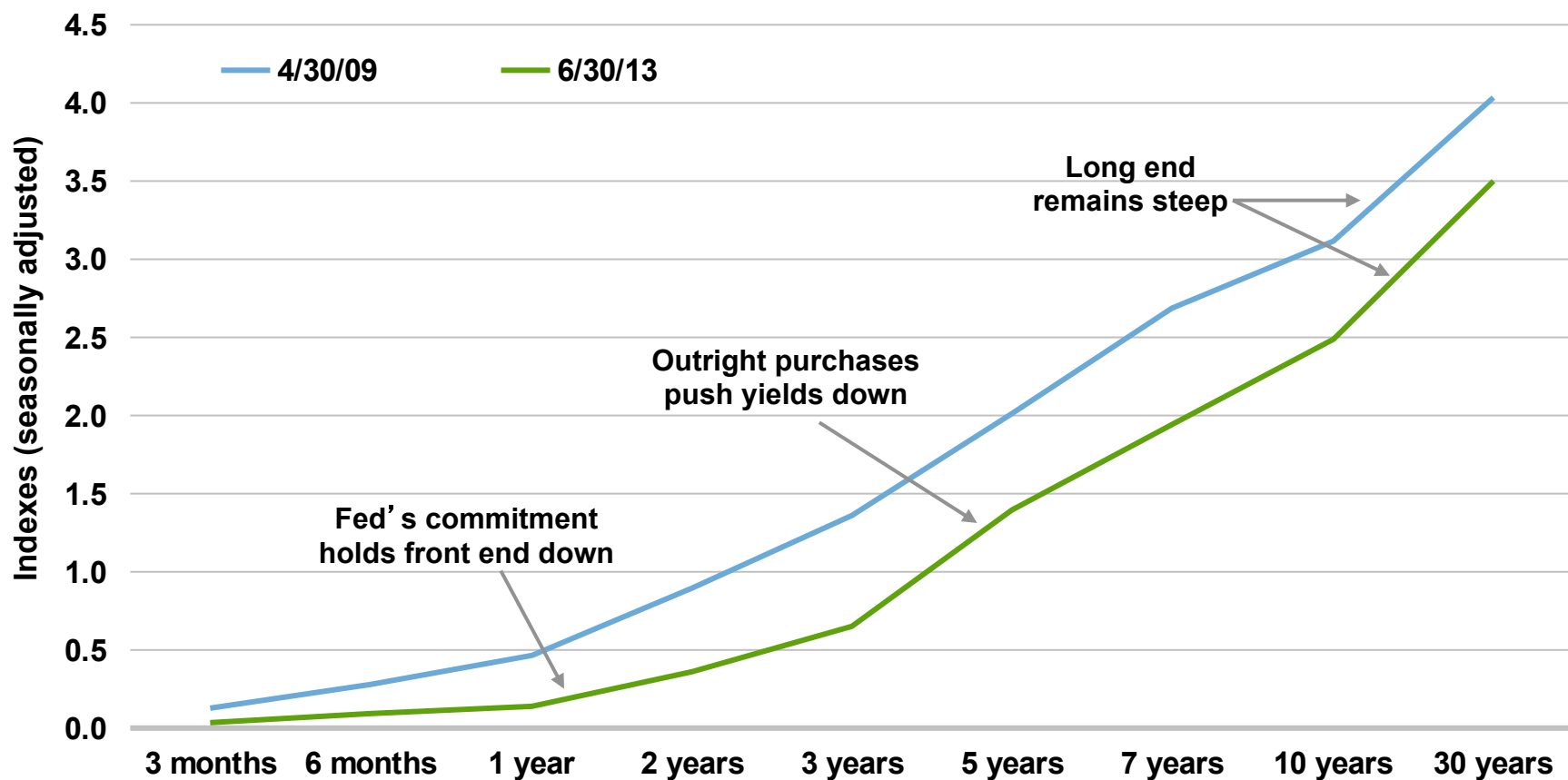
**Annual return: 6.4%**

**Average CPI: 2.8%**

**Real return: 3.6%**

Sources: Bloomberg, Barclays, as of 6/30/13. Past performance is not indicative of future results.

