Q3 2018 | Putnam Multi-Asset Absolute Return Fund Q&A

Headwinds for non-directional strategies despite rallying equities

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The U.S. economy and corporate profits posted strong growth, while trade tensions with China persist. Meanwhile, U.S. stocks widened their lead over other markets in the third quarter.

Broad weakness in non-directional strategies offset positive results from directional strategies this period.

We believe the fundamental backdrop remains supportive for U.S. equities, but are concerned that risks related to global trade and tariffs are not fully reflected in prices.

What was the fund's investment environment like during the third quarter of 2018?

Trade tensions eased between the United States and most of its major trading partners, except for China. Beginning in July, both governments moved beyond rhetorical threats and imposed tariffs on hundreds of billions of dollars of each country's products. Late in the quarter, the U.S. Treasury Secretary was attempting to organize talks with high-level Chinese officials in an effort to lower the heat between the two countries.

U.S. gross domestic product grew at a robust 4.2% annualized rate for the second quarter of 2018, fueled by stronger business investment, which in turn was driven by solid earnings growth. U.S. corporate earnings rose 25% in the second quarter, boosted by a lower corporate tax rate, but the pace of earnings growth may have moderately slowed in the third quarter.

Overseas, eurozone economic growth decelerated in the second quarter to an annualized rate of 1.5%, as imports rose at almost twice the pace of exports, despite weak household spending. Meanwhile, in China, the intensifying trade battle with the United States appears to be taking a heavier toll on that nation's economy. Weakening foreign demand and sluggish domestic consumption caused Chinese manufacturers to significantly scale back production. The manufacturing slowdown raises the prospects that China's leaders may ramp up economic stimulus measures to support growth.

U.S. stocks widened their lead over the rest of the world in the third quarter, with the S&P 500 Index advancing 7.7%, its strongest quarterly gain since the end of 2013. On a year-to-date basis, the S&P 500 is up 9%, while the Stoxx Europe 600 Index is down 1.5%, China's Shanghai Composite Index has fallen 15%, and Japan's Nikkei Average rose 6%, in U.S.-dollar terms. For the third quarter, growth stocks continued to outpace value shares, and large caps outperformed small and mid caps.

Broad fixed-income performance was generally muted in the third quarter, although positive results from several sectors stood out: Japanese government debt and emerging-market bonds (both in U.S.-dollar terms); high-yield corporate credit in the United States and internationally; and floating-rate bank loans.

Immediately after the quarter ended, oil prices reached multiyear highs, with West Texas intermediate crude hitting $75.30 per barrel on October 1. Brent crude, the global benchmark, was even higher, at $84.98 per barrel. Both benchmarks climbed on the view that U.S. sanctions against Iran and lower output from producers such as Venezuela and Libya will cause supply deficits.

As expected, the Federal Reserve raised its target for short-term interest rates to a range of 2% to 2.25% at its September policy meeting, the third hike this year and the eighth in the past three years. U.S. Treasury yields rose across the curve during the third quarter, as investors anticipated that the Fed would continue to raise interest rates at a steady pace. At the same time, accelerating economic growth increased the potential for inflation to pick up.

The U.S. dollar rose by about 1.5% during the quarter, but weakened in September. A gradual U.S. approach to imposing tariffs on Chinese goods sparked hopes that the two countries may eventually resolve their trade dispute. As a result, investors cut back on their dollar exposure — generally considered a safe haven during periods of geopolitical turmoil — and shifted assets to U.S. stocks, as well as beaten-down emerging-market assets. The dollar is up about 4% on a year-to-date basis.

Before we discuss performance, would you summarize the fund's overall investment objective and strategy?

Putnam Multi-Asset Absolute Return Fund seeks a positive return exceeding the return of Treasury bills over a reasonable period of time, regardless of market conditions. The fund seeks to achieve its risk-and-return characteristics by dynamically allocating assets using a combination of directional (or market sensitive) and non-directional (or market neutral) strategies. In addition, both the composition and total level of risk can be dynamically managed depending on market conditions and the prevailing opportunity set. The fund also employs strategies that may produce lower volatility over time.

How did the fund perform, and what factors had the biggest influence on performance?

The fund generated slightly negative performance for the third quarter, due to weakness in our non-directional strategies, primarily in August.

Our directional strategies added value for the quarter, led by exposure to U.S. stocks. Broad index exposure to corporate credit and commodities also contributed. The S&P GSCI Index — a comprehensive measure of commodities — rose 1.34% in the quarter, lifted by rising oil prices.

Within non-directional strategies, broad-based underperformance across a diverse group of equity-selection alpha strategies — which are market-neutral trades designed to perform independently of global equity markets — weighed on the fund's performance. Specifically, long/short strategies in the United States and in foreign developed markets, a sector rotation strategy, and a forensic accounting strategy delivered disappointing results for the quarter.

