

Q1 2018 | Putnam Convertible Securities Fund Q&A

Convertibles stay resilient as stocks, bonds struggle



Robert L. Salvin
Portfolio Manager
Industry since 1986



Anthony J. Daigle*
Portfolio Manager, Analyst
Industry since 2004

Market conditions worsened after an initial rally in January, but convertibles resisted the negative trend experienced by the equity and bond markets.

The fund's class Y share 1.95% quarterly return lagged that of its benchmark index, even as overweight exposure to the top-performing technology sector helped performance.

While the uncertainty surrounding U.S. trade policy may cause persistent market volatility, a rising rate cycle historically has supported outperformance by the convertibles asset class.

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

Fears of a spike in inflation, political trade war headlines, and idiosyncratic company news led to increased volatility in equity markets. However, convertibles largely remained insulated with little exposure to the most volatile companies. In fixed-income markets, yields rose sharply for Treasuries during the quarter, and spreads widened for both investment-grade and high-yield convertible securities. Overall, convertibles posted positive results for the quarter, outperforming major equity and bond indexes. For the three months ended March 31, 2018, the ICE BofAML U.S. Convertible Index [the convertibles index] rose 2.40%, while the underlying equity performance of convertible issuers was slightly lower at 1.80%, according to Barclays.

By comparison, large-cap equities, as represented by the S&P 500 Index, registered a -0.76% decline in the first quarter, and the small-cap Russell 2000 Index finished just below even at -0.08%. In fixed-income markets, U.S. high-yield spreads widened, and the JPMorgan Developed High Yield Index returned -0.83%.

Convertibles issued by large-cap companies led performance during January, but in the following month leadership shifted to small-cap convertibles. During March, both small- and mid-cap convertibles

* Anthony Daigle became Assistant Portfolio Manager on this fund effective 12/31/17.

outperformed large-cap convertibles. On a credit quality basis, investment-grade convertibles outperformed below-investment-grade/speculative-grade convertibles for the quarter.

New issuance was robust in January, evaporated during the market volatility of February, and then jumped again during March. Performance followed a similar trend: New issues performed well in January as the equity market rose, but experienced poor results in February before rebounding in March. Technology and health-care companies issued the lion's share of new securities.

Sector leadership in the convertibles market was inconsistent from month to month. The strongest results were in the technology sector, while consumer staples also performed well. Investment-grade convertibles outperformed their high-yield counterparts.

What was your strategy for Putnam Convertible Securities Fund?

To help the portfolio weather potential volatility, we favored higher-quality and large-cap names. Additionally, we continued to trim exposure to securities in which the underlying equity valuations have become stretched, in our view. We offset that exposure with new issues where opportunities presented themselves.

We also continued to maintain a balanced "pure play" convertibles portfolio, with few common stocks or straight corporate bonds, which we believe sets the portfolio apart from its peers. At quarter-end, the portfolio had a delta — a measure of equity sensitivity — of 56, which is slightly higher year to date due to equity valuations. In our opinion, keeping the delta in the 50s range represents a balanced profile of capital preservation and reduced volatility from the bond component and upside opportunity from the equity conversion option.

How did the fund perform?

For the three months ended March 31, 2018, the fund delivered positive performance but underperformed the convertibles index. On an absolute and benchmark-relative basis, overweight positioning within the

technology sector was the largest contributor to the fund's performance, driven by strength in the sector and concentration in high-returning technology names. Positive security selection within the energy and utilities sectors also added to relative performance.

Positive performance was offset by underweight positioning and security selection within the health-care sector. Additionally, security selection within the financials and consumer staples sectors modestly detracted from performance.

What is your outlook for the months ahead?

Investor confidence in the economy, coupled with solid underlying fundamentals, leads us to believe that the outlook for convertible securities remains constructive. The U.S. tax overhaul framework includes a reduction of the corporate tax rate, a lower repatriation tax rate, full expensing of capital expenditures, and the capping of interest deductibility. On balance, we believe these changes will be positive for convertible issuers.

Convertibles continue to witness a healthy new-issue market with the first quarter being one of the best in over 10 years. Increased supply has expanded the universe of investment options in the U.S. convertibles market, creating attractive associated return opportunities, in our view. We expect this robust environment for new issues to continue in the face of rising interest rates, barring any short-term volatility. Additionally, the new tax law increases the relative attractiveness of convertible market funding versus corporate debt, particularly for more highly levered companies. With regard to the broader macroeconomic environment, as central banks begin the process of normalizing monetary policy, which could cause unease to equity markets, we believe convertible securities may continue to be an attractive option. Investors seeking current income and capital appreciation as well as the potential for lower portfolio volatility can find opportunities in convertibles, in our view.

Putnam Convertible Securities Fund (PCGYX)

Annualized total return performance as of 3/31/18

Class Y shares Inception 12/30/98	Net asset value	ICE BofAML U.S. Convertible Index
Last quarter	1.95%	2.40%
1 year	11.60	10.57
3 years	5.53	6.58
5 years	8.20	9.65
10 years	7.35	8.22
Life of fund	9.84	—

Total expense ratio: 0.82%

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 Russell 2000 Index is an unmanaged index of 2,000 small companies in the Russell 3000 Index. 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 ICE BofAML U.S. Convertible Index consists of convertible bonds traded in U.S. dollar-denominated investment-grade and non-investment-grade convertible securities that are sold into the U.S. market and are publicly traded in the United States. 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.

Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company.

The views and opinions expressed are those of the portfolio managers as of March 31, 2018. 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.

This material is for informational and educational purposes only. It is not a recommendation of any specific investment product, strategy, or decision, and is not intended to suggest taking or refraining from any course of action. It is not intended to address the needs, circumstances, and objectives of any specific investor. Putnam, which earns fees when clients select its products and services, is not offering impartial advice in a fiduciary capacity in providing this sales and marketing material. This information is not meant as tax or legal advice. Investors should consult a professional advisor before making investment and financial decisions and for more information on tax rules and other laws, which are complex and subject to change.

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.