

What would the end of the pandemic mean for the bull market?

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2020 election: Implications for industries

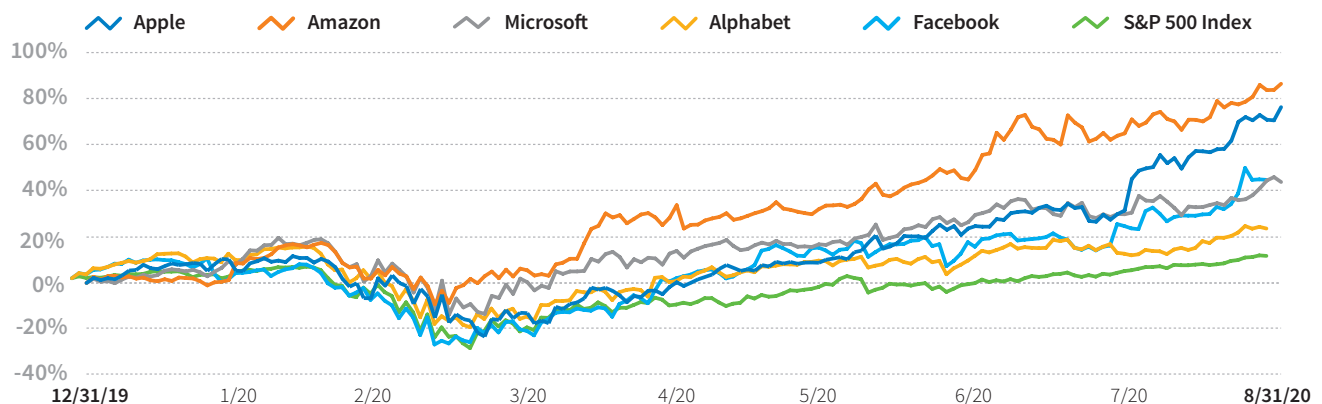
The active edge in sustainable investing

Advances in equities continued through another quarter, but experienced investors know that a measure of caution is warranted. Today's market is considerably one-sided, skewed heavily toward a narrow band of high-growth stocks. We see some trends that are rare for a recessionary environment and that are worth considering as we position portfolios.

We explore what makes this recession unique and why COVID-19 vaccine progress could be disruptive to markets. Members of our equity research team discuss the potential impact of the U.S. presidential election on a range of industries. And our Sustainable Investing team outlines how they seek an "active edge" versus passive ESG peers.

Large technology stocks lead in a market skewed toward growth

Performance for five largest S&P companies



Sources: S&P Dow Jones Indices, NASDAQ.

A recession like no other



Shep Perkins, CFA
Chief Investment Officer, Equities
Portfolio Manager of Putnam Global Equity Fund

As we enter the final quarter of this unforgettable year, the COVID-19 pandemic remains at the forefront of investor concerns. Clearly, a solution to this problem would be extremely beneficial for public health, sentiment, and global economies. However, for U.S. equity markets, such a development won't be as sanguine.

“ With so much equity ownership skewed toward growth, we could see a sharp sector rotation. ”

If virus fears subside, markets could be volatile

Today's equity market is considerably one-sided. Based on estimates from FundStrat, approximately 70% of the S&P 500 Index, as measured by market capitalization, consists of companies that are reasonably well positioned for the current constrained conditions. This includes high-growth, mega-cap “virus beneficiaries” in the technology sector. It also includes bond proxy stocks that are thriving in the low-interest-rate environment and would benefit from a prolonged economic slowdown. Other beneficiaries include those that are ideally suited for a pandemic, such as Clorox, or the housing sector, which is seeing a fundamental boost from the ultra-low interest rates. One example of the exuberance for growth stocks today is Tesla. The company has undoubtedly seen improvement in fundamentals. However, 2021 revenue and EPS estimates haven't changed since 2018, yet the stock is up 10-fold since then.

Only about 30% of the market is oriented toward cyclically sensitive stocks in sectors such as industrials, financials, and consumer discretionary. So what

happens if we see meaningful progress toward eliminating the virus, such as an approved vaccine or evidence of herd immunity? The consensus view is that equity markets would rally even further, but we could see disruption in the overall index averages in the equity markets — possibly in the form of a sharp sector rotation as so much of equity ownership today is skewed toward growth.