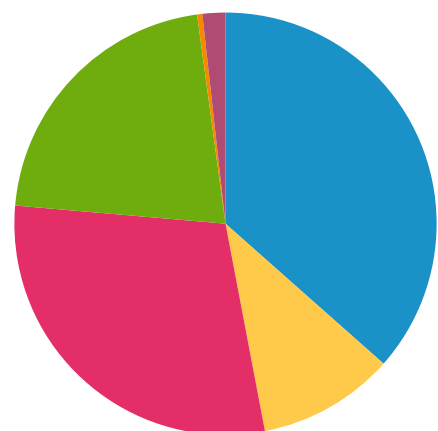
# The yield curve and quantitative easing (QE)



Source: Bloomberg, as of 6/30/13.

# Composition of the U.S. Aggregate Bond Index by market value

- Over 75% of the index is composed of government securities (Treasuries, agencies, and MBS)



■ Treasuries  
■ MBS  
■ ABS  
■ Gov't related  
■ Corporate  
■ CMBS

## Barclays U.S. Aggregate Bond Index

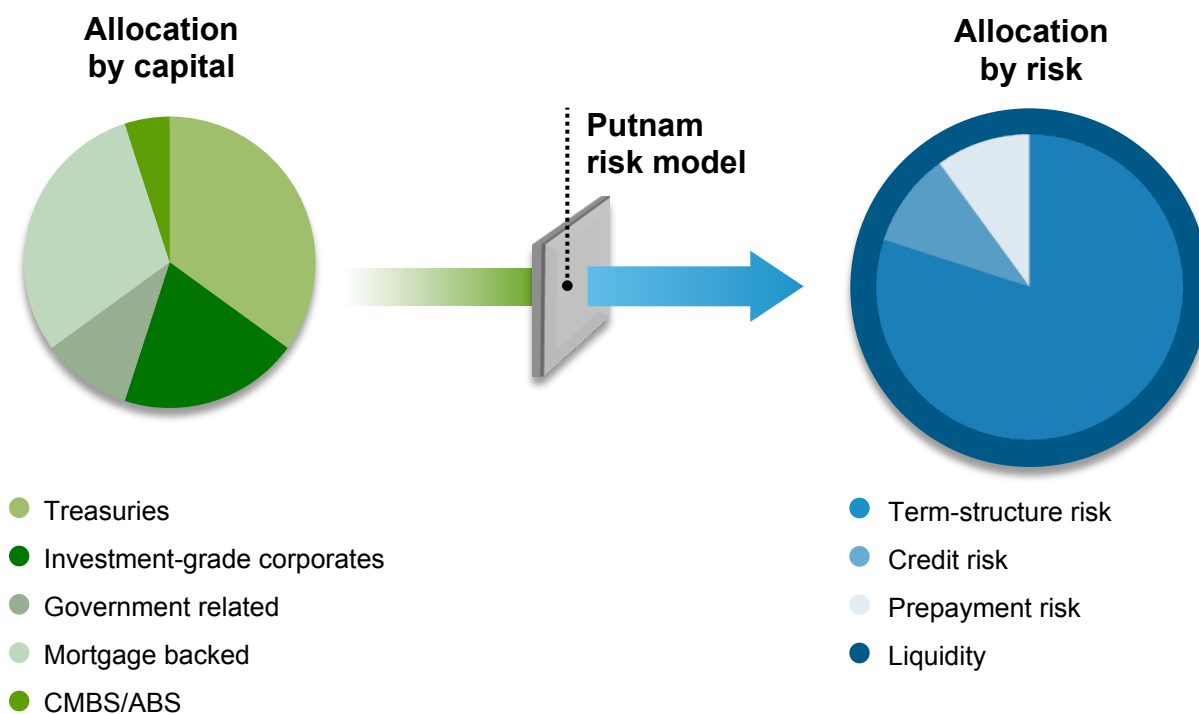
- \$17 trillion market value
- Average yield: 2.35%
- Average OAS: 61 bps
- Average duration: 5.49 years

Sources: Barclays, Putnam, as of 6/30/13.



