Q2 2021 | Putnam High Yield Fund Q&A

High yield gains amid rising oil prices

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High-yield bonds gained about 3% in the second quarter, aided by demand for higher-yielding securities, rising oil prices, and overall economic optimism.

Security selection in energy contributed the most versus the benchmark, while picks in consumer products, along with positioning in retail and gaming, lodging & leisure, detracted.

We have a generally positive outlook for the market's fundamental environment and supply-and-demand backdrop, but are more neutral toward valuation.

Not FDIC insured | May lose value | No bank guarantee

How did the fund perform for the three months ended June 30, 2021?

The fund's class Y shares rose 2.83%, slightly outpacing the 2.73% return of the benchmark JPMorgan Developed High Yield Index.

What was the market environment like for high-yield bonds during the second quarter of 2021?

High-yield bonds rose in April, fueled by an accelerating U.S. economic recovery, better-than-expected corporate earnings for the first quarter of 2021, and a modest decline in U.S. Treasury yields. Reflecting the country's emergence from the Covid-19-induced recession, the Commerce Department announced that U.S. gross domestic product [GDP] grew at a 6.4% seasonally adjusted annual rate in the first quarter of 2021. Forecasts for second-quarter GDP growth are even stronger.

The asset class posted a muted gain in May, as investors weighed advancing Covid vaccination campaigns, accelerating economic growth, and strong earnings against a rise in inflation. Following the announcement of the highest Consumer Price Index reading since 1982, some U.S. Federal Reserve governors indicated openness to discussing when the Fed would begin reducing its bond purchase program.

High yield rallied in June, along with stocks and Treasuries, amid growing confidence that inflation will likely prove transitory.

Relative to other asset classes, high-yield bonds outpaced high-yield bank loans and the broad investment-grade [IG] fixed-income market, but modestly lagged IG corporate credit.

Within the fund's benchmark, every cohort generated a positive result. Energy [+5%] was the best-performing group, powered by a 24% advance in the price of U.S. crude oil. Other outperformers included metals & mining, diversified media, and gaming, lodging & leisure, each of which gained about 3%. Utilities, cable & satellite, and broadcasting were the weakest performers, with each returning about 1%. From a credit-rating perspective, lower-quality debt outperformed the benchmark, signaling a comfort level with risk as investors sought higher yields.

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

Security selection in energy added the most value on a relative basis, driven by greater-than-benchmark positions in several top-performing index members. On the downside, picks in consumer products, along with underweight allocations in retail and gaming, lodging & leisure, dampened performance versus the benchmark.

What is the team's near-term outlook?

We have a positive outlook for high-yield market fundamentals and the overall supply-and-demand backdrop. Our view on valuation is more neutral, given the relative tightness of yield spreads in the market as of quarter-end. Our optimism is grounded in the rapidly growing percentage of Americans receiving Covid-19 vaccines, sustained government stimulus, and the continuing recovery of the U.S. economy. That said, we continue to closely monitor issuers' balance sheets and liquidity metrics, with an eye toward default risk or a credit-rating downgrade. Risks to our generally constructive outlook include any new developments with Covid-19, volatility in commodity prices, and policy missteps from global central banks.

Expectations for defaults have meaningfully improved this year, given the liquidity in the market. Many troubled issuers have been given the lifeline they need to continue operating. Including distressed exchanges, the U.S. high-yield default rate ended the quarter at 1.87%, meaningfully below the long-term average of 3% to 3.5%, and down from nearly 7% seven months ago. The departure of large default/distressed totals from last June helped lower the rolling 12-month default rate calculation.

As for supply/demand dynamics, new issuance of high-yield debt totaled $299.1 billion on a year-to-date basis through June 2021, a 37% increase over the same period last year. Roughly two thirds of this year's new issuance has been used to refinance existing debt. On the demand side, high-yield funds [mutual funds and exchange-traded funds] experienced outflows of $13.8 billion for the year-to-date period compared with inflows of $28.6 billion during the same period in 2020. Despite fund outflows, demand from institutional investors for newly issued bonds supports our positive view of market technicals.

From a valuation standpoint, the average spread of the fund's benchmark tightened to 3.7 percentage points over 10-year U.S. Treasuries as of quarter-end, below the long-term average of 6 percentage points. The benchmark's yield was at 4.3% as of June 30, a record low. Optimism over government stimulus and vaccine distribution continued to drive bond prices higher and yields lower this quarter. Despite tighter spreads and lower yields, we think the market's income potential remains attractive in the face of much lower global yields.

How was the fund positioned as of June 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 broadcasting, diversified media, and housing/building products.

Putnam High Yield Fund (PHAYX)

Annualized total return performance as of 6/30/21

	Class Y shares Inception 12/31/98	**JPMorgan Developed High Yield Index**
Last quarter	2.83%	2.73%
1 year	14.61	16.55
3 years	6.70	7.08
5 years	6.67	7.43
10 years	5.91	6.81
Life of fund	7.38	—

Total expense ratio: 0.79%

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 June 30, 2021, 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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Putnam Retail Management

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