Q2 2019 | Putnam Dynamic Asset Allocation Funds Q&A

The tide keeps changing for global markets

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Equity markets remain cautious on trade truce and growth.

The 10-year U.S. Treasury yield tumbles to below 2%.

The Fed signals possible rate cut, boosting appetite for risk assets.

What was the market environment during the second quarter?

Global financial markets advanced during the quarter. Investor appetite for risk assets has ebbed and flowed because of the U.S.–China trade rift and growing fears the dispute would worsen a global economic slowdown. At the Group of 20 meeting in June, President Trump and Chinese President Xi Jinping made headway on stabilizing tariffs as they continue to work on long-term trade issues. Stocks and other risky assets enjoyed a brief rally after the announcement of the trade truce. The S&P 500 Index, a broad measure of U.S. stocks, rose 4.30% and the MSCI World Index rallied 4.00% during the period.

The Federal Reserve held interest rates steady during the quarter and signaled a possible cut if the U.S. economic outlook doesn't improve. Earlier this year, the central bank had surprised investors by signaling it was done raising interest rates for now. The Fed's shift in monetary policy has lifted investor sentiment and boosted global markets. In Europe, lower growth has spurred the European Central Bank [ECB] toward loosening monetary policy. The ECB has signaled that it could start introducing new stimulus measures, including a reduction in already record low interest rates, to support growth.

Risk-averse investors had also flocked to the safety of government bonds during the quarter. This flight to perceived safe havens saw U.S. Treasury yields tumble. The yield on the benchmark 10-year note — widely used in setting borrowing costs for consumers and businesses worldwide — tumbled to multi-year lows at the end of

June 2019. The two-year Treasury yield, which often moves with expectations for Fed policy, fell below 1.8%. The rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index rose 3.08% during the quarter.

How did Putnam Dynamic Asset Allocation Funds perform?

The three Dynamic Asset Allocation funds had positive returns during the quarter. The Conservative Fund, with its more fixed-income-centric investments, gained 2.70%. The more equity-centric Balanced Fund and Growth Fund rose 2.80% and 2.68%, respectively. The funds, however, slightly underperformed their custom benchmarks because of some weakness in our asset allocation strategies and active implementation decisions.

What strategies affected performance?

Performance for the quarter was largely a product of positive returns from stocks and bonds, albeit with some volatility during the past three months. The majority of our positions were near all three funds' respective benchmarks. We held underweight positions in interest-rate risk in all three strategies. These positions detracted from performance as yields moved lower because of concerns about economic growth and expectations for a Fed rate cut. Bond prices rise as yields decline.

Our active implementation decisions and security selections also detracted slightly from relative performance. Our stock selections in U.S. and international-developed markets experienced some weakness, particularly in May. We did see positive contributions from our fixed-income selection strategies. Our emerging-market stock selection in the Growth portfolio boosted returns. Overall, these strategies helped offset some of the weakness elsewhere.

What is the outlook for the third quarter of 2019?

The global economy has cooled in 2019 as the fallout from the ongoing trade rifts, waning business confidence, and financial market volatility have kept the lid on expansion. The U.S. economy is also likely to expand at a more moderate pace compared with that of 2018. Still, unemployment has touched multi-decade lows, inflation remains anchored, and the likelihood of a recession — while higher than a few months ago — remains low.

Fed Chair Jerome Powell in June 2019 said the central bank "will act as appropriate" to sustain U.S. economic expansion, fueling market speculation of a rate cut this year. The Fed dropped its pledge to remain "patient" on rates from its policy statement at the June meeting. The central bank expects 2.1% growth this year, down from the 2.3% rate that it forecast in December 2018. The economy surged in the first quarter of 2019, expanding at a 3.1% annual rate after growing 2.2% in the fourth quarter.

We expect some stock and bond market volatility to persist in 2019. Financial markets will remain cautious because of uncertainties related to the outcome of the U.S.–China trade talks and the pace of global growth. The trade truce in itself will not resolve the underlying differences between Beijing and Washington, but it may give officials another chance to reach a permanent accord. Investors are still attempting to gauge the potential fallout from protectionist tariffs on economic growth and corporate profits.

During the quarter, we decreased our exposure to equity, credit risk (high-yield corporate bonds), and interest-rate risk (government bonds). We are currently neutral on equities and commodities relative to our benchmarks. However, we are underweight in credit-sensitive and rate-sensitive fixed-income assets. We have a slightly negative outlook on credit risks. High-yield bond spreads — the difference in yield between two securities — have narrowed and are back to near their tightest point of this cycle. As a result, our quantitative model has become more bearish. In addition, uncertainty surrounding the U.S.–China trade negotiations provide scope for further spread widening.

As for our rates positioning, we believe bond yields will drift higher in 2019 as interest-rate normalization continues in the United States and globally. That is because the real yield on the 10-year Treasury note remains below average and the term premia estimates on the notes are at historically low levels. The term premium is the extra return [a risk premium] that investors demand to hold a long-term bond. In addition, we think interest rates are unattractive because of the very low carry inherent in the asset class due to the flat shape of the yield curve.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 6/30/19

Class Y shares Inception 7/5/94	**Net asset value**	**Russell 3000 Index**	**Putnam Balanced Blended Benchmark**
Last quarter	2.80 %	4.10%	3.75%
1 year	4.60	8.98	8.16
3 years	8.40	14.02	9.22
5 years	6.07	10.19	6.75
10 years	10.37	14.67	10.03
Life of fund	7.27	9.59	—

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 6/30/19

Class Y shares Inception 7/14/94	**Net asset value**	**Bloomberg Barclays U.S. Aggregate Bond Index**	**Putnam Conservative Blended Benchmark**
Last quarter	2.70%	3.08%	3.46%
1 year	5.20	7.87	8.18
3 years	5.30	2.31	5.93
5 years	4.39	2.95	4.96
10 years	7.60	3.90	7.16
Life of fund	6.04	5.24	—

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 6/30/19

Class Y shares Inception 7/14/94	**Net asset value**	**Russell 3000 Index**	**Putnam Growth Blended Benchmark**
Last quarter	2.68%	4.10%	3.72%
1 year	3.31	8.98	7.46
3 years	10.13	14.02	11.17
5 years	6.65	10.19	7.40
10 years	11.34	14.67	11.35
Life of fund	7.95	9.59	—

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. 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.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of June 30, 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. 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. You can lose money by investing in the fund.

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