What was the market environment during the quarter?

Global financial markets capped off a strong year in 2019 with gains across risk assets. Investors breathed a sigh of relief as the Federal Reserve lowered interest rates, and the United States and China reached an initial trade deal. The S&P 500 Index, a broad measure of U.S. stocks, rallied 9.07%, and the MSCI World Index rose 8.56% during the period. With interest rates already low, bonds ended the period on a positive note. The rate-sensitive Bloomberg Barclays U.S. Aggregate Bond Index rose 0.18% during the quarter.

The Fed cut its benchmark rate three times between July and October to a range of 1.50%–1.75%. But the central bank held rates steady in mid-December and signaled a pause in 2020. To add reserves back into the banking system, the Fed also began buying short-term Treasury bills in October. Elsewhere, the European Central Bank [ECB] left its key rate on hold at minus 0.5% in December, after unveiling a sweeping package of rate cuts and bond purchases in September. China and the United States agreed to sign the so-called “phase one” trade agreement in January. The agreement reduces uncertainty tied to the trade war.

Solid demand for short-term corporate bonds has caused spreads to tighten.

The Treasury yield curve steepened as the Fed cut rates and risk sentiment improved.

We expect short-term interest rates to be range-bound in early 2020.
The U.S. Treasury yield curve steepened during the quarter, marking a significant reversal for the bond market. Short duration yields are no longer higher than the rates on the long end, like the benchmark 10-year Treasury note. The curve had inverted over the summer. The yield on the 10-year note rose to about 1.92% at the end of the quarter from 1.65% at the start of the period. Meanwhile, short-term corporate bond spreads continued to grind tighter. The Bloomberg Barclays U.S. 1-3 Year Corporate Bond Index returned 0.86% during the quarter. The three-month London Interbank Offered Rate (LIBOR) fell to 1.91%.

How did the fund perform?
The fund outperformed its benchmark, the ICE BofA U.S. Treasury Bill Index, during the period. The fund returned 0.53% versus 0.48% for the index for the three months ended December 31, 2019.

What were the drivers of performance during the quarter?
All sectors contributed to the results, reflecting another quarter of strength for risky assets. Bank holdings and securitized bonds — including short-term asset-backed securities and collateralized mortgage obligations — were the biggest drivers of performance. The fund was primarily invested in corporate securities and commercial paper (CP), which provided attractive income above short-term Treasury securities. The financial industry typically makes up about half of the fund’s exposure. We invest in short-dated assets with maturities of 3.5 years or less, including corporate CP, which makes up approximately 30% of the fund’s holdings.

We have taken steps to reduce the fund’s sensitivity to credit spread movements as we are cognizant of ongoing uncertainties related to trade talks and the U.S. presidential elections this year. Specifically, we have lowered our exposure to the relatively longer-dated securities of the portfolio. We also positioned the portfolio to generate natural liquidity through ongoing bond maturities into year-end in anticipation of volatility driven by regulatory policies.

There were no major detractors this period. Some securitized assets marginally underperformed but had a negligible effect on relative results.

What is the outlook for short-term fixed-income markets?
We expect short-term interest rates to be range-bound as we head into 2020. Fed officials have indicated comfort with leaving monetary policy on hold while keeping an eye on inflation, trade, and global growth risks. We believe the Fed could maintain the federal funds rate within the 1.50%–1.75% target range as the economy appears to be stabilizing. With the Fed likely “on hold” in the near term, we expect to keep the portfolio’s current duration.

There are also risks related to the final outcome of the U.S.–China trade talks, global growth prospects, and U.S. elections. Additionally, short-term corporate bond spreads are nearing their post-recession tights. With that in mind, we continue to structure the portfolio with a barbell approach: investing in lower quality investment-grade securities (BBB or equivalent) maturing in 1 year or less and in higher quality investment-grade securities (A or AA rated) maturing between 1 and 3.5 years.

Despite ongoing changes in the market environment, capital preservation remains the primary objective of the fund. We believe our expertise on the short end will allow us to appropriately position the fund as the markets evolve and capitalize on opportunities as they arise.
Putnam Ultra Short Duration Income Fund (PSDYX)

Annualized total return performance as of 12/31/19

<table>
<thead>
<tr>
<th>Class Y shares</th>
<th>Net asset value</th>
<th>ICE BofA U.S. Treasury Bill Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inception 10/17/11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Last quarter</td>
<td>0.53%</td>
<td>0.48%</td>
</tr>
<tr>
<td>1 year</td>
<td>2.85</td>
<td>2.35</td>
</tr>
<tr>
<td>3 years</td>
<td>2.06</td>
<td>1.68</td>
</tr>
<tr>
<td>5 years</td>
<td>1.52</td>
<td>1.10</td>
</tr>
<tr>
<td>Life of fund</td>
<td>1.23</td>
<td>0.70</td>
</tr>
</tbody>
</table>

Total expense ratio: 0.38%
What you pay: 0.30%

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

“What you pay” reflects Putnam Management’s decision to contractually limit expenses through 11/30/20.

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.

LIBOR, the “London Interbank Offered Rate,” is the rate at which banks lend to each other on the London interbank market for terms ranging from overnight to one year.

The ICE BofA U.S. Treasury Bill Index is an unmanaged index that tracks the performance of U.S. dollar-denominated U.S. Treasury bills publicly issued in the U.S. domestic market. Qualifying securities must have a remaining term of at least one month to final maturity and a minimum amount outstanding of $1 billion. You cannot invest directly in an index.

ICE Data Indices, LLC (ICE BofA), used with permission. ICE BofA permits use of the ICE BofA indices and related data on an “as is” basis; makes no warranties regarding same; does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the ICE BofA indices or any data included in, related to, or derived therefrom; assumes no liability in connection with the use of the foregoing; and does not sponsor, endorse, or recommend Putnam Investments, or any of its products or services.

Duration measures the sensitivity of bond prices to interest-rate changes. A negative duration indicates that a security or fund may be poised to increase in value when interest rates increase.
The views and opinions expressed are those of the portfolio managers of Putnam Ultra Short Duration Income Fund as of December 31, 2019. They are subject to change with market conditions and are not meant as investment advice.

**Consider these risks before investing:** Putnam Ultra Short Duration Income Fund is not a money market fund. The effects of inflation may erode the value of your investment over time. Funds that invest in government securities are not guaranteed. Mortgage-backed investments, unlike traditional debt investments, are also subject to prepayment risk, which means that they may increase in value less than other bonds when interest rates decline and decline in value more than other bonds when interest rates rise. The fund may have to invest the proceeds from prepaid investments, including mortgage-backed investments, in other investments with less attractive terms and yields. The value of investments in the fund’s portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general economic, political, or financial market conditions; investor sentiment and market perceptions; government actions; geopolitical events or changes; and factors related to a specific issuer, geography, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the fund’s portfolio holdings. 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 generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds. Credit risk is generally greater for debt not backed by the full faith and credit of the U.S. government. 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 fund.