

Q4 2017 | Putnam Spectrum Funds Q&A

A difficult quarter for key holdings



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In a difficult quarter for a number of key holdings, both funds underperformed their benchmarks.

For both funds, DISH Network and Jazz Pharmaceuticals were top detractors, while Pioneer Natural Resources contributed to returns.

I continue to maintain large positions in stocks that I consider my best investment ideas.

How did the funds perform for the quarter?

Both funds underperformed their benchmarks for the quarter. Putnam Capital Spectrum Fund returned -2.78%, while its custom benchmark, the Capital Spectrum Blended Index, returned 3.67%. Putnam Equity Spectrum Fund returned -2.57%, while its benchmark, the S&P 500 Index, returned 6.64%.

What were key factors that detracted from fund performance for the quarter?

For both portfolios, the top detractor was DISH Network. The struggle for this stock continued to be more about a lack of news or notable developments for the company, rather than a company-specific headwind, in my view. As with many companies in the Spectrum Fund portfolios, an investment in DISH requires the ability to maintain conviction through periods of decline. Not all investors have the patience to stick with a thesis that may take time to develop, as we have seen for several recent quarters as DISH stock encountered volatility.

Has your long-term outlook for DISH changed?

While the performance of DISH stock has been disappointing recently, it does not change my conviction in the long-term value of this pay-TV, broadband, and wireless communications company. I continue to believe that DISH offers attractive long-term capital appreciation potential, due in large part to its spectrum assets. "Spectrum" refers to wireless signals sent through the airwaves, and DISH recently won a \$6 billion bid in a Federal Communications

Commission auction for low-band wireless spectrum assets. As the demand for mobile networking has continued to rise, wireless spectrum has become a highly valuable asset for communications companies. I believe DISH has the opportunity to monetize these assets, perhaps through a lease agreement or partnership with a company in need of wireless spectrum.

What other holdings held back performance for the quarter?

Jazz Pharmaceuticals was also a detractor for both funds in the quarter. Investors continue to be concerned about Xyrem, the company's narcolepsy drug, which has had patent challenges as well as lower-than-expected sales. I believe investors may be focused too heavily on Xyrem's challenges while overlooking the potential of Jazz's broader drug portfolio. For example, Jazz has continued to deliver good news related to JZP 110, the company's narcolepsy treatment currently in development. The company has seen positive results for its clinical trials of JZP 110, conducted for patients with obstructive sleep apnea.

What other securities had a significant impact in the quarter?

For Putnam Equity Spectrum Fund, GenMark Diagnostics was a detractor. The company, a maker of molecular testing equipment and technology, reported lower-than-expected third-quarter revenues. Also contributing to declines was the company's weaker outlook for 2018, and issues with a European product launch. My long-term outlook for the business remains positive. I believe GenMark offers a best-in-class product platform in a growing market, and I expect its revenue to accelerate over the next three years.

What were some holdings that contributed to the funds' performance in the quarter?

Pioneer Natural Resources, a Texas-based oil and gas exploration and production company, was a highlight for both funds in the fourth quarter. The company benefited from rising oil prices, which stabilized considerably after plunging in early 2017. In addition, investors were pleased with Pioneer's production results in the Permian Basin, which were expected to be disappointing.

For Equity Spectrum Fund, another top contributor was STAAR Surgical, a maker of implantable contact lenses. STAAR, which had been struggling with some regulatory issues, reported record third-quarter revenues, and it appears that more investors are beginning to recognize the company's long-term growth potential.

Another notable holding for Capital Spectrum Fund was satellite services company EchoStar, which had been a detractor in the previous quarter. While there were no significant developments for the company in the fourth quarter, investors appear to be gaining appreciation for its growth prospects. EchoStar has been launching new satellites that provide expanded digital television and broadband data services.

Can you provide an update on the portfolios' cash positions?

At the close of the fourth quarter, cash levels in both portfolios were higher than they were at the end of the third quarter. Cash in the portfolios assists the funds in meeting redemptions and can serve as a "dry powder" that enables me to add to positions when price dislocations occur.

Putnam Capital Spectrum Fund has the flexibility to invest in high-yield debt. What is your view of this asset class?

I continued to steer away from high-yield bonds, as I currently do not have a favorable view of their overall risk-reward characteristics. The Capital Spectrum portfolio had minimal exposure to high-yield debt at the close of the quarter.

