Q4 2020 | Putnam Small Cap Growth Fund Q&A

A strong 2020 for fund performance

William J. Monroe, CFA
Portfolio Manager
Industry since 1996

The fund underperformed in the fourth quarter but outperformed the benchmark for the 1-, 3-, 5-, and 10-year periods and the life-of-fund period ended December 31, 2020.

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We believe we will see enormous progress from many of the innovative companies in our portfolio over the next three to five years.

How has the fund performed?

For the fourth quarter, the fund delivered a solid return but underperformed its benchmark, the Russell 2000 Growth Index. However, it is worth noting the longer-term performance as well. The fund outperformed the benchmark for the 1-, 3-, 5-, and 10-year periods and the life-of-fund period ended December 31, 2020.

In the fourth quarter, our stock selection in health care and industrials was a drag on performance, as was our underweight exposure to the high-risk biotechnology industry, where stock performance surged.

How were market conditions in the quarter?

The quarter was marked by the U.S. presidential election, global surges in COVID-19 cases, and the authorization and start of distribution for two COVID-19 vaccines. It was a strong quarter for the overall equity market, and we also saw strong risk seeking, as investors turned toward small-cap stocks and the much-beleaguered value stocks. The Russell 2000 Value Index, for example, returned a stunning 33.36% for the fourth quarter. Prior to the election, returns overall were subdued, but they surged once it became clearer that Joe Biden would be the winner.

Could you provide some more detail on the types of companies you own?

We look for small companies that we believe can grow their earnings and cash flows at a rapid pace for many years. Ideally, we seek small-cap companies that can grow into large-cap businesses over time. We are not typically attracted to companies that have been small for a while and are likely to remain small. We are attracted to businesses in big addressable markets that have products or services that enable them to take market share from peers.

The small-cap asset class can be volatile, especially when targeting the fastest growing companies. For this reason, it is important to note that the largest portion of our portfolio consists of stable, well-established companies that we believe are mispriced by the market. We believe these companies, which typically comprise 60% to 80% of the portfolio, can grow at above-average rates and the market is not pricing in their full profitability potential.

What is your outlook going into 2021?

We remain optimistic about the prospects for equity market returns in 2021 and beyond. Monetary policymakers in the United States and abroad remain vigilant. They are keeping policy relatively loose and have hinted that they will do so for the foreseeable future. This will potentially keep interest rates low. Also, the depression-like economic damage caused by the pandemic has eased concerns about inflation.

In terms of economic metrics, in 2021 we are likely to see some dramatic "optics," but the conditions of modest GDP growth, low inflation, and low baseline interest rates should be positive for equities overall, in our opinion. While it has become a bit cliché, we believe that the pandemic has accelerated many disruptive forces in the economy, with many growth companies becoming the beneficiaries of these changes. Overall, we continue to see compelling opportunities in smaller growth-oriented companies and we believe we will see enormous progress from many of the innovative companies in our portfolio over the next three to five years.

Putnam Small Cap Growth Fund (PNSAX)

Annualized total return performance as of 12/31/20

Class Y shares Inception 11/3/03	**Net asset value**	**Russell 2000 Growth Index**
Last quarter	22.71%	29.61%
1 year	48.02	34.63
3 years	25.89	16.20
5 years	21.20	16.36
10 years	15.58	13.48
Life of fund	12.74	7.98

Total expense ratio: 0.99%

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 of class Y shares 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. Performance for class Y shares before their inception are derived from the historical performance of class A shares (inception 12/31/97), which have not been adjusted for the lower expenses; had they, returns would have been higher. Recent performance may have benefited from one or more legal settlements. For the most recent month-end performance, please visit putnam.com.

The Russell 2000 Growth Index is an unmanaged index of those companies in the small-cap Russell 2000 Index chosen for their growth orientation. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. You cannot invest directly in an index.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio manager, as of December 31, 2020. They are subject to change with market conditions and are not meant as investment advice.

Consider these risks before investing: Investments in small and/or midsize companies increase the risk of greater price fluctuations. Growth stocks may be more susceptible to earnings disappointments, and the market may not favor growth-style investing. 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, geography, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund's portfolio holdings. These risks are generally greater for small and midsize companies. From time to time, the fund may invest a significant portion of its assets in companies in one or more related industries or sectors, which would make the fund more vulnerable to adverse developments affecting those industries or sectors. 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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