Q4 2018 | Putnam Retirement Advantage Funds Q&A

Stocks tumble on rising interest rates and uncertain economic outlook

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Global stocks slumped during the fourth quarter as investors hit the sell button.

Bond yields in the United States and globally could continue to rise.

Further Federal Reserve rate increases may pressure U.S. equity markets.

What was the equity market environment during the fourth quarter?

The period was fraught with volatility. Markets started the quarter near record highs before a sharp reversal. By the end of December, U.S. and many international stock markets posted their worst yearly performances since the financial crisis. The U.S. economy remained strong but interest rates, market volatility, and global trade tensions increased. Buoyed by government spending and tax cuts, the U.S. economy grew at a 3.5% annual rate in the third quarter of 2018, after expanding 4.2% in the second quarter. Unemployment has touched multi-decade lows, inflation remains anchored, and the likelihood of a recession remains low.

Still, the outlook for global economic growth has eased over the past few months because of protectionist tariffs, higher interest rates, and weakness in many emerging markets, including China. The United States and China, the world's two largest economies, launched new trade tariffs and tensions escalated at the beginning of the quarter. But by December 2018, Chinese and U.S. negotiators were starting to work toward a deal that could defuse trade tensions by boosting U.S. exports and loosening regulations for U.S. companies operating in China.

Large-cap stocks and their mid- and small-cap counterparts declined as market volatility and losses spiked in October and December 2018. The broad S&P 500 Index fell to the brink of a bear market in December. It ended 2018 down 4.4%. For the quarter, the S&P 500 declined 13.5% and international stocks, as measured by the MSCI EAFE Index [ND], dropped 12.5%.

The Federal Reserve raised its benchmark interest rate in December for the fourth time in 2018. The rate hike took the federal funds rate to a range of 2.25% to 2.5%. It was the ninth increase since the Fed began normalizing policy in December 2015. Across the Atlantic, the European Central Bank [ECB] said it was ending its multi-trillion bond-buying program in December. The ECB also left benchmark interest rates unchanged.

How did bond markets perform?

Treasury yields moved higher on the short end of the curve and lower on the intermediate and long end. The widely watched spread between two- and 10-year Treasury yields narrowed to less than 10 basis points following the Fed's rate boost in December. The decline in long-term yields is a sign that bond investors expect the economy to slow. Also, higher short-term rates are a headwind for fixed-income asset holders. The yield on the benchmark 10-year note ended at 2.66%, while the two-year yield held at around 2.50% at year-end 2018. High-yield bonds were negative for the period, with the risk-off sentiment pushing spreads wider. The more rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index rose 1.6% during the quarter, benefiting from the move lower in intermediate- and long-term yields.

How did Putnam Retirement Advantage Funds perform?

The Retirement Advantage funds posted negative returns during the quarter. For the funds at all stages of the glide path, performance trailed that of our internal custom benchmarks.

The glide path of Retirement Advantage strategies is an important tool that distinguishes Putnam from its peers. Our glide path starts off more aggressive than the average for our peer group, with a higher equity weight in the early part of the glide path for funds serving people retiring in the 2050s or 2060s. Our glide path becomes more conservative relative to peers for the funds serving investors nearing retirement in the 2020s or 2030s. Our near-retirement portfolios performed better than longer-dated strategies given the orientation of the glide path and our emphasis on protecting near-retirement participants.

What strategies affected performance?

Our strategies underperformed our internal benchmarks. Stocks and commodities were the biggest decliners. We took a tactical overweight position in U.S. equities after the moderate correction in October. This position later detracted from fund performance as stocks slumped from mid-year highs. Our out-of-benchmark commodities position also detracted. The commodities sector struggled during the dramatic sell-off in crude oil prices. This occurred when the U.S. government granted waivers from sanctions to some of the biggest buyers of oil exports from Iran.

Our active implementation decisions and security selections also detracted during the quarter. They were driven by our quantitative strategies in U.S. large-cap and international developed equity markets. Our team analyzes stock market history to identify characteristics of stocks (factors) that have excess risk-adjusted returns. Despite a strong long-term relationship between these factors and positive stock performance, the strategies underperformed during the quarter.

What is the outlook for the first quarter of 2019?

Economic growth in the United States is likely to slow in the first half of 2019. The fast pace set during the second and third quarters of 2018 is decelerating as the impact of the year-end 2017 corporate tax cut fades. Fed Chair Jerome H. Powell in December acknowledged the economy is showing signs of "softening." In January, he said that low inflation would allow the Fed to be "patient" in deciding whether to continue raising interest rates. Overall, the combination of a peak in global growth momentum, mounting trade risks, and a more restrictive Fed is a good recipe for higher volatility in markets.

Although stock and bond market volatility is likely to persist in 2019, we recently increased our exposure to equities, inflation (commodities), and credit risks, looking to take advantage of short-term market weakness. We expect bond yields to continue to drift higher in 2019 as interest-rate normalization continues in the United States and globally. The Fed has been reducing its balance sheet, allowing up to $30 billion of Treasuries and $20 billion of mortgages that it holds to mature without re-investing the proceeds.

