Q2 2018 | Putnam Retirement Advantage Funds Q&A

Portfolios advance as interest rates rise and trade uncertainty increases

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U.S. stocks had moderate gains during the second quarter.

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

A hawkish Federal Reserve contrasts with the slower tightening pace of the European Central Bank.

What was the market environment during the second quarter?

Global markets were marked by ups and downs during the second quarter. The overall volatility was driven primarily by a more hawkish sounding U.S. Federal Reserve, signs of inflation risk, changes in U.S. trade policies, and consequent negative investor sentiment. The Fed raised rates in June as it did in March and has signaled that it is on track to raise rates at least twice more this year.

During the second quarter, President Trump's hard line on trade policies increased the risk of retaliatory measures by U.S. trading partners, including China, the European Union, and Mexico. Canada, a member of the North American Free Trade Agreement (NAFTA), announced retaliatory tariffs against $12.6 billion of U.S. products. The European Union and China, the world's second-largest economy, have announced similar measures. Trade-war jitters, global political risks, and higher borrowing costs dampened gains in international and U.S. equities during the quarter. The broad S&P 500 stock index rose 3.43% in the second quarter of 2018, while the Dow Jones Industrial Average was up 0.70%.

Across the Atlantic, the European Central Bank [ECB] in June decided to end its 2.6 trillion-euro bond purchase program by the end of 2018. The ECB said it did not expect to raise interest rates, which are at historic lows, until the fall of 2019 at the earliest. The anticipation of a more aggressive unwinding of accommodative monetary policy had weighed on the markets.

How did bond markets perform?

Short-term interest rates continued to increase steadily during the quarter. The Fed again raised short-term rates in the middle of June, and officials have penciled in a total of four rate hikes for 2018, up from a projection of three at their March meeting. Evidence of U.S. economic strength, including a tightening labor market and an improving outlook for wage gains, also drove bond yields higher. The yield on the 10-year U.S. Treasury briefly crossed 3% in May but later fell back amid concerns about the impact of a trade war, and finished the quarter only slightly higher than where it began. High-yield bonds gained during the period, but global bonds in developed and emerging markets came under pressure.

How did Putnam Retirement Advantage Funds perform?

The second quarter was an eventful period for the Retirement Advantage Funds. Across the glide path, performance was mixed, reflecting the overall moves in equity and fixed-income markets for the period. Much of the performance strength enjoyed in April and May was erased in June. Putnam's near-retirement strategies, which have significant fixed-income exposure, generally outperformed their custom benchmarks, and longer-dated strategies with greater equity exposure lagged on a relative basis.

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 quite a bit more conservative relative to peers in the funds for people nearer to retirement.

What strategies contributed to performance?

Our asset allocation strategies during the quarter added value. We maintained an overweight position in equities relative to benchmark allocations and held an out-of-benchmark position in commodities. There was little contribution from credit or interest-rate positioning.

We also seek to add value through active implementation and security selection. Security selection, despite strong results in April, ended up being a net detractor during the period. June was the weakest month, and our equity selection was the primary driver of this decline. There was weakness in U.S. large-cap and international developed equities during the quarter. Underperformance in equity selection had a greater impact on strategies further from retirement, which have higher overall equity allocations. Emerging-market equity is held in all portfolios except those nearest retirement, and strong security selection here added value. Outside of equities, we saw positive quarterly performance from fixed-income selection and strategic global macro positions, including a short-term S&P 500 mean-reversion strategy.

What is the outlook for the third quarter of 2018?

This year is turning out to be more volatile than 2017. Despite strong underlying fundamentals, stock performance may be affected by trade protectionism, the trajectory of U.S. interest rates, and political risks. We expect the Fed to increase rates another two times in 2018 as it pursues a return to more normal interest-rate levels. We expect bond yields in the United States and globally to continue rising over the next few years. However, recent forward guidance from the ECB indicating a slow pace of rate increases should keep a lid on how high global yields could increase in the short term.

