Putnam INVESTMENTS

Q2 2018 | Putnam Dynamic Asset Allocation Funds Q&A

Diversification lifts funds as rates, trade issues worsen

Robert J. Schoen
CIO, GAA
Industry since 1990

James A. Fetch
Co-Head, GAA
Industry since 1994

Jason R. Vaillancourt, CFA
Co-Head, GAA
Industry since 1993

U.S. stocks had moderate gains during the second quarter.

Bond yields in the United States and globally will likely continue to rise.

A hawkish Federal Reserve contrasts with the slower tightening pace of the European Central Bank.

What was the market environment during the second quarter?

Global markets were marked by ups and downs during the second quarter. The overall volatility was driven primarily by a more hawkish sounding U.S. Federal Reserve, signs of inflation risk, changes in U.S. trade policies, and consequent negative investor sentiment. The Fed raised rates in June as it did in March and has signaled that it is on track to raise rates at least twice more this year.

During the second quarter, President Trump's hard line on trade policies increased the risk of retaliatory measures by U.S. trading partners, including China, the European Union, and Mexico. Canada, a member of the North American Free Trade Agreement (NAFTA), announced retaliatory tariffs against $12.6 billion of U.S. products. The European Union and China, the world's second-largest economy, have announced similar measures. Trade-war jitters, global political risks, and higher borrowing costs dampened gains in international and U.S. equities during the quarter. The broad S&P 500 stock index rose 3.43% in the second quarter of 2018, while the Dow Jones Industrial Average was up 0.70%.

Across the Atlantic, the European Central Bank [ECB] in June decided to end its 2.6 trillion-euro bond purchase program by the end of 2018. The ECB said it did not expect to raise interest rates, which are at historic lows, until the fall of 2019 at the earliest. The anticipation of a more aggressive unwinding of accommodative monetary policy had weighed on the markets.

Not FDIC insured | May lose value | No bank guarantee

How did bond markets perform?

Short-term interest rates continued to increase steadily during the quarter. The Fed again raised short-term rates in the middle of June, and officials have penciled in a total of four rate hikes for 2018, up from a projection of three at their March meeting. Evidence of U.S. economic strength, including a tightening labor market and an improving outlook for wage gains, also drove bond yields higher. The yield on the 10-year U.S. Treasury briefly crossed 3% in May but later fell back amid concerns about the impact of a trade war, and finished the quarter only slightly higher than where it began. High-yield bonds gained during the period, but global bonds in developed and emerging markets came under pressure.

How did Putnam Dynamic Asset Allocation Funds perform?

The three Dynamic Asset Allocation Funds reported positive returns during the quarter. However, much of the performance strength enjoyed in April and May was erased in June. The Conservative Fund's more fixed-income-centric construction delivered a return of 0.97%, while the more equity-centric Growth Fund and Balanced Fund returned 1.71% and 1.88%, respectively.

What strategies contributed to performance?

Our asset allocation strategies during the quarter added value. We maintained an overweight position in equities relative to benchmark allocations and held an out-of-benchmark position in commodities. There was little contribution from credit or interest-rate positioning.

Security selection, despite strong results in April, ended up being a net detractor during the period. June was the weakest month, and our equity selection was the primary driver of this decline. There was weakness in U.S. large-cap and international developed equities during the quarter. Underperformance in equity selection had a greater impact on the portfolios of the Growth Fund and Balanced Fund, which have higher target equity allocations. Emerging-market equity selection, held in the Growth Fund, added value. Outside of equities, we saw positive quarterly performance from fixed-income selection and strategic global macro positions, including a short-term S&P 500 mean-reversion strategy.

What is the outlook for the second quarter of 2018?

This year is turning out to be more volatile than 2017. Despite strong underlying fundamentals, stock performance may be affected by trade protectionism, the trajectory of U.S. interest rates, and political risks. We expect the Fed to increase rates another two times in 2018 as it pursues a return to more normal interest-rate levels. We expect bond yields in the United States and globally to continue rising over the next few years. However, recent forward guidance from the ECB indicating a slow pace of rate increases should keep a lid on how high global yields could increase in the short term.

Global growth prospects are expected to remain relatively stable in 2018. The U.S. economy is poised to pick up some speed this year given indicators for consumer spending, corporate capital expenditure, and fiscal spending. The labor market remains strong as Americans saw wage gains accelerate and hiring improve. Meanwhile, U.S. inflation reached a six-year high of 2.8% in May. The price measure watched closely by the Fed topped the central bank's target amid a strong labor market, higher wages, and economic growth. In addition, concerns about a potential trade war between the United States and other major economies continue to plague markets around the world.