“ Second-quarter earnings announcements brought a scenario of ‘haves’ and ‘have-nots.’ ”

Moreover, if pandemic worries subside, investors will anticipate a sustained and robust economic recovery over the next few years. This, in turn, could lead to inflationary concerns and eventually higher interest rates, further pressuring the growth and quality sectors that are widely favored today.

Earnings extremes

Although it's not unprecedented to see a strong stock market early in an economic downturn, we've seen other trends that are rare for a recessionary environment. Second-quarter earnings announcements brought a scenario of “haves” and “have-nots.” Some businesses experienced extremely strong year-over-year growth while others saw their revenues decline by staggering amounts. This contrast is unusual in the midst of a deep recession, when typically most businesses struggle to varying degrees. Obviously, leisure-related industries, such as hotels, casinos, airlines, cruise lines, and concert venues have been hit hard. But auto parts and home improvement retailers have experienced phenomenal results. Lowe's, for example, reported same-store sales growth of an astounding 34% in the most recent quarter. Also, construction activity has rebounded meaningfully, and U.S. pending home sales have skyrocketed. Many of these trends are the result of pandemic-related shifts in business practices and consumer behavior, as well as ultra-low interest rates, making this a recession like no other in history.

Multiples and interest rates: A vulnerable equity market?

Also worth noting in today’s market are rapidly expanding price/earnings multiples. The adage that “stock prices follow earnings” seems true only in terms of direction but not at all in magnitude. Apple’s stock price, for example, has soared fourfold in the past four years, yet earnings have increased just 50%. And over the past five years, the company’s compounded annual revenue growth has been less than 4% per year. Apple’s P/E multiple has expanded from 13 times 2016 forward earnings to a record 34x today.

“ The adage that ‘stock prices follow earnings’ seems true only in terms of direction but not at all in magnitude. ”

Many factors could be contributing to Apple’s multiple expansion, such as an appreciation for the company’s resilience and pent-up earnings potential given the challenging 2020 environment. However, another key driver is the low-interest-rate environment spurred by a hyper-accommodative Federal Reserve. This drives

investors to equities from low-yielding bonds — Apple’s dividend yield is in line with the 10-year Treasury — and it increases the present value of future growth through a lower discount rate.

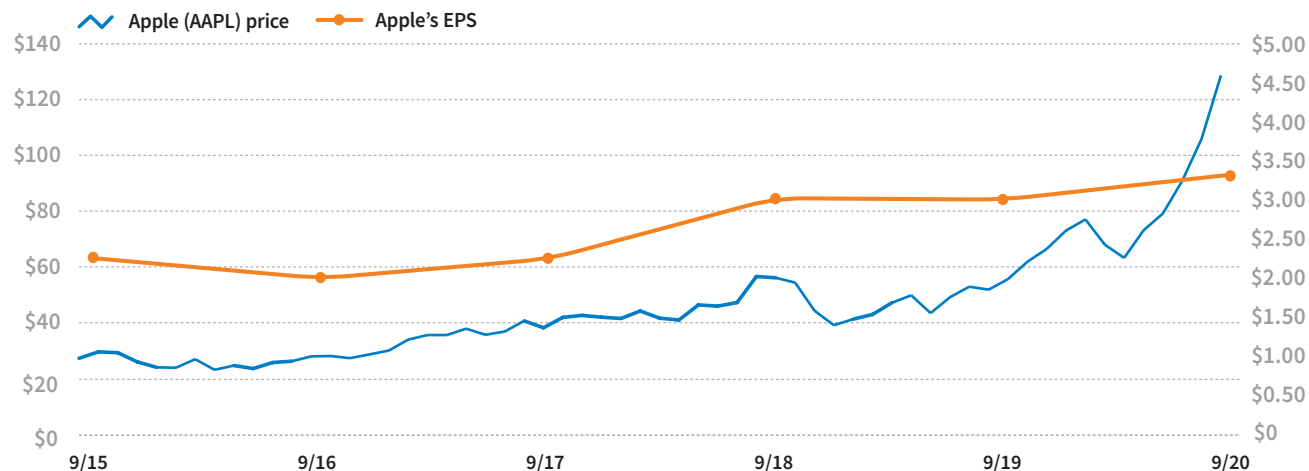
“ Pandemic-related shifts have made this a recession like no other in history. ”

This represents a key risk for the equity market. If interest rates rise, P/E multiples are more likely to contract. High-growth stocks would be particularly vulnerable, as their elevated multiples have the farthest to compress. Since the global financial crisis, each time rates moved higher, equity market volatility intensified. Many investors remember the 2013 “Taper Tantrum,” when emerging market stocks corrected.

