Q2 2020 | Putnam Dynamic Asset Allocation Funds Q&A

Market resilience, recession, and a second wave

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Equity and bond markets prove resilient even as COVID-19 takes a toll on economic growth.

Risks on the horizon include growth, corporate earnings, and a second wave of the virus.

We will continue to take a tactical approach and adjust the fund's investments as needed.

How were market conditions in the second quarter?

Global financial markets proved to be surprisingly resilient during the second quarter. The coronavirus pandemic and the collapse in oil prices had sent equity and fixed-income markets into a tailspin during the first few months of the year. Bouncing from their lows in March, the S&P 500 Index, a broad measure of stocks, rose 20.54% and the MSCI World Index (ND) gained 19.36% during the period. The market's resilience has also benefited bondholders. The rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index advanced 2.90% during the quarter.

Investors, however, are bracing for a global recession and a second wave of the coronavirus outbreak. A flight-to-safety trade has pushed the yields on U.S. Treasuries lower. The yield on the 10-year Treasury note ended the quarter at 0.66% compared with 0.70% on March 31. The Fed cut interest rates to near zero in mid-March, and unleashed a torrent of bond-buying programs to help stabilize the markets. These actions have increased liquidity in the bond markets and, in turn, stabilized spreads. The U.S. Congress has also pumped trillions of stimulus dollars into the economy. Central banks across Europe, Asia, and other regions also rolled out COVID-19 stimulus measures.

The three Dynamic Asset Allocation Funds gained during the quarter. The Conservative Fund, with its more fixed-income-centric investments, rose 7.83%. The more equity-centric Balanced Fund and Growth Fund advanced 13.41% and 17.24%, respectively. The funds performed largely in line with their custom benchmarks.

What strategies affected performance?

All of the Dynamic Asset Allocation funds finished with positive returns, reflecting equity market strength. During the quarter, we continued to actively adjust our allocation mix. On balance, the strategies were slightly underweight equity risk and interest-rate risk, and overweight credit risk. Overall, these asset allocation decisions detracted a bit. The funds were slightly underweight equity risk entering the period, having benefited significantly in the first quarter from defensive positioning. This underweight was a small detractor early in the second quarter as equity markets rebounded sharply from the lows in late March. Equity risk was moved back to neutral in mid-April. In fixed income, the funds were slightly underweight rate risk and overweight credit risk. Still, these positions did not have a significant impact on quarterly performance.

Our active implementation decisions added to benchmark-relative performance. Security selection within equities was positive. We saw strength across U.S. large-cap equity strategies with both quantitative and fundamental sleeves adding value. In the Growth Fund, emerging-market equity selection boosted performance. Opportunistic fixed income, specifically a strategy focused on structured mortgage credit, was also additive, and made back a large portion of first-quarter weakness.

What is the outlook for the remainder of 2020?

Markets rebounded in the second quarter as governments and central banks introduced very significant stimulus measures to reduce the damage caused by the economic shutdown. However, the biggest risk on the horizon is the impact of a coronavirus resurgence on economic growth, corporate earnings growth, and cash flows. Many investors are wary as numerous uncertainties and challenges remain. In equities, we believe that a second wave may not cause a meaningful pullback because investors are prepared. Typically, bad news must be unexpected in order to have a severe negative impact, and historically, equity markets have tended to shrug off second waves of pandemics.

In corporate credit, both investment-grade and high-yield bonds advanced and spreads tightened, mirroring the strength seen across equity markets. We believe credit markets will continue to improve as the Fed stands as a backstop to spread widening with the purchase of investment-grade corporates. Interest rates remained range bound. Fed Chair Jerome Powell signaled in June that the central bank plans to keep rates near zero for "as long as it takes to provide some relief and stability." Therefore, we expect short-term rates to remain near record lows this year.

Against this backdrop, we continue to have conviction in our investment strategies based on their strong long-term results. As for asset allocation, we will continue to take a tactical approach, adjusting the fund's exposure across various markets as conditions warrant. We will continue to monitor equity and fixed-income markets, and add securities when we see more attractive valuation levels.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 6/30/20

Class Y shares Inception 7/5/94	**Net asset value**	**Russell 3000 Index**	**Putnam Balanced Blended Benchmark**
Last quarter	13.41%	22.03%	13.83%
1 year	3.15	6.53	6.23
3 years	5.26	10.04	7.45
5 years	5.47	10.03	7.22
10 years	8.84	13.72	9.30
Life of fund	7.11	9.47	—

Total expense ratio: 0.73%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 6/30/20

Class Y shares Inception 7/14/94	**Net asset value**	**Bloomberg Barclays U.S. Aggregate Bond Index**	**Putnam Conservative Blended Benchmark**
Last quarter	7.83%	2.90%	8.46%
1 year	5.24	8.74	7.46
3 years	4.76	5.32	6.47
5 years	4.54	4.30	5.88
10 years	6.41	3.82	6.71
Life of fund	6.01	5.37	—

Total expense ratio: 0.75%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Growth Fund (PAGYX)

Annualized total return performance as of 6/30/20

Class Y shares Inception 7/14/94	**Net asset value**	**Russell 3000 Index**	**Putnam Growth Blended Benchmark**
Last quarter	17.24%	22.03%	17.19%
1 year	1.79	6.53	4.50
3 years	5.22	10.04	7.41
5 years	5.77	10.03	7.55
10 years	9.81	13.72	10.33
Life of fund	7.71	9.47	—

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 June 30, 2020, 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. Our investment techniques, analyses, and judgments may not produce the outcome we intend. The investments we select for the fund may not perform as well as other securities that we do not select for the fund. We, or the fund's other service providers, may experience disruptions or operating errors that could have a negative effect on the fund. You can lose money by investing in the fund.

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