Investor Education

Reduce interest rate risk with floating rate bank loans

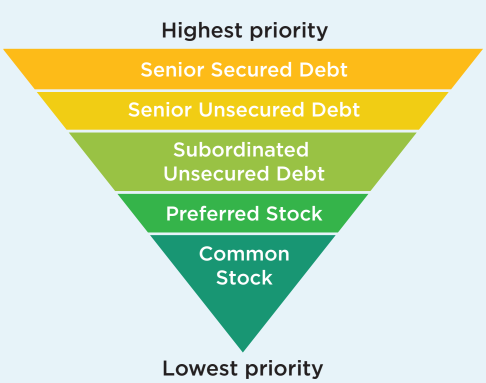
Putnam Floating Rate Income Fund offers investors a portfolio of floating rate bank loans, which deliver higher coupon payments as short-term rates rise.

What are floating rate loans?

Floating rate loans are debt obligations issued by banks and other financial institutions that consist of loans made to companies. They are called "floating rate" securities because the interest rates on the loans adjust at regular intervals to reflect changes in short-term interest rates as tracked by commonly accepted measures such as LIBOR (London Interbank Offered Rate). The companies that issue bank loans for financing generally lack investment grade credit ratings.

Indeed, many corporations issue both bank loans and high yield bonds. Whereas high yield bonds are usually unsecured, bank loans are typically secured by the issuer's assets, such as property, equipment, or rights to inventories or receivables. In this way, floating rate bank loans have a senior position in the firm's capital structure and are considered Senior Secured Debt. Accordingly, loans also rank above equities in a corporation's capital structure.

BANK LOANS RANK HIGH IN A COMPANY'S CAPITAL STRUCTURE



Why do loans have less interest rate risk than bonds?

The biggest difference between bank loans and traditional, fixed rate bonds involves how each reacts to interest rate changes. Bond prices move inversely to interest rates: When interest rates rise, bond prices fall, and when rates fall, bond prices rise. With floating rate loans, there is a different outcome: Their coupons adjust by increasing to the higher-rate scenario, and the resulting higher income makes the security more valuable. Even though a loan's price should fall as rates rise, the price does not fluctuate in the typical manner because the additional interest earned makes the security worth more. In addition, rates and loan prices typically increase during periods of strong economic growth, conditions that help to reduce the perceived credit risk of bank loans.

With these characteristics, loans can help diversify a portfolio that favors traditional, fixed rate bonds. Loans can help protect against rising interest rates, which typically have an adverse impact on fixed rate bonds.

BANK LOANS OFFER DIFFERENT RISKS THAN BONDS

	Interest rate risk	Credit risk	Liquidity risk	Income potential
Floating rate loans	Low	Medium/ High	Medium/ High	Medium
High yield bonds	Medium	High	Medium	High
Long-term investment grade bonds	High	Low/ Medium	Low/ Medium	Medium
Money market securities	Low	Low	Low	Low
CDs	Low	Low	Medium	Medium

Source: Putnam Investments.

How are floating rate funds different from money market funds?

Bank loans, like other short-term securities, are influenced by short-term interest rates, but loans should not be confused with money market securities, certificates of deposit (CDs), or other short-term instruments that seek to provide stability of principal. The prices of bank loans and mutual funds that invest in them may not always be stable. Loan prices can fluctuate as their interest rates reset periodically; when the market perceives changes in credit and default risk, as loans are considered part of the high yield universe; or due to market technicals.

Why Putnam Floating Rate Income Fund?

Putnam Floating Rate Income Fund invests in bank loans and gives investors an opportunity to diversify their portfolios. The fund seeks high current income with preservation of capital as a secondary goal. The fund can partially offset interest rate risk because the yield on floating rate bank loans adjusts with changes in short-term interest rates. Bank loans have historically performed well amid rising interest rates because their yields adjust higher and become more attractive. In many periods when interest rate sensitive bonds and bond funds have lost value because of rising interest rates, floating rate loans have provided positive returns.

Compared with high yield bonds, bank loans in general — as well as the fund's portfolio — largely benefited in 2015 from having considerably less exposure than high yield bonds to commodity-related sectors during a period when the price of oil and other commodities generally declined. What's more, the liquidity profile of the fund's portfolio is robust, as the portfolio managers typically seek issues in excess of $150 million for investment.

Putnam Floating Rate Income Fund is actively managed by experts in the sector. Portfolio Managers Paul D. Scanlon, CFA; Norman P. Boucher; and Robert L. Salvin each have more than 25 years of investment experience. They lead fundamental credit research teams who analyze bank loans to select a portfolio diversified across industries.

Talk with your financial advisor about how Putnam Floating Rate Income Fund can play a role in a diversified portfolio.

ANNUALIZED TOTAL RETURN PERFORMANCE
as of December 31, 2015

Class A shares inception 8/4/04	Before sales charge	After sales charge	Barclays U.S. High Yield Loan Index	S&P/LSTA Leveraged Loan Index
1 year	-1.17%	-2.16%	-0.83%	-0.69%
3 years	1.51	1.17	2.00	2.04
5 years	3.08	2.88	3.41	3.41
10 years	3.10	2.99	4.40	4.31
Life of fund	3.18	3.09	—	4.41

Total expense ratio: 0.99%

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. The class A share performance shown assumes reinvestment of distributions and does not account for taxes. After-sales-charge returns reflect a maximum load of 1.00%. For a portion of the periods, the fund had expense limitations, without which returns would have been lower. A short-term trading fee of 1% may apply to redemptions or exchanges from certain funds within the time period specified in the fund's prospectus. To obtain the most recent month-end performance, visit putnam.com.

Consider these risks before investing: Lower-rated bonds may offer higher yields in return for more risk. 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. Unlike bonds, funds that invest in bonds have fees and expenses. Bond prices may fall or fail to rise over time for several reasons, including general financial market conditions, changing market perceptions of the risk of default, changes in government intervention, and factors related to a specific issuer or industry. These factors may also lead to periods of high volatility and reduced liquidity in the bond markets. 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. Floating rate loans may reduce, but not eliminate, interest rate risk. These loans are typically secured by specific collateral or assets of the issuer. (Holders of the loan, such as the fund, have a priority claim on those assets in the event of the issuer's default or bankruptcy.) Value of collateral may be insufficient to meet the issuer's obligations, and the fund's access to collateral may be limited by bankruptcy or other insolvency laws. You can lose money by investing in the fund.

Investors should carefully consider the investment objectives, risks, charges, and expenses of a fund before investing. For a prospectus, or a summary prospectus if available, containing this and other information for any Putnam fund or product, call Putnam at 1-800-225-1581 and ask for a prospectus. Please read the prospectus carefully before investing.