Q4 2020 | Putnam Dynamic Asset Allocation Funds Q&A

Markets pin hope on vaccines and stimulus

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Credit markets, supported by the Fed's ongoing quantitative easing, will continue to recover.

Rising COVID-19 cases across the globe will create challenges for policymakers.

How were market conditions in the fourth quarter?

Despite some weakness during the three-month period, global financial markets advanced overall. Equity indices reached record highs, continuing the market's run from the downturn earlier in the year. The rally was fueled by the development of COVID-19 vaccines, signs of economic recovery, and the U.S. election results. President-elect Joe Biden will be sworn in as the 46th president of the United States in January 2021. As equity markets trended higher, COVID-19 infection rates surged, and new travel and business restrictions went into effect. The S&P 500 Index, a broad measure of stocks, rose 12.15% during the period. International stocks, as measured by the MSCI EAFE Index [ND], gained 16.05%.

Fixed-income assets finished with mixed results in the fourth quarter. U.S. Treasury bond yields moved slightly higher, and prices fell as the passage of a $900 billion pandemic relief package boosted investor optimism. Investment-grade bonds ended the period roughly flat, after months of strong gains. The rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index rose 0.67% during the period. High-yield bonds finished with strong positive returns as credit spreads tightened, reflecting equity market strength.

The three Dynamic Asset Allocation Funds gained during the quarter. The Conservative Fund, with its more fixed-income-centric investments, rose 4.98%. The more equity-centric Balanced Fund and Growth Fund advanced 9.04% and 11.81%, respectively. The Growth and Balanced Funds slightly underperformed their custom benchmarks. The Conservative Fund finished in line with its custom benchmark.

What strategies affected performance?

All of the Dynamic Asset Allocation funds finished with positive returns, reflecting equity market strength. Over the quarter, our tactical allocation calls resulted in a positive contribution from dynamic allocation. On balance, the portfolios were slightly overweight to equity risk, neutral to credit risk, and slightly underweight to interest-rate risk relative to their benchmarks. Early in the period, we moved our equity position from neutral to modestly overweight. This aided performance as stock markets soared to record highs. In fixed income, our slight underweight position to interest-rate risk led to a small positive contribution. We moved that position to neutral toward the end of the quarter. Our slight overweight position to credit risk at the beginning of the period led to a small positive contribution. We moved our position to neutral about midway through the period.

Our active implementation decisions detracted from performance relative to the benchmarks. Security selection within U.S. large-cap equities drove this negative result as there was significant weakness across both our quantitative and fundamental strategies. Fixed income selection experienced strength, specifically a strategy focused on structured mortgage credit. These gains helped to mitigate the loss from equity selection. International equity selection slightly added to performance. In the Growth Fund, emerging-market equity selection was a slight detractor.

What is your near-term outlook for the markets?

While rising virus infections could lead to weaker-than-expected economic activity in the coming months, the vaccine progress has reduced the chances of much slower growth in 2021.

In November, several drug makers released positive news about vaccines against COVID-19, including vaccines with efficacy in excess of 90%. The U.S. Food and Drug Administration in December approved two vaccines just as infection rates and shutdowns were spiking globally. The financial markets are now pinning hope on widespread vaccinations by the middle of 2021.

As we enter the new year, we are mildly bullish on equities but tactically wary of overextended sentiment and additional virus-related setbacks. We believe credit markets, supported by the Fed's promise to maintain quantitative easing, will continue to recover. With interest rates pinned near zero and asset purchases becoming the main stimulus tool, Fed officials said they wouldn't lift rates before the labor market recovers. And there is risk to growth over the next few months amid rising COVID-19 cases across the globe. That will continue to create challenges for consumers, businesses, and policymakers.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 12/31/20

Class Y shares Inception 7/5/94	Net asset value	Russell 3000 Index	Putnam Balanced Blended Benchmark
Last quarter	9.04%	14.68%	9.47%
1 year	12.67	20.89	14.80
3 years	7.24	14.49	10.22
5 years	8.78	15.43	10.67
10 years	8.62	13.79	9.33
Life of fund	7.51	10.20	—

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 12/31/20

Class Y shares Inception 7/14/94	Net asset value	Bloomberg Barclays U.S. Aggregate Bond Index	Putnam Conservative Blended Benchmark
Last quarter	4.98%	0.67%	5.20%
1 year	10.36	7.51	11.40
3 years	5.67	5.34	7.95
5 years	6.36	4.44	7.75
10 years	6.27	3.84	6.74
Life of fund	6.19	5.32	—

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 12/31/20

Class Y shares Inception 7/14/94	Net asset value	Russell 3000 Index	Putnam Growth Blended Benchmark
Last quarter	11.81%	14.68%	12.62%
1 year	14.67	20.89	16.45
3 years	7.94	14.49	11.00
5 years	10.30	15.43	12.31
10 years	9.63	13.79	10.37
Life of fund	8.27	10.20	—

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. 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 December 31, 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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