

Q3 2018 | Putnam Retirement Advantage Funds Q&A

Rallying U.S. stocks boost portfolios despite fixed-income weakness



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U.S. stocks gained during the third quarter on economic expansion.

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

The Federal Reserve's rate increases may pressure U.S. equity markets.

What was the equity market environment during the third quarter?

Stock markets around the world advanced during the third quarter following several months of volatility from trade conflicts and geopolitical concerns. Steady global growth and corporate earnings remained a positive backdrop for equity markets. However, a more hawkish-sounding U.S. Federal Reserve, trade-war jitters, and global political risks dampened gains in international and U.S. equities during the quarter. The United States and China, the world's two largest economies, launched new trade tariffs, and tensions escalated.

U.S. stocks posted strong quarterly gains as all three major indexes recorded their best quarterly performance in five years. Both the Dow Jones Industrial Average and the S&P 500 Index have now advanced in 11 of the past 12 quarters, and the Nasdaq marked its ninth consecutive quarterly gain. Stocks were lifted by strong economic growth and positive corporate earnings. The broad S&P 500 rose 7.7%, and the Dow gained 9.6%. International stocks as measured by the MSCI EAFE Index [ND] returned 1.35% for the quarter.

The U.S. economy remained healthy. The economy added more jobs than expected in August 2018, and wages grew at the fastest pace since 2009. Real GDP increased at an annual rate of 4.2% in the second quarter, its best performance in nearly four years, and a gauge of consumer sentiment also reached new highs. Still, trade policy caused some pullbacks in the markets as the United States added tariffs to \$200 billion in Chinese goods.

The dollar surged after the Fed raised rates in September for the third time this year, and signaled that it is on track to hike one more time in 2018. That takes the federal funds rate to a range of 2% to 2.25% and is the eighth increase since the Fed began normalizing policy in December 2015. Across the Atlantic, the European Central Bank [ECB] confirmed that it will cut bond-buying in half in October 2018 and anticipates that new purchases will be halted by the end of the year.

How did bond markets perform?

Short-term interest rates continued to increase steadily during the quarter. The yield on the two-year U.S. Treasury bill traded above 2.8%, and the benchmark 10-year Treasury yield rose steadily to above the psychologically important 3% level in the final two weeks of the quarter. As mentioned, the Fed raised short-term rates at the end of September, the third hike this year, and officials have penciled in another hike by the end of the year. U.S. economic strength, including a tightening labor market and an improving outlook for wage gains, also drove bond yields higher. High-yield bonds gained during the period, and spreads remained tight due to steady risk appetite from investors, though emerging-market debt came under pressure due to higher U.S. rates and a strong dollar. The Bloomberg Barclays U.S. Aggregate Bond Index was little changed during the quarter.

How did Putnam Retirement Advantage Funds perform?

The Retirement Advantage Funds posted consistently positive returns during the quarter. Across the glide path, performance was in line with their internal custom benchmarks, reflecting the overall moves in equity and fixed-income markets for the period.

The glide path of Retirement Advantage strategies is an important tool that distinguishes Putnam from its peers. Our glide path starts off more aggressive — with a higher equity weight in the early part of the glide path — before becoming more conservative relative to peers in the funds for investors nearing retirement.

What strategies contributed to performance?

Our asset allocation strategies during the quarter were, in aggregate, roughly flat, reflecting our close-to-benchmark allocations. We maintained a slightly overweight tactical position in equities relative to benchmark allocations and held an out-of-benchmark position in commodities. Those positions were net positive contributors owing to the strength in equity markets and the rally in oil prices. Our slightly underweight position in high-yield fixed-income securities was a small detractor.

Security selection was also roughly flat during the period, but there were meaningful contributors and detractors within our strategies. Our U.S. large-cap stocks outperformed the broad market, helping to erase some of the losses in the year-to-date period. Our international developed-market equities also outperformed. Emerging-market stock selection, affecting only funds that are further from retirement, detracted, as did our currency overlay strategy.

In a year like this, when U.S. stocks outperform significantly, what is the benefit of holding other assets in the portfolios?

We believe global diversification across equities and fixed income is important at the portfolio level. In a year like 2018, when there has been a substantial divergence between the performances of U.S. stocks and world equity markets, it could be a challenge holding securities that have underperformed those in the United States. Still, we know that over time there is a diversification benefit from holding equities from around the globe. The United States is not always going to be as strong an outperformer as it has been in 2018.