The equity market has benefited from low inflation expectations and no deflation, which is a near-perfect Goldilocks scenario. If we were to move out of this range and inflationary pressures increase, especially if the economy gains strength, we could see rising interest rates — a risk we are monitoring in the closing months of 2020.

Share prices are outpacing earnings

Apple’s share price has soared while Apple’s earnings growth has been less robust



Sources: NASDAQ and SEC filings. Stock price adjusted for 4:1 split on 8/28/20. 2020 EPS is a forecast.

2020 election analysis

As we approach the 2020 U.S. presidential election, Putnam's investment professionals consider the impact each candidate could have on an array of industries.

INFRASTRUCTURE

Elizabeth C. McGuire

Analyst, materials and industrials

With either a Biden or a Trump administration, we believe that a large federal infrastructure bill is likely to be passed in 2021. This has been a focus for governing officials for a while for a number of reasons. They include high-profile bridge collapses as well as a D+ grade on the American Society of Civil Engineers' 2017 Infrastructure Report Card. Now, our crumbling infrastructure will be combined with the need for post-COVID economic stimulus, increasing the likelihood of an infrastructure bill.

Biden's current proposal is to spend \$2 trillion on infrastructure over four years. This includes more traditional spending on roads, bridges, and waterways, as well as "green" spending in areas such as electric vehicle charging stations and sustainable homes. Trump has floated a \$1 trillion amount, with a heavy focus on traditional road and bridge work.

Congress matters too

Congressional races are also important. We believe a Biden administration with a Democratic House and Senate would result in the quickest passage of an infrastructure bill, and one that would include a higher spending total and a greater focus on "green" projects. For stocks, we believe construction materials and equipment companies would benefit most directly, as would electric vehicle suppliers. Indirectly, to the extent that an infrastructure program creates more jobs, consumer stocks should also benefit.

Companies we're watching: Aggregate and cement suppliers Summit Materials (SUM) and CRH (CRH LN).

PIPELINES

William C. Rives, CFA

Analyst, Portfolio Manager of Putnam Research Fund

Oil and gas pipelines and midstream infrastructure face a challenging outlook regardless of who is elected,

although a Biden victory could bring additional long-term difficulties. Conditions are not good for the pipeline industry. Some of the largest U.S. pipeline projects, costing billions, have been canceled due to regulatory uncertainty. Existing pipelines are also being challenged and could face temporary or permanent shutdowns.

The biggest headwind has been the ability of environmentalists to use courts to delay projects until it doesn't make economic sense to continue them. In our view, conditions will not change if Trump wins in November, since many of the issues are not driven by federal policy.

Biden win could bring longer-term challenges

We believe the near-term impacts of a Biden administration would be manageable. There is the potential for Biden to eliminate fracking permits on federal land, but this is not a major source of production. Other issues are more significant. Biden wants to eliminate carbon from the power sector by 2035. The power sector represents roughly one third of U.S. natural gas demand, and this would be a headwind for natural gas pipeline volumes. Biden also supports expanded electric vehicle adoption, which could pressure oil pipeline volumes.

Companies we're watching: Entrenched pipeline operators Williams (WMB) and Enterprise (EPD).

OIL AND GAS

Ryan W. Kauppila

Analyst, global natural resources

The politicization of energy and climate issues that accelerated under President Obama has continued under the Trump administration. Campaign rhetoric suggests more of the same under Biden, who declared in a March debate: "No ability for the oil industry to continue to drill, period." There is little evidence that either party wants to use free-market tools to address de-carbonization (e.g., a carbon tax). Rather, the preferred policy choices are myriad supply- and demand-side decrees such as rules around federal drilling permits, biofuels regulations, and highly complex fuel efficiency mandates.

Potential for international oil price inflation

In aggregate, Trump's deregulation efforts and tax policies have lowered the costs of U.S. production and the slope

of global oil and gas supply curves, negatively impacting both prices and the returns achieved for producers. The consensus view today is that Biden's anti-hydrocarbon mantra would translate into a similarly challenging period for energy equities. However, I suspect the supply impact will overwhelm any demand attrition over the near and medium term. We could see a surprising inflationary period for international oil prices under a Biden administration. From an equity investing perspective, that would likely be negative for the returns of U.S. producers, but beneficial for producers outside the United States.

