Q1 2019 | Putnam Convertible Securities Fund Q&A

Stocks' strongest quarter in a decade lifts convertibles

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Convertibles tracked 75% of the upside of the S&P 500 Index and outperformed most fixed-income indices for the quarter.

We believe the competitive performance of convertibles in the past two quarters demonstrates their relative attractiveness during the later parts of the equity and credit cycles.

We will continue to maintain a balanced portfolio with no large macroeconomic bias or issuer concentration, which we believe sets the fund apart from several of its competitors.

Please describe conditions in the U.S. convertibles market in the first quarter.

After last year's grueling fourth quarter for stocks, market conditions improved markedly in the first quarter of 2019. The S&P 500 Index recorded its largest first-quarter gain since 2009 with a return of 13.65%. The main catalysts behind the rally were the Federal Reserve's dovish comments about its interest-rate policy and optimism over a U.S.–China trade agreement. Global growth concerns also eased during the quarter. Oil prices recovered, China reduced taxes and boosted credit for small businesses to stimulate its economy, and fourth-quarter earnings came in better than expected.

In January, Fed Chair Jerome Powell signaled that the impasses over U.S. trade and government budget negotiations and slower growth in Europe and China warranted a "patient" approach to future rate increases. The Fed also referenced "muted inflationary pressure" and acknowledged that the pace of U.S. economic growth had slowed from the previous quarter. In February, investors welcomed the Trump administration's decision to extend trade talks beyond its March 1 deadline — granting negotiators more time to hammer out an agreement. Just before the close of the quarter, the Fed surprised investors by indicating that no further rate hikes were expected in 2019 and that only one was likely in 2020.

With interest-rate expectations lowered, fixed-income markets also moved higher. [Bond prices rise as yields fall.] Returns were not as striking as those in the equity markets but still noteworthy, with the JPMorgan Developed High Yield Index and the Bloomberg Barclays U.S. Aggregate Bond Index returning 7.30% and 2.94%, respectively, for the quarter. Outside of the short end of the yield curve, U.S. Treasury yields fell 20 to 30 basis points, or 0.20 to 0.30 percentage points, reflecting the market's anticipation of the Fed's hiatus in normalizing interest rates. The yield on the benchmark 10-year Treasury fell from 2.67% at the beginning of the quarter to 2.39% at quarter-end.

Due to its hybrid characteristics, the convertible asset class performed as it is designed to do — capturing much of the upside of equities and some degree of support from its fixed-income attributes. Convertibles tracked 75% of the upside of the S&P 500 Index and outperformed most fixed-income indices for the quarter. Fueled by the momentum of January's strong 7.05% result, the ICE BofAML U.S. Convertible Index [the convertibles index] closed out the quarter with a return of 10.26%. Eleven of the twelve sectors within the convertibles index delivered positive performance for the quarter, led by technology [13.60%], energy [13.57%], and industrials [13.35%]. Consumer staples [-4.13%] was the only negative performing sector in the index. In terms of underlying equities, large- and mid-cap convertibles outperformed small-cap convertibles. On a credit quality basis, below-investment-grade/speculative-grade convertibles outperformed investment-grade convertible bonds for the quarter.

What was your strategy for Putnam Convertible Securities Fund?

We continue to maintain a "pure-play" balanced convertibles portfolio, holding few common stocks or straight corporate bonds, which we believe sets the fund apart from its peers. The portfolio maintains a delta, or equity sensitivity, in the mid-50s, which rose during the past year as equities appreciated in value or declined due to the fourth-quarter 2018 market correction. In our opinion, keeping the delta in the 50s range represents a more balanced profile of capital preservation and reduced volatility from the bond component, as well as upside opportunity from the equity conversion option. We believe this positioning will help cushion the fund from potential volatility.

How did the fund perform?

For the three months ended March 31, 2019, the fund outperformed the convertibles index. On a relative basis, security selection and overweight positioning in the technology sector, along with security selection in consumer staples, were the largest contributors to relative performance at the sector level. Our decision to underweight financials was the largest detractor to the fund's relative performance. Underweight positioning and security selection within the health-care sector also weighed on results.

What is your outlook for convertibles in 2019?

The current market environment leads us to believe that the outlook for convertible securities remains constructive for several reasons. First, the sell-off in equities in the fourth quarter of 2018 resulted in a more balanced convertibles market. Second, we saw positive growth in convertible new issuance, which led to greater diversification of issuers, in our view. Finally, reasonable equity valuations coupled with solid earnings provide a sound fundamental backdrop. Ultimately, we believe convertibles will continue to be an attractive option for investors seeking current income and capital appreciation, while also lowering portfolio volatility.

Against this backdrop, we will continue to maintain a balanced portfolio with no large macroeconomic bias or large issuer concentration, which we believe sets the fund apart from several of its competitors. As part of this strategy, we will continue to trim winners, that is, sell securities after a period of outperformance to help keep the portfolio balanced and protect shareholders in down markets.

Putnam Convertible Securities Fund (PCGYX)

Annualized total return performance as of 3/31/19

Class Y shares Inception 12/30/98	**Net asset value**	**ICE BofAML U.S. Convertible Index**
Last quarter	11.96%	10.26%
1 year	6.47	7.84
3 years	11.65	12.09
5 years	6.00	7.13
10 years	12.34	13.00
Life of fund	9.77	—

Total expense ratio: 0.80%

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 6/29/72), 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 ICE BofAML U.S. Convertible Index tracks the performance of publicly issued U.S. dollar-denominated convertible securities of U.S. Companies. You cannot invest directly in an Index.

ICE Data Indices, LLC (ICE BofAML), used with permission. ICE BofAML permits use of the ICE BofAML indices and related data on an "as is" basis; makes no warranties regarding same; does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the ICE BofAML indices or any data included in, related to, or derived therefrom; assumes no liability in connection with the use of the foregoing; and does not sponsor, endorse, or recommend Putnam Investments, or any of its products or services.

The S&P 500 Index is an unmanaged index of common stock performance.

The JPMorgan Developed High Yield Index is an unmanaged index of high-yield fixed-income securities issued in developed countries.

The Bloomberg (BBG) Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities.

The views and opinions expressed are those of the portfolio managers as of March 31, 2019. They are subject to change with market conditions and are not meant as investment advice.

Consider these risks before investing: Convertible securities prices may fall or fail to rise over time for several reasons, including general financial market conditions, changing market perceptions (including perceptions about the risk of default and expectations about monetary policy or interest rates), changes in government intervention in the financial markets, and factors related to a specific issuer or industry. These and other factors may also lead to increased volatility and reduced liquidity in the fund's portfolio holdings. These risks are generally greater for convertible securities issued by small and/or midsize companies. Convertible securities' prices may be adversely affected by underlying common stock price changes. While convertible securities tend to provide higher yields than common stocks, the higher yield may not protect against the risk of loss or mitigate any loss associated with a convertible security's price decline. Convertible securities are subject to credit risk, which is the risk that an issuer of the fund's investments may default on payment of interest or principal. Credit risk is greater for below-investment-grade convertible securities. Convertible securities may be less sensitive to interest-rate changes than non-convertible bonds because of their structural features (e.g., convertibility, "put" features). Interest-rate risk is generally greater, however, for longer-term bonds and convertible securities whose underlying stock price has fallen significantly below the conversion price. You can lose money by investing in the fund.

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