Q1 2018 | Putnam Retirement Advantage Funds Q&A

Inflation and trade issues interrupt market rally

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Rising interest rates had a larger impact on fixed-income strategies.

Federal Reserve will continue gradually raising interest rates.

What was the market environment during the first quarter?

There was a spike in volatility across global markets during the first quarter of 2018, one that included a U.S. equity market correction that began at the end of January. This broad market decline was driven primarily by a more hawkish sounding Federal Reserve and the risk of a trade war. The Fed raised rates in March 2018 and signaled that the central bank is on track to raise rates at least twice more this year.

It is fair to say that trade protectionism and the risk of a trade war has risen over the past few weeks. President Trump slapped tariffs on an estimated $50 billion of imports from China, weeks after announcing tariffs on aluminum, steel, washing machines, and solar panels. Global and U.S. equities — and specifically technology stocks — were also undermined by user data privacy issues engulfing Facebook and other social media companies. The broad Standard & Poor's 500 Index fell 0.76% in the first quarter of 2018, while the Dow Jones Industrial Average dropped 1.96%.

On a more positive note, the U.S. tax reform that went into effect includes a reduction in the corporate tax rate to 21% from 35%. This law is widely seen as a near- to medium-term positive factor for corporations in the United States and provided some impetus to stock performance during the first few weeks of the year. Across the Atlantic, the European Central Bank left interest rates unchanged at its January meeting. However, investors remained skeptical about how long the economic stimulus program would remain in place. The anticipation of a more aggressive unwinding of accommodative monetary policy ultimately weighed negatively on the market risk premium, resulting in declines in both equities and bonds.

How did bond markets perform?

Treasury yields and short-term interest rates continued to increase steadily during the quarter. With short-duration yields climbing faster than long-term Treasury yields, the curve has flattened. Evidence of economic strength, including a tightening labor market and an improving outlook for wage gains, also drove bond yields higher. However, inflation has remained muted.

How did Putnam Retirement Advantage Funds perform?

Across the glide path, each of the target-date funds had negative returns, reflecting the setback for equity and fixed-income markets at the start of 2018. Performance varied based on each fund's exposure to stocks and bonds. The longer-dated, more stock-focused portfolios held up better than more fixed-income-oriented portfolios, as rising interest rates had a larger impact on those strategies than the weakness in global equity markets. Putnam's target-date glide path also favors relatively greater equity exposure for the longer-dated funds — those serving shareholders who still have a couple of decades or more until retirement — than can be found in the average target-date fund. These allocations further contributed to results on a relative basis for this period.

Although the shorter-dated funds have equity allocations below the industry average, poor performance from bonds were the primary reason for negative quarterly returns. Stocks, despite losing value to start the year, generally outperformed bonds, which negatively impacted our near retirement strategies.

What strategies contributed to performance?

We made minor shifts around benchmark allocations to favor U.S. large-cap stocks, but otherwise we maintained allocations close to the strategic benchmark across domestic and international stock categories. Our asset allocation strategies during the quarter had a negative impact. Generally, favoring U.S. large-cap equities worked against the funds over the period. This was partially offset by an out-of-benchmark position in commodities, which was implemented tactically during March. This exposure to a broad basket of commodities had a positive impact on the portfolio and serves as an example of using our tactical asset allocation flexibility to find opportunities outside of the asset classes included in our benchmark.

Security selection and implementation was also negative for the quarter. The slow start to the year was primarily due to selection within U.S. large-cap equities. Selection in international developed equities was positive over the quarter. Where applicable, emerging-market equity selection added value. An out-of-benchmark fixed-income strategy, which focused on securitized debt — primarily mortgages — had a modest positive impact; however, these strengths were not enough to offset U.S. large-cap equity selection weakness.

What is the outlook for the second quarter of 2018?

Early 2018 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. However, new Fed Chair Jerome Powell's congressional testimony earlier this year raised concerns that an additional rate hike may be possible.

The U.S. and global economy's prospects for 2018 remain solid, buoyed by consumption and investment. The U.S. labor market began this year on a strong note as Americans saw wage gains accelerate and hiring improve. While inflation has remained subdued, recent wage growth sparked concerns about rising prices. In Europe, higher-than-expected inflation could produce some volatility in euro-based sovereigns and corporate bonds. We expect rate normalization to continue, though ECB monetary policy on the whole remains mostly accommodative.

A much larger challenge for markets in the coming months will be the Trump administration's return to its campaign promises of "America First" trade policies. The administration in February announced tariffs on steel and aluminum, which were subsequently watered down to provide waivers for many companies and countries. Of even greater concern is the more China-targeted Section 301 findings on the cumulative costs of intellectual property theft and forced technology transfer; the preliminary estimates dwarf the expected impact of the initial metals tariffs.

While these political and geopolitical risks warrant monitoring, we currently prefer equity over both rates and credit in our multi-asset portfolios and maintain our positive view on commodities.

Putnam Retirement Advantage Funds

Annualized total return performance as of 3/31/18

Class I	Inception	Last quarter	1 year	3 years	5 years	Life of fund
Putnam RA Maturity Portfolio	1/3/08	-1.40%	5.00%	4.13%	5.63%	5.04%
RA Maturity Custom Benchmark		-1.21	4.30	3.50	4.63	5.00
Putnam RA 2020 Portfolio	1/3/08	-1.76	4.89	3.40	5.97	4.95
RA 2020 Custom Benchmark		-0.89	5.18	3.91	5.62	4.62
Putnam RA 2025 Portfolio	1/3/08	-1.86	7.27	4.89	7.78	5.53
RA 2025 Custom Benchmark		-0.87	7.57	5.55	7.39	5.42
Putnam RA 2030 Portfolio	1/3/08	-1.80	9.46	6.00	8.91	5.89
RA 2030 Custom Benchmark		-0.81	9.63	6.63	8.44	5.87
Putnam RA 2035 Portfolio	1/3/08	-1.61	11.31	6.89	9.79	6.26
RA 2035 Custom Benchmark		-0.76	11.20	7.46	9.23	6.18
Putnam RA 2040 Portfolio	1/3/08	-1.41	12.40	7.31	10.33	6.39
RA 2040 Custom Benchmark		-0.74	12.06	7.93	9.77	6.30
Putnam RA 2045 Portfolio	1/3/08	-1.40	12.94	7.51	10.73	6.52
RA 2045 Custom Benchmark		-0.73	12.73	8.29	10.22	6.42
Putnam RA 2050 Portfolio	1/3/08	-1.37	13.42	7.71	11.08	6.73
RA 2050 Custom Benchmark		-0.72	13.40	8.65	10.64	6.64
Putnam RA 2055 Portfolio	12/22/10	-1.30	13.93	7.90	11.32	10.86
RA 2055 Custom Benchmark		-0.72	13.94	8.94	10.91	10.61
Putnam RA 2060 Portfolio	2/10/16	-1.28	14.11	—	—	19.47
RA 2060 Custom Benchmark		-0.72	14.04	—	—	20.07
S&P 500 Index		-0.76	13.99	10.78	13.31	8.36*
Bloomberg Barclays U.S. Aggregate Bond Index		-1.46	1.20	1.20	1.82	3.69*

* Returns reflect the period 1/2/08–3/31/18.

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 views and opinions expressed are those of the portfolio managers as of March 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.

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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