Asset Allocation Strategies

CALAMOS® INVESTMENTS

JOHN P. CALAMOS, SR.

CEO AND GLOBAL CO-CIO

TABLE OF CONTENTS

Asset allocation and diversification do not guarantee investment returns and do not eliminate the risk of loss.

Managing Short-Term Uncertainties With a Proactive Approach

With the bull market in U.S. stocks in its sixth year and a still-uncertain timeline for the Federal Reserve's first interest rate increase, investors may be concerned about their asset allocations. Can stocks continue to advance? Are bonds positioned for a downturn? Are falling energy prices a harbinger of trouble? What does the falling euro mean for investors?

In this paper, we assess the opportunities in the global markets and the potential implications of macro factors on asset allocation. We discuss our framework for asset allocation, which is built around the use of core strategies, and our current rationale for underweighting and overweighting asset classes.

Key Observations

- We expect the global economy will expand in 2015. We believe the U.S. can maintain its growth trajectory and that a weakened euro could ultimately contribute to a healthier global economic environment.

- The Federal Reserve has demonstrated its willingness to take a deliberate and globally informed approach. A rise in short-term U.S. interest rates should be viewed as a signal that the U.S. economy is healthy and the global economy is improving. A more normal rate environment should provide banks with increased incentives to lend to small businesses, the engine of job growth.

- When interest rates rise, investors have often been caught by surprise—by both the timing and the speed of the increase. Asset allocation should proactively address the potential for rising rates.

- We believe U.S. stocks have more room to advance but that volatility will continue, making fundamental research and active management particularly important.

- Our view is that convertibles are well suited to address multiple asset allocation considerations. In addition to using convertibles as a core allocation through full market cycles, we believe we are in an environment where convertibles are an especially compelling alternative to traditional fixed income securities.

I. The Calamos Approach to Asset Allocation

Asset allocation is about matching investor risk tolerance to long-term investment objectives, and may be influenced by regional differences. In the U.S., a 40% fixed income/60% equity allocation is typical for many investors, while investors in Europe may favor a more conservative allocation, along the lines of 70% fixed income/30% equity. In Latin America, even larger fixed income allocations are common.

Many recognize the need to adjust their asset allocations in response to their changing personal circumstances or as portfolio weightings shift due to the appreciation of certain asset classes. However, investors may be less aware that the risks associated with asset classes can shift. For example, for U.S. investors, the potential for higher interest rates alters the risk profile of traditional fixed income allocations. Meanwhile, the falling euro has more direct implications for euro zone investors.

Our use of core strategies within the asset allocation framework has its roots in our pioneering use of convertibles.

Our approach to asset allocation goes beyond focusing on traditional asset class categories, and instead considers how a security or asset type can be actively managed to achieve a specific objective over market cycles. At the broadest level, our asset allocation framework includes the following categories: **traditional fixed income, enhanced fixed income, core and equity.**

We believe our use of core strategies is a key differentiator of our asset allocation philosophy. Core strategies are neither tactical overweights nor underweights. Instead, they reflect a consistent commitment over full market cycles, with an emphasis on preserving capital during down markets. Core strategies can also focus on long-term durable investing trends because secular themes (e.g., the expansion of the emerging market middle class) can provide long-term growth potential and resilience, even when shorter-term economic conditions are less hospitable.

Our use of core strategies within the asset allocation framework has its roots in our pioneering use of convertibles, which we have used since the 1970s as a means to potentially manage risk and enhance returns. **Compared with the "balanced" allocations of stocks and bonds upon which other asset allocation approaches rely, our core strategies are structured to provide more upside participation than balanced strategies with similar risk postures.** We seek to provide an asymmetrical risk/return profile, with more equity upside than downside over full market cycles, aiming to outperform the typical balanced strategy.

Because of our focus on full market cycle performance and downside risk management, we are willing to give up some upside equity market participation for a cushion on the downside. In regard to managing volatility versus the broad market, we may target a beta in the range of 0.70—that is, 30% less volatile than a relevant equity benchmark.

We may place a specific asset type within more than one of the four broad groups (traditional fixed income, enhanced fixed income, core and equity) at different points in the market cycle. For example, our approach utilizes convertibles as a mainstay within a core allocation, but in certain periods—such as in the current environment—we believe investors can benefit from increasing their more-tactical allocations to convertibles within the enhanced fixed income segment.

