

Q2 2019 | Putnam Global Income Trust Q&amp;A

# Declining rates boost fund's diversified strategy



**D. William Kohli**  
CIO, Fixed Income  
Industry since 1988



**Robert L. Davis, CFA**  
Portfolio Manager  
Industry since 1999



**Michael V. Salm**  
Co-Head of Fixed Income  
Industry since 1989



**Paul D. Scanlon, CFA**  
Co-Head of Fixed Income  
Industry since 1986

**Michael J. Atkin**  
Portfolio Manager  
Industry since 1988  
(Photo not available)

***A substantial drop in global interest rates provided a generally helpful backdrop for risk assets.***

***Favorable interest-rate and yield-curve positioning aided the fund's relative performance, as did an allocation to commercial mortgage-backed securities.***

***With economic growth slowing in the United States and overseas, we think the U.S. Federal Reserve will cut rates at least once this year.***

## **What was the fund's investment environment like during the second quarter of 2019?**

As markets cross the halfway point for the year, the first six months have been positive for risk assets, aside from a modest pullback in May. In the second quarter, a sizable decline in global interest rates was the biggest development.

In the United States, government-bond yields fell for a third consecutive quarter, reflecting investor concerns about slowing growth and global trade tensions. The yield on the benchmark 10-year U.S. Treasury note — which falls when bond prices rise — declined by 0.49 percentage point during the quarter, finishing at 2%. The 10-year yield has declined by more than a full percentage point during the past three quarters, its biggest drop over such a period since 2011. Outside the United States, rates fell across a range of markets, with several ending in negative territory.

In early June, U.S. Federal Reserve Chair Jerome Powell addressed the fears of how the continuing U.S.–China trade dispute might hurt the economy, saying the central bank could respond by cutting interest rates if the economic outlook deteriorated. Investors cheered the news, leading to a rally in stocks and credit-sensitive bonds. Risk assets received a further boost at the end of June, when President Trump and his Chinese counterpart, Xi Jinping, agreed to resume formal trade talks following a meeting at the G-20 summit in Japan.

In Europe, European Central Bank [ECB] President Mario Draghi stated that unless inflation data improve, additional stimulus will be required. Analysts expect the ECB to cut rates, which are already negative, at or before its September policy meeting.

To be sure, sentiment indicators for global trade and manufacturing remain under pressure. Given those uncertainties, the U.S. dollar weakened against many other major developed-market currencies during the quarter.

**For the quarter, the fund posted a solidly positive return and slightly outpaced its benchmark. Which holdings and strategies aided relative performance?**

Our interest-rate and yield-curve positioning was the biggest contributor on a relative basis. The fund's duration was modestly longer than that of the benchmark, which aided performance as rates declined globally. Also, the fund's positioning benefited from a flattening of yield curves, as yields declined across the curve in the United States, the eurozone, and the United Kingdom.

Our allocation to commercial mortgage-backed securities [CMBS] also meaningfully contributed, led by exposure to CMBX, an index that references a basket of CMBS issued in a particular year. Within CMBX, the fund benefited from exposure representing 2012 issuance. CMBX rallied along with other risk-driven assets in April and June, and actually held up better than corporate credit during the market pullback in May.

Our positions in investment-grade corporate bonds modestly contributed, driven by favorable sector and security selection. Given the spread widening that occurred in May, yield spreads for investment-grade corporate credit ended the quarter near where they started. Consequently, spread movements had a minimal impact on our holdings.

**What detracted from performance this quarter?**

Our active currency strategy was the biggest relative detractor. Lower-than-benchmark exposure to the Japanese yen, the euro, and the Canadian dollar — all of which strengthened versus the U.S. dollar — worked against our positioning. Overweight exposure to the Australian dollar, which weakened against the greenback, also hampered our results.

Within strategies targeting prepayment risk, holdings of interest-only collateralized mortgage obligations [IO CMOs] modestly detracted. Falling interest rates raised concerns about increased refinancing of the loans underlying these securities. A higher level of refinancing tends to increase the prepayment speeds of the mortgages underlying IO CMOs.

Holdings of emerging-market debt were also a modest dampener, as an uncertain growth outlook in many countries, trade fears, and lower oil prices weighed on the sector. Our positions in Argentina and Mexico were the biggest negatives.

**What is your near-term outlook?**

Global economic growth has slowed. However, despite the uncertainty surrounding the ultimate resolution of U.S.–China trade policy, we think growth is likely to continue at a moderate level.

As of quarter-end, we thought market participants, as a whole, were being too aggressive in their forecasts of Fed rate cuts. As a result, we think the market has priced in too many reductions. We believe investors will adjust once they acknowledge that economic growth, both in the United States and overseas, is likely to continue at a measured pace.

In our view, we expect the Fed to trim rates at least once this year. In light of continued moderate growth, we don't believe the Fed needs to be too aggressive in reducing rates.

**Given this outlook, how are you positioning the fund?**

We continue to favor mortgage credit, prepayment risk, and corporate credit. In our view, the yield premiums provided by CMBS and other types of mortgage credit, as well as investment-grade and high-yield corporate bonds, give the fund an attractive risk/reward profile. However, because we are in the later stages of both the economic and credit cycles, we are taking a somewhat more conservative approach than previously. We are doing this by purchasing securities with less price sensitivity to changes in yield spreads.

After de-emphasizing interest-rate risk relative to the benchmark for many years, we are now taking a more balanced approach. As noted above, having a duration that was longer than the benchmark provided a substantial boost to the fund’s performance this quarter, as interest rates declined around the world.

Given where we are in the economic and credit cycles, combined with slowing economic growth, we don’t believe rates are likely to rise substantially over the intermediate term. At the same time, we are cognizant of interest-rate risk. In our view, for rates to move significantly lower from current levels would require an imminent recession, which we view as being very unlikely.

**Putnam Global Income Trust (PGGYX)**

Annualized total return performance as of 6/30/19

<b>Class Y shares</b> Inception 10/4/05	<b>Net asset value</b>	<b>Bloomberg Barclays Global Aggregate Bond Index</b>
Last quarter	3.47%	3.30%
1 year	5.70	5.85
3 years	3.49	1.62
5 years	1.97	1.20
10 years	5.31	2.89
Life of fund	6.39	—
Total expense ratio: 0.99%		
What you pay: 0.97%		

“What you pay” reflects Putnam Management’s decision to contractually limit expenses through 2/28/20.

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 6/1/87), 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 Bloomberg Barclays Global Aggregate Bond Index is an unmanaged index of global investment-grade fixed-income securities.

The views and opinions expressed are those of the portfolio managers as of June 30, 2019, are subject to change with market conditions, and are not meant as investment advice. All performance and economic information is historical and is not indicative of future results.

**Consider these risks before investing:** International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed investments, unlike traditional debt investments, are subject to prepayment risk, which means that they may increase in value less than other bonds when interest rates decline and decline in value more than other bonds when interest rates rise. The fund concentrates on a limited group of industries and is non-diversified. Because the fund may invest in fewer issuers than a diversified fund, it is vulnerable to common economic forces and may result in greater losses and volatility. 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. 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. 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. You can lose money by investing in the fund.

For informational purposes only. Not an investment recommendation.

**A world of investing.®**



**Request a prospectus or summary prospectus from your financial representative or by calling 1-800-225-1581. The prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.**