## Convertible and High Income Fund (CHY) Commentary

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#### **FUND**

- » CHY is an enhanced fixed income offering that seeks to provide an attractive monthly distribution, with a secondary objective of capital appreciation.
- » Invests in: high yield and convertible securities, issued primarily by U.S. companies.

Market Price	\$12.15
NAV	\$13.10
Current Annualized Distribution Rate1	8.40%

#### ASSET ALLOCATION

Corporate Bonds	65.9%
Convertible Bonds	11.8
Convertible Preferred Stock	10.0
Synthetic Convertibles	8.1
Sovereign Bonds	0.9
Common Stock	0.9
US Government Securities	0.5
Cash and Receivables/Payables	1.9

# Current Annualized Distribution Rate is the Fund's distribution, expressed as an annualized percentage of the Fund's current market price per share. Under the Fund's level rate distribution policy, distributions paid to common shareholders typically include net investment income and net realized short-term capital gains. When the net investment income and net realized short-term capital gains are not sufficient, a portion of the level rate distribution will be a return of capital. In additional a limited number of distributions per calendar year may include net realized long-term capital gains. Distributions are subject to re-characterization for tax purposes after the end of the fiscal year.

The portfolio is actively managed. Holdings and weightings are subject to change at any time without notice. Asset Allocation Weightings are calculated as a percentage of Managed Assets. The tables exclude cash or cash equivalents, any government / sovereign bonds or broad based index hedging securities the portfolio may hold.

#### Overview

In spite of the Federal Reserve's declaration of QE3, Treasury yields changed only slightly during the fourth quarter. However, there was volatility within the period as the 10-year fluctuated between 1.58% and 1.86%, settling at 1.78% at quarter end. Otherwise, a general price improvement occurred in most segments. Shorter-term Treasurys retreated slightly, and higher yielding corporate bonds outperformed the aggregate bond market as buyers continued to take on risk for income. Although volatile, prices of 10-year European sovereign bonds improved during the quarter due to intervention from the European Central Bank. Emerging market bonds rallied, sparked by their own monetary policy easing, as well as demand for assets in nations with lower debts and higher growth rates. During the fourth quarter, the fund gained 2.44% on an NAV basis and dropped by 1.39% on a market price basis. The Credit Suisse High Yield Index returned 3.15% during the quarter.

Distributions Remained Competitive. The fund maintained a monthly distribution of \$0.085 throughout the quarter. The fund's current annualized distribution rate was 8.40% of market price as of December 31, 2012. We believe that the fund's monthly distributions are very competitive, given that very low interest rates and yields remain the norm throughout much of the global marketplace. For example, the 10-year U.S. Treasury bond yield was 1.78% and the 30-year U.S. Treasury bond yield was 2.95% as of December 31, 2012.\*

As do all five Calamos closed-end funds, this fund has adopted a level distribution policy.

Our policy is to pay a distribution reflective of the fund's past results and projected earnings potential through income as well as capital gains. We focus on delivering an attractive monthly distribution, while maintaining a long-term focus on risk management.

2.44	14.76	10.77	7.40	8.94
-1.39% On NAV	13.99%	10.37%	8.11%	7.57%
On Market Price				
QUARTER	RETURN AS OF 12/31/ 1-YEAR	12 3-YEAR	5-YEAR	SINCE INCEPTION (05/28/03)

Source: State Street Corporation

Returns of less than 12 months are cumulative returns. Returns for periods greater than 12 months are annualized returns. Total return measures net investment income and capital gain or loss from portfolio investments as an annualized average.

Performance data quoted represents past performance, which is no quarantee of future results. Current performance may be lower or higher than the performance quoted. Portfolios are managed according to their respective strategies which may differ significantly in terms of security holdings, industry weightings, and asset allocation from those of the benchmark(s). Portfolio performance, characteristics and volatility may differ from the benchmark(s) shown.

You can purchase or sell common shares daily. Like any other stock, market price will fluctuate with the market. Upon sale, your shares may have a market price that is above or below net asset value and may be worth more or less than your original investment. Shares of closed-end funds frequently trade at a market price that is below their net asset value.

Please refer to back page for important notes.

\*Source: U.S. Treasury

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#### **Performance Review**

The fund benefited from a slight overweight to the industrials sector during the fourth quarter. However, an underweight position did not allow us to participate in a meaningful way in the improvements in the telecommunication services sector, as this area continued to measure high performance during the quarter. We have generally been less attracted to this sector as we find many of the businesses to be relatively less dynamic and more cyclical in nature. We continue to find more attractive opportunities elsewhere and therefore remain underweight.

Security selection in the information technology sector hindered performance for the quarter. Our securities in the materials sector also underperformed, especially with respect to gold mining. Although the fund had benefited from holdings in the sector during the third quarter as a result of rising oil and natural gas prices, these raw commodities declined in the fourth quarter, and our convertible securities with exposure to these areas were impacted accordingly. Holdings in the consumer staples sector contributed to returns, driven by strong performance in the packaged foods and meats industry in particular. Security selection in the consumer discretionary sector also helped bolster quarterly returns, as our names within apparel and cruise lines performed well.