In the current environment, we believe investors can benefit from increasing their more-tactical allocations to convertibles within the enhanced fixed income segment.

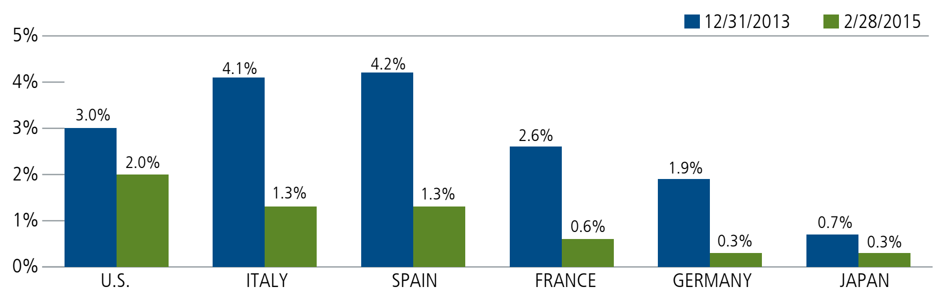
II. Traditional Fixed Income Allocation: Underweight

ASSET CLASS	SEGMENT	OUTLOOK	RATIONALE
Traditional Fixed Income	U.S. Investment Grade	Underweight	Long-term debt is particularly vulnerable to interest rate risk; conservative duration management is imperative but further tempers income potential
	Global Bonds	Underweight	Risks include currency volatility (due to a strong dollar), geopolitics in euro zone

Traditional fixed income strategies (investment grade bonds) are often viewed as the less risky portion of an asset allocation, versus more risky equity strategies. However, an eventual rise in rates may leave many investors exposed to unintended risks. A proactive approach to interest rates is critical for several reasons. First, the ongoing expansion of the U.S. economy coupled with the euro zone's continued progress toward recovery should ultimately lead to less accommodative global monetary policy. Second, factors beyond monetary policy can move interest rates—including inflation and geopolitical uncertainty. Finally, history has shown that when interest rates rise, they can ascend rapidly and catch investors by surprise.

In addition to the risks that are down the road, traditional fixed income allocations are likely falling short of current investors' income expectations (Figure 1). This leaves fixed income investors between a rock and a hard place: While interest rate risk can be managed by maintaining a shorter duration, a shorter duration means less income. Against this backdrop, we see considerable risks in outsized allocations to traditional fixed income securities, both U.S. and global.

FIGURE 1. GOVERNMENT BONDS PROVIDE LACKLUSTER INCOME



Source: Bloomberg.

> Increasingly, we are seeing institutional fixed-income investors look to convertible securities as a way to potentially insulate an asset allocation against rising interest rates.

III. Enhanced Fixed Income Allocation: Overweight

ASSET CLASS	SEGMENT	OUTLOOK	RATIONALE
Convertible	Convertible Securities	Overweight	Convertibles have demonstrated less sensitivity to rising interest rates, often outperforming traditional bonds in a rising rate environment
Liquid Alternatives	Market Neutral	Overweight	Market neutral can provide an alternative to interest-rate sensitive fixed-income investments, and may help offset equity market volatility
	Long/Short Equity	Overweight	Long/short equity strategies may entail less duration risk than long-only strategies
High Yield	Higher-Quality High Income	Neutral	Shorter-duration higher-quality high yield has been less sensitive to interest rate risk, compared to investment-grade bonds

While our caution about traditional fixed income is heightened, investors who wish to maintain well-diversified portfolios still have many choices, including what we refer to as enhanced fixed income approaches. Although the risk of such strategies has historically been higher than those of investment-grade bonds, there is less potential interest rate risk, and income prospects are better. Convertible bond, higher-quality high income, and market neutral strategies are examples of enhanced fixed income strategies that we believe can work well in this environment, as well as when interest rates rise.

