

## Q1 2023 | Putnam Small Cap Growth Fund Q&amp;A

# A solid quarter for small-cap growth stocks in volatile markets



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Industry since 1996

*Small-cap growth stocks outperformed their value counterparts by a significant margin in the first quarter.*

*The fund outperformed its benchmark for the first quarter and for the 1-, 3-, 5-, and 10-year and life-of-fund periods ended March 31, 2023.*

*The fund's outperformance was largely driven by stock selection, which was strongest in the technology sector.*

## How were investing conditions in the first quarter?

The first quarter finished with most U.S.-based equities delivering gains, although they came with a lot of week-to-week volatility. Overall equity market performance was led by large technology companies, and the quarter was marked by significant swings in interest-rate expectations. Markets were also challenged by a crisis in the banking industry, where investors witnessed an old-fashioned bank run at modern-day speed. It resulted in the bankruptcies of Silicon Valley Bank and Signature Bank, and emergency action from the Federal Reserve.

Most equity indexes had started to drift lower after their peak on February 2 and as businesses began to report earnings in the following six weeks. Indexes dropped again in response to the banking crisis before stabilizing toward the second half of March. This tumultuous period also saw a Swiss government-engineered takeover of Credit Suisse by UBS, ending years of weakening business lines for Credit Suisse. In the U.S., the Fed worked to reassure investors that deposits were safe, although a full guarantee would require an act of Congress, which does not appear to be imminent.

## How was performance for small-cap growth stocks versus other asset classes?

Small- and large-cap growth stocks outperformed their value counterparts by a significant margin in the first quarter. While the large-cap growth index peaked at the close of the quarter, the majority of other size and style indexes topped out in early February and then retreated for much of the next two months.

## How did the fund perform?

The fund outperformed the benchmark in the first quarter and for the 1-, 3-, 5-, and 10-year and life-of-fund periods ended March 31, 2023. The outperformance was largely driven by stock selection, while sector allocation contributed modestly. Cash and currency fluctuations were a slight drag on returns. Stock selection was strongest in the technology sector, while selection was weakest in health care. Selection was positive in 6 of 10 sectors.

## As we begin a new quarter, how are you positioning the portfolio?

In the first quarter, we added positions in businesses that are levered to industrial activity and new home construction. Within industrial manufacturing, we added companies that have broad end market exposures, through software for industrial design and engineering, as well as through disposal of hazardous waste streams. We believe companies exposed to home building offer an attractive outlook for 2024 despite the well-known decline in demand in 2023. We believe interest rates are near a peak, which should allow for demand to reemerge.

We exited several positions that were tied to the general technology-spending landscape. For some of these firms, their sales enablement data and analytics services are valuable in our view, but we believe the businesses are set to grow at slower rates than we previously estimated. This is due largely to a macroeconomic outlook that will likely reduce spending on software. Similarly, we believe demand for other services, such as technology consulting, is likely to be delayed or canceled, leading to a slower growth outlooks for the businesses. Finally, prior to the banking crisis, we exited ServisFirst Bancshares, as the company was seeing more competition for deposits, which are needed to fund its generally higher-than-average loan production.

## Putnam Small Cap Growth Fund (PSYGX)

Annualized total return performance as of 3/31/23

|              | Class Y shares<br>Inception 11/3/03 | Russell 2000<br>Growth Index |
|--------------|-------------------------------------|------------------------------|
| Last quarter | 7.03%                               | 6.07%                        |
| 1 year       | -8.50                               | -10.60                       |
| 3 years      | 16.77                               | 13.36                        |
| 5 years      | 10.93                               | 4.26                         |
| 10 years     | 11.68                               | 8.49                         |
| Life of fund | 10.99                               | 6.31                         |

Total expense ratio: 0.98%

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.*

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As of 3/31/23, Putnam Small Cap Growth Fund did not hold Credit Suisse or UBS.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio manager, as of March 31, 2023. 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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