Q3 2019 | Putnam Dynamic Asset Allocation Funds Q&A

Markets likely to remain polarized

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Trade tensions and a global growth slowdown may continue to dent stocks.

Treasury yields swing as recession fears ebb and flow.

Federal Reserve sends mixed signals on future rate moves.

What was the market environment during the third quarter?

International financial markets had uneven results during the quarter. The U.S.–China trade conflict, signs of slowing global growth, and fears of a recession have weighed on global equity markets. Market volatility sent stocks on a rollercoaster ride before they recouped some of the losses by the end of the quarter. The S&P 500 Index, a broad measure of U.S. stocks, rallied 1.70% and the MSCI World Index [ND] rose 0.53% during the period.

President Trump's back-and-forth exchange with China has increased volatility in asset markets and soured business sentiment. China and the United States, the world's two largest economies, have imposed tariffs on billions of dollars' worth of one another's goods since the start of 2018. As of September 2019, both countries indicated that trade officials will try to resolve their differences despite higher tensions over the summer.

Against this backdrop, the Federal Reserve lowered short-term interest rates for the second time this year. The July cut was the first since the financial crisis, as the central bank acted to guard the economy against trade uncertainties and cooling global growth. The rate cuts are also part of an effort to keep borrowing cheap, credit available, and businesses and consumers confident.

Geopolitical uncertainty also weighed on markets in Europe. British Prime Minister Boris Johnson suspended Parliament, escalating fears that an October no-deal Brexit would become reality. However, a high court decision reversed the suspension near quarter-end. Germany, Europe's largest economy, is teetering on the brink of a recession. As the world braces for more turbulence, central banks around the world have been cutting borrowing costs. The European Central Bank lowered one of its policy rates to a record low and rolled out a broader package of monetary stimulus.

Market worries also drove many investors to bonds. Different parts of the U.S. Treasury yield curve inverted during the quarter, stoking fear the economy may be headed for a recession. The difference in the yields of the 2-year and the benchmark 10-year Treasury note turned negative in August for the first time since 2007. In addition, the 1-year, 2-year, and 10-year note yields have been below the 3-month yield for months. The rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index rose 2.27% during the quarter.

How did Putnam Dynamic Asset Allocation Funds perform?

The Dynamic Asset Allocation Conservative Fund and the Balanced Fund finished with positive results for the quarter while the Growth Fund was flat. The Conservative Fund, with its greater fixed-income emphasis, gained 1.05%. The more equity-centric Balanced Fund and Growth Fund ended 0.60% and 0.00%, respectively. The funds slightly underperformed their custom benchmarks because of some weakness in asset allocation and active implementation decisions.

What strategies affected performance?

Both U.S. stocks and bonds delivered positive returns for the quarter. International developed- and emerging-market equities were negative contributors. Most of our tactical allocations were held close to benchmark weight for the quarter. The portfolios were underweight interest-rate risk early in the period. This positioning worked against the strategies as rates moved lower, particularly in August.

Our active implementation decisions and security selections also detracted during the period. That resulted mostly from our quantitative strategies for U.S. large-cap and international developed equity markets. Our team analyzes stock market history to identify characteristics of stocks [factors] that have excess risk-adjusted returns. Despite a strong long-term relationship between these factors and positive stock performance, the strategies underperformed over this time period. We did see continued positive contributions from emerging-market equity selection, but that was not enough to offset losses from U.S. and international equity selection.

What is the outlook for the fourth quarter of 2019?

We expect equity and bond market volatility for the remainder of this year. Investors should remain cautious because of the risks related to the outcome of U.S.–China trade talks and to the downtrend in global growth. The global economy has cooled in 2019 as uncertainties about tariffs undermine demand for exports and business investment. The continued, gradual slowdown in global economic growth is something we are closely monitoring. The U.S. economy is also likely to expand at a slower pace compared with 2018. On the positive side, the jobless rate is near an historic low and consumer spending remains strong.

Federal Reserve Open Market Committee [FOMC] members in September raised predictions of GDP growth for this year to 2.2% from 2.1% in June 2019. Fed Chairman Jerome Powell said that central bank officials expect the economy to expand at a moderate rate. He has called the rate cuts an “insurance against ongoing risks.” In actual data, the U.S. economy expanded at a 2.0% annual rate in the second quarter after growing 3.1% in the first quarter, according to the latest estimate from the Bureau of Economic Analysis.

During the quarter, we eliminated our underweight to rate-sensitive fixed income. We believe that U.S. rates are anchored by the low or even negative rates seen in other global government bonds, although they could move higher over the next several years.

We also slightly increased our outlook for equities during the quarter. Our quantitative models have recently become more bullish, and we are encouraged by how broad-based recent stock market performance has been.

Finally, we maintain our slightly negative outlook for credit risks. High-yield bond spreads — the difference in yield between two securities — have narrowed, and our quantitative model remains bearish. We believe there is scope for spreads to widen further.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 9/30/19

Class Y shares Inception 7/5/94	**Net asset value**	**Russell 3000 Index**	**Putnam Balanced Blended Benchmark**
Last quarter	0.60%	1.16%	1.36%
1 year	1.32	2.92	5.62
3 years	7.37	12.83	8.54
5 years	6.24	10.44	7.17
10 years	8.94	13.08	8.93
Life of fund	7.22	9.54	—

Total expense ratio: 0.72%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 9/30/19

Class Y shares Inception 7/14/94	**Net asset value**	**Bloomberg Barclays U.S. Aggregate Bond Index**	**Putnam Conservative Blended Benchmark**
Last quarter	1.05%	2.27%	1.80%
1 year	4.20	10.30	8.01
3 years	4.90	2.92	5.87
5 years	4.61	3.38	5.39
10 years	6.59	3.75	6.52
Life of fund	6.02	5.28	—

Total expense ratio: 0.74%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Growth Fund (PAGYX)

Annualized total return performance as of 9/30/19

Class Y shares Inception 7/14/94	**Net asset value**	**Russell 3000 Index**	**Putnam Growth Blended Benchmark**
Last quarter	0.00%	1.16%	0.75%
1 year	-0.99	2.92	3.56
3 years	8.49	12.83	9.86
5 years	6.82	10.44	7.80
10 years	9.60	13.08	9.88
Life of fund	7.87	9.54	—

Total expense ratio: 0.82%

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. The MSCI World Index (ND) is an unmanaged index of equity securities from developed countries. 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.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of September 30, 2019, 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. The value of investments in the fund's portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general economic, political, or financial market conditions; investor sentiment and market perceptions; government actions; geopolitical events or changes; and factors related to a specific issuer, asset class, geography, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund's portfolio holdings. 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 generally greater for longer-term bonds, and credit risk is generally 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 fund.

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