FIGURE 2. CONVERTIBLES DELIVERED COMPELLING PERFORMANCE IN RISING INTEREST RATE ENVIRONMENTS

	10/15/93-11/7/94	1/18/96-6/12/96	10/5/98-1/20/00	11/7/01-4/1/02	6/13/03-6/14/04	6/1/05-6/28/06	12/30/08-6/10/09	10/7/10-2/8/11	7/26/12-12/27/13
Yield Increase (bps)	287	154	263	125	176	136	189	134	159
BofA ML All U.S. Convertibles	-2.28%	11.97%	68.85%	2.29%	11.49%	9.46%	24.68%	11.63%	35.49%
S&P 500	2.22	11.42	46.59	3.07	14.66	6.71	9.41	14.89	42.09
Barclays U.S. Govt/Credit	-5.15	-4.08	-3.38	-3.09	-3.64	-1.49	-2.08	-3.94	-2.14

Past performance is no guarantee of future results.

Source: Morningstar Direct and Bloomberg; most recent data as of 12/31/2014. Yield increase represented by the 10-year Treasury yield, showing periods where yields rose more than 100 basis points. Performance shown is cumulative.

Convertible bonds: Because they have equity characteristics in addition to their fixed income attributes, convertibles have been less susceptible to rising interest rates than investment-grade bonds. Figure 2 shows that U.S. convertibles have performed more like stocks than bonds over past periods of rising interest rates and, at times, have outperformed stocks by a wide margin. Increasingly, we are seeing institutional fixed-income investors look to convertible securities as a way to potentially insulate an asset allocation against rising interest rates. Because rising rates are typically associated with economic growth—a favorable backdrop for equities—the convertibles' embedded option becomes more valuable to investors as rates rise.

Liquid alternatives: Enhanced fixed income allocations can also include liquid alternative strategies, such as market neutral approaches that do not rely on bonds for income but instead utilize a blend of strategies to generate income. These less interest-rate sensitive strategies include covered call writing and convertible arbitrage.

By potentially reducing duration and equity market risk, long/short equity strategies can also support objectives associated with the enhanced fixed income allocation. A long/short equity strategy may mitigate equity risk because the short positions may provide upside when equities are retreating. (Short positions are established by borrowing an equity, selling it and buying it back.) Also, although investing in stocks, long/short equity strategies may be less sensitive to interest rates than long-only strategies, particularly long strategies focused on companies with earnings prospects that are many years out.

High yield bonds: While we are quite concerned about traditional fixed income securities, we are relatively more constructive on high yield, especially mid-grade credits. Strategies focused on credits rated B and BB may enhance the income potential of an investment grade allocation. Or, given the historically lower default rates among mid-tier credits, an allocation to higher-quality high yield may reduce the volatility of a more speculative high yield allocation.

IV. Core Allocation: Maintain Throughout Market Cycles

ASSET CLASS	SEGMENT	OUTLOOK	RATIONALE
Convertible	Convertible Securities	Neutral	Convertibles may provide lower-volatility participation in the equity market over full market cycles; this lower-volatility approach may be achieved through dedicated convertible strategies or those that blend equities and convertibles
Multiple	Global Secular Themes	Neutral	Core allocations often focus on providing exposure to durable global growth themes, such as the rise of the EM consumer, mobile technology, and productivity enhancement

Core allocations share a focus on capturing upside equity market potential with downside risk management over full market cycles.

Core allocations share a focus on capturing upside equity market potential with downside risk management over full market cycles. We use a range of strategies and security types within core allocations, including:

Convertible securities: In addition to using convertibles tactically within the enhanced fixed income category when conditions dictate, we use them as a cornerstone within core strategies to pursue lower volatility equity exposure, either within dedicated convertible strategies or within strategies that include equities as well.

As hybrid securities, convertibles provide equity upside participation with potential downside protection when equity markets decline. This may offer a more comfortable way to access the equity markets for investors who are especially concerned about volatility. **Just as convertibles may mitigate anxiety about positioning a portfolio ahead of eventual interest rate increases, they may also lessen the temptation to try to time the stock market.**

Global secular growth opportunities: As we noted, we believe core strategies should provide investors with a way to participate in long-term growth themes, such as the rise of the emerging market consumer; demand for connectivity and information, anywhere and any time; and the drive for enhanced productivity in a globally competitive environment. Companies that are capitalizing on secular themes may be better able to withstand economic weakness and grow during more challenging environments. We apply this thematic approach across asset classes (such as equities and convertibles) and geographies.

