

Q3 2017 | Putnam Spectrum Funds Q&A

Focusing on long-term value through a challenging quarter



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Industry since 1987

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

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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 -4.65%, while its custom benchmark, the Capital Spectrum Blended Index, returned 3.27%. Putnam Equity Spectrum Fund returned -5.14%, while its benchmark, the S&P 500 Index, returned 4.48%.

Was it a challenging investing environment in the quarter?

Conditions for the U.S. equity market overall were positive in the quarter, with major equity indexes advancing, led primarily by a narrow group of large-cap growth stocks. However, in today's market, it has become increasingly difficult for many companies — whose stocks may be priced for perfection — to keep investors satisfied. The slightest sign of weakness in revenue or earnings can cause the market to overreact and punish a stock harshly. In an environment like this, it is important to stay focused on the underlying fundamentals of each business and its long-term capital appreciation potential.

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

For both portfolios, the top detractor was DISH Network. The decline over the three-month period appeared to be related to a larger-than-expected loss of subscribers in DISH's core pay-TV business. In addition, the company reported a writedown due to a fine for violating do-not-call restrictions. While the decline in DISH stock was

disappointing, it does not change my conviction in the long-term value of this pay-TV, broadband, and wireless communications company.

How might your investment thesis for DISH play out?

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.

As with many companies in the Spectrum Fund portfolios, an investment in DISH requires patience and the ability to maintain conviction through periods of short-term volatility. Not all investors have the patience to stick with a thesis that may take time to develop, as we have seen throughout 2017 as DISH stock encountered volatility. In many cases, declines occur when there is no news or notable developments for a company, and investors shift focus in search of shorter-term gains.

What other holdings held back performance for the quarter?

A lack of news also seemed to have a negative effect on Jazz Pharmaceuticals — another detractor for both funds in the quarter. In its quarterly financial results, Jazz reported slightly weaker revenue for Xyrem, its narcolepsy drug, but maintained its outlook for 2017 full-year earnings. From my perspective, nothing has changed fundamentally for Jazz, which was the top contributor to the funds’ performance in the previous quarter. It is also worth noting that this recent decline was relatively short-lived. Jazz’s share price dropped sharply following the earnings announcement, but rebounded over the remainder of the quarter.

Jazz has continued to deliver good news related to JZP 110, the company’s narcolepsy treatment currently in development. Positive results of clinical trials, conducted for patients with obstructive sleep apnea, have been well received by investors and offer evidence that Jazz may be able to successfully expand its narcolepsy franchise beyond Xyrem.

Were there other securities that had a significant impact in the quarter?

For both funds, EchoStar was a detractor in the quarter. The stock declined when the satellite services company reported weaker-than-expected quarterly earnings growth. I continue to believe that the company represents an attractive investment opportunity. EchoStar has a strong balance sheet and healthy cash-flow levels, and has been launching new satellites — providing expanded digital television and broadband data services — which could boost the company’s subscriber growth.

For Putnam Capital Spectrum Fund, a position in Priceline Group was a drag on relative performance. This appears to be another case of exceedingly high expectations from investors. Although the company reported solid quarterly earnings growth and an impressive outlook for future growth, investors were disappointed, and the stock declined sharply. Priceline operates several lines of business, including OpenTable, a restaurant booking service, and Booking.com, a European hotel reservation site that is gaining market share in the United States. Priceline generates healthy cash flows and has experienced strong organic growth due to diversification and global expansion.

What are some holdings that contributed to the funds’ performance in the quarter?

A highlight in the Capital Spectrum Fund portfolio was defense contractor Northrop Grumman, which in my view is an efficiently run business with an excellent management team that focuses on long-term profitability — and not just growth for the sake of growth. The most important development in the quarter was Northrop’s announcement that it is buying Orbital ATK, a maker of components for missiles and satellites, which should be particularly beneficial as defense spending continues to grow worldwide.

Two highlights for Equity Spectrum Fund were investments in Altisource Residential, a real estate investment trust, and Altisource Portfolio Solutions, a provider of services and technology for the mortgage and real estate industries. Both companies rebounded after a period of underperformance due to their close relationships with Ocwen Financial, which has struggled with regulatory issues.

Another Equity Spectrum Fund holding that delivered strong performance was STAAR Surgical, a maker of implantable contact lenses. STAAR shares advanced as investors seemed pleased with recent analyst upgrades of the stock and the company's quarterly earnings results, which exceeded consensus estimates.

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

At the close of the third quarter, cash levels in both portfolios were lower than they were at the end of the second 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 (PVSYX)

Annualized total return performance as of 9/30/17

Class Y shares Inception 5/18/09	Net asset value	Capital Spectrum Blended Index*
Last quarter	-4.65%	3.27%
1 year	11.02	14.11
3 years	2.37	8.52
5 years	10.44	10.53
Life of fund	15.00	13.69

Total expense ratio: 0.70%

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

Top 10 holdings

Jazz Pharmaceuticals	Uber Technologies
DISH Network	American Airlines Group
EchoStar	United Continental Holdings
Northrop Grumman	Pioneer Natural Resources
Priceline Group	W.R. Grace

Holdings represent 78.8% 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 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 Equity Spectrum Fund (PVSYX)

Annualized total return performance as of 9/30/17

Class Y shares Inception 5/18/09	Net asset value	S&P 500 Index
Last quarter	-5.14%	4.48%
1 year	13.88	18.61
3 years	0.75	10.81
5 years	9.98	14.22
Life of fund	15.93	15.36

Total expense ratio: 0.06%

Top 10 holdings

Jazz Pharmaceuticals	Altisource Portfolio Solutions
DISH Network	American Airlines Group
EchoStar	Altisource Asset Management
STAAR Surgical	W.R. Grace
Uber Technologies	United Continental Holdings

Holdings represent 81.2% 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 September 30, 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 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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