

Q1 2022 | Putnam Dynamic Asset Allocation Funds Q&A

Global assets retreat amid heightened uncertainty



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Global equities and fixed income posted losses due to geopolitical uncertainty, persistently high inflation, and rising rates.

We are refraining from a bearish position to equities given slightly bullish signals from our quantitative model, strong economic data, and the Fed's aggressive efforts to tackle inflation.

We believe our investment strategies give us the ability to adapt the portfolio to changing market conditions.

How were market conditions in the first quarter?

It was a challenging quarter for global financial markets amid increasing headwinds. The Russian invasion of Ukraine, hawkish comments from the Federal Reserve, and persistently high inflation sent equity markets lower. Stocks rebounded slightly in March when the Fed lifted the federal funds rate to a range of 0.25% to 0.50%. Investors viewed this interest-rate hike as a positive step by the Fed to combat inflation. Peace talks between Ukraine and Russia also helped stocks move slightly higher, but not enough to erase earlier losses. The S&P 500 Index returned -4.60%. International stocks, as measured by the MSCI EAFE Index, posted a return of -5.91%.

Bond markets also experienced significant declines over the quarter. Following the Fed's rate hike in March, Fed policymakers penciled in six more increases by year-end, reduced their U.S. growth estimates for 2022, and raised their inflation expectations. The Fed's median projections show their benchmark interest rate rising to a range of 2.50% to 2.75% by the end of 2022. This would be the highest level since 2008.

At times, yields on some shorter-term U.S. Treasuries, such as the 2-year note, edged above those of longer-term Treasuries. This created a flat or inverted yield curve. By quarter-end, the yield on the 2-year Treasury note had climbed from 0.73% on December 31, 2021, to 2.28% on March 31, 2022. The yield on the benchmark 10-year Treasury note rose from 1.52% to 2.32% for the same period. The Bloomberg U.S. Aggregate Bond Index, which is largely composed of Treasuries, highly rated corporate bonds, and mortgage-backed securities, returned -5.93% for the quarter.

How did the funds perform?

The three Dynamic Asset Allocation Funds delivered negative returns for the quarter. The Conservative Fund, with its more fixed income-centric investments, returned -5.43%. The more equity-centric Balanced Fund and Growth Fund returned -5.19% and -5.41%, respectively. All three funds outperformed their custom benchmarks for the quarter. The funds' absolute negative returns were a result of weakness across global equity and global fixed income markets.

What strategies affected performance?

Overall, our asset allocation decisions aided benchmark-relative performance. The portfolios gained most from equity positioning during the quarter. The equity position ranged from modestly overweight to modestly underweight before we moved the position to neutral toward the end of March. Our modest underweight position to interest-rate risk slightly benefited the portfolios. We moved the position to neutral at the beginning of February. An out-of-benchmark, long position to commodity risk, implemented at the beginning of March, led to a small gain. Credit positioning did not have a significant impact on performance. Overall, we have been more active in adjusting our asset allocation positions, seeking to take advantage of volatility across stock, bond, and commodity markets.

Security selection was slightly additive relative to the benchmark for the Conservative and Balanced Funds. Our fundamental U.S. large-cap value equity, quantitative U.S. large-cap equity, and opportunistic fixed income strategies ended slightly positive. The Growth Fund experienced a roughly flat contribution from security selection, with gains from strategies mentioned above offset by weakness from our fundamental emerging market equity strategy.

What is your near-term outlook for the markets?

The first few months of 2022 saw significant volatility. Rising inflation, supply chain disruptions, monetary tightening, and Russia's invasion of Ukraine fueled sell-offs in stocks and bonds. Looking ahead, we expect volatility to persist and market sentiment to waver as these issues continue to plague markets with no clear resolutions in sight.

Our current outlook on equities is neutral. The stock market presently faces major headwinds, including a slowdown in earnings growth, rising interest rates, and geopolitical tensions in Ukraine. However, we are refraining from a bearish position given slightly bullish signals from our quantitative model, strong economic data, and the Fed's aggressive efforts to tackle inflation.

In fixed income, our view on credit is modestly bearish. Should we move beyond the pandemic, we believe it's likely that the United States emerges very close to where it was in the credit cycle in late 2019 before the pandemic began. We also believe the high-yield index has reached peak credit quality and is not likely to improve from here. Our outlook on rate-sensitive fixed income is neutral. Yields have moved higher due to a significant and possibly overdone shift in Fed expectations, in our view. At the end of 2021, markets had priced in three interest-rate hikes for 2022. By quarter-end, the Fed had raised rates by a quarter of a percentage point, and markets had priced in six additional rate hikes for 2022. We expect a balanced distribution of outcomes moving forward.

Against this backdrop, we continue to have conviction in our investment strategies given our ability to adapt the portfolio to changing market conditions.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 3/31/22

	Class Y shares Inception 7/5/94	Russell 3000 Index	Putnam Balanced Blended Benchmark
Last quarter	-5.19%	-5.28%	-5.46%
1 year	4.61	11.92	4.57
3 years	9.35	18.24	10.89
5 years	8.11	15.40	9.53
10 years	8.50	14.28	8.97
Life of fund	7.45	10.41	—

Total expense ratio: 0.69%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 3/31/22

	Class Y shares Inception 7/14/94	Bloomberg U.S. Aggregate Bond Index	Putnam Conservative Blended Benchmark
Last quarter	-5.43	-5.93	-5.64
1 year	0.32	-4.15	0.29
3 years	5.32	1.69	6.43
5 years	4.89	2.14	5.97
10 years	5.54	2.24	5.74
Life of fund	5.91	4.79	—

Total expense ratio: 0.72%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Growth Fund (PAGYX)

Annualized total return performance as of 3/31/22

	Class Y shares Inception 7/14/94	Russell 3000 Index	Putnam Growth Blended Benchmark
Last quarter	-5.41	-5.28	-5.46
1 year	5.79	11.92	6.06
3 years	11.38	18.24	12.97
5 years	9.73	15.40	11.25
10 years	9.96	14.28	10.43
Life of fund	8.28	10.41	—

Total expense ratio: 0.77%

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 March 31, 2022, 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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