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Q1 2019 | Putnam Dynamic Asset Allocation Funds Q&A

Markets rebound as the Fed turns dovish

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Global equity markets recover from 2018 lows as risk aversion declines.

Parts of the U.S. Treasury yield curve have inverted, raising concerns about a recession.

Federal Reserve turns dovish on interest rates as U.S. economy cools.

What was the equity market environment during the first quarter?

Global equity markets recovered during the quarter, rebounding from last quarter's slide that was spurred by worries over global economic growth and rising interest rates. The Federal Reserve left its benchmark rate unchanged in March and signaled little appetite for raising it again in the near future. The Fed's dovish pivot boosted U.S. and international equities and sent long-term Treasury yields on a declining streak. Large-cap stocks and their mid- and small-cap counterparts gained as market volatility fell. The broad S&P 500 Index rose 13.65% during the quarter, and the MSCI World Index [ND] gained 12.48%.

U.S. growth is cooling from last year under the weight of the Trump administration's trade war, economic slowdowns in Europe and China, and fading stimulus from the tax cuts of 2017. The economy grew at a 2.2% annual rate in the fourth quarter of 2018, after expanding 3.4% in the third quarter. Still, the unemployment rate touched multi-decade lows, inflation remains anchored, and the likelihood of a recession remains low. Slowing economic activity contributed to the Fed's decision to pause its three-year campaign to tighten monetary policy. The Fed will also begin to taper the runoff from its estimated $4.5 trillion bond portfolio in May and end it in September.

The global economy is also slowing. China's economy, the world's second-biggest, is also grappling with a slowdown as policy makers roll out more fiscal and monetary measures to cushion growth. China and the United States appear to be close to a trade deal, and any truce would be a positive step. Across the Atlantic, the European Central Bank [ECB] also left benchmark interest rates unchanged in March. The bank said it expects its key interest rates "to remain at their present levels" at least through the end of 2019.

How did bond markets perform?

U.S. Treasury yields generally fell across the yield curve, which continued to flatten. The yield on the benchmark 10-year note traded around 2.41%, while the two-year yield fell to around 2.27% at the end of March 2019. Parts of the Treasury yield curve have inverted. In March, the yield on the 10-year note dipped below the yield on 3-month bills for the first time since mid-2007. An inverted yield curve — which plots bond yields with differing maturity dates — is considered a potential recession indicator.

High-yield bonds had positive returns for the period and generally outperformed investment-grade fixed-income securities. The return of investor appetite for holding riskier assets and a lack of new issuance helped pull high-yield bond spreads tighter. The more rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index rose 2.94%.

How did Putnam Dynamic Asset Allocation Funds perform?

The three Dynamic Asset Allocation Funds had positive returns during the quarter, reflecting the market rebound. The Conservative Fund, with its more fixed-income-centric investments, gained 6.03%. The more equity-centric Balanced Fund and Growth Fund rose 9.25% and 11.27%, respectively.

What strategies affected performance?

The funds' positive performance resulted from our investments in equities, bonds, and commodities. Each of the portfolios held out-of-benchmark positions in commodities at the start of the year. This allocation boosted the funds' returns as energy prices rebounded from the sell-off in the fourth quarter. We also held an overweight position in U.S. equities at the start of 2019. These positions helped performance because of the sharp bounce in stock prices in January and February.

Our active implementation decisions and security selections detracted at the beginning of the year. Our quantitative strategy in U.S. large-cap stocks was the primary area of weakness during the quarter. As we discussed before, our team analyzes stock market history to identify characteristics of stocks [factors] that have excess risk-adjusted returns. Despite a strong long-term relationship between these factors and positive stock performance, the strategies underperformed during the quarter. We did see positive contributions from our fixed-income selection strategies. But that was not enough to offset losses from our equity selection.

Overall, the positive contributions from our dynamic allocation decisions were largely offset by implementation weakness. That left our strategies near the benchmark performance for the quarter.