Companies we're watching: Cenovus (CVE), BP (BP), and Total (TOT).

HEALTH CARE

Michael J. Maguire, CFA

Analyst, Portfolio Manager of Putnam Global Health Care Fund

It's not easy to find areas where politicians from both sides of the aisle are in agreement. Medicare Advantage, the privatized version of Medicare coverage, has been a resounding success in the view of Republicans and Democrats. Because of this and our aging population, we believe many managed care insurance companies are well positioned for growth, regardless of the election outcome. Medicare Advantage is likely to stay intact, but a Biden administration may seek to expand the benefits, such as lowering the eligibility age. Democrats are also more likely to seek increases in government funding for Medicaid. This could weigh on managed-care stocks because margins are typically lower with government coverage.

The most complex challenge: Drug pricing

Both parties agree that drug pricing is a significant problem. Drugs are getting more expensive, and the co-pay structure is poorly designed. Both Biden and Trump are likely to focus on this issue, putting pressure on retail pharmacies, drug manufacturers, wholesalers, and pharmacy benefit managers. This incredibly complex challenge will continue long after the election. We also find bipartisan support when it comes to medical innovation. From gene therapies to targeted oncology, highly innovative assets tend to be viewed favorably from a legislative and regulatory perspective.

Companies we're watching: UnitedHealth Group (UNH), Eli Lilly (LLY), Acceleron Pharma (XLRN), and Danaher (DHR).

TECHNOLOGY

Robert B. Gray

Analyst, technology

A common belief is that only Biden would be negative for "big tech." However, there is bipartisan support for regulation of businesses such as Amazon, Apple, Facebook, and Google. With internet regulation, many issues are at play, such as consumer data/privacy, the role of social media in elections, and free speech. In our view, the most significant regulatory risk is around competition, and anti-trust-related regulation could have negative consequences for large internet companies. However, we believe the path to comprehensive regulation will be long and complicated.

Cable: Rate regulation and net neutrality

For cable companies, a key area of focus is net neutrality. This is the principle that internet service providers must treat all communications equally, and they may not intentionally slow down, block, or charge for prioritization of specific types of online content. We fully expect Biden to push for reinstatement of the net neutrality rules overturned by Trump. The impact on cable companies would be immaterial, we believe, as they already largely abide by net neutrality principles.

A Biden administration could be more stringent, perhaps seeking to regulate pricing for internet service. In our view, however, this is a low probability event. For both the cable and internet industries under either administration, calls for regulation are not likely to result in significant near-term disruptions.

Companies we're watching: Charter (CHTR), Amazon (AMZN), and Alphabet (GOOG/GOOGL).

The active edge in sustainable investing



Stephanie Dobson
Portfolio Manager, Putnam Sustainable Leaders and Sustainable Future Funds



Katherine Collins, CFA, MTS
Head of Sustainable Investing
Portfolio Manager, Putnam Sustainable Leaders and Sustainable Future Funds

The challenges of 2020 have given us an opportunity to test our processes and performance in an extreme set of conditions. During this time, sustainable investing strategies have fared well, as has our active investment approach. We believe that active, fundamental research is key to unlocking differentiated insights and creating alpha for all strategies. The potential benefits are even more clear for sustainable investing, where underlying environmental, social, and governance (ESG) data is still evolving, and context matters greatly.

“ We seek out companies where a leading sustainability strategy is fueling financial outperformance. ”

Focus on inclusion is key to alpha and impact

As active managers, we take an inclusionary approach and seek out companies where a leading sustainability strategy is fueling financial outperformance. One example is First Republic Bank, where a strong culture leads to lower employee turnover, higher referral rates, and more sustainable loan growth.

