Q3 2021 | Putnam Dynamic Asset Allocation Funds Q&A

Markets fluctuate as central banks signal shift from pandemic stimulus

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Risk assets hang on to gains amid multiple risks, including inflation, Covid-19, and tighter policies.

Our outlook on equities is neutral due to higher seasonal volatility, a move past peak earnings growth, and central bank tapering.

We expect upward pressure on bond yields as the Fed gets ready to roll back its stimulus plan.

How were market conditions in the third quarter?

Global equity markets ended the period mixed. Stocks were buoyed by a recovering economy, the lifting of public health restrictions in some countries, and fiscal stimulus. However, risks including higher inflation, likely near-term asset-purchase tapering, China's weaker economy, and the Covid-19 Delta variant percolated through the markets and pulled stocks down from recent highs. For the three-month reporting period, the S&P 500 Index — a broad measure of U.S. stock performance — gained 0.58%. But the MSCI World Index [ND], a broad measure of equity securities from developed countries, dropped 0.01%.

Interest rates fluctuated within a tight range over the last three months, ultimately ending the quarter slightly higher. Rates fell when the Fed called the rise in inflation "transitory" but moved higher when it signaled tapering could begin soon. In late September, the Fed indicated it was ready to scale back asset purchases as soon as November and could lift interest rates as early as next year. The European Central Bank also said it would conduct bond purchases under its emergency program at a "moderately lower pace" over the next three months.

The rate-sensitive Bloomberg U.S. Aggregate Bond Index, a measure of investment-grade [IG] corporate bonds, rose 0.05% for the period. The yield on the benchmark 10-year U.S. Treasury note rose to 1.52% at the end of September from 1.45% at the end of the previous quarter.

How did the funds perform?

The three Dynamic Asset Allocation Funds finished slightly negative for the quarter. The Conservative Fund, with its more fixed income-centric investments, fell 0.29%. The more equity-centric Balanced Fund and Growth Fund lost 0.43% and 0.89%, respectively. All three funds slightly trailed their custom benchmarks for the quarter.

What strategies affected performance?

Overall, our asset allocation decisions slightly enhanced benchmark-relative performance. The portfolios benefited most from our equity positioning during the period. The equity position ranged from modestly overweight to overweight relative to the benchmark early on before we moved the position to neutral at the end of August. In fixed income, our modest underweight position to interest-rate risk and modest overweight position to credit risk did not have a material effect on performance. We moved our credit position to neutral at the end of August. An out-of-benchmark long position to commodity risk contributed a tiny gain. We eliminated this position in mid-August.

Active implementation detracted from benchmark-relative performance. Strategic global macroeconomic trades were the primary source of weakness during the period. The portfolios also experienced a slight loss from our fundamental U.S. large-cap growth strategy. These losses were partially offset by small positive contributions from our fundamental U.S. large-cap value, international equity, and opportunistic fixed income strategies. Our quantitative U.S. large-cap equity and international equity strategies were also slightly additive. In quantitative strategies, our team analyzes stock market history to identify characteristics of stocks [factors] that have excess risk-adjusted returns. During the quarter, our momentum and short-interest factors outperformed.

What is your near-term outlook for the markets?

Despite recent volatility caused by concerns around central bank asset-purchase tapering, inflation, and Covid-19 variants, markets have recovered this year. The stimulative monetary and fiscal policy backdrop among the Group of Ten [G10] advanced countries, historically strong earnings, positive economic data, and ample liquidity fueled financial markets. While we remain optimistic about the recovery, we also anticipate more volatility ahead as investors weigh the impacts of a shift in central bank policy and the unlikely chance of further stimulus. The Fed's rate-setting committee indicated in September that it could start to taper its $120 billion in monthly asset purchases as soon as its next scheduled meeting in early November. New projections released at the end of the Fed's two-day policy meeting showed half of 18 officials expect to raise interest rates by the end of 2022.

Given the current environment, our outlook on equities is neutral. This position is supported by a combination of factors including seasonally increased volatility, a move past peak earnings growth, and the expectation for a shift in central bank policy. While we maintain a positive disposition toward equities, we feel risks have become more balanced.

In fixed income, our outlook on credit is also neutral. Given that spreads have been hovering at the tight end of their recent range, and volatility and defaults are extremely low, we expect an uptick in volatility and thus a lower risk-adjusted return as opposed to a substantial widening in spreads. Our outlook on interest-rate sensitive fixed income is slightly bearish, as we believe risks are skewed to higher yields given the expectations for continued economic momentum and inflation spikes. We expect upward pressure on yields as asset-purchase tapering and a shift in Fed rate policy approach. Against this backdrop, we continue to have conviction in our investment strategies based on their strong, long-term results.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 9/30/21

	Class Y shares Inception 7/5/94	Russell 3000 Index	Putnam Balanced Blended Benchmark
Last quarter	–0.43%	–0.10%	0.00%
1 year	18.98	31.88	18.11
3 years	9.05	16.00	11.35
5 years	9.64	16.85	10.82
10 years	10.39	16.60	10.64
Life of fund	7.64	10.47	—

Total expense ratio: 0.71%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 9/30/21

	Class Y shares Inception 7/14/94	Bloomberg U.S. Aggregate Bond Index	Putnam Conservative Blended Benchmark
Last quarter	–0.29%	0.05%	0.06%
1 year	9.45	–0.90	8.64
3 years	6.87	5.36	8.53
5 years	6.22	2.94	7.03
10 years	6.95	3.01	6.98
Life of fund	6.18	5.11	—

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 9/30/21

	Class Y shares Inception 7/14/94	Russell 3000 Index	Putnam Growth Blended Benchmark
Last quarter	–0.89%	–0.10%	–0.45%
1 year	24.33	31.88	24.03
3 years	10.18	16.00	12.58
5 years	11.53	16.85	12.81
10 years	12.25	16.60	12.42
Life of fund	8.45	10.47	—

Total expense ratio: 0.80%

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 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 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 U.S. Aggregate Bond Index, 5% JPMorgan Developed High Yield Index, and 5% MSCI Emerging Markets Index (GD). The Bloomberg 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. The Dow Jones Industrial Average Index (DJIA) is an unmanaged price-weighted index composed of 30 blue-chip stocks. The S&P 500 Index is an unmanaged index of common stock performance. 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.

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The views and opinions expressed are those of the portfolio managers as of September 30, 2021, 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.

Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. 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). 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. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are 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. The fund may have to invest the proceeds from prepaid investments, including mortgage- and asset-backed investments, in other investments with less attractive terms and yields. International investing involves currency, economic, and political risks. Emerging-market securities have illiquidity and volatility risks. Our alpha strategy may lose money or not earn a return sufficient to cover associated trading and other costs.

Our use of leverage obtained through derivatives increases these risks by increasing investment exposure. Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. The fund's efforts to produce lower-volatility returns may not be successful. The fund may not achieve its goal, and it is not intended to be a complete investment program.

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 negatively impact the fund. The fund is not intended to outperform stocks and bonds during strong market rallies. The fund's prospectus lists additional risks. You can lose money by investing in the fund.

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