In our interconnected global economy, we find these sorts of opportunities all over the world. When we identify companies in relatively more volatile markets, we employ a range of techniques to potentially mitigate risk, consistent with the parameters of a core allocation.

V. Equity Allocation: Overweight U.S. Growth

ASSET CLASS	SEGMENT	OUTLOOK	RATIONALE
Equity	U.S. Growth	Overweight	Although its pace may slow, we believe the U.S. economy can continue to expand, and valuations remain attractive versus bonds, inflation and value stocks
	U.S. Value	Neutral	Relatively less attractive than growth
	International Developed	Neutral	Japan and euro zone offer attractively valued pockets of bottom-up opportunity, but economic fundamentals are weaker than in the U.S. We believe a weaker euro can ultimately contribute to a healthier global growth environment.
	Emerging Markets	Neutral	Secular growth themes are intact, but selectivity remains paramount as commodity prices weaken and countries pursue different economic reform trajectories

Companies that are capitalizing on secular themes may be better able to withstand economic weakness and grow during more challenging environments.

U.S. growth equities: We continue to believe the case for overweighting U.S. growth equities is strong. Although U.S. economic growth may be more measured over these next quarters, the U.S. looks positioned for continued expansion. We don't view the strong dollar as a material hindrance to economic growth at this point, and while oil prices have remained volatile, we believe they can stabilize over the coming months. Looking longer term, our view is that increased energy independence in the Americas will have a positive impact, with foreign policy spending likely decreasing.

Although U.S. equities have enjoyed an extended bull run, we see continued upside. The earnings yields of stocks are attractive relative to bonds and inflation. We believe low corporate borrowing costs and high dividend yields will encourage continued merger-and-acquisition and buyback activity, which in turn would provide support to the equity market. Valuations are especially compelling for growth stocks. The current 1.2x* premium for large-cap growth over large-cap value is far below the 3.0x multiple we saw at the technology peak and also less than long-term averages (1.4x since 1990).

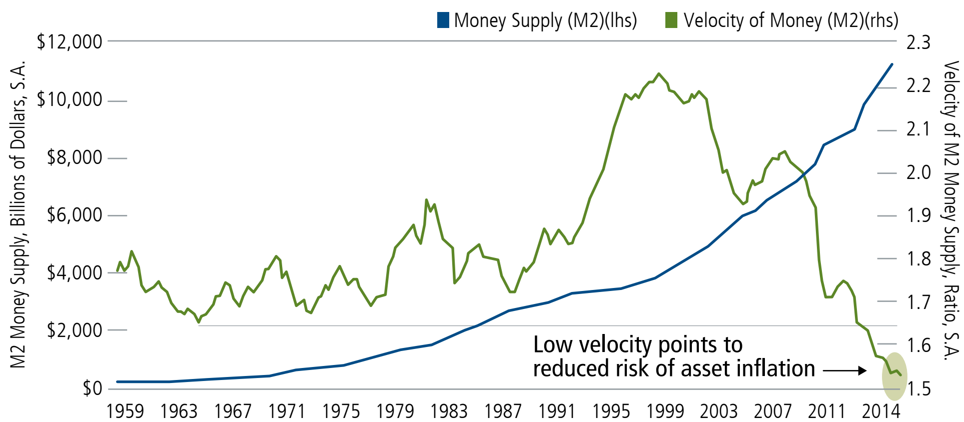
*As of December 31, 2014

Many have asked about the impact of an eventual rise in interest rates on equities. Moderately higher longer-term interest rates (in the 4% to 5% range) have been associated with higher P/Es among U.S. stocks. While a steep run-up in rates and a sharp spike in inflation could create headwinds in equities, core inflation is well contained. Employment gains have not been accompanied by a commensurate level of wage growth and productivity improvements, while falling energy prices further reduce inflationary pressures. Moreover, the historically low velocity of money points to a reduced likelihood of asset inflation (Figure 3).

While a steep run-up in rates and a sharp spike in inflation could create headwinds in equities, core inflation is well contained.

