Q3 2017 | Putnam Convertible Securities Fund Q&A

Convertibles closely track performance of record-setting stock market

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(Photo not available)

The strong correlation of convertibles to their underlying equities translated into gains for the asset class.

Effective security selection within the consumer cyclicals and capital goods sectors was one of the largest contributors to the fund's performance.

To help weather potential volatility, we are favoring higher-quality names, along with higher market capitalization issuers.

* Anthony Daigle became Assistant Portfolio Manager on this fund effective 9/30/17.

What was the market environment like for U.S. convertible securities during the third quarter of 2017?

Despite tensions with North Korea and waning optimism about the ability of Congress and the White House to pass pro-growth policies, stocks rallied during the quarter. The S&P 500 Index, Nasdaq Composite Index, and Russell 2000 Index closed out the quarter at all-time highs, with the S&P 500 achieving its eighth straight quarterly gain. Given their strong correlation with stocks, convertibles benefited from the rally — capturing much of the rise in large- and small-cap stocks, as measured by the 4.48% and 5.67% return for the S&P 500 Index and the Russell 2000 Index, respectively.

Within the convertibles universe, large-cap convertible securities [4.45%] outperformed their small-cap [2.54%] and mid-cap [2.68%] peers. On a credit-quality basis, investment-grade convertibles [5.34%] performed roughly in line with below-investment-grade/speculative convertibles [5.26%]. Transportation and materials were the best-performing sectors of the BofA Merrill Lynch Convertible Index for the third quarter, whereas the health-care sector lagged due to weakness in a few large holdings.

How did Putnam Convertible Securities Fund perform?

For the three months ended September 30, 2017, the fund delivered positive performance that outperformed its benchmark. On an absolute and benchmark-relative basis, effective security selection within the consumer cyclicals and capital goods sectors was the largest contributor to the fund's performance. Overweight positioning and positive security selection within the technology sector also added to relative performance due to strong second-quarter revenue and earnings growth for some positions.

Positive performance was modestly offset by security selection within the health-care sector. Additionally, underweight positioning and security selection within the basic materials sector modestly detracted from performance.

How were technicals in the convertibles market for the third quarter?

Market dynamics in the convertibles market were healthy in terms of supply and demand dynamics and valuations. New-issue activity approached a 10-year high, while secondary market liquidity also remained healthy.

What was your strategy in this environment?

In response to the rise in new issuance, we selectively participated in a few deals, which resulted in a modest increase in our allocation to "pure-play" convertible bonds and a reduction in mandatory convertibles — essentially equities. Broadly speaking, the recent surge in new issuance was focused on convertible bonds, rather than mandatory convertibles, which typically offer a higher yield than both convertible bonds and preferreds. Mandatories dominated the new-issue market from December 31, 2014, through October 31, 2016, when they made up approximately 46% of new issuance. Since October 31, 2016, the issuance of mandatories has declined, and by period-end, this class of convertibles only composed 17% of new issuance.

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 more balanced profile of capital preservation and reduced volatility from the bond component, and upside opportunity from the equity conversion option. We believe this positioning will help the fund weather potential volatility in the coming months, aside from any short-term volatility driven by company-specific developments at the issuer level.

The fund reduced its dividend rate during the quarter. What led to that decision?

The fund, which seeks high current income and capital appreciation, has maintained a stable dividend since August 2014. As a result of the low-interest-rate environment and lower coupons of securities in the portfolio, the fund's monthly distribution rate was reduced from $0.0309 per share to $0.0283 per share in August 2017.

What is your outlook, and how does it influence the fund's positioning for the balance of 2017?

The convertibles market continued to advance during the quarter despite a more risk-off market sentiment. With equity valuations arguably stretched, geopolitical risk regarding North Korea intensifying, and progress on important U.S. legislation lacking, we believe convertibles can offer attractive risk-adjusted returns over time. Additionally, we believe the markets are currently anticipating a December 2017 interest-rate hike by the Federal Reserve, which we expect will be supportive for the asset class. New issuance, which spiked in August, is expected to remain robust, although short-term volatility may impact the timing of certain deals.

To help the portfolio weather potential volatility, we are favoring higher-quality names, along with higher market capitalization issuers. Additionally, we have trimmed exposure to securities in which the underlying equity valuations have become stretched, in our view. We have offset that exposure with new issues where opportunities presented themselves.

Putnam Convertible Securities Fund (PCGYX)

Annualized total return performance as of 9/30/17

Class Y shares *Inception 12/30/98*	**Net asset value**	**BofA ML U.S. Convertible Index**
Last quarter	4.44%	3.77%
1 year	14.27	14.31
3 years	5.59	6.82
5 years	9.41	11.01
10 years	6.02	6.83
Life of fund	9.86	—

Total expense ratio: 0.84%

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 Bank of America (BofA) Merrill Lynch U.S. Convertible Index consists of convertible bond trades in U.S. dollar-denominated 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. The index data referenced herein is the property of Merrill Lynch, Pierce, Fenner & Smith Incorporated ("BofAML") and/or its licensors and has been licensed for use by Putnam Investments. BofAML and its licensors accept no liability in connection with its use. See prospectus for a full copy of the Disclaimer.

The views and opinions expressed are those of the portfolio managers as of September 30, 2017. 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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