Q1 2018 | Putnam Multi-Asset Absolute Return Fund Q&A

Widespread weakness weighs on fund performance

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Stock market volatility and increasing risk-aversion created a challenging environment in February and March.

Directional and non-directional strategies detracted about equally during the quarter.

We made several positioning adjustments that were based on technical signals and fundamental value rather than market volatility.

Note: On April 30, 2018, the fund's name was changed from Putnam Absolute Return 700 Fund.

What was the investment environment like during the first quarter of 2018?

Following a strong start in January, the majority of risk-driven asset classes declined in February and March, as market volatility and investor risk aversion returned after being largely absent from the market for the past two years.

At the onset of 2018, stocks and credit-sensitive bonds performed well amid an improving outlook for global economic growth, positive sentiment surrounding U.S. tax reform, and continued strength in corporate earnings. The yield on the benchmark 10-year U.S. Treasury rose by 0.26% in January, ending the month at 2.72%, as optimism about a synchronized global recovery spread.

The environment shifted in late January due to interest-rate jitters, collapsing strategies predicated on market volatility remaining low, and uncertainty about inflation expectations and a corresponding response from the Federal Reserve. Stocks reached correction territory in February, declining by roughly 12% from their January highs, with declines worsening when the Trump administration announced that it would impose tariffs on imports of steel and aluminum, sparking widespread fear of a trade war.

After recovering slightly from mid-February to mid-March, stocks slid again in late March, pulled down by a selloff in previously high-flying technology names, as well as an escalating trade dispute with China. For the quarter, the S&P 500 declined 0.76%, its first quarterly loss since 2015.

Even after a rocky quarter, major stock indexes remain in positive double-digit territory over the past 12 months. The consensus view among market participants is that both the U.S. and global economies will likely continue to expand throughout the year. This positive outlook is partly fueled by U.S. tax cuts, which are expected to boost corporate earnings and help prolong the eight-year U.S. economic expansion.

As for fixed income, Treasury yields and short-term interest rates rose during the quarter. With short-term Treasury yields climbing faster than long-term yields, the yield curve flattened. Evidence of economic strength, including a tightening labor market and an improving outlook for wage gains, drove bond yields higher.

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 over a reasonable period of time, regardless of market conditions. The fund seeks to achieve 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 a negative return, with directional and non-directional strategies detracting about equally from performance.

Within our directional strategies, exposure to U.S. interest-rate risk hurt, as bond yields rose and prices fell during the quarter. Exposure to U.S. stocks also weighed on results, hampered by market volatility in February and March.

On the plus side, broad index exposure to commodities — which we tactically added in March — was the biggest contributor among our directional strategies, aided by strong performance across a range of commodities, along with a weak U.S. dollar.

A short position in high-yield corporate credit in March helped marginally, as the asset class fell into negative territory amid the risk-aversion present in the market in February and March.

Within non-directional strategies, the primary detractors were a strategy that seeks to capture the difference between implied and realized stock market volatility, and an equity mean-reversion strategy, which seeks to capitalize on short-term fluctuations in the S&P 500.

Equity-selection alpha strategies — which are market-neutral trades designed to perform independently of global equity markets — also worked against performance this period. In particular, we had negative results from a quantitative position in the United States. A fundamentally driven, U.S.-focused long/short strategy also struggled.

The overall negative impact of our non-directional strategies was partially offset by positive results from fixed-income selection and regional fixed-income long/short strategies. Overall, however, these pockets of non-directional strength were not enough to meaningfully offset weakness elsewhere.

What is your outlook, and how have you positioned the fund in light of that outlook?

Since January, we have made several adjustments to portfolio positioning. These changes were driven by technical signals and our view of fundamental values, and not as a direct response to market volatility.

Entering 2018, we were aware that extremely bullish market sentiment and stretched valuations had the potential to reintroduce volatility. That said, we believed that global economic growth, strong corporate earnings, and the possibility of accelerated share buybacks driven by repatriation of cash held overseas would more than offset short-term setbacks. We continue to hold that view. The recent market correction helped to remove some froth from stock valuations and is, in our view, more of a return to a normal market environment than a cause for serious concern.

We expect bond yields in the United States and globally to continue rising. Our rate view is based on several factors, including continued strength in global economic growth; positive momentum resulting from U.S. tax reform; a persistently heavy supply of new bonds entering the market; the gradual movement of the European Central Bank toward rate normalization; and growing uncertainty regarding inflation.

In corporate credit, we think positive overall momentum and a benign economic environment are offset by unattractive balance sheet fundamentals, such as high debt levels and declining interest-coverage ratios. Spreads for investment-grade and high-yield corporate credit finished the period near their lows for the current market cycle — another factor that prevents us from being overly constructive. As a result, we have moved to a slight short position in credit.

We increased the fund's allocation to commodities. Our view here has strengthened, based on numerous factors that we believe to be supportive. These include solid readings from the Purchasing Managers Index, strong performance in emerging markets versus other equity markets, and a weakening U.S. dollar.

We continue to favor non-directional risk over directional risk, and 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 3/31/18

Class Y shares *Inception 12/23/08*	**Net asset value**	**ICE BofAML U.S. Treasury Bill Index**
Last quarter	-3.35%	0.34%
1 year	3.06	1.04
3 years	1.80	0.53
5 years	3.15	0.35
Life of fund	5.03	0.27

Total expense ratio: 0.96%

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. 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.

The views and opinions expressed are those of the portfolio managers as of March 31, 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: Our allocation of assets among permitted asset categories may hurt performance. The prices 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 both general financial market conditions and factors related to a specific issuer or industry. Our active trading 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. Bond investments are subject to interest-rate risk, which means the prices of the fund's bond investments are likely to fall if interest rates rise. Bond investments also are subject to credit risk, which is the risk that the issuer of the bond may default on payment of interest or principal. Interest-rate risk is generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds, which may be considered speculative. Unlike bonds, funds that invest in bonds have ongoing 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. International investing involves certain risks, such as currency fluctuations, economic instability, and political developments. Additional risks may be associated with emerging-market securities, including illiquidity and volatility. Our use of derivatives may increase these risks by increasing investment exposure (which may be considered leverage) or, in the case of many over-the-counter instruments, because of 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 may not achieve its goals, and it is not intended to be a complete investment program. 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. In addition, under certain market conditions, the fund may accept greater volatility than would typically be the case, in order to seek its targeted return. REITs involve the risks of real estate investing, including declining property values. Commodities involve the risks of changes in market, political, regulatory, and natural conditions. Additional risks are listed in the fund's prospectus. You can lose money by investing in the fund.

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