

Q1 2022 | Putnam Small Cap Value Fund Q&amp;A

# Fund weathers a difficult first quarter for small-cap value



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Portfolio Manager  
Industry since 1999

*The fund outperformed its benchmark for the first quarter and for the 1-, 3-, 5-, and 10-year and life-of-fund periods ended March 31, 2022.*

*Given the macroeconomic and geopolitical backdrop, we believe taking some defensive steps and moving the fund to a more neutral posture is prudent.*

*Recently, we reduced the fund's exposure to pure value stocks that had a tilt toward lower valuations over other qualities, such as earnings.*

## **How did the fund perform in the first quarter?**

In a challenging first quarter for financial markets, the fund delivered a positive return while its benchmark posted a loss. Performance was aided by strong stock selection in the health care sector. The fund also outperformed the benchmark for the 1-, 3-, 5-, and 10-year and life-of-fund periods ended March 31, 2022.

## **How did you position the portfolio in this environment?**

Recently, we reduced the fund's exposure to pure value stocks that had a tilt toward lower valuations over other qualities, such as earnings. We have increased investments in companies with stronger earnings outlooks. Given the macroeconomic and geopolitical backdrop, we believe taking some defensive steps and moving the fund to a more neutral posture is prudent.

## **Do you see further outperformance potential for small-cap value stocks?**

Investors started to pay attention to small-cap value last year, as the promise of strong growth began to trickle down to the more economically sensitive businesses in this investment universe. In 2021, small-cap value stocks outperformed their large-cap value and large- and small-cap growth peers. However, for more than a decade through 2020, small-cap stocks, especially small-cap value stocks, underperformed their larger and growth-oriented peers.

Today, we believe conditions are good for small-cap value to experience a prolonged period of outperformance. Despite near-term global headwinds, small caps should benefit as the economy rebounds from the depths of the pandemic and growth broadens beyond select work-from-home technology beneficiaries. A healthy economy combined with higher

inflation could bring double-digit nominal growth rates to a wider swath of the investing universe. This should make reasonable growth less scarce and attract investors to the long-neglected small-cap value space.

**Inflation has become a key concern for investors. How might it affect small-cap value stocks?**

We are not surprised by the recent surge in inflation. And we believe a reversal of the multi-decade disinflationary trend is underway, which could be positive for value stocks. The Russell 2000 Value Index has greater exposure to sectors likely to benefit from sustained inflation. These include financials, energy, and basic materials stocks. Just as important, substantially less of this small-cap value index is allocated to sectors that are retreating — notably those that were boosted by the pandemic, such as health care and technology.

**What is your outlook for the fund in the months ahead?**

Regarding the fund’s investment strategy, we believe the portfolio’s U.S.-centric focus is a plus. In our view, the U.S. economy is in a better position than economies abroad to weather any pullback in growth. Small-cap stocks also tend to have less exposure to international markets than large-cap stocks. And, as we’ve seen recently, value stocks, with their high concentration of banks, energy, and basic materials stocks, tend to outperform growth stocks in an inflationary environment.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed here are those of the portfolio manager as of March 31, 2022, are subject to change with market conditions, and are not meant as investment advice.

**Consider these risks before investing:** Value stocks may fail to rebound, and the market may not favor value-style investing. Income provided by the fund may be reduced by changes in the dividend policies of, and the capital resources available at, the companies in which the fund invests. 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.

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 Small Cap Value Fund (PYSVX)**

Annualized total return performance as of 3/31/22

	Class Y shares Inception 1/3/01	Russell 2000 Value Index
Last quarter	0.47%	-2.40%
1 year	13.60	3.32
3 years	16.92	12.73
5 years	9.21	8.57
10 years	11.14	10.54
Life of fund	9.99	9.75
Total expense ratio: 1.38%		

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 (inception 4/13/99), which have not been adjusted for the lower expenses; had they, returns would have been higher. For a portion of the periods, this fund 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.*

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