FIGURE 3. STAGNANT VELOCITY OF MONEY INDICATES CONTAINED INFLATION

1Q 1959 THROUGH 4Q 2014



Source: Federal Reserve Bank of St. Louis

Developed market equities: In regard to developed markets outside the U.S., our outlook is neutral. As we discussed in our January Economic Review and Outlook, growth fundamentals are weaker in Europe versus other regions, but we are identifying bottom-up opportunities with attractive valuations. We are encouraged the European Central Bank has commenced with quantitative easing, and that euro zone nations have been persistent in working through their differences. And despite consternation over the euro's recent slide, we believe a closer parity between the dollar and the euro will lead to more global growth. In particular, we expect multinational companies in the euro zone to benefit from more competitive pricing. Meanwhile in Japan, corporate fundamentals have shown improvements, share buybacks have increased and monetary policy remains accommodative.

Emerging market equities: While we are proponents of including EM secular growth themes within core allocations, we have a neutral stance regarding additional tactical EM exposure within equity allocations. From a risk/reward standpoint, the current environment calls for a selective approach versus a benchmark-constrained strategy. In what will likely be a multi-year cyclical strong dollar environment, we believe commodity-consuming economies will fare better versus commodity-producing economies. Countries that are embracing economic reform should also enjoy more tailwinds versus those that are not. Accordingly, strategies that track the broad EM stock market will be more vulnerable to more troubled countries (such as Russia and Brazil), and less exposed to the more compelling growth stories (such as India and China).

VI. Conclusion

Fears that the equity market could be losing steam, concerns about interest rate increases, and uncertain global growth prospects have left some investors jittery about about how to approach asset allocation. We encourage investors to take a long-term approach, guided by global perspective. In this regard, core strategies can provide a foundation of upside participation and potential downside protection, ideally mitigating the temptation to make shorter-term timing decisions.

Although we expect equity market volatility will continue, we believe stocks can continue to advance. We are especially constructive on U.S. growth equities, given our view that the U.S. economy can continue to grow, albeit at a slower pace.

While global interest rates have remained lower for longer than many anticipated, we believe investors should take a proactive approach to warding against a rate ramp-up, most immediately in the U.S., where it is likely that rate rises will begin before year end. Against this backdrop, we believe this is an especially good opportunity to increase exposure to convertibles, as an alternative to traditional fixed income investments.

Core strategies provide a foundation of upside participation and potential downside protection, ideally mitigating the temptation to make shorter-term timing decisions.

VII. Summary: Asset Class Outlook

	ASSET CLASS	SEGMENT	OUTLOOK	RATIONALE
EQUITY	Equity	U.S. Growth	Overweight	Although its pace may slow, we believe the U.S. economy can continue to expand, and valuations remain attractive versus bonds, inflation and value stocks
		U.S. Value	Neutral	Relatively less attractive than growth
		International Developed	Neutral	Japan and euro zone offer attractively valued pockets of bottom-up opportunity, but economic fundamentals are weaker than in the U.S. We believe a weaker euro can ultimately contribute to a healthier global growth environment.
		Emerging Markets	Neutral	Secular growth themes are intact, but selectivity remains paramount as commodity prices weaken and countries pursue different economic reform trajectories
CORE	Convertible	Convertible Securities	Neutral	Convertibles may provide lower-volatility participation in the equity market over full market cycles; this lower-volatility approach may be achieved through dedicated convertible strategies or those that blend equities and convertibles
	Multiple	Global Secular Themes	Neutral	Core allocations often focus on providing exposure to durable global growth themes, such as the rise of the EM consumer, mobile technology, and productivity enhancement
ENHANCED FIXED INCOME	Convertible	Convertible Securities	Overweight	Convertibles have demonstrated less sensitivity to rising interest rates, often outperforming traditional bonds in a rising rate environment
	Liquid Alternatives	Market Neutral	Overweight	Market neutral can provide an alternative to interest-rate sensitive fixed-income investments, and may help offset equity market volatility
		Long/Short Equity	Overweight	Long/short equity strategies may entail less duration risk than long-only strategies
	High Yield	Higher-Quality High Income	Neutral	Shorter-duration higher-quality high yield has been less sensitive to interest rate risk, compared to investment-grade bonds
FIXED INCOME	Traditional Fixed Income	U.S. Investment Grade	Underweight	Long-term debt is particularly vulnerable to interest rate risk; conservative duration management is imperative but further tempers income potential
		Global Bonds	Underweight	Risks include currency volatility (due to a strong dollar), geopolitics in euro zone

ABOUT THE AUTHOR

John P. Calamos, Sr. is chairman, chief executive officer and global co-chief investment officer of the firm he founded in 1977, which he took public as Calamos Asset Management in 2004 (Nasdaq: CLMS). A recognized authority on convertible securities, he has pioneered investment strategies and techniques to help manage risk for major institutional and individual investors for more than 40 years.

