Q4 2017 | Putnam Convertible Securities Fund Q&A

Tax reform and strong earnings propel convertibles higher

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Convertibles continued their rally, led by smaller-company and investment-grade securities.

Effective security selection within the technology and communication services sectors was one of the largest contributors to the fund's performance.

We expect a robust environment for new issues to continue in the face of record equity index levels and rising interest rates.

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

Not FDIC insured | May lose value | No bank guarantee

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

Investor optimism about U.S. tax reform, easing geopolitical tensions with North Korea, and strong third-quarter corporate earnings contributed to a favorable environment for convertible securities in the fourth quarter. Convertible securities tend to take on equity characteristics during rising markets, and it was a solid quarter for equities — led by better-than-expected results in the technology sector.

Convertibles captured some of the equity market's upside during the quarter. For the three months ended December 31, 2017, the ICE BofAML U.S. Convertible Index [the convertible index] rose 1.56%, while the underlying equities of convertible securities returned roughly 1.3%, according to Barclays.

Within the convertibles universe, small-cap [2.25%] convertible securities outperformed their large-cap [1.69%] and mid-cap [1.20%] peers. On a credit-quality basis, investment-grade convertibles [4.64%] outperformed below-investment-grade/speculative convertibles [0.83%]. Industrials and materials were the best-performing sectors of the convertible index for the quarter, whereas the media and transportation sectors lagged.

The fixed-income markets held in positive territory, although returns were less favorable than those in the equity markets, as measured by the 0.39% return for the Bloomberg Barclays U.S. Aggregate Bond Index. With the return for the broader fixed-income markets less competitive, having an underlying exposure to the stock market was helpful for convertibles' performance results.

How did Putnam Convertible Securities Fund perform?

For the three months ended December 31, 2017, the fund delivered positive performance that outperformed the convertible index.

On an absolute and benchmark-relative basis, effective security selection and overweight positioning within the technology sector was the largest contributor to the fund's performance. Positive security selection within the communication services and financials sectors also added to relative performance due to strong third-quarter earnings.

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

What was your strategy?

To help the portfolio weather potential volatility, we favored higher-quality and large-cap names. Additionally, we trimmed 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 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.

We believe this positioning will help the strategy weather potential volatility in the coming months, aside from any short-term volatility driven by company-specific developments at the issuer level.

What is your outlook as 2018 begins?

A series of initiatives emanating from Washington, coupled with the strong corporate earnings season, helped to drive equity and credit markets higher during the period. Stocks, in particular, saw strong gains in 2017 in response to investor optimism that tax cuts would boost U.S. earnings and economic growth. The Tax Cuts and Jobs Act, which was finalized just before the end of the quarter, includes a reduction of the corporate tax rate, a lower repatriation tax rate, full expensing of capital expenditures, and capping of interest deductibility. On balance, we believe these changes could be positive for convertible issuers.

With all S&P 500 companies reporting earnings for the third quarter of 2017, 70% of those companies surpassed bottom-line estimates. S&P profits are poised to grow almost 12% in the fourth quarter of 2017 according to market consensus, with 6.2% revenue growth. Additionally, the Federal Reserve raised rates in December and suggested more hikes in 2018, which is expected to be supportive for the asset class as well.

New issuance of convertibles remained robust with approximately $37.4 billion in supply coming to market in 2017. Increased supply has expanded the universe of investment options in the U.S. convertibles market and created attractive return opportunities, in our view. We expect this robust environment for new issues to continue in an environment of record equity index levels and rising interest rates. Additionally, the new tax law increases the relative attractiveness of convertible market funding versus corporate debt, particularly for more highly leveraged companies, in our opinion. Ultimately, we believe convertible securities continue to be an attractive option for investors as central banks normalize interest rates and stocks trade at elevated prices. 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 12/31/17

Class Y shares *Inception 12/30/98*	**Net asset value**	**ICE BofAML U.S. Convertible Index**
Last quarter	1.88%	1.56%
1 year	15.24	13.70
3 years	5.65	6.80
5 years	9.21	10.74
10 years	6.54	7.35
Life of fund	9.85	—

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.

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.

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The views and opinions expressed are those of the portfolio managers as of December 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, 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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