Q3 2020 | Putnam Dynamic Asset Allocation Funds Q&A

Hazy market outlook as U.S. elections loom

Robert J. Schoen
CIO, Global Asset Allocation
Industry since 1990

James A. Fetch
Co-Head of Global Asset Allocation
Industry since 1994

Jason R. Vaillancourt, CFA
Co-Head of Global Asset Allocation
Industry since 1993

Brett S. Goldstein, CFA
Portfolio Manager
Industry since 2010

U.S. economic recovery will likely flatten without more fiscal policy support from Congress.

High valuations and volatility, driven by the pandemic and the presidential election, keep us mostly on the sidelines.

We believe that longer-dated U.S. Treasury bonds are an effective diversifier to risky assets.

How were market conditions in the third quarter?

Equity markets corrected a bit in the waning days of the third quarter but ended the period on a strong note. All major U.S. equity indices have climbed for a second consecutive quarter, continuing the market's run from the downturn earlier in the year. The S&P 500 Index, a broad measure of U.S. stocks, rose 8.93% and the Dow Jones Industrial Average rallied 8.22% over the past three months. The Bloomberg Barclays U.S. Aggregate Bond Index, a broad measure of U.S. investment-grade fixed-income securities, gained 0.62%.

The rally was largely fueled by signs of economic recovery, stimulus from the Federal Reserve and Congress, and progress toward a coronavirus vaccine. In September, the Fed committed to keep its policy rate anchored at zero until average inflation reaches the central bank's 2% target and the economy achieves maximum employment. The Fed's shift in how it sets the policy rate indicates it will tolerate "lower for longer" rates. The yield on the 10-year Treasury note ended September at 0.69% from 1.88% at the beginning of the year. Central banks across Europe, Asia, and other regions also rolled out COVID-19 stimulus measures.

Still, investors are bracing for potential headwinds, including slower global growth, spikes in COVID-19 cases, and a prolonged U.S. legislative gridlock on a new stimulus package. U.S. legislators — Democrats and Republicans — have been at an impasse over the next virus relief bill. In addition, the November election campaigns have kicked into full gear.

The three Dynamic Asset Allocation Funds gained during the quarter. The Conservative Fund, with its more fixed-income-centric investments, rose 2.76%. The more equity-centric Balanced Fund and Growth Fund advanced 4.98% and 6.76%, respectively. The funds slightly underperformed 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 held allocations relatively close to the benchmarks, which resulted in a roughly flat contribution from dynamic allocation. On balance, the portfolios were slightly underweight equity risk and interest-rate risk, and slightly overweight credit risk relative to their benchmarks. Entering the period, we were slightly underweight equity risk, which detracted from performance as equity markets continued their rally. We moved our position back to neutral toward the end of the quarter. In fixed income, our slight overweight position to credit risk aided results as spreads tightened, offsetting the loss from equities. Our slight underweight position to interest-rate risk had a muted impact on performance.

Our active implementation decisions slightly 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. International equity selection slightly added to performance. In the Growth Fund, emerging-market equity selection was a strong positive contributor. Fixed income selection, specifically a strategy focused on structured mortgage credit, experienced strength, helping to mitigate the loss from equity selection.

What is your near-term outlook for the markets?

The global economy is recovering at an uneven pace after an initial burst of activity and somewhat of a slowdown in the early part of the summer. The development of a vaccine or vaccines for COVID-19 could help provide a boost to economic growth. That said, risks to steady growth and corporate earnings included newly emerging coronavirus hotspots, slowing job gains, and cooling investment. The recovery in the United States has continued but is likely to flatten out without more fiscal policy support.

We don’t expect to see a significant pullback in equity markets. Investors are waiting for clues on what will come next, either on the economy or action from lawmakers in another stimulus bill for Americans. The Fed has also signaled that rates would stay near zero until at least 2023. We conclude that, on the surface, the Fed’s message of looser policy should be bullish for risky assets as long as the United States does not experience outright deflation. We also believe that longer-dated U.S. Treasury bonds will continue to be an effective diversifier to risky assets while inflation and inflation expectations stay low and the yield curve remains upward sloping.

As we near the end of 2020, high valuations and bouts of volatility driven by the pandemic and the U.S. presidential election keep us mostly on the sidelines with tactical asset allocation. The election has the possibility of an uncertain outcome and could drag on for weeks or months. However, the removal of concerns about monetary policy becoming restrictive will provide a tailwind once we view risks as being properly priced. We see in the Fed’s policy shift reasons for bullishness after the election is resolved.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 9/30/20

Class Y shares Inception 7/5/94	Net asset value	Russell 3000 Index	Putnam Balanced Blended Benchmark
Last quarter	4.98%	9.21%	5.59%
1 year	7.64	15.00	10.66
3 years	5.67	11.65	8.26
5 years	7.62	13.69	9.39
10 years	8.41	13.48	8.99
Life of fund	7.24	9.74	—

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 9/30/20

Class Y shares Inception 7/14/94	Net asset value	Bloomberg Barclays U.S. Aggregate Bond Index	Putnam Conservative Blended Benchmark
Last quarter	2.76%	0.62%	3.22%
1 year	7.02	6.98	8.96
3 years	4.86	5.24	6.87
5 years	5.64	4.18	6.94
10 years	6.12	3.64	6.46
Life of fund	6.06	5.34	—

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 9/30/20

Class Y shares Inception 7/14/94	Net asset value	Russell 3000 Index	Putnam Growth Blended Benchmark
Last quarter	6.76%	9.21%	7.10%
1 year	8.67	15.00	11.09
3 years	5.82	11.65	8.41
5 years	8.82	13.69	10.60
10 years	9.35	13.48	9.94
Life of fund	7.90	9.74	—

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. 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, 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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Putnam Investments | 100 Federal Street | Boston, MA 02110 | putnam.com

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