Economic Outlook

CALAMOS INVESTMENTS

July 2017

CALAMOS INVESTMENT COMMITTEE

JOHN P. CALAMOS, SR.
Founder, Chairman and Global CIO

Matt Freund, CFA
Co-CIO and Senior Co-Portfolio Manager

Michael Grant
Senior Co-Portfolio Manager

John Hillenbrand, CPA
Co-CIO and Senior Co-Portfolio Manager

Nick Niziolek, CFA
Co-CIO and Senior Co-Portfolio Manager

Eli Pars, CFA
Co-CIO and Senior Co-Portfolio Manager

We see a favorable backdrop for equities and convertible securities through the remainder of the year, although late-cycle pressures may increase going into 2018. Global growth has rebounded significantly, and we maintain our expectation for sustained and balanced global expansion through 2017. PMIs are converging and expanding, there is little risk of the U.S. overheating, the recovery in Europe is strengthening, and many emerging markets continue on favorable trajectories.

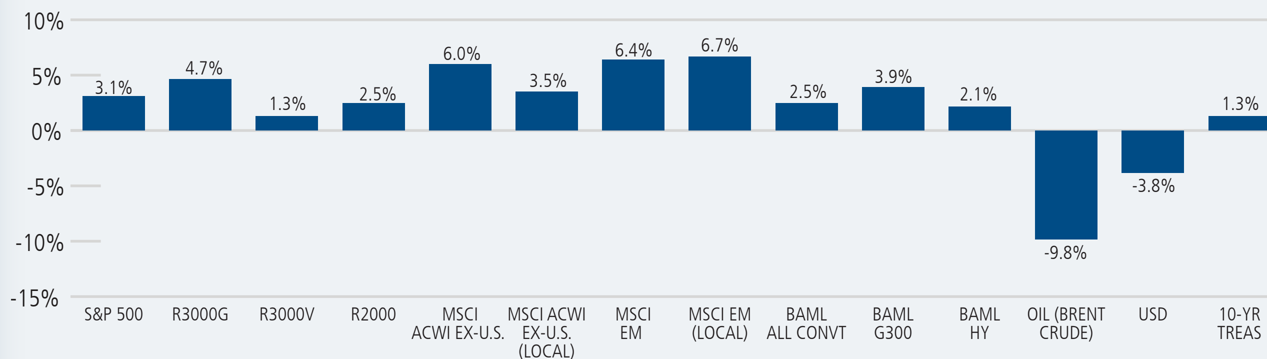
Global monetary policy should provide a near-term tailwind to equities and convertibles while not creating stiff headwinds for fixed income. We expect the Federal Reserve to maintain a gradual approach to increasing short-term rates. Other central banks have also begun to assume less accommodative stances, but we anticipate slow and deliberate approaches across the globe. As long-term rates are unlikely to soar, there are ongoing opportunities within the fixed income market.

We remain mindful of risk. Populist pressures have lessened in Europe, but elevated political uncertainty and contentious fiscal policy negotiations in the U.S. persist. North Korea's bellicose stance gives pause, as do strained U.S. ties with China and Russia, and evolving trade relationships. Central banks remain very accommodative, but unexpected shifts in monetary policy could have negative consequences for

MARKET REVIEW

During the second quarter, market participants looked through global geopolitical tensions and U.S. fiscal policy challenges, focusing instead on generally improving economic survey data, strong corporate earnings, contained inflation and well-behaved long-term interest rates. Stocks marched higher and convertible securities participated in a healthy measure of these gains. Emerging markets set the pace to beat, with a weaker dollar providing a supportive tailwind. Globally, growth led value. Although the Fed continued to tighten and announced its intention to slow its bond-buying activities sooner than many anticipated, U.S. Treasury bonds demonstrated continued resilience.

FIGURE 1. GLOBAL ASSET CLASS PERFORMANCE, 2Q 2017



Past performance is no guarantee of future results. Source: Morningstar and Bloomberg. Data shown in USD unless otherwise noted.