The portfolios have an overweight in U.S. equities and commodities. We are neutral on high-yield credit and slightly underweight in interest-rate-sensitive fixed-income assets. For U.S. stocks, we expect to see short-term upgrades. Valuations are more appealing, and companies may return to buying back their own shares. We are constructive on commodities because the correction in oil has brought prices to levels that are unlikely to persist when there are positive supply/demand dynamics that can push energy prices higher. In terms of credit, we recently upgraded our position due to positive indications from our quantitative model. Also, fundamentals are better in this sector following third-quarter earnings reports.

Putnam Retirement Advantage Funds

Annualized total return performance as of 12/31/18

Class I	Inception	Last quarter	1 year	3 years	5 years	10 years	Life of fund
Putnam RA Maturity Portfolio	1/3/08	–5.43%	–3.50%	4.58%	3.89%	8.00%	4.49%
RA Maturity Custom Benchmark		–3.31	–1.70	3.72	3.88	5.87	4.62
Putnam RA 2020 Portfolio	1/3/08	–5.48	–4.02	3.26	3.62	8.49	4.38
RA 2020 Custom Benchmark		–3.68	–1.58	4.13	3.85	7.71	4.24
Putnam RA 2025 Portfolio	1/3/08	–7.83	–5.32	4.41	4.55	9.70	4.80
RA 2025 Custom Benchmark		–5.99	–2.68	5.50	4.75	9.12	4.86
Putnam RA 2030 Portfolio	1/3/08	–10.32	–6.75	5.10	4.98	10.33	4.98
RA 2030 Custom Benchmark		–8.31	–4.03	6.28	5.13	9.86	5.14
Putnam RA 2035 Portfolio	1/3/08	–11.90	–8.01	5.53	5.26	10.76	5.18
RA 2035 Custom Benchmark		–9.78	–5.11	6.83	5.42	10.33	5.31
Putnam RA 2040 Portfolio	1/3/08	–12.85	–8.73	5.66	5.39	11.00	5.21
RA 2040 Custom Benchmark		–10.72	–5.75	7.09	5.60	10.65	5.36
Putnam RA 2045 Portfolio	1/3/08	–13.25	–8.93	5.79	5.54	11.25	5.30
RA 2045 Custom Benchmark		–11.42	–6.15	7.30	5.76	10.97	5.43
Putnam RA 2050 Portfolio	1/3/08	–13.58	–9.11	5.95	5.67	11.50	5.47
RA 2050 Custom Benchmark		–12.10	–6.53	7.53	5.92	11.23	5.59
Putnam RA 2055 Portfolio	12/22/10	–13.76	–9.18	6.14	5.80	—	8.67
RA 2055 Custom Benchmark		–12.68	–6.88	7.71	6.04	—	8.70
Putnam RA 2060 Portfolio	2/10/16	–13.88	–9.24	—	—	—	10.82
RA 2060 Custom Benchmark		–12.88	–7.00	—	—	—	11.95
S&P 500 Index		–13.52	–4.38	9.26	8.49	13.12	7.40*
Bloomberg Barclays U.S. Aggregate Bond Index		1.64	0.01	2.06	2.52	3.48	3.58*

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

* Returns reflect the period 1/2/08–12/31/18.

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. Performance data reflect the impact of a 0.50% management fee. In certain cases, your plan's management fee may be higher and your return lower. For the most recent month-end performance, call your plan's toll-free number.

The Retirement Advantage Custom Benchmarks are unmanaged indexes administered by Putnam Management, consisting of various indexes that follow the underlying strategies of the portfolios. The S&P 500 Index is an unmanaged index of common stock performance. The Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities. You cannot invest directly in an index.

Each Putnam Retirement Advantage Fund has a different target date indicating when the fund's investors expect to retire and begin withdrawing assets from their account, typically at retirement. The funds are generally weighted more heavily toward more aggressive, higher-risk investments when the target date of the fund is far off, and more conservative, lower-risk investments when the target date of the fund is near. The principal value of the funds is not guaranteed at any time, including the target date.

The MSCI EAFE Index (ND) is an unmanaged index of equity securities from developed countries in Western Europe, the Far East, and Australasia.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of December 31, 2018, are subject to change with market conditions, and are not meant as investment advice.

The funds are a collective trust managed and distributed by Putnam Fiduciary Trust Company, a non-depository New Hampshire trust company. However, they are not FDIC insured; they are not a deposit or other obligation of, and are not guaranteed by, Putnam Fiduciary Trust Company or any of its affiliates. The funds are not a mutual fund registered under the Investment Company Act of 1940, and their units are not registered under the Securities Act of 1933. The funds are only available for investment by eligible, qualified retirement plan trusts, as defined in the declaration of trust and participation agreement.

Diversification does not guarantee a profit or ensure against loss. It is possible to lose money in a diversified portfolio.

Consider these risks before investing: International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Investments in small and/or midsize companies increase the risk of greater price fluctuations. 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.

Money market options are not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other governmental agency. Although the funds seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in these funds.

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. 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. Unlike bonds, funds that invest in bonds have fees and expenses. You can lose money by investing in the funds. See the fund's offering statement for more information.

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You should carefully consider the investment objective, risks, charges, and expenses of a fund before investing. To request the offering document of the fund, call your financial representative or call Putnam at 1-800-225-1581. You should read the offering document carefully before investing.