

Q1 2022 | Putnam Small Cap Growth Fund Q&A

A difficult quarter for small-cap growth stocks



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Industry since 1996

Surging inflation figures, shifting economic outlooks, and changing risk appetites were headwinds in the first quarter.

Despite a difficult first quarter, the fund outperformed its benchmark for the 1-, 3-, 5-, and 10-year and life-of-fund periods ended March 31, 2022.

We continue to focus on what drives stock prices over the long term, and then apply that to our active, fundamental research of individual companies.

How were conditions for investing in the first quarter?

It was a tough start to the year for financial markets. Surging inflation figures, shifting economic outlooks, and changing risk appetites were headwinds, compounded by an intensifying Russia-Ukraine war. Demand for goods was high as we emerged from the pandemic while many supply chains remained disrupted. This combination of rising demand and weaker supply brought inflation to a multi-decade high. The Federal Reserve's posture on inflation has certainly changed, and the market is recalibrating along with it. The potential for rising interest rates shifted investor appetites away from many of the fastest-growing companies in the market. Many investors also fear that efforts to reduce inflation will ultimately slow the U.S. economy and push it into a recessionary environment in 2023.

How did small-cap growth stocks perform relative to other styles?

Again this quarter, we saw a wide divergence in performance across the market. And while the quarter-end index returns are certainly disappointing, they actually underplay the volatility of the period. The decline of large-cap stocks, as measured by the S&P 500 Index, was less severe than that of small-cap stocks, as measured by the Russell 2000 Index. Among both large- and small-cap stocks, growth underperformed value for the quarter. Within the small-cap growth index, we saw tremendous strength in the energy sector, which gained 34%. Conversely, the consumer discretionary sector declined 19%, with many of the housing and auto industry names leading on the downside.

How did the fund perform?

In this difficult first quarter, the fund underperformed its benchmark. Stock selection in the industrials, energy, and materials sectors detracted from performance, as did our underweight position in the energy sector. However, the fund's performance over longer periods is worth noting. It outperformed the benchmark for the 1-, 3-, 5-, and 10-year and life-of-fund periods ended March 31, 2022.

What is your outlook as we begin a new quarter?

Uncertainty will likely be the greatest headwind for the market as investors weigh the potential impact of the Russia-Ukraine war, inflation, and a changing monetary policy framework. Over the longer term, we remain optimistic about the potential for equities as technological advancements continue to fuel worker productivity. We continue to focus on what drives stock prices over the long term, and then apply that to our active, fundamental research of individual companies. We seek to target companies that can grow profits at high rates for long periods, and we seek to pay a reasonable price for that growth.

Putnam Small Cap Growth Fund (PSYGX)

Annualized total return performance as of 3/31/22

	Class Y shares Inception 11/3/03	Russell 2000 Growth Index
Last quarter	-15.68%	-12.63%
1 year	-6.47	-14.33
3 years	18.02	9.88
5 years	17.14	10.33
10 years	14.01	11.21
Life of fund	11.88	7.08

Total expense ratio: 0.96%

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

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 of class Y shares assumes reinvestment of distributions and does not account for taxes. Class Y shares, available to investors through an asset-based fee program or for institutional clients, are sold without an initial sales charge and have no CDSC. Performance for class Y shares before their inception are derived from the historical performance of class A shares (inception 12/31/97), which have not been adjusted for the lower expenses; had they, returns would have been higher. Recent performance may have benefited from one or more legal settlements. For the most recent month-end performance, please visit putnam.com.

The Russell 2000® Growth Index is an unmanaged index of those companies in the small-cap Russell 2000 Index chosen for their growth orientation. The Russell Microcap® Index measures the performance of the microcap segment of the U.S. equity market. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. You cannot invest directly in an index.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio manager, as of March 31, 2022. They are subject to change with market conditions and are not meant as investment advice.

Consider these risks before investing: Investments in small and/or midsize companies increase the risk of greater price fluctuations. Growth stocks may be more susceptible to earnings disappointments, and the market may not favor growth-style investing.

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. These risks are generally greater for small and midsize companies. From time to time, the fund may invest a significant portion of its assets in companies in one or more related industries or sectors, which would make the fund more vulnerable to adverse developments affecting those industries or sectors.

Our investment techniques, analyses, and judgments may not produce the outcome we intend. The investments we select for the fund may not perform as well as other securities that we do not select for the fund. We, or the fund's other service providers, may experience disruptions or operating errors that could have a negative effect on the fund. You can lose money by investing in the fund.

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Request a prospectus or summary prospectus from your financial representative or by calling 1-800-225-1581. The prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.