

Selecting Stocks Globally

Identifying the right stocks in a vast global universe of over 2,500 stocks is both cumbersome and difficult. Shigeki Makino and Brad Greenleaf, portfolio managers for Putnam Global Equity Fund, and their global team of experts carry out this task by utilizing a process that blends quantitative and fundamental analysis, which they believe will deliver consistent returns and outperform their global benchmark.

Q: Why is investing globally important?

A: We think geographical boundaries that constrain people's investment universe are artificial. Increasingly, with globalization most companies' businesses expand well beyond their country borders. So if an investor wants to find the best investment opportunities it seems smart to look globally. As you look around the world, companies are less correlated with their countries and more with their sectors and that will only continue in the future. Moreover, the global economy is no longer leveraged to the U.S. economy as before and even emerging economies are quite robust.

Q: What is your investment philosophy?

A: Our global investing universe consists of mainly large and mid-cap companies. We use a bottom-up stock selection approach to identify underpriced stocks around the world. We tend to shy away from macroeconomic calls.

Common behavioral biases and market forces result in stocks that can sell well below their intrinsic value. We use an analytical process that blends quantitative and fundamental elements to identify these market mispricings, which we believe will deliver consistent returns. Our

primary goal is to outperform our benchmark - the broad global, Morgan Stanley Capital International World Index.

The term "world" for us is synonymous with "global" and includes both the U.S. and non-US companies. Consequently, our fund has invested globally in markets across the U.S., Japan, Canada and in the European Union. We have a small exposure in emerging markets.

Q: What is your investment strategy?

A: Stock selection is the key to our success in achieving consistent returns and outperforming our benchmark and this involves blending in-depth fundamental analysis with rigorous quantitative analysis.

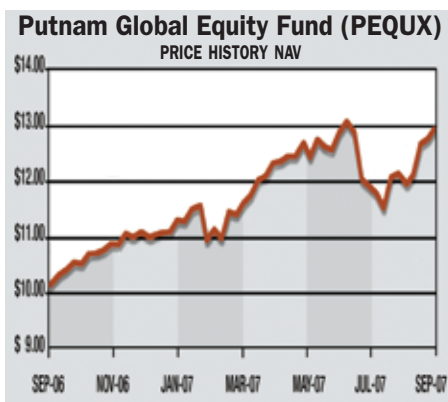
A proprietary discounted cashflow model is the key input in our fundamental analysis in estimating the intrinsic value of each company. On the quantitative side, our model is composed of 25 individual metrics that fall into four categories. They are relative value, where a company's current price is compared to different measures of economic and financial health; earnings momentum, where we look at sell-side changes to earnings forecast and cash flow forecast



SHIGEKI MAKINO is a Managing Director and Chief Investment Officer of the Global Core Equity team. He heads the team that manages global core equity retail and institutional portfolios. He is also a Portfolio Leader on the Putnam Global Equity Fund. Makino joined Putnam in 2000 and has 18 years of investment experience.



BRAD GREENLEAF is a Managing Director and Portfolio Manager on the Global Core Equity team. He is a member of the team responsible for managing Global Core Equity institutional portfolios and is also a portfolio member of the Putnam Global Equity Fund. A CFA charterholder, Greenleaf joined Putnam in 2004 and has 21 years of investment industry experience.



“Our global investing universe consists of mainly large and mid-cap companies belonging to either the value or growth categories. We use a bottom-up global stock selection approach to identify underpriced stocks around the world.”

Ticker staff searches for mutual funds for their consistency in performance and durability of investment style.

Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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over the next two years; price momentum, which is positive momentum over the last twelve months, and financial fundamental statistics and quality; which is looking at how efficiently companies use their capital.

These quantitative tools enable us to study in depth and filter through our universe of stocks. With our fundamental tools, we are able to make individual assessments of stocks in order to confirm what our quantitative models indicate, or get additional information that may reveal that the particular stock does not meet our criteria.

Q: Can you walk us through your research process?

