Q1 2017 | Putnam Convertible Securities Fund Q&A

Convertibles tally gains as stocks move higher

Eric N. Harthun, CFA
Industry since 1994

Robert L. Salvin
Industry since 1986

Convertible securities performance was led by larger-company stocks and below-investment-grade bonds.

We continued to see a surge in convertible issuance during the quarter due to improved market sentiment.

We expect that the shorter duration of convertibles will lend support to the asset class, which has historically performed well in rising-rate environments.

How was the market environment for U.S. convertible securities during the first quarter of 2017?

Convertible securities gained ground during the reporting period — helped in large measure by their underlying equity sensitivity. Despite the uncertainty around the effects of President Trump's policies on the U.S. economy, speculation that his administration and a Republican-controlled Congress would pursue pro-growth policies, including lower taxes, greater infrastructure spending, and less regulation, helped many equity benchmark indexes add to all-time highs. In this market environment, investors' appetite for riskier assets generally rose, despite some pauses, as the markets questioned whether geopolitical developments would tarnish an improving global economic outlook.

The fixed-income markets also moved higher, although returns were not as favorable as those in the equity markets. With the unemployment rate below 5%, and consumer and business confidence improving, the Federal Reserve raised its benchmark interest rate to the range of 0.75 to 1% on March 15. While the increase was widely expected, the markets were looking for hints about the future pace of rate increases in 2017. In her press conference, Fed Chair Janet Yellen stated that the "simple message is that the economy is doing well." The markets reacted positively, as her comments did not appear to signal a faster pace of rate increases for the balance of the year — suggesting that the Fed hadn't fallen behind in its effort to contain inflation.

For the three months ended March 31, 2017, the BofA Merrill Lynch All U.S. Convertibles Index [the convertibles index] rose 5.30% — while the S&P 500 Index and the Bloomberg Barclays U.S. Aggregate Bond Index rose 6.07% and 0.82%, respectively. Within the convertibles universe, large-cap convertible securities [7.22%] outperformed their mid-cap [2.24%] and small-cap [2.20%] peers. On a credit-quality basis, below-investment-grade/speculative convertibles [6.16%] slightly outperformed investment-grade convertibles [5.52%]. Materials and health care were the best-performing sectors of the convertibles index for the first quarter, whereas the energy sector lagged due to a decline in commodities prices.

How did Putnam Convertible Securities Fund perform in this environment?

For the three months ended March 31, 2017, the fund delivered positive performance in line with its benchmark, the convertibles index.

On an absolute and benchmark-relative basis, effective security selection within the communication services and health-care sectors was the largest contributor to the fund's performance. Security selection within financials also added to relative performance on the heels of positive earnings announcements from key financial institutions for the fourth quarter of 2016.

Negative security selection within the energy sector detracted from benchmark-relative returns, sector, particularly overweight positioning in companies that released weak fourth-quarter earnings in 2016. An overweight position combined with security selection in the capital goods sector was another relative detractor for the quarter.

What is your outlook, and how does it influence the fund's positioning going forward?

Despite the growing uncertainty regarding President Trump's ability to implement his proposed policies and their effect on the U.S. economy, the convertibles market continued to advance. Although we believe it is unlikely that we will see any economic effects of policy changes in the near term, the economy's underlying pace of demand should help keep 2017 gross domestic product growing by approximately 2%, in our opinion. In addition, the first-quarter 2017 earnings season is projected to be the strongest in several years, with year-over-year earnings up in the double digits. Against this backdrop, convertibles could benefit from upside stock appreciation, but also provide downside protection if volatility rises.

Although there is increased uncertainty because of the U.S. election, economic data have strengthened the argument that more Fed rate hikes could be in store in 2017. If interest rates continue to rise, we expect convertible securities' inherently shorter duration to support the asset class, which has historically performed well in rising-rate environments. Echoing our thoughts, convertibles demonstrated this tendency, remaining in positive territory and outperforming the S&P 500 Index and the Russell 2000 Index for the balance of the quarter following the Fed's March rate hike announcement.

We continue to see a surge in convertible issuance due to improved market sentiment, which is leading issuers to take advantage of rising equity prices to offer aggressively priced convertible securities with terms that are favorable for issuers. On a year-over-year basis for the three months ended March 31, 2017, new issuance increased 78%. The month of March was especially noteworthy, with 10 new issues coming to market totaling $4.9 billion, an 81% increase in year-over-year issuance. While this level of new issuance is a sign of an active and healthy convertibles market, demand has been more muted. We believe this is due to the aggressive pricing of the deals and the small number of issuers participating, which has limited the ability of investors to diversify.

Against this backdrop, we currently plan to keep the fund's overweight positioning in the health-care, communication services, and transportation sectors for the foreseeable future, while remaining underweight in technology and energy.

Putnam Convertible Securities Fund (PCGYX)

Annualized total return performance as of 3/31/17

Class Y shares *Inception 12/30/98*	**Net asset value**	**BofA ML U.S. Convertible Index**
Last quarter	5.28%	5.30%
1 year	17.14	18.12
3 years	4.04	5.77
5 years	8.26	9.97
10 years	5.86	6.73
Life of fund	9.80	—

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 views and opinions expressed are those of the portfolio managers as of March 31, 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, factors related to a specific company or industry, changing market perceptions of the risk of default, and changes in government intervention in the financial markets. These factors may also lead to increased volatility and reduced liquidity in the markets for convertible securities. 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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Putnam Investments | One Post Office Square | Boston, MA 02109 | putnam.com

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