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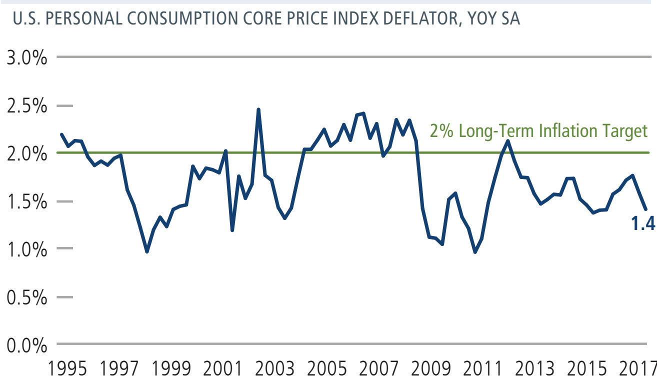
FIGURE 2. GLOBAL GROWTH IS REBOUNDING SIGNIFICANTLY

GLOBAL NOMINAL GDP Y/Y (USD)

Source: Haver, Morgan Stanley Research as of 1Q17.

FIGURE 3. U.S. INFLATION IS CONTAINED

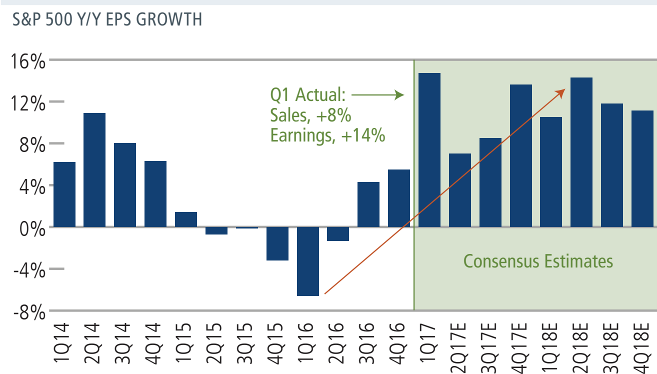
U.S. PERSONAL CONSUMPTION CORE PRICE INDEX DEFLATOR, YOY SA



Source: Bloomberg. Data from 3/31/95 to 5/30/17.

FIGURE 4. ACCELERATION IN S&P 500 EARNINGS

S&P 500 Y/Y EPS GROWTH



Source: Thomson Financial, Morgan Stanley Research as of 6/23/17.

FIGURE 5. GLOBAL VALUATIONS

AS OF 6/30/17

	FWD P/Ex	EPS CAGR 2016-2018	FWD Px/ SALES	SALES CAGR 2016-2018	EPS 2017E REVISION YTD
U.S.	19.0	16.7%	2.0	6.0%	+1%
Japan	14.5	21.6%	0.9	6.6%	-2%
Europe	15.8	39.0%	1.3	7.1%	+6%
EM	13.2	19.6%	1.3	8.3%	0%

Source: Bloomberg. Data in USD terms.

risk asset prices and real economic activity, particularly after years of unprecedented support. Corporate earnings are on the rise, but so too are levels of debt.

Market rotation is likely to continue, which may exact a steeper toll on higher-valued names. More broadly, we would not be surprised to see the market retrace ground in the midst of its advance— indeed, the absence of corrections over recent months is perhaps more surprising.

United States

We believe the U.S. is positioned for continued slow and stable expansion through 2017, framed by the larger synchronized global growth story (Figure 2). While many "hard" measures of economic activity are still less strong than "soft" measures, the near-term risk of recession is slight, and the pace of expansion could increase. Unemployment, leading economic indicators, capital expenditures, and PMIs are moving in the right direction; and inflation is well contained (Figure 3). Fiscal policy has encountered hurdles, but there has been more momentum on the pro-business regulatory front. Also, enacting tax reform—even to a lesser extent than originally expected—should boost corporate spending and bolster U.S. economic growth.

We see broad global economic expansion underpinning the U.S. sales and profit cycle. Earnings growth is likely to accelerate through late 2017 or even further (Figure 4). There is a good deal of variation among sectors, however. Apart from energy and materials companies (which are each coming off a very low base), financials and information technology have the brightest EPS prospects, while the more defensive sectors remain lackluster. Across our U.S. equity portfolios, we are favoring companies that should perform well in an environment of modest economic expansion and gradually rising interest rates. Financials are well represented in our portfolios as are technology names, although we are highly mindful of valuations.

Global and International

In our global and international strategies, we are favoring non-U.S. markets. Valuations appear more reasonable (Figure 5) and many countries are in earlier stages of economic recovery. We are emphasizing

a blend of cyclical and secular growth opportunities, including in the financials and technology sectors. In contrast, we are underweighting defensive areas of the market, although we have found attractively valued securities within health care.