A: We have over 50 research analysts. The majority of them are located in Boston, but some are based in London and Tokyo. They are industry-based analysts and contribute to various Putnam products. Each analyst covers roughly 30 companies in depth. The team leverages a proprietary discounted cashflow model, which provides “forward-looking” attractiveness/unattractiveness score for each company. Their job is to provide information over and above what we may glean from our quantitative models. Brad Greenleaf and his team of quantitative analysts focus on developing quantitative tools culminating in model portfolios that can outperform their benchmark. These models are incorporated in the portfolio and combined with our fundamental analysis to build a fund that we believe optimizes the balance of return and risk.

Q: What process do you follow to build your portfolio? What is your buy and sell discipline?

A: We follow a three-step portfolio building process. Step one is screening, step two is analysis, and step three is portfolio construction.

Under screening, we first rank every one of our potential investable companies on

a fundamental metric. Ranking is done on standard deviation basis plus three to minus three. At the intersection are companies that are attractive on both quantitative and fundamental basis so that they have multiple attractive metrics. Beginning with our universe of 10,000 listed companies, then 2,500 investable companies, we end up finally with a trimmed down list – our buy list - of between 100 and 200 companies that we focus on.

Next, we analyze companies in the buy list and spend time on understanding their businesses, meeting with managements, analysts, both internally as well as externally and deciding whether we should add the company to the fund or add it to the exception list.

Those exceptions come in multiple flavors, such as “do not buy” or “we don’t agree”, so we will not buy them. Then there’s the “do not buy more” list, which are companies that we feel we already have enough exposure to. There are companies that are already in the portfolio that for a set of reasons are in the “do not sell” list. And then there’s the “must buy” list of companies or sometimes “must sell” names. Those are the sets of lists that we combine to call “the exception list”.

The last step leads to portfolio construction. Here, we take our existing portfolio, the buy-list of 100 companies, and the ‘exception list’ and put all of them into a BARRA risk-based optimizer. The optimizer analyzes the information and generates a set of trades that help in building a portfolio based on risk-adjusted maximum returns possible. If we don’t agree with some of the trades, we again update the “exception list” and re-run that optimizer. Every fortnight, we operate this three-step process and also turn over about 3% of the portfolio. In the interim period, we again analyze the companies on the “buy list.”

This process is thus quite different from the traditional “push-based” approach, where money managers receive different recommendations from the brokers and analysts with their sets of buys and sells, and from the companies themselves. We adopt the “pull-based” model where we take a look at what’s attractive in the market, and then meet with those companies and their analysts which we believe will be more successful in stock selection.

Q: At any given time how many stocks do you have in the portfolio?

A: Currently, our portfolio has about 80 stocks, but typically, we have plus or minus 100. As for asset allocation, our fund portfolio exhibits sector weights that are similar to those of the benchmark. This is because, stock selection is vital to our success and sector weights depends on what stocks are ultimately included in the portfolio. Currently, the financial sector, at 26%, has the highest allocation followed by 14% in industrial materials, 13% in health, 12% in energy, 10% in consumer goods. At 2%, media and utilities sectors have the least weight.

Q: Can you give some examples of holdings that vindicate your stock selection decisions and improving the fund’s performance?

A: Examples abound in energy sector stocks, including U.S. companies Marathon Oil and Valero Energy, and Canada’s Canadian Natural Resources that delivered good results. Strong oil prices helped these stocks to outperform the benchmark.

However, we have since sold our Canadian Natural Resources holding as it reached our fair value target. Nippon Mining Holdings of Japan, another of our energy holdings, has benefited from rising prices of oil and copper due to strong demand from China.


The basic materials sector benefited from the high prices of both precious and base

metals. An example is Arcelor, a Luxembourg-based steel company. A takeover bid by steel giant Netherlands-based Mittal sharply boosted Arcelor. We then sold our holdings in Arcelor at a good profit when it reached our target price. On the U.S. side of this sector, Nucor, a steel manufacturer, and Phelps Dodge, a mining company, also achieved healthy gains.

