Q1 2018 | Putnam Dynamic Asset Allocation Funds Q&A

Global asset rally pauses as caution emerges

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Stocks, despite losing value to start the year, generally outperformed bonds.

Rising interest rates had a larger impact on fixed-income strategies.

Federal Reserve will continue gradually raising interest rates.

Please describe the global market environment during the first quarter.

There was a spike in volatility across global markets during the first quarter of 2018, one that included a U.S. equity market correction that began at the end of January. This broad market decline was driven primarily by a more hawkish sounding Federal Reserve and the risk of a trade war with China. The Fed raised rates in March 2018 and signaled that the central bank is on track to raise rates at least twice more this year.

It is fair to say that trade protectionism and the risk of a trade war have risen over the past few weeks. President Trump slapped tariffs on an estimated $50 billion of imports from China, weeks after announcing tariffs on aluminum, steel, washing machines, and solar panels. Global and U.S. equities — and specifically technology stocks — were also undermined by user data privacy issues engulfing Facebook and other social media companies. The broad Standard & Poor's 500 stock index fell 0.76% in the first quarter of 2018, while the Dow Jones Industrial Average dropped 1.96%.

On a more positive note, the U.S. tax reform that went into effect includes a reduction in the corporate tax rate to 21% from 35%. This law is widely seen as a near- to medium-term positive factor for corporations in the United States and provided some impetus to stock performance during the first few weeks of the year. Across the Atlantic, the European Central Bank left interest rates unchanged at its January meeting. However, investors remained skeptical about how long the economic stimulus program would remain in place. The anticipation

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of a more aggressive unwinding of accommodative monetary policy ultimately weighed negatively on the market risk premium, resulting in declines in both equities and bonds.

How did bond markets perform?

Treasury yields and short-term interest rates continued to increase steadily during the quarter. With short-duration yields climbing faster than long-term Treasury yields, the curve has flattened. Evidence of economic strength, including a tightening labor market and an improving outlook for wage gains, also drove bonds yields higher. However, inflation has remained muted.

How did Putnam Dynamic Asset Allocation Funds perform?

Each of the three Dynamic Asset Allocation Funds had negative returns, reflecting the setback for equity and fixed-income prices during the quarter, as the funds are currently invested close to our strategic allocations. Stocks, despite losing value to start the year, generally outperformed bonds. Accordingly, the Growth Fund had the strongest absolute return at -1.45%. The Conservative Fund's more fixed-income-centric construction produced a lower return of -2.06%, while the Balanced Fund's return of -1.93% represented stronger performance within equities and lower relative performance in rate-sensitive fixed income.

What strategies contributed to performance?

We made minor shifts around benchmark allocations to favor U.S. large-cap stocks, but otherwise we maintained allocations close to the strategic benchmark across domestic and international stock categories. Our asset allocation strategies during the quarter had a negative impact. Generally, favoring U.S. large-cap equities worked against the funds over the period. This was partially offset by an out-of-benchmark position in commodities, which was implemented tactically during March. This exposure to a broad basket of commodities had a positive impact on the portfolio and serves as an example of using our tactical asset allocation flexibility to find opportunities outside of the asset classes included in our benchmark.

Security selection and implementation was also negative for the quarter. The slow start to the year was primarily due to selection within U.S. large-cap equities. Selection in international developed equities was positive over the quarter. Specific to the Growth portfolio, emerging-market equity selection added value. An out-of-benchmark fixed-income strategy, which focused on securitized debt — primarily mortgages — had a modest positive impact; however, these strengths were not enough to offset U.S. large-cap equity selection weakness.

What is the outlook for the second quarter of 2018?

Early 2018 is turning out to be more volatile than 2017. Despite strong underlying fundamentals, stock performance may be affected by trade protectionism, the trajectory of U.S. interest rates, and political risks. We expect the Fed to increase rates another two times in 2018 as it pursues a return to more normal interest-rate levels. However, new Federal Reserve Chair Jerome Powell's congressional testimony earlier this year raised concerns that an additional rate hike may be possible.

The U.S. and global economy prospects for 2018 remain solid, buoyed by consumption and investment. The U.S. labor market began 2018 on a strong note as Americans saw wage gains accelerate and hiring improve. While inflation has remained subdued, recent wage growth sparked concerns about rising prices. In Europe, higher-than-expected inflation could produce some volatility in euro-based sovereigns and corporate bonds. We expect rate normalization to continue, though ECB monetary policy on the whole remains mostly accommodative.

A much larger challenge for markets in coming months will be the Trump administration's return to its campaign promises of "America First" trade policies. The administration in February announced tariffs on steel and aluminum, which were subsequently watered down to provide waivers for many companies and countries. Of even greater concern is the more China-targeted Section 301 findings on the cumulative costs of intellectual property theft and forced technology transfer; the preliminary estimates dwarf the expected impact of the initial metals tariffs.

While these political and geopolitical risks warrant monitoring, we currently prefer equity over both rates and credit in our multi-asset portfolios, and maintain our positive view on commodities.

Putnam Dynamic Asset Allocation Balanced Fund (PABYX)

Annualized total return performance as of 3/31/18

Class Y shares Inception 7/5/94	**Net asset value**	**Russell 3000 Index**	**Putnam Balanced Blended Benchmark**
Last quarter	-1.93%	-0.64%	-0.98%
1 year	8.97	13.81	8.93
3 years	5.73	10.22	6.45
5 years	8.42	13.03	8.11
10 years	7.30	9.62	7.09
Life of fund	7.38	9.54	—

Total expense ratio: 0.74%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Conservative Fund (PACYX)

Annualized total return performance as of 3/31/18

Class Y shares Inception 7/14/94	**Net asset value**	**Bloomberg Barclays U.S. Aggregate Bond Index**	**Putnam Conservative Blended Benchmark**
Last quarter	-2.06%	-1.46%	-1.18%
1 year	5.15	1.20	5.11
3 years	3.42	1.20	3.96
5 years	5.49	1.82	5.06
10 years	5.73	3.63	5.60
Life of fund	6.10	5.19	—

Total expense ratio: 0.77%

Class A share inception: 2/7/94

Putnam Dynamic Asset Allocation Growth Fund (PAGYX)

Annualized total return performance as of 3/31/18

Class Y shares Inception 7/14/94	**Net asset value**	**Russell 3000 Index**	**Putnam Growth Blended Benchmark**
Last quarter	-1.45%	-0.64%	-0.79%
1 year	12.57	13.81	12.07
3 years	7.35	10.22	7.98
5 years	10.12	13.03	9.66
10 years	7.74	9.62	7.56
Life of fund	8.16	9.54	—

Total expense ratio: 0.84%

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. Class Y shares, available to investors through an asset-based fee program or for institutional clients, are sold without an initial sales charge and have no CDSC. For the most recent month-end performance, please visit putnam.com.

The funds' benchmarks are administered by Putnam Investments and have the following compositions: 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; 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); 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.

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