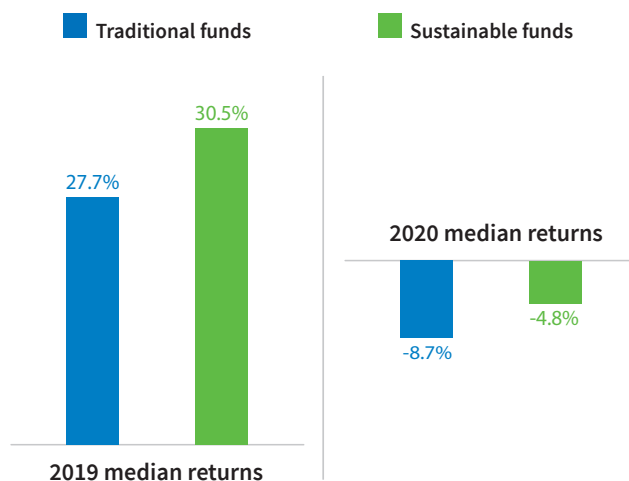
Within the sustainable investment landscape, many passive strategies take an exclusionary approach that eliminates exposure to certain types of businesses, while other passive strategies take a “best-in-class” approach that

aims for sector-neutral portfolio construction by owning stocks with the highest sustainability ratings within each sector or industry. For example, one of the largest passive ESG exchange-traded funds (ETFs) available today holds shares in Exxon and Chevron, two of the world’s largest publicly traded hydrocarbon producers. Several of the other top passive ESG ETFs hold shares in other large global hydrocarbon producers such as Saudi Arabian Oil Company, NK Lukoil, and others. This is because the investment process for passive ETF portfolios is typically based on excluding certain business involvements and incorporating assessments of ESG practices.

In contrast, our forward-looking fundamental approach, focused on long-term trends and company-specific business analysis, helped us to identify companies like AES, a global power company proactively transitioning power generation from hydrocarbons to renewable energy. The stocks of large hydrocarbon producers have underperformed in recent years in part due to the industry’s transition to lower cost renewable energy sources, whereas AES stock had a one-year gain of more than 19% as of August 31, 2020. Of course, an active approach does not always lead to such divergence in performance, but this example illustrates the potential benefit of investing in companies that are leading sustainability trends like the shift to renewable energy.

Sustainable funds have outperformed

U.S sustainable funds outperformed their traditional peers in 2019 and in the first half of 2020.



Source: Morgan Stanley. Data as of 6/30/20.

Considering companies of all sizes

As active managers, we sometimes seek opportunities in smaller, faster-growth companies that are creating innovative and impactful solutions. Many passive strategies rely at least in part on third-party ESG ratings, which tend to favor larger-cap companies. Larger companies have more resources to devote to ESG disclosure, which tends to lead to higher scores. Smaller companies with fewer resources, yet with products or services that might be tied to powerful sustainability themes, often have lower, or incomplete, scores from third-party data providers.

This dynamic can also be seen with newer companies, and especially with recent IPOs. Our ability as active managers to incorporate timely and unstructured ESG information before it is reflected in third-party scores is essential. Without this approach, our shareholders might miss out on the potentially strong performance of smaller or newly public companies that focus on sustainability solutions.

We learn from the past, but are focused on the future

A company’s disclosure on greenhouse gas emissions over the past five years is likely not the determining factor for financial performance (or environmental progress) over the next five years. Our approach allows us to use valuable historical and external ESG data as context for considering future prospects.

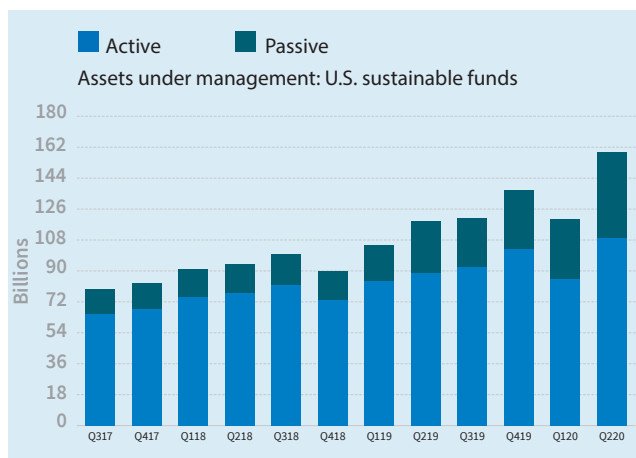
With an understanding of history, we can analyze future potential in areas like commitment to improvements in resource intensity, strength of corporate culture, and ability to invest future cash flows wisely. All of these elements are harder-to-quantify, forward-looking ESG characteristics that are not easily captured by third-party data, but can meaningfully impact future fundamental performance.

“ We analyze harder-to-quantify, forward-looking ESG characteristics that are not easily captured by third-party data, but can impact future performance.”