Our positioning reflects a constructive view of Europe. Growth fundamentals continue to improve, with the Eurozone several years behind the U.S in its economic recovery. Liquidity conditions are very accommodative, issues in the banking system have begun to be addressed, and loan growth has picked up (Figure 6). Many companies have seen steady positive revisions to earnings expectations this year. Valuations are relatively attractive, with margins still near trough levels with considerable room for pick-up as top-line growth improves.

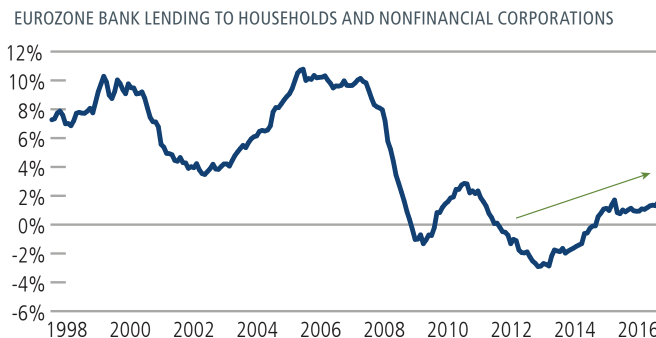
In Japan, we continue to emphasize export-oriented companies positioned to benefit from improving global growth and a weaker yen. Reasonable valuations and accommodative liquidity conditions provide a favorable landscape for our bottom-up security selection. By not discussing reduced accommodation over the medium term, the Bank of Japan has set itself apart as an outlier among major central banks, thereby limiting potential yen appreciation.

In the emerging markets, many countries are benefiting from strengthening economic fundamentals. Liquidity conditions are improving across many economies as inflation has eased and higher interest rates have attracted capital flows. These factors, along with balance sheet improvements over recent years (Figure 7), should help many emerging markets navigate interest rate rises in the developed markets. Against this backdrop, we continue to identify a breadth of opportunities. Still, our positioning is selective, emphasizing consumption-oriented themes and countries with favorable economic reform trajectories, such as India and China.

Convertible Securities

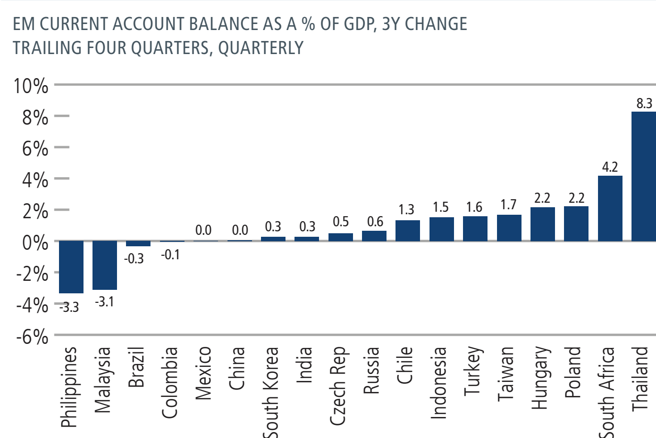
Through the first half of the year, global convertible issuance has been solid at $41 billion, led by the U.S. at $23.2 billion. We expect healthy issuance over 2H 2017 as companies seek to raise capital for growth projects.

FIGURE 6. IMPROVING CREDIT CONDITIONS IN EUROZONE



Source: Gavekal Data/Macrobond. Data through May 2017.

FIGURE 7. EM BALANCE SHEETS HAVE STRENGTHENED



Source: Gavekal Data/Macrobond. Data as of January 2017, excluding Brazil (October 2014) and Russia (April 2017), the most recent data available.

There is a strong case for convertible securities in this phase of the market cycle. Because convertible securities have equity characteristics as well as fixed income attributes, they have proven more resilient than non-convertible fixed income securities when interest rates rise. Conversely, fixed income characteristics can provide downside protection during periods of short-term equity turbulence. Additionally, in an environment where equity valuations in some areas give pause, convertibles offer a way to invest in some of the fastest-growing companies, with downside protection.

We have identified many companies in the technology sector where innovative businesses are capitalizing on cyclical and secular trends. Our security selection criteria have led us to companies in the consumer discretionary sector, as well. We are selective toward more defensive sectors, including REITs, utilities and consumer staples.

