Q3 2020 | Putnam High Yield Fund Q&A

High yield advances amid supportive risk environment

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High-yield bonds advanced by about 5% in the third quarter, fueled by strong demand for higher-yielding securities.

The fund's overweight exposure to the strong-performing housing industry contributed the most versus the benchmark. Conversely, security selection in services detracted from relative performance.

Despite ongoing uncertainty, we have a moderately constructive intermediate-term view on the market's fundamental environment and supply-and-demand backdrop.

How did the fund perform for the three months ended September 30, 2020?

The fund's class Y shares returned 4.59%, trailing the 5.11% result of the benchmark JPMorgan Developed High Yield Index.

What was the market environment like for high-yield bonds during the third quarter of 2020?

The quarter began on a very strong note, with the fund's benchmark index advancing 4.5% in July. A confluence of factors lifted market sentiment, including positive developments on a potential vaccine, progress on a new economic relief package, and corporate earnings that came in above consensus expectations. These dynamics boosted sentiment despite heightening U.S.–China tensions and rising COVID-19 case counts across parts of the globe.

High-yield bond prices continued to climb throughout August amid larger gains for stocks, as investors focused on heavy new-issuance, better-than-forecast earnings, an economic revival, and improving prospects for a vaccine.

High yield pulled back moderately in September, partly due to increased global economic concerns stemming from an upsurge in virus cases in Europe. Fading hope for another U.S. stimulus package and uncertainty surrounding upcoming U.S. elections also weighed on the asset class.

Reflecting renewed investor demand for risk, high-yield bonds outpaced high-yield bank loans, investment-grade corporate bonds, and the broad investment-grade fixed-income market.

Within the JPMorgan index, all cohorts posted gains, led by gaming, lodging & leisure [+7%], transportation [+7%], retail [+6%], and industrials [+6%]. Conversely, utilities [+3%], diversified media [+4%], and energy [+4%] lagged the fund's benchmark. From a credit-rating perspective, lower-quality debt generated the highest gains, reflecting increased risk appetite on the part of investors and demand for higher yields.

What factors had the biggest influence on the fund's relative performance?

On the plus side, overweight exposure to the outperforming housing/building products cohort aided performance versus the benchmark, as did security selection in financials. On the downside, selection in services, along with lower-than-benchmark allocations in transportation and automotive, detracted on a relative basis.

What is your outlook for the high-yield market over the coming months?

We have a moderately constructive outlook overall. The biggest risk on the horizon continues to be the impact of the coronavirus pandemic on economic growth, corporate earnings growth, and cash flows.

That said, except for the energy sector, we have a fairly positive intermediate-term view on corporate fundamentals and the market's supply-and-demand backdrop. Also, even though high-yield spreads retightened following their sizable widening in March, we think valuations remain relatively attractive. [Spreads are the yield advantage high-yield bonds offer over comparable-maturity U.S. Treasuries.]

From a fundamental perspective, we are closely watching sectors vulnerable to the disruption caused by the pandemic. In addition to energy, we are monitoring the impact on gaming, lodging & leisure, retail, and several other cohorts. Within these groups, we are focusing on the health of issuers' balance sheets and liquidity metrics, as well as the increasing risk of defaults or credit-rating downgrades.

As for supply/demand dynamics, on a year-to-date basis through September, net new-issue volume [new issuance excluding bonds issued to refinance existing debt] totaled $121.1 billion, a 78% increase over the same period in 2019. On the demand side, high-yield funds [mutual funds and ETFs] saw inflows of $39.3 billion year to date versus $18.8 billion in the first nine months of 2019. Overall, a resurgence in new-issue supply is being met by strong demand.

From a valuation standpoint, the average spread of the fund's benchmark rose 3.65 percentage points during March to about 9.5 percentage points over Treasuries. This was the highest spread level since early 2016 and was well above the 20-year average of 6.1 percentage points. The benchmark's average yield spiked to 10% during this time. At the end of the third quarter, spreads had tightened back close to their long-term average and the benchmark's yield was at 6.3%. In our view, spreads at this level continue to offer a broad range of attractive relative-value investment opportunities. Moreover, we think the market's yield remains compelling in the face of much lower global yields.

How was the fund positioned as of September 30?

Relative to the benchmark, the portfolio had overweight exposure to the higher-quality segment of the market and an underweight allocation in lower-quality bonds. From an industry perspective, we favored cable & satellite, utilities, housing/building products, and broadcasting.

Putnam High Yield Fund (PHAYX)

Annualized total return performance as of 9/30/20

Class Y shares Inception 12/31/98	**Net asset value**	**JPMorgan Developed High Yield Index**
Last quarter	4.59%	5.11%
1 year	2.66	1.80
3 years	3.63	3.71
5 years	5.85	6.57
10 years	5.75	6.63
Life of fund	7.26	—

Total expense ratio: 0.77%

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 3/25/86), 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 JPMorgan Developed High Yield Index is an unmanaged index of high-yield fixed-income securities issued in developed countries. You cannot invest directly in an index.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of September 30, 2020, are subject to change with market conditions, and are not meant as investment advice.

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. Lower-rated bonds may offer higher yields in return for more risk. 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 generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds (a significant part of the fund's investments). 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. 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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