From a quality standpoint, our overall credit tier weighting relative to the Credit Suisse High Yield Index was a drag on performance, as lower-rated issues performed well for the quarter. We focus on higher-quality names and have an overweight to the BBB and BB segments of the market. In our enhanced fixed income approach, we carefully balance yield considerations with potential risks. As we have stated, our

view is that a higher income stream over the short term would not be sufficient compensation for a default.

In pursuit of income-oriented total return, the fund employs a dynamic approach to asset allocation, including high yield securities and convertible securities. Over the long term, we believe this is an important differentiator in our ability to provide competitive distributions and total return. In our view, this multi-asset class approach also enhances our ability to manage the risk/reward characteristics of the portfolio through diversification decisions. During the period, the fund's investments in convertible securities impaired relative performance, as these asset class underperformed high yield debt.

#### **Positioning**

From a sector standpoint, we are positioned with overweight exposure to the information technology, health care and energy sectors. In health care, we continue to favor companies in the biotechnology and pharmaceutical industries. We also tend to prefer those companies furthest removed from government regulation, such as those in the health care equipment and technology industries. In the information technology sector, we believe there continues to be a desire among consumers to have access to information anywhere at any time, as well as increased spending among companies to help boost productivity.

The fund maintains underweight exposure to the consumer discretionary, financials and telecommunication services sectors. Fundamentally, we believe the portfolio is positioned properly given the macroeconomic uncertainty that remains.

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#### Leverage

We believe that this is an environment that is conducive to the prudent use of leverage as a means of enhancing total return and supporting the fund's distribution rate. Over the quarter, our use of leverage enhanced returns. We were able to borrow at rates we believe were attractive, and invested the proceeds to achieve a greater return than the cost of leverage. underweight the most speculative CCC credit tier. We are finding opportunities where we see strong or improving corporate balance sheets, growing cash flows and yields that still offer a real return to investors.

#### Conclusion

We maintain our outlook for slow but sustained economic growth in the U.S. and globally heading into 2013, yet we are becoming more optimistic about market opportunities.

In the U.S., we have seen improvements in the housing market, better-than-expected data from retail sales and industrial production, improvements within the financial sector and slow but marginally improving job data. Additionally, monetary policy remains stimulative to risk assets and the cost of capital remains incredibly low – much lower than returns on capital for most corporations. U.S. corporate earnings have been solid, corporate balance sheets are robust and consumers have been resilient on the whole.

Despite lingering macro concerns, we believe markets are returning to more of a bottom-up focus, with greater distinctions being made on fundamentals. The Federal Reserve's recent meeting minutes indicated a shift to an emphasis on the unemployment rate rather than inflation, and interest rates will remain low for the foreseeable future. At current credit spread levels, we believe that returns are much more likely to come from a bottom-up focus than from a significant further narrowing of credit spreads.

Our largest overweight from a credit perspective is in the BB area of the market, while we continue to be significantly

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#### Important Fund Information

Important Fund information
The goal of the level-rate distribution policy is to provide investors a predictable, though not assured, level of cash flow. Monthly distributions paid may include net investment income, net realized short-term capital gains and, if necessary, return of capital. Maintenance of this policy may increase transaction and tax costs associated with the fund.

Leverage creates risks which may adversely affect return, including the likelihood of greater volatility of net asset value and market price of common shares; and fluctuations in the variable rates of the leverage financing. The ratio is the percent of total managed assets.

The fund may invest up to 25% of its assets in foreign securities and invest in an array of security types and market-cap sizes, each of which has a unique risk profile. As a result of political or economic instability in foreign countries, there can be special risks associated with investing in foreign securities. These include fluctuations in currency exchange rates, increased price volatility, and difficulty obtaining information.

There are certain risks associated with an investment in a convertible bond such as default risk—that the company issuing a convertible security may be unable to repay principal and interest—and interest rate risk—that the convertible may decrease in value if interest rates increase.

Investments by the fund in lower-rated securities involve substantial risk of loss and present greater risks than investments in higher-rated securities, including less liquidity

and increased price sensitivity to changing interest rates and to a deteriorating economic environment.

Fixed-income securities are subject to interest rate risk; as interest rates go up, the value of debt securities in the fund's portfolio generally will decline.

The fund may invest in derivative securities, including options. The use of derivatives presents risks different from, and possibly greater than, the risks associated with investing directly in traditional securities. There is no assurance that any derivative strategy used by the fund will succeed. One of the risks associated with purchasing an option is that the fund pays a premium whether or not the option is exercised.

fund pays a premium whether or not the option is exercised. The fund may seek to purchase index put options to help reduce downside exposure however, the effectiveness of the fund's index option-based risk management strategy may be reduced if the fund's equity portfolio does not correlate to the performance of the underlying option positions. The fund also risks losing all or part of the cash paid for purchasing index options. Unusual market conditions or lack of a ready market of any particular option at a specific time may reduce the effectiveness of the fund's option strategies, and for these and other reasons the fund's option strategies may not reduce the fund's volatility to the extent desired. From time to time, the fund may reduce its holdings of put options, resulting in an increased exposure to a market decline. Please refer to the fund's prospectus for a full description of risks.

The Credit Suisse High Yield Index is an unmanaged index of high yield debt securities. Unmanaged index returns

assume reinvestment of any and all distributions and, unlike fund returns, do not reflect fees, expenses or sales charges. Investors cannot invest directly in an index.

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