SPONSORED COMMENTARY

Convertible Securities: A Compelling Diversifier in an Environment of Economic Growth

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Q. What factors support the case for convertible securities today?

Convertible security strategies are best viewed as strategic allocations to be held for full and multiple market cycles, but there are factors that make convertibles especially compelling today. As equity-sensitive instruments, convertibles have historically fared well during periods of rising equity markets, economic expansion, and increasing interest rates. Convertibles have also historically helped mitigate the impact of downside volatility in the equity markets.

We believe these are key considerations for investors today. The global economy is enjoying a period of expansion, with favourable trajectories in Europe, the United States and many emerging markets. A stabilising dollar, contained inflation and an increased emphasis on fiscal policy – most notably but not exclusively in the United States – can provide tailwinds to sustain this economic growth and additional equity market upside.

Against this backdrop, we expect the Federal Reserve to continue gradually tightening short-term rates. Looking further out, as economic growth continues globally, the historically low-to-negative rates to which investors have grown accustomed eventually should give way to a more normal interest rate environment worldwide. This more normal rate environment is positive, both from an economic standpoint as well as for equities and equity-sensitive convertible securities.

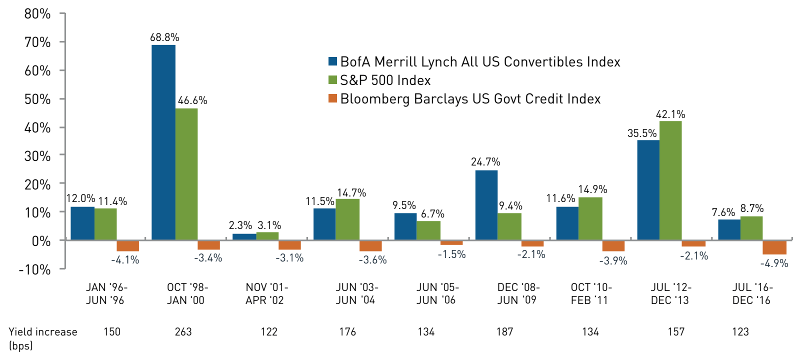
Q. If equities have potential for continued upside, why should investors look to convertible securities as well?

Every bull market climbs a wall of worry. For many investors, convertibles provide a more comfortable way to maintain exposure to the equity market and lessen the inclination to time the market.

Whilst our outlook on the global economy is constructive and we see further room for equity markets to run, we believe investors should not lose sight of downside risk, especially in this highly politically charged environment. In this regard, the fixed income attributes of the convertible security can prove advantageous with coupon income and the bond value of the convertible providing a degree of resilience in periods of downside volatility.

Further, convertible securities provide a more attractive alternative to the defensive and low-volatility stocks that investors have favoured over recent years. We are concerned that many investors may be over-utilising bond surrogates and may be overly vulnerable as the market's preference for growth companies strengthens.

When Interest Rates Rise, Convertibles Have Historically Performed Well



In the past 20 years, when the 10-year Treasury yield rose more than 100 basis points, US convertible returns tended to more closely reflect equity returns than bond returns. **Performance data quoted represents past performance, which is no guarantee of future results. Current performance may be lower or higher than the performance quoted.** Source: Morningstar Direct and Bloomberg. Most recent data as of 31 March 2017. Rising rate environment periods from troughs to peak from January 1996 to December 2016. Results shown are cumulative.

Q. How important are credit ratings to your portfolio construction?

We rely foremost on our proprietary, comprehensive capital structure analysis, which encompasses credit, equity and convertible analysis. Proprietary analysis is especially important because unrated credits represent the majority of the global convertible universe and the percentage of investment-grade credits is low and has been on a long-term downtrend. Currently, the investment grade universe is quite narrow. So it's challenging to optimise the risk/reward of a portfolio composed entirely of investment-grade credits.

Q. Where do convertible strategies fit within a portfolio?

The answer very much depends on the outcome that an investor seeks to achieve. Convertible securities are often viewed as a single asset class but this overlooks the complexity and diversity of the asset class. Convertibles have varying degrees of equity and fixed income sensitivity, and these attributes can change over time. Active management is essential.

Indeed, it is not simply the convertibles that make a strategy work, but how convertibles are managed to achieve a particular investment objective. We have long used convertibles within lower-volatility equity allocations for institutional clients who seek equity participation with less exposure to short-term downside volatility. In these instances, the fixed income characteristics of the convertible can provide resilience during equity downturns. We also use convertibles within enhanced fixed income strategies. These strategies complement a traditional investment-grade fixed income portfolio, as a high-yield allocation could. Additionally, for decades, we have utilised convertibles within alternative strategies, such as convertible arbitrage.

Q. What factors drive convertible issuance?

The convertible structure has long been a vehicle of choice for innovative growth companies to access the capital markets. Issuance blossomed during the 1980s when banks were capital constrained. Today, the convertible market is a truly global asset class, providing access to capital for companies around the world.

We see continued opportunities for convertible issuers and investors alike. Convertible issuance is about capital market access, and capital market access is closely tied to economic growth. Moreover, because convertibles provide the opportunity for equity upside, they can be offered with lower coupons than non-convertible debt, which makes the structure attractive for issuers in a rising rate environment.

John P. Calamos, Sr., founded Calamos Investments in 1977. With origins as an institutional convertible bond manager, the firm has grown into a global asset management firm with major institutional and individual clients around the world. With 47 years of investment industry experience, John pioneered innovative convertible strategies to achieve superior risk-adjusted performance over full market cycles. He is often quoted as an authority on risk-managed investment strategies, markets and the economy, and has authored two books on convertible securities.

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