We believe that thoughtful fundamental analysis is required to identify the relevant and financially material sustainability issues that will impact the future performance of a given company. By taking an integrated fundamental approach to research, we identify companies where sustainability leadership and innovative solutions will contribute to long-term financial success. Our active portfolios therefore pursue excellence in financial performance that is intrinsically linked to excellence in sustainability performance.

Active sustainable flows are growing

Inflows into active U.S. sustainable funds have accelerated in 2020, driving active AUM to more than \$100 billion.



Sources: Morningstar Direct, Morningstar Research. Data as of June 2020.

An active, research-driven approach to investing in equities

Equity investing at Putnam features a tenured and talented team of portfolio managers backed by an integrated group of research analysts with worldwide reach. Our research organization is structured to focus fundamental analysis on the factors that matter most in global equity markets.

EQUITIES AT PUTNAM



Shep Perkins, CFA
 Chief Investment Officer, Equities
Investing since 1993
Joined Putnam in 2011



Kate Lakin
 Director of Equity Research
In the investment industry since 2008
Joined Putnam in 2012

The power of independent research

Fundamental research has always been an important driver of security selection for Putnam. Our firm is built with the scale to research global markets while also allowing analysts to achieve thorough conviction in their recommendations. Our research organization thrives in an entrepreneurial and collaborative environment, where out-of-the-box critical thinking is encouraged, and analysts are focused on developing differentiated insights.

S&P 500 Index is an unmanaged index of common stock performance. You cannot directly invest in an index.

Alpha is a measure of performance on a risk-adjusted basis. Alpha takes the volatility of a mutual fund and compares its risk-adjusted performance with a benchmark index. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

Top 10 holdings as of 6/30/20:

Putnam Global Equity Fund: Amazon (5.13%); NRG Energy (4.88%); Microsoft (4.26%); Nomad Foods (3.13%); ServiceNow (2.58%); Union Pacific (2.34%); Visa (2.16%); Assured Guaranty (1.98%); Nestle (1.95%); Alphabet (1.93%). Holdings represented 30.34% of the portfolio.

Putnam Sustainable Future Fund: Adobe (3.58%); Danaher (3.37%); Thermo Fisher Scientific (2.89%); Chipotle Mexican Grill (2.40%); GoDaddy (2.16%); RingCentral (2.07%); Dynatrace (2.07%); First Republic Bank (2.02%); DocuSign (1.96%); McCormick & Co.

(1.94%). Holdings represented 24.46% of the portfolio.

Putnam Sustainable Leaders Fund: Microsoft (7.77%); Apple (5.93%); Amazon (4.97%); Adobe (2.96%); Danaher (2.74%); Alphabet (2.63%); Visa (2.41%); BlackRock (2.39%); Bank of America (2.37%); Thermo Fisher Scientific (2.26%). Holdings represented 36.43% of the portfolio.

The views and opinions expressed are those of the authors: Shep Perkins, CFA; Elizabeth C. McGuire; William C. Rives, CFA; Ryan W. Kauppila; Michael J. Maguire, CFA; Robert B. Gray; Katherine Collins, CFA, MTS; and Stephanie Dobson as of August 31, 2020, are subject to change with market conditions, and are not meant as investment advice.

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Consider these risks before investing: The value of investments in the fund's portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general economic, political, or financial market conditions; investor sentiment and market perceptions; government actions; geopolitical events or changes; and factors related to a specific issuer, geography, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund's portfolio holdings. Growth stocks may be more susceptible to earnings disappointments, and the market may not favor growth-style investing. Value stock 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. Investments in small and/or midsize companies increase the risk of greater price fluctuations. International investing involves currency, economic, and political risks. Emerging-market securities have illiquidity and volatility risks. The fund's investment strategy of investing in companies that exhibit a commitment to sustainable business practices may result in the fund investing in securities or industry sectors that underperform the market as a whole or underperform other funds that do not invest with a sustainable focus. 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. In evaluating an investment opportunity, we may make investment decisions based on information and data that is incomplete or inaccurate. Due to changes in the products or services of the companies in which the fund invests, the fund may temporarily hold securities that are inconsistent with its sustainable investment criteria. Our investment techniques, analyses, and judgments may not produce the outcome we intend. The investments we select for the fund may not perform as well as other securities that we do not select for the fund. We, or the fund's other service providers, may experience disruptions or operating errors that could have a negative effect on the fund. You can lose money by investing in the fund.

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