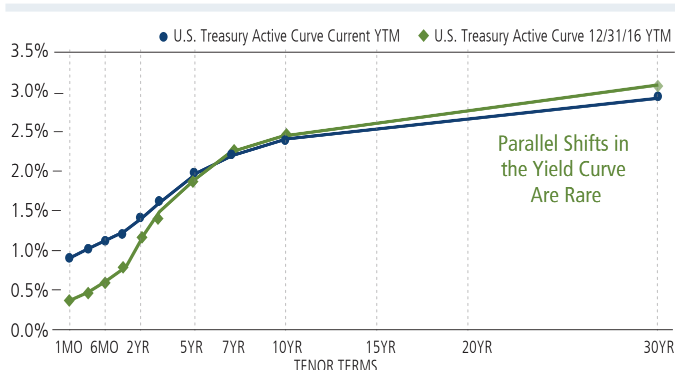
Fixed Income

Demonstrating that parallel shifts in the yield curve are rare, 10-year Treasury yields have remained contained in the wake of Fed hikes (Figure 8). We expect further flattening of the yield curve over these next months, with U.S. 10-year yields gently rising to 3% into 2018. That said, if the Fed does proceed with its intention to reduce its bond-buying activities before it finishes raising short-term rates, we would enter uncharted waters, and long-term rates could rise more quickly.

The Fed is unlikely to raise short-term rates more than one more time before year end. As we noted, while the U.S. economy is growing, expansion remains moderate with inflation still below the Fed's target. Further, although some other central banks are also moving to more normalized short-term rates, tightening is likely to be gradual, which should help contain long-term rates globally.

From a sector standpoint, we currently favor corporate bonds over Treasury and agency positions. In high yield, defaults are rising, but slowly and from historically low levels. Given range-bound interest rates and spreads over the first half of 2017, coupled with spreads trading well below long-run averages, we anticipate the high yield asset class is likely to generate a coupon-like return through the end of the year. However, our fundamental bottom-up analysis continues to lead us to opportunities that offer more attractive price return potential.

FIGURE 8. THE U.S. YIELD CURVE FLATTENS



Source: Bloomberg. Data as of 7/5/17.

Conclusion

Steady and balanced global GDP growth, deliberate central bank policies, and favorable corporate earnings prospects support our positive outlook for equities and convertibles for the remainder of the year. Given our expectation for contained long-term rates and low inflation, the current landscape should sustain select opportunities within fixed income as well. Despite this broadly constructive view, uneven valuations in the market, fiscal policy challenges and political uncertainties underscore the importance of risk management. We expect volatility to increase in the months ahead and believe our portfolios are well positioned for this environment.

Indexes are unmanaged, not available for direct investment and do not include fees and expenses. The **U.S. Dollar Index** measures the value of the U.S. dollar relative to a basket of foreign currencies, including Euro Area, Canada, Japan, United Kingdom, Switzerland, Australia, and Sweden. The **Russell 3000 Growth Index** and **Russell 3000 Value Index** measure U.S. growth and value equities, respectively. The **Russell 2000 Index** measures U.S. small cap stock performance. The **S&P 500 Index** is considered generally representative of the U.S. equity market. The **MSCI All Country ex U.S. Index** represents the performance of global equities, excluding the U.S. The **MSCI Emerging Markets Index** is a measure of the performance of emerging market equities. The **BofA Merrill Lynch U.S. High Yield Index** is an unmanaged index of U.S. high yield debt securities. The **BofA Merrill Lynch All U.S. Convertible Index (VXA0)** is a measure of the U.S. convertible market. The **BofA Merrill Lynch G300 Index** measures the performance of 300 global convertibles. **Oil** is represented by current pipeline export quality Brent blend. **Core PCE** is a gauge for inflation, measuring personal consumption expenditures excluding food and energy prices.

Purchasing Managers Indexes measure manufacturing sector strength. **Earnings per share (EPS)** is a company's profit divided by its number of common outstanding shares. **Price-to-earnings ratio (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings; forward P/Es are based on forecasted earnings. **CAGR**, or compounded annual growth rate measures year-over-year growth. **Price-to-sales ratio** measures a company's stock price versus its revenues.

Opinions, estimates, forecasts, and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. The views and strategies described may not be suitable for all investors. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations.

CALAMOS® INVESTMENTS

Calamos Investments 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
Tel: +44 (0)20 3744 7010 | www.calamos.com/global

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