

Q3 2020 | Putnam Small Cap Growth Fund Q&A

A strong quarter of performance as market rebound continues



William J. Monroe, CFA
Portfolio Manager
Industry since 1996

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How did the fund perform in the third quarter?

The fund delivered a solid return for the quarter and outperformed its benchmark, the Russell 2000 Growth Index. The fund also outperformed the benchmark for the 1-, 3-, 5-, and 10-year periods and the life-of-fund period ended September 30, 2020.

The fund's outperformance was driven by positive stock selection in the majority of sectors in the market. The top-contributing sector was health care, followed by communication services and financials. Our stock selection in industrials was a drag on performance for the quarter. Within health care, biotechnology holdings added most to performance, and our underweight position was also beneficial as biotech underperformed the broader market.

How were market conditions in the quarter?

The equity market continued with its remarkable rebound from the pandemic-induced market collapse in March. Equities advanced in July and August, but posted declines in September. Large-cap stocks declined most in September as mega-cap technology stocks pulled back after demonstrating amazing resilience and leadership throughout the year. For the quarter overall, small-cap stocks underperformed their large-cap counterparts.

The September market downturn appeared to be tied to rising numbers of Covid-19 cases in the United States and Europe, which had investors anxious about a potential "second wave" surge of the virus. Additionally, investors were distracted by a contentious presidential election season and sometimes hour-by-hour changes in headlines around a stimulus package from Congress.

What areas of the market look promising to you right now?

We always search for unique growth opportunities across the market landscape, but we are often led to the technology and health-care sectors. They both continue to see a quick pace of change and disruption, which often leads to great investing opportunities in our view. Moreover, the benefits of technology implementation and the ability to analyze massive amounts of data tend to permeate other less obvious sectors. For example, many of our holdings in the consumer and even real estate industries are benefiting from shifts in consumer behavior due to advances in technology.

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 much higher rates and the market is not pricing in their full profitability potential.

What is your outlook going into the final quarter of the year?

The remainder of 2020 will likely be volatile for U.S. equity markets. We are dealing with the typical risks associated with an election cycle, compounded by the additional risk of further spreading of COVID-19. This, of course, could be offset by a rapid advance in the development of a vaccine or therapeutics. On the positive side, as we move through the final quarter of 2020, many of these risk factors could abate, and we could conclude the year with a bit more certainty — which is something the financial markets always crave.

Putnam Small Cap Growth Fund (PNSAX)

Annualized total return performance as of 9/30/20

Class Y shares Inception 11/3/03	Net asset value	Russell 2000 Growth Index
Last quarter	11.00%	7.16%
1 year	30.45	15.71
3 years	20.10	8.18
5 years	17.45	11.42
10 years	15.11	12.34
Life of fund	11.87	6.84
Total expense ratio: 0.95%		

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.

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For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio manager, as of September 30, 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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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.