Q: You are a global fund. Do you engage in active currency hedging?

A: Yes. We have a currency specialist team within Putnam. Their job is to make calls on currencies around the world. In this portfolio, first they hedge back our currency exposures from our portfolio back to the benchmark, and then they’re given a small risk budget to make active currency bets within the portfolio as well. For example, they may have a 0.50% tracking error, a risk budget, and that’s relative to 3.50% to 4.00% tracking error in the portfolio. Currency has added value on a pretty consistent basis over time but it will not outweigh the influence of individual stock picking in our performance.

Q: What is your view on risk and how do you manage it?

A: Our expertise at Putnam is in stock selections. When we put together portfolios against global benchmarks, typically, 70% to 80% of our active risk tracking error will come from our stock selection. The rest of it will come from very modest contributions from country and sector selections and also from company sizes and investment styles. Therefore, we believe, where many managers fail is in constructing their portfolios without a rigorous disciplined approach. Consequently, they take unintended bets that may affect return. We, however, are much more disciplined and focus on our in-depth stock selection process. Since both fundamental and quantitative analysis provide insights into potential future returns, we blend insights from both to improve our chances of successful stock selection and portfolio construction. 

Putnam Global Equity Fund

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|-----------|--|
| Symbol | PEQUX |
| Website | www.putnam.com |
| Address | Putnam Investment Mgt LLC One Post Office Square, 6th Floor Boston, MA 02109 |
| Tel. No. | 800-225-1581 |
| Inception | 07/01/1994 |

PORTFOLIO

| | |
|------------------------------|----------|
| Total Net Assets* | \$2.24 |
| Avg Mkt Cap (\$ Weighted)* | \$74,528 |
| Average Price/Earnings Ratio | 12.17x |
| Average Price/Book Ratio | 2.51x |
| Turnover Ratio | 88% |

INVESTMENT INFORMATION

| | |
|---------------------------|-------|
| New Investment | Open |
| Min Initial Investment | \$500 |
| Min Subsequent Investment | \$50 |

RISK (AGAINST MSCI EAFE ND INDEX - 3 YEARS)

| | |
|--------------------|------|
| Alpha | 0.08 |
| Beta | 1.09 |
| R-Squared | 0.77 |
| Ann. Std Deviation | 9.22 |
| Sharpe Ratio | 1.91 |

RETURNS VS. MSCI WORLD INDEX

| | PEQUX | Index |
|---------------|--------|--------|
| 1 Year (Cum.) | 27.99% | 22.13% |
| 3 Year (Ann.) | 20.03% | 17.86% |
| 5 Year (Ann.) | 19.25% | 19.13% |

RETURNS VS. LIPPER GLOBAL LARGE-CAP CORE FDS IX

| | PEQUX | Index |
|---------------|--------|--------|
| 1 Year (Cum.) | 27.99% | 24.17% |
| 3 Year (Ann.) | 20.03% | 19.03% |
| 5 Year (Ann.) | 19.25% | 18.47% |

RETURNS VS. S&P 500 INDEX

| | PEQUX | Index |
|---------------|--------|--------|
| 1 Year (Cum.) | 27.99% | 18.36% |
| 3 Year (Ann.) | 20.03% | 13.04% |
| 5 Year (Ann.) | 19.25% | 15.39% |

FEES AND EXPENSES

| | |
|--------------------------------|-------|
| Max Sales Charge - Front** | 5.25% |
| Max Sales Charge - Deferred*** | 0.00% |
| Max Redemption Fee**** | 1.00% |
| Total Expense Ratio***** | 1.28% |

PORTFOLIO MANAGER

| | |
|----------------|------------|
| Shigeki Makino | 12/31/2002 |
| Brad Greenleaf | 12/31/2005 |

*millions

**for amount invested less than \$50,000

***a deferred sales charge of 1.00% on class A shares may be imposed on certain redemptions bought without an initial sales charge

****3 months after purchase

*****versus Lipper category average of 1.41%

Data through: 09/30/2007

Source: Company Documents; Lipper