We recently reduced our exposure to equities, moving closer to neutral and our quantitative model remains slightly bearish. The prospect for an uptick in buybacks — one of the reasons for our overweight position in the past few months — has temporarily diminished, with many companies now in blackout periods. In corporate credit, there are high debt levels and declining interest-coverage ratios. High-yield spreads — the difference in a bond's yield relative to the yield of the highest-rated bonds of the same maturity — remain largely range bound. We prefer to be slightly underweight corporate credit risk at these spread levels.

We have reduced our out-of-benchmark allocation to commodities after our quantitative model moved more bearish and several oil producing countries started to ease their production cuts. We do maintain a slightly bullish outlook for the asset class as a whole.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 6/30/18

Class Y shares Inception 7/5/94	Net asset value	Russell 3000 Index	Putnam Balanced Blended Benchmark
Last quarter	1.88%	3.89%	1.82%
1 year	8.11	14.78	7.96
3 years	6.55	11.58	7.24
5 years	8.81	13.29	8.42
10 years	7.51	10.23	7.41
Life of fund	7.38	9.61	—

Total expense ratio: 0.74%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 6/30/18

Class Y shares Inception 7/14/94	Net asset value	Bloomberg Barclays U.S. Aggregate Bond Index	Putnam Conservative Blended Benchmark
Last quarter	0.97%	-0.16%	0.85%
1 year	3.83	-0.40	3.82
3 years	4.09	1.72	4.61
5 years	5.91	2.27	5.45
10 years	5.90	3.72	5.80
Life of fund	6.07	5.13	—

Total expense ratio: 0.77%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Growth Fund (PAGYX)

Annualized total return performance as of 6/30/18

Class Y shares Inception 7/14/94	Net asset value	Russell 3000 Index	Putnam Growth Blended Benchmark
Last quarter	1.71%	3.89%	1.79%
1 year	10.77	14.78	10.36
3 years	7.98	11.58	8.61
5 years	10.33	13.29	9.90
10 years	7.93	10.23	7.90
Life of fund	8.14	9.61	—

Total expense ratio: 0.84%

Class A share inception: 2/8/94

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, which have not been adjusted for the lower expenses; had they, returns would have been higher. For a portion of the periods, these funds 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 funds' benchmarks are administered by Putnam Investments and have the following compositions: For Putnam Conservative Blended Benchmark, 65% Bloomberg Barclays U.S. Aggregate Bond Index, 25% Russell 3000 Index, 5% JPMorgan Developed High Yield Index, and 5% MSCI EAFE Index (ND); for Putnam Balanced Blended Benchmark, 50% Russell 3000 Index, 35% Bloomberg Barclays U.S. Aggregate Bond Index, 10% MSCI EAFE Index (ND), and 5% JPMorgan Developed High Yield Index; and for Putnam Growth Blended Benchmark, 60% Russell 3000 Index, 15% MSCI EAFE Index (ND), 15% Bloomberg Barclays U.S. Aggregate Bond Index, 5% JPMorgan Developed High Yield Index, and 5% MSCI Emerging Markets Index (GD). The Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities. The JPMorgan Developed High Yield Index is an unmanaged index of high-yield fixed-income securities issued in developed countries. The MSCI EAFE Index (ND) is an unmanaged index of equity securities from developed countries in Western Europe, the Far East, and Australasia. The MSCI Emerging Markets Index (GD) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The Russell 3000 Index is an unmanaged index of the 3,000 largest U.S. companies. Securities in the funds do not match those in the indexes, and performance of the funds will differ. It is not possible to invest directly in an index.

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 June 30, 2018, are subject to change with market conditions, and are not meant as investment advice.

Consider these risks before investing: Allocation of assets among asset classes may hurt performance. Stock and bond prices may fall or fail to rise over time for several reasons, including general financial market conditions, factors related to a specific issuer or industry and, with respect to bond prices, changing market perceptions of the risk of default and changes in government intervention. These factors may also lead to increased volatility and reduced liquidity in the bond markets. International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Investments in small and/or midsize companies increase the risk of greater price fluctuations. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. Funds that invest in government securities are not guaranteed. Mortgage-backed investments, unlike traditional debt investments, are also subject to prepayment risk, which means that they may increase in value less than other bonds when interest rates decline and decline in value more than other bonds when interest rates rise. Bond investments are subject to interest-rate risk (the risk of bond prices falling if interest rates rise) and credit risk (the risk of an issuer defaulting on interest or principal payments). Default risk is generally higher for non-qualified mortgages. Interest-rate risk is greater for longer-term bonds, and credit risk is greater for below-investment-grade bonds. Unlike bonds, funds that invest in bonds have fees and expenses. The use of derivatives may increase these risks by increasing investment exposure (which may be considered leverage) or, in the case of over-the-counter instruments, because of the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. You can lose money by investing in the funds.

Diversification does not guarantee a profit or ensure against loss. It is possible to lose money in a diversified portfolio.

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.

Putnam Retail Management

Putnam Investments | One Post Office Square | Boston, MA 02109 | putnam.com

TL059 311577 7/18