What is the outlook for the second quarter of 2019?

Higher interest rates, weaker demand from China, political troubles in the eurozone, and protectionist tariffs have put pressure on growth. But we expect global growth to stabilize as 2019 progresses. The U.S. economy is also facing rising headwinds and is expected to expand at a more moderate pace in 2019 compared with last year. The Fed expects 2.1% growth this year, down from the 2.3% it forecast in December. We believe inflationary pressures will also remain modest.

The Fed's Jerome Powell said at the March rate-setting meeting that short-term interest rates could be on hold for "some time" as global risks weigh on the economic outlook and inflation remains muted. In December 2018, Fed officials said they expected two rate increases this year and another in 2020. They now project one rate hike in 2020 and none in 2021.

We expect stock and bond market volatility to persist in 2019. During the quarter, we decreased our exposure to equity, inflation [commodities], and interest rates [government bonds] and increased our exposure to credit [corporate bond spreads]. We downgraded our position in equities from overweight to slightly overweight relative to the benchmarks. We had increased our equity allocation in the fourth quarter to take advantage of short-term market weakness. But we have reverted to only a slight overweight because of the rebound in stocks in January, improvements in market sentiment and positionings, and the continued potential for negative trade-related headlines.

In credit-sensitive fixed income, we upgraded our position to a slight overweight. This is due to positive signals from our quantitative model, attractive bond spreads, and lower new issuance. In rate-sensitive fixed income, we downgraded our position to underweight. We expect interest rates to trend higher given the below-average real yields on the 10-year Treasury and the historically low premium attached to the 10-year note.

Finally, we downgraded our commodities exposure to neutral and removed commodities from our portfolios. The strong rally in energy prices made the qualitative view more balanced after being skewed positive following the fourth-quarter sell-off. We moved to neutral in the absence of strong qualitative or quantitative signals.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 3/31/19

Class Y shares Inception 7/5/94	**Net asset value**	**Russell 3000 Index**	**Putnam Balanced Blended Benchmark**
Last quarter	9.25%	14.04%	9.37%
1 year	3.65	8.77	6.15
3 years	7.99	13.48	8.69
5 years	6.21	10.36	6.73
10 years	11.72	16.00	10.93
Life of fund	7.23	9.51	—

Total expense ratio: 0.72%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 3/31/19

Class Y shares Inception 7/14/94	**Net asset value**	**Bloomberg Barclays U.S. Aggregate Bond Index**	**Putnam Conservative Blended Benchmark**
Last quarter	6.03%	2.94%	6.25%
1 year	3.44	4.48	5.46
3 years	5.00	2.03	5.55
5 years	4.44	2.74	4.84
10 years	8.56	3.77	7.59
Life of fund	5.99	5.16	—

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 3/31/19

Class Y shares Inception 7/14/94	**Net asset value**	**Russell 3000 Index**	**Putnam Growth Blended Benchmark**
Last quarter	11.27%	14.04%	11.20%
1 year	2.34	8.77	5.47
3 years	9.71	13.48	10.58
5 years	6.93	10.36	7.52
10 years	13.06	16.00	12.69
Life of fund	7.92	9.51	—

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 MSCI World Index (ND) is an unmanaged index of equity securities from developed countries. The Russell 3000 Index is an unmanaged index of the 3,000 largest U.S. companies. 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. The S&P 500 Index is an unmanaged index of common stock performance.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of March 31, 2019, 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. Stock and bond prices may fall or fail to rise over time for several reasons, including general financial market conditions, changing market perceptions (including, in the case of bonds, perceptions about the risk of default and expectations about monetary policy or interest rates), changes in government intervention in the financial markets, and factors related to a specific issuer or industry. 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. You can lose money by investing in the funds.

Diversification does not guarantee a profit or ensure against loss. It is possible to lose money in a diversified portfolio.

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Request a prospectus or summary prospectus from your financial representative or by calling 1-800-225-1581. The prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

Putnam Retail Management

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