Global growth prospects are expected to remain relatively stable in 2018. The U.S. economy is poised to pick up some speed this year given indicators for consumer spending, corporate capital expenditure, and fiscal spending. The labor market remains strong as Americans saw wage gains accelerate and hiring improve. Meanwhile, U.S. inflation reached a six-year high of 2.8% in May. The price measure watched closely by the Fed topped the central bank's target. In addition, concerns about a potential trade war between the United States and other major economies continue to plague markets around the world.

We recently reduced our exposure to equities, moving closer to neutral, and our quantitative model remains slightly bearish. The prospect for an uptick in buybacks — one of the reasons for our overweight position in the past few months — has temporarily diminished, with many companies now in blackout periods. In corporate credit, there are high debt levels and declining interest-coverage ratios. High-yield spreads — the difference in a bond's yield relative to the yield of the highest-rated bonds of the same maturity — remain largely range bound. We prefer to be slightly underweight corporate credit risk at these spread levels.

We have reduced our out-of-benchmark allocation to commodities after our quantitative model moved more bearish and several oil-producing countries started to ease their production cuts. We do maintain a slightly bullish outlook for the asset class as a whole.

Putnam Retirement Advantage Funds

Annualized total return performance as of 6/30/18

Class I	Inception	Last quarter	1 year	3 years	5 years	10 years	Life of fund
Putnam RA Maturity Portfolio	1/3/08	0.85%	3.88%	5.11%	5.83%	5.53%	5.01%
RA Maturity Custom Benchmark		0.84	3.28	4.22	5.04	5.43	4.97
Putnam RA 2020 Portfolio	1/3/08	1.00	3.99	4.02	6.23	5.80	4.93
RA 2020 Custom Benchmark		0.97	4.23	4.48	5.82	5.48	4.61
Putnam RA 2025 Portfolio	1/3/08	1.56	6.54	5.57	8.07	6.59	5.56
RA 2025 Custom Benchmark		1.42	6.57	6.17	7.60	6.48	5.43
Putnam RA 2030 Portfolio	1/3/08	1.90	8.65	6.75	9.22	7.07	5.94
RA 2030 Custom Benchmark		1.70	8.45	7.27	8.68	7.06	5.89
Putnam RA 2035 Portfolio	1/3/08	1.83	10.03	7.59	10.03	7.52	6.30
RA 2035 Custom Benchmark		1.72	9.66	8.06	9.45	7.45	6.20
Putnam RA 2040 Portfolio	1/3/08	1.75	10.79	7.96	10.51	7.69	6.41
RA 2040 Custom Benchmark		1.79	10.39	8.54	9.97	7.65	6.33
Putnam RA 2045 Portfolio	1/3/08	1.73	11.18	8.10	10.86	7.87	6.53
RA 2045 Custom Benchmark		1.90	11.04	8.91	10.40	7.84	6.46
Putnam RA 2050 Portfolio	1/3/08	1.69	11.59	8.29	11.16	8.10	6.74
RA 2050 Custom Benchmark		2.00	11.69	9.29	10.82	8.09	6.68
Putnam RA 2055 Portfolio	12/22/10	1.61	11.91	8.45	11.37	—	10.72
RA 2055 Custom Benchmark		2.09	12.20	9.61	11.10	—	10.54
Putnam RA 2060 Portfolio	2/10/16	1.57	11.97	—	—	—	18.06
RA 2060 Custom Benchmark		2.12	12.31	—	—	—	18.86
S&P 500 Index		3.43	14.37	11.93	13.42	10.17	8.50*
Bloomberg Barclays U.S. Aggregate Bond Index		-0.16	-0.40	1.72	2.27	3.72	3.59*

* Returns reflect the period 1/2/08–6/30/18.

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 June 30, 2018, are subject to change with market conditions, and are not meant as investment advice.

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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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