What is your rationale for the funds' concentrated strategy?

I build large positions in stocks that I consider my best investment ideas. I believe that overdiversification of the portfolio may dilute its long-term performance. I take a bottom-up, fundamental approach to stock selection and generally do not make investment decisions based on macroeconomic factors. Instead, I focus on the fundamental strength of individual companies, seeking those that I believe are ripe for significant capital appreciation because they have an internal catalyst that will eventually unlock value.

Putnam Capital Spectrum Fund (PVSYX)

Annualized total return performance as of 12/31/17

Class Y shares Inception 5/18/09	Net asset value	Capital Spectrum Blended Index*
Last quarter	-2.78%	3.67%
1 year	4.81	14.66
3 years	-0.59	9.23
5 years	8.42	11.03
Life of fund	14.15	13.74

Total expense ratio: 0.70%

* 50% S&P 500 Index/50% JPMorgan Developed High Yield Index.

Top 10 holdings

Jazz Pharmaceuticals	Priceline Group
DISH Network	Pioneer Natural Resources
EchoStar	W.R. Grace
Northrop Grumman	Altisource Residential
American Airlines Group	Delivery Hero

Holdings represent 79.5% of the portfolio and will vary over time.

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, 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.

The JPMorgan Developed High Yield Index is an unmanaged index of high-yield fixed-income securities issued in developed countries. The S&P 500 Index is an unmanaged index of common stock performance. You cannot invest directly in an index.

Putnam Equity Spectrum Fund (PVSYX)

Annualized total return performance as of 12/31/17

Class Y shares Inception 5/18/09	Net asset value	S&P 500 Index
Last quarter	-2.57%	6.64%
1 year	6.89	21.83
3 years	-1.30	11.41
5 years	8.18	15.79
Life of fund	15.08	15.74

Total expense ratio: 0.06%

Top 10 holdings

Jazz Pharmaceuticals	Altisource Asset Management
EchoStar	American Airlines Group
DISH Network	W.R. Grace
STAAR Surgical	Uber Technologies
Altisource Portfolio Solutions	Pioneer Natural Resources

Holdings represent 85.3% of the portfolio and will vary over time.

The views and opinions expressed are those of David L. Glancy, Portfolio Manager of Putnam Spectrum Funds, as of December 31, 2017. They are subject to change with market conditions and are not meant as investment advice.

Consider these risks before investing: The value of stocks 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 and factors related to a specific issuer, industry, or sector. 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. These risks are generally greater for small and midsize companies. The fund will be more susceptible to these risks than other funds because it may concentrate its investments in a limited number of issuers and currently focuses its investments in particular sectors. Because the fund currently invests significantly in the communications services and health-care sectors, the fund may perform poorly as a result of adverse developments affecting those companies or sectors. The fund may focus its investments in other sectors in the future, in which case it would be exposed to risks relating to those sectors. The value of international investments traded in foreign currencies may be adversely impacted by fluctuations in exchange rates. International investments, particularly investments in emerging markets, may carry risks associated with potentially less stable economies or governments (such as the risk of seizure by a foreign government, the imposition of currency or other restrictions, or high levels of inflation or deflation), and may be or become illiquid. The fund's investments in leveraged companies and the fund's "non-diversified" status, which means the fund may invest a greater percentage of its assets in fewer issuers than a "diversified" fund, and the fund's use of short selling can increase the risks of investing in the fund. You can lose money by investing in the fund. **For Capital Spectrum Fund, these risks also apply:** The fund has the flexibility to focus its investments in particular

types of securities. From time to time the fund may, without limit, emphasize investments in a particular type of security (i.e., in particular part of the capital structure) at various points during a credit cycle. This may mean that the fund may invest only modestly, or not at all, in fixed-income or equity securities at any given time. The risks associated with bond investments include interest-rate risk, which means the prices of the fund's investments are likely to fall if interest rates rise. Bond investments are also subject to credit risk, which is the risk that the issuers 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. Mortgage- and other asset-backed investments carry the risk that they may increase in value less when interest rates decline and decline in value more when interest rates rise. We may have to invest the proceeds from prepaid investments, including mortgage- and asset-backed investments, in other investments with less attractive terms and yields. Our use of derivatives may increase the risks of investing in the fund by increasing investment exposure (which may be considered leverage) or, in the case of many over-the-counter instruments, because of the potential failure of the other party to the instrument to meet its obligations.

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