# A traditional bond portfolio construction process results in concentrated interest-rate risk

Traditional asset allocation by sector, when viewed by Putnam's analysis of risk and return, reveals unbalanced risk exposure



For illustrative purposes only. This is not indicative of any Putnam fund or product.

# The problem: Your sponsors and participants are at risk

- The top 10 most widely held fixed-income funds are heavily exposed to term-structure/interest-rate risk.

	<b>Fund size</b>	<b>Treasury %</b>	<b>MBS %</b>
<b>Fund A</b>	267,996,785,843	38.00	36.00
<b>Fund B</b>	110,609,013,948	37.04	25.60
<b>Fund C</b>	70,057,882,841	46.89	0.00
<b>Fund D</b>	38,265,150,665	4.80	48.00
<b>Fund E</b>	33,807,328,286	0.00	92.76
<b>Fund F</b>	32,106,289,956	99.95	0.00
<b>Fund G</b>	30,411,356,539	25.60	29.00
<b>Fund H</b>	26,615,919,019	31.20	36.21
<b>Fund I</b>	26,253,251,412	24.70	49.60
<b>Fund J</b>	25,865,387,594	16.80	34.90

Top ten funds based on AUM as of 6/30/13 as ranked by Morningstar.

# Current spreads relative to historical period

Sector	Average OAS 12/31/97–12/31/07	June Month-End 6/30/13	Difference
<b>Sectors within the Aggregate Index</b>			
Agencies	34	38	<b>+4</b>
Agency MBS	56	61	<b>+5</b>
Investment-grade corporates	130	152	<b>+22</b>
AAA commercial MBS	89	130	<b>+41</b>
<b>“Out of benchmark” opportunities</b>			
High yield	573	538	<b>-35</b>
Non-agency residential MBS	123	200–725	<b>+77–602</b>
Agency IO	150	300–800	<b>+150–650</b>
Emerging-market debt	425	345	<b>-80</b>

Sources: Barclays, Bloomberg, Putnam, as of 6/30/13.

Data is provided for informational use only. Past performance is no guarantee of future results. All spreads are in basis points and measure option-adjusted yield spread relative to comparable maturity U.S. Treasuries with the exception of non-agency RMBS, which are loss-adjusted spreads to swaps calculated using Putnam's projected assumptions on defaults and severities, and agency IO, which is calculated using assumptions derived from Putnam's proprietary prepayment model. Agencies are represented by Barclays U.S. Agency Index. Agency MBS are represented by Barclays U.S. Mortgage Backed Securities Index. Investment-grade corporates are represented by Barclays U.S. Corporate Index. High yield is represented by Barclays U.S. Corporate High Yield Index. AAA CMBS is represented by Aaa portion of Barclays Investment Grade CMBS Index. EMD is represented by Barclays Global Emerging Markets Index. Non-agency is estimated using average market level of a sample of below-investment-grade securities backed by various types of non-agency mortgage collateral (excluding prime securities). Agency IO is estimated from a basket of Putnam-monitored interest-only (IO) and inverse IO securities. Option-adjusted spread (OAS) measures the yield over duration equivalent Treasuries for securities with different embedded options.