As has been the case for most of the post-financial crisis period, equities around the world have been very highly correlated with each other. One of the important things we see is the power of that diversification benefit coming back, as not all equity markets at the country-level behave the same. Obviously in a year like 2018, diversification is a challenge when you have assets allocated to countries that are not performing as well as the United States. Being concentrated in a U.S. portfolio has been beneficial, but we believe that diversification is very important to managing volatility in portfolios over the long term.

What is the outlook for the fourth quarter of 2018?

This year is turning out to be more mixed than 2017. Global growth prospects are expected to remain relatively stable in 2018. The U.S. economy is poised to expand further this year given indicators for consumer spending, corporate investment, and government fiscal stimulus. The labor market remains strong as Americans saw wage gains accelerate and hiring improve. Meanwhile, U.S. inflation remains benign. However, concerns about an escalation in the trade wars between the United States and other major economies continue to plague markets around the world.

Despite strong underlying fundamentals, stocks may be affected by continued trade tensions, the trajectory of U.S. interest rates, and geopolitical risks. At the September 2018 rate meeting, the Fed raised its projection for economic growth this year and next, and provided a road map of what lies ahead through 2021. Along with the rate increase, the FOMC continued to project one more hike before the end of the year and three in 2019. The federal funds rate serves as the baseline for multiple forms of consumer debt as well as savings accounts and CD rates.

In terms of our investment strategies, we recently reduced our equities exposure to neutral. We are concerned that the markets are shrugging off risks from trade policies and tariffs. In addition, companies are operating at near-peak margins and the bar may be too high for 2019 company earnings. In credit, while fundamentals appear fair, high-yield bond spreads remain near 2018 levels, skewing potential outcomes negative. For commodities, we are maintaining a slightly bullish outlook for the asset class as a whole although we have reduced our exposure from earlier in the year.

We expect bond yields in the United States and globally to continue rising over the next few years. However, we will increase our exposure over the short term if we believe that U.S. rates are rising too quickly. There is potential for Fed rate hikes to pressure risky assets, specifically U.S. equities, and drive people to the safety of Treasuries. Bond yields may also dip and prices rise if the weakness in emerging-market assets prompts investors to reduce their appetite for riskier assets or if U.S. economic data are weaker than anticipated.

Putnam Retirement Advantage Funds

Annualized total return performance as of 9/30/18

Class I	Inception	Last quarter	1 year	3 years	5 years	10 years	Life of fund
Putnam RA Maturity Portfolio	1/3/08	2.61%	3.93%	7.11%	5.81%	6.77%	5.14%
RA Maturity Custom Benchmark		1.77	3.27	5.15	4.99	5.89	5.02
Putnam RA 2020 Portfolio	1/3/08	2.34	3.97	5.94	5.90	7.24	5.04
RA 2020 Custom Benchmark		2.02	4.27	6.06	5.50	6.51	4.69
Putnam RA 2025 Portfolio	1/3/08	3.07	6.40	8.46	7.68	8.32	5.72
RA 2025 Custom Benchmark		2.95	6.78	8.79	7.23	7.82	5.58
Putnam RA 2030 Portfolio	1/3/08	3.92	8.66	10.41	8.89	9.02	6.18
RA 2030 Custom Benchmark		3.76	8.82	10.73	8.32	8.60	6.12
Putnam RA 2035 Portfolio	1/3/08	4.22	9.73	11.74	9.70	9.60	6.55
RA 2035 Custom Benchmark		4.19	9.96	12.07	9.08	9.11	6.46
Putnam RA 2040 Portfolio	1/3/08	4.41	10.36	12.37	10.17	9.90	6.69
RA 2040 Custom Benchmark		4.49	10.74	12.85	9.59	9.40	6.61
Putnam RA 2045 Portfolio	1/3/08	4.66	10.84	12.80	10.50	10.17	6.83
RA 2045 Custom Benchmark		4.75	11.46	13.50	10.01	9.68	6.76
Putnam RA 2050 Portfolio	1/3/08	4.87	11.20	13.24	10.80	10.47	7.05
RA 2050 Custom Benchmark		5.00	12.16	14.14	10.43	9.98	7.00
Putnam RA 2055 Portfolio	12/22/10	5.02	11.49	13.57	11.02	—	11.06
RA 2055 Custom Benchmark		5.22	12.73	14.65	10.72	—	10.91
Putnam RA 2060 Portfolio	2/10/16	5.11	11.64	—	—	—	18.43
RA 2060 Custom Benchmark		5.29	12.89	—	—	—	19.24
S&P 500 Index		7.71	17.91	17.31	13.95	11.97	9.05*
Bloomberg Barclays U.S. Aggregate Bond Index		0.02	-1.22	1.31	2.16	3.77	3.51*

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

* Returns reflect the period 1/2/08–9/30/18.

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 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.

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.