Outside of equity selection, the fund benefited from an equity mean-reversion strategy, which seeks to capitalize on short-term fluctuations in the S&P 500, a volatility-carry strategy, and a cross-asset trend-following strategy.

By way of background, our forensic accounting strategy identifies companies that we believe use aggressive accounting practices that can cause their stocks to underperform. Sector rotation is a quantitative approach that seeks to identify the most attractive U.S. equity sectors and takes long positions in those sectors. Volatility-carry strategies attempt to capitalize on differences in implied versus realized stock market volatility. And cross-asset trend-following is a quant strategy that seeks to identify asset classes exhibiting favorable characteristics across stocks, bonds, commodities, and currencies.

What is your near-term outlook?

Although we believe that the fundamental backdrop remains supportive for stocks, we are concerned that risks related to global trade and tariffs are not yet fully reflected in equity prices. Also, despite robust earnings growth thus far in 2018, we think companies are operating near peak margins and may not be able to meet the market's elevated earnings expectations as we move into next year.

Within credit, while we think the market's fundamental backdrop remains reasonably supportive, high-yield credit spreads remain near their tightest level of the year as of period-end. In our view, this suggests a less-than-favorable near-term risk/reward profile.

Globally, we think economic growth remains on track, led by the United States. As a result, we believe the stage is set for bond yields to rise. However, if we think U.S. interest rates are rising too quickly, we may increase the fund's exposure to U.S. fixed income in an effort to capitalize on short-term relative-value opportunities. Other factors that could bolster U.S. Treasuries and other interest-rate-sensitive fixed-income categories include the pace of Fed rate hikes, ongoing weakness in emerging-market stocks, and weaker-than-expected U.S. economic data.

How have you positioned the fund in light of this outlook?

We reduced the fund's allocation to commodities from an overweight earlier this year. However, we continue to have a slightly bullish outlook for the asset class. When looking at individual strategies, directional inflation risk via long exposure to commodities was the single-biggest contributor to overall portfolio risk as of September 28.

We added several new non-directional strategies to the portfolio in 2018, including strategies in equity and fixed-income selection, regional fixed income, commodity alpha, and alternative beta. As of quarter-end, various equity-selection alpha strategies account for the largest portion of non-directional risk.

Putnam Multi-Asset Absolute Return Fund (PDMYX)

Annualized total return performance as of 9/30/18

Class Y shares *Inception 12/23/08*	**Net asset value**	**ICE BofAML U.S. Treasury Bill Index**
Last quarter	-0.34%	0.49%
1 year	-0.81	1.54
3 years	2.77	0.82
5 years	3.43	0.52
Life of fund	4.76	0.35

Total expense ratio: 0.83%

What you pay: 0.82%

Returns for periods of less than one year are not annualized.

"What you pay" reflects Putnam Management's decision to contractually limit expenses through 4/30/19.

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. For a portion of the periods, the 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.

The ICE BofAML U.S. Treasury Bill Index is an unmanaged index that tracks the performance of U.S. dollar-denominated U.S. Treasury bills publicly issued in the U.S. domestic market. Qualifying securities must have a remaining term of at least one month to final maturity and a minimum amount outstanding of $1 billion. You cannot invest directly in an index.

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The S&P GSCI Index is a composite index of commodity sector returns that represents a broadly diversified, unleveraged, long-only position in commodity futures.

The views and opinions expressed are those of the portfolio managers as of September 30, 2018, are subject to change with market conditions, and are not meant as investment advice. All performance and economic information is historical and is not indicative of future results.

The fund is not intended to outperform stocks and bonds during strong market rallies.

Consider these risks before investing: Allocation of assets among asset classes may hurt performance. The value of stocks and bonds in the fund's portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general financial market conditions, changing market perceptions (including, in the case of bonds, perceptions about the risk of default and expectations about monetary policy or interest rates), changes in government intervention in the financial markets, and factors related to a specific issuer or industry. These and other factors may also lead to increased volatility and reduced liquidity in the fund's portfolio holdings. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. 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). Interest-rate risk is greater for longer-term bonds, and credit risk is greater for below-investment-grade bonds. Unlike bonds, funds that invest in bonds have fees and expenses. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are subject to prepayment risk and the risk that they may increase in value less when interest rates decline and decline in value more when interest rates rise. International investing involves currency, economic, and political risks. Emerging-market securities have illiquidity and volatility risks. Our alpha strategy may lose money or not earn a return sufficient to cover associated trading and other costs. Our use of leverage obtained through derivatives increases these risks by increasing investment exposure. Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. The fund's efforts to produce lower-volatility returns may not be successful and may make it more difficult at times for the fund to achieve its targeted return. Under certain market conditions, the fund may accept greater-than-typical volatility to seek its targeted return. The fund may not achieve its goal, and it is not intended to be a complete investment program. You can lose money by investing in the fund. The fund's prospectus lists additional risks.

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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.

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