# Potential options to diversify risk in a DC lineup

- Consider a Global Bond strategy as a compliment
  - Wrinkle: the Global Agg. has similar yield/duration and risk concentration issues
- Include sector-specific strategies in the fund lineup
  - Offers more options and puts asset allocation decision in the participants' hands
- Consider an Agg.-based bond fund where the PM can invest outside the benchmark
  - Leaves fixed-income asset allocation decision to the “experts”
- Remove the benchmark completely (i.e., absolute return fixed-income and/or strategic-income funds)
  - Some institutional plans, consultants, and financial advisors are beginning to explore
  - Still a very new concept for both individual investors and plan sponsors

# Putnam's diverse fixed-income lineup

	Barclays U.S. Aggregate	Barclays Global Aggregate	Income Fund	Global Income Trust	Absolute Return 300 Fund®
<b>Total ex-ante risk</b>	<b>3.3%</b>	<b>4.9%</b>	<b>5.2%</b>	<b>4.6%</b>	<b>2.8%</b>
<b>Term</b>					
Global term structure	103%	36%	63%	49%	-2%
Currency	—	60	—	19	-3
<b>Credit</b>					
Corporate credit	-5	1	11	10	28
MBS credit	—	—	13	8	32
Emerging markets	—	2	—	4	4
Prepayment	2	1	13	10	41
Benchmark			Barclays U.S. Aggregate	Barclays Global Aggregate	U.S. T-Bills

Data as of 6/30/13. Allocations will vary over time. Risk as measured by standard deviation. Standard deviation measures how widely a set of values varies from the mean. Indexes are unmanaged and used as a broad measure of market performance. It is not possible to invest directly in an index. Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities. Barclays Global Aggregate Bond Index is an unmanaged index of global investment-grade fixed-income securities.

# Morningstar mutual fund rankings

## Number of funds\* (as of 6/30/13)

	1 year	3 years	5 years	10 years
Top decile	9/47	6/44	9/42	7/41
Top quartile	28/47	22/44	23/42	17/41
Above median	43/47	38/44	32/42	26/41
Bottom quartile	3/47	2/44	2/42	5/41

## Percent of funds (as of 6/30/13)

	1 year	3 years	5 years	10 years
Top decile	19%	14%	21%	17%
Top quartile	60%	50%	55%	41%
Above median	91%	86%	76%	63%
Bottom quartile	6%	5%	5%	12%

- Global Sector, Spectrum, and Absolute Return funds evaluated relative to benchmark
  - 3 years as of 6/30/13
    - 5 of 9 sector funds ahead of benchmark
    - Capital Spectrum ahead of benchmark by 6.9%, Equity Spectrum by 5.4%
    - AR funds ahead of benchmark over the full (3-year) cycle

\* Note: Does not include RetirementReady, Global Sector, Spectrum, Money Market, or Absolute Return fund performance.

# Wrap Up

- The right direction for your plans
- Why do you own fixed income?
  - Income
  - As a diversifying asset class
  - Lowers overall volatility
    - You need a different approach to get that now
- Your next steps
- Q&A

The views and opinions expressed are those of the Core Fixed Income team, are subject to change with market conditions, and are not meant as investment advice.

**Consider these risks before investing:** International investing involves certain risks, such as currency fluctuations, economic instability, and political developments. Additional risks may be associated with emerging-market securities, including illiquidity and volatility. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are subject to prepayment risk. The use of derivatives involves additional risks, such as the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations.

Bond investments are subject to interest-rate risk, which means the prices of the funds' bond investments are likely to fall if interest rates rise. Bond investments also are subject to credit risk, which is the risk that the issuer of the bond may default on payment of interest or principal. Interest-rate risk is generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds, which may be considered speculative. Unlike bonds, funds that invest in bonds have ongoing fees and expenses.

The prices of bonds in the funds' portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including both general financial market conditions and factors related to a specific issuer or industry.

Our allocation of assets among permitted asset categories may hurt performance. The prices of stocks and bonds in the funds' portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including both general financial market conditions and factors related to a specific issuer or industry. Our active trading strategy may lose money or not earn a return sufficient to cover associated trading and other costs. Our use of leverage obtained through derivatives increases these risks by increasing investment exposure.

Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are subject to prepayment risk. International investing involves certain risks, such as currency fluctuations, economic instability, and political developments.



Additional risks may be associated with emerging-market securities, including illiquidity and volatility. Our use of derivatives may increase these risks by increasing investment exposure (which may be considered leverage) or, in the case of many over-the-counter instruments, because of the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations.

The funds may not achieve their goal, and they are not intended to be a complete investment program. The funds' effort to produce lower-volatility returns may not be successful and may make it more difficult at times for the fund to achieve their targeted return. In addition, under certain market conditions, the funds may accept greater volatility than would typically be the case, in order to seek their targeted return. **For the 500 Fund and 700 Fund, these risks also apply:** REITs involve the risks of real estate investing, including declining property values. Commodities involve the risks of changes in market, political, regulatory, and natural conditions. Additional risks are listed in the funds' prospectus. You can lose money by investing in the funds.

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*Your clients should carefully consider the investment objectives, risks, charges, and expenses of a fund before investing. For a prospectus, or a summary prospectus if available, containing this and other information for any Putnam fund or product, call Putnam Dealer Marketing Services at 1-800-354-4000. Your clients should read the prospectus carefully before investing.*

**Putnam Retail Management**  
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# Putnam fund Morningstar rankings

## (As of 6/30/13)

Fund name	Category	1-year	3-year	5-year	10-year
Putnam Emerging Markets Income Y	Emerging Markets Bond	—	—	—	—
Putnam Global Dividend Y	World Stock	—	—	—	—
Putnam Intermediate-Term Muni Inc Y	Muni National Interm	—	—	—	—
Putnam Low Volatility Equity Y	Large Blend	—	—	—	—
Putnam Short-Term Municipal Income Y	Muni National Short	—	—	—	—
Putnam Strategic Volatility Equity Y	Large Blend	—	—	—	—
Putnam Short Duration Income Y	Ultrashort Bond	45% (57/126)	—	—	—
Putnam Multi-Cap Core Y	Large Blend	7% (110/1565)	—	—	—
Putnam Dynamic Risk Allocation Y	World Allocation	80% (464/574)	—	—	—
Putnam Europe Equity Y	Europe Stock	12% (13/105)	10% (10/93)	32% (27/83)	56% (39/69)
Putnam Dynamic Asset Allocation Gr Y	Aggressive Allocation	15% (62/416)	10% (31/330)	18% (54/308)	12% (15/123)
Putnam International Value Y	Foreign Large Value	22% (79/354)	13% (40/320)	72% (199/276)	60% (87/144)
Putnam Income Y	Intermediate-Term Bond	5% (50/1189)	14% (136/1005)	4% (36/873)	10% (61/616)
Putnam Global Income Y	World Bond	18% (63/345)	14% (35/255)	13% (27/207)	11% (12/124)
Putnam OH Tax Exempt Income Y	Muni Ohio	2% (2/54)	14% (8/52)	11% (6/49)	28% (12/41)
George Putnam Balanced Y	Moderate Allocation	19% (169/919)	20% (159/789)	85% (603/705)	96% (406/422)
Putnam Investors Y	Large Blend	27% (415/1565)	20% (271/1381)	17% (216/1254)	66% (515/774)
Putnam MA Tax Exempt Income Y	Muni Massachusetts	32% (22/66)	21% (14/64)	2% (2/63)	6% (4/54)
Putnam CA Tax Exempt Income Y	Muni California Long	14% (20/143)	21% (28/134)	19% (25/128)	30% (33/107)
Putnam AZ Tax Exempt Income Y	Muni Single State Long	20% (58/294)	21% (59/280)	10% (26/269)	23% (51/226)
Putnam Small Cap Value Y	Small Value	47% (170/364)	21% (62/295)	56% (144/254)	85% (129/151)
Putnam Tax-Free High Yield Y	High Yield Muni	36% (58/159)	23% (34/149)	7% (9/121)	26% (22/92)
Putnam MN Tax Exempt Income Y	Muni Minnesota	19% (12/60)	24% (14/55)	21% (12/53)	25% (11/45)
Putnam International Growth Y	Foreign Large Blend	23% (182/793)	24% (172/710)	13% (77/622)	27% (88/324)
Putnam Dynamic Asset Allocation Bal Y	Moderate Allocation	26% (237/919)	24% (192/789)	24% (171/705)	34% (145/422)
Putnam Fund for Growth & Income Y	Large Value	10% (114/1199)	25% (264/1047)	21% (194/935)	84% (513/605)
Putnam Research Y	Large Blend	38% (594/1565)	25% (343/1381)	12% (148/1254)	69% (535/774)