He has shared his expertise in two books, *Convertible Securities: The Latest Instruments, Portfolio Strategies, and Valuation Analysis* (McGraw-Hill, 1998) and *Investing in Convertible Securities: Your Complete Guide to the Risks and Rewards* (Longman Financial Services Publishing, 1988). He has also authored numerous articles in various financial journals and is a frequent guest on nationally syndicated financial networks, including CNBC, Bloomberg TV and Fox Business Channel.

ALSO BY THE AUTHOR

- **"The Case for Strategic Convertible Allocations,"** a white paper focused on convertible securities in asset allocation
- **"Advice for Investing in Today's Volatile Markets: 5 Points,"** a blog post
- **"Navigating the Oil Slick,"** a quarterly economic review and outlook

This material is distributed for informational purposes only. The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the information mentioned, and while not guaranteed as to the accuracy or completeness, has been obtained from sources we believe to be reliable.

Outside the U.S., this presentation is directed only at professional/sophisticated investors and it is for their exclusive use and information. This document should not be shown to or given to retail investors.

Investments in overseas markets pose special risks, including currency fluctuation and political risks, and greater volatility than typically associated with U.S. investments. Investments in emerging markets may present additional risk due to potential for greater economic and political instability in less developed countries. Risks may include fluctuations in currency exchange rates, increased price volatility and difficulty in obtaining information.

The price of equity securities may rise or fall because of changes in the broad market or changes in a company's financial condition, sometimes rapidly or unpredictably. These price movements may result from factors affecting individual companies, sectors or industries.

Fixed-income securities are subject to interest rate risk and default risk. If rates increase, the value of fixed-income investments generally declines. The risk of default is increased among high-yield securities.

Convertible securities are subject to interest rate risk and credit risk.

A credit rating is a relative and subjective measure of a bond issuer's credit risk, including the possibility of default. Credit ratings are assigned to companies by third-party groups, such as Standard and Poor's. Ratings are measured using a scale that typically ranges from AAA (highest) to D (lowest). Assets with the highest ratings are referred to as "investment grade" while those in the lower tiers are referred to as "noninvestment grade" or "high-yield."

Short sales entail potential for unlimited losses and leverage risk.

As the writer of a covered call option on a security, the investor foregoes, during the option's life, the opportunity to profit from increases in the market value of the security, covering the call option above the sum of the premium and the exercise price of the call.

The S&P 500 Index is considered generally representative of the market for U.S. stocks; the **BofA ML All U.S. Convertible Index** is considered generally representative of the U.S. convertible market; the **Barclays Government/Credit Index** is a measure of the U.S. government and corporate bond market. Indexes are unmanaged, do not include fees or expenses and are not available for direct investment.

Beta is a historic measure of an investment's volatility, which is one measure of risk. A beta of 0.5 reflects 1/2 of the market's volatility versus a benchmark, while a beta of 2.0 reflects twice the volatility. **Duration** is a measure of interest rate sensitivity. **Velocity of money** is the rate at which money is exchanged from one transaction to another, and how much a unit of currency is used in a given period of time. **M2** is a measure of money supply that includes cash and checking deposits (M1) as well as near money. "Near money" in M2 includes savings deposits, money market mutual funds and other time deposits, which are less liquid and not as suitable as exchange mediums but can be quickly converted into cash or checking deposits. **Price to earnings ratio (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings. **Quantitative easing (QE)** is a government monetary policy used to increase the money supply by buying government securities or other securities from the market, with the intention of promoting increased lending or liquidity.

CALAMOS®
INVESTMENTS

Calamos Advisors LLC
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | www.calamos.com | caminfo@calamos.com

Calamos Investments LLP
62 Threadneedle Street | London, EC2R 8HP, UK
Tel: +44 (0) 20 3178 8838 | www.calamos.co.uk

INVPERCOM 17053 0315O C