# Putnam fund Morningstar rankings

## (As of 6/30/13)

Fund name	Category	1-year	3-year	5-year	10-year
Putnam Tax Exempt Income Y	Muni National Long	25% (59/239)	26% (58/221)	26% (55/207)	25% (43/171)
Putnam MI Tax Exempt Income Y	Muni Single State Inter	6% (13/232)	3% (6/219)	4% (8/216)	6% (11/201)
Putnam Convertible Securities Y	Convertibles	14% (13/86)	30% (22/72)	25% (15/57)	14% (7/45)
Putnam NY Tax Exempt Income Y	Muni New York Long	29% (33/112)	30% (29/96)	24% (23/93)	28% (25/86)
Putnam PA Tax Exempt Income Y	Muni Pennsylvania	22% (19/84)	32% (27/82)	34% (28/80)	22% (16/70)
Putnam Growth Opportunities Y	Large Growth	23% (387/1698)	33% (494/1488)	9% (119/1308)	62% (534/863)
Putnam US Government Income Y	Intermediate Government	15% (49/327)	34% (107/315)	2% (5/286)	1% (3/247)
Putnam High Yield Y	High Yield Bond	31% (190/624)	34% (176/525)	34% (158/467)	18% (57/326)
Putnam American Government Income Y	Intermediate Government	25% (82/327)	38% (121/315)	3% (7/286)	7% (16/247)
Putnam High Yield Advantage Y	High Yield Bond	48% (303/624)	38% (201/525)	30% (142/467)	8% (26/326)
Putnam Multi-Cap Growth Y	Large Growth	22% (378/1698)	38% (567/1488)	49% (636/1308)	49% (425/863)
Putnam Multi-Cap Value Y	Mid-Cap Value	36% (151/423)	40% (149/369)	63% (198/312)	60% (106/176)
Putnam Floating Rate Income Y	Bank Loan	36% (74/203)	40% (53/133)	64% (79/122)	—
Putnam Dynamic Asset Allocation Cnsv Y	Conservative Allocation	29% (213/729)	43% (253/587)	27% (135/502)	41% (86/207)
Putnam Small Cap Growth Y	Small Growth	20% (144/713)	44% (276/632)	78% (437/558)	90% (329/362)
Putnam AMT - Free Municipal Y	Muni National Long	29% (70/239)	45% (99/221)	27% (57/207)	60% (103/171)
Putnam NJ Tax Exempt Income Y	Muni New Jersey	34% (20/58)	47% (27/56)	27% (15/54)	24% (11/43)
Putnam Equity Income Y	Large Value	7% (78/1199)	5% (50/1047)	5% (41/935)	7% (41/605)
Putnam International Capital Opp Y	Foreign Small/Mid Value	60% (34/56)	57% (21/36)	52% (17/32)	16% (4/20)
Putnam International Equity Y	Foreign Large Blend	6% (47/793)	6% (43/710)	64% (399/622)	71% (231/324)

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in the funds' monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its 3-, 5-, and 10-year (if applicable) Morningstar Rating metrics. Data is historical. Past performance is no guarantee of future results. Morningstar Ratings shown are for class A shares class only; other classes may have different performance characteristics.



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