

Market Review and Outlook

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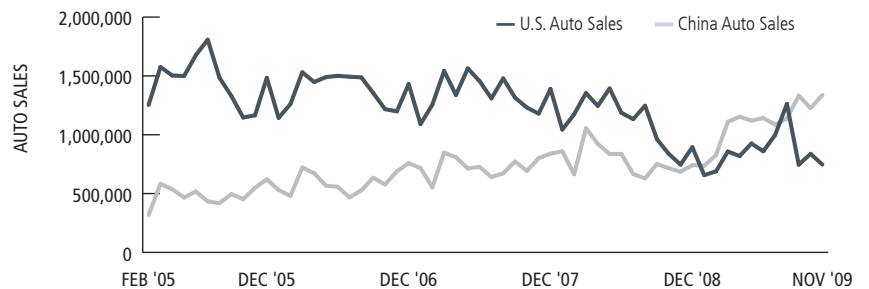
A great deal has been written about the potential opportunity of emerging markets as an asset class. At Calamos, we believe emerging markets will drive the global economy in the decades to come.

Emerging Markets, Developing Opportunities

According to The Economist,* GDP growth in China for 2010 is expected to be 8.6%, 6.3% for India and 3.8% for Brazil. This growth outpaces the 2010 estimates for key developed markets: the United States is expected to grow GDP at 2.7% and Japan at 1.5%. In the Euro area, GDP growth is forecast at only 1.2%.

Since the Asian crisis of 1997, there have been continued improvements in the fiscal positions of many emerging economies—improvements which we believe enhance the prospects for more sustainable growth. Dramatic increases in foreign currency reserves, less debt, lower inflation, smaller budget deficits and higher GDP growth are among the factors contributing to a brighter fiscal picture. Compared to developed economies, emerging economies are on the right track.

Figure 1. In 2009, Auto Sales in China Topped the U.S.



Source: Bloomberg LP

*Estimates from www.economist.com, as of December 30, 2009.

Demographic trends are another important factor in our favorable outlook for emerging markets. Future population growth is expected to occur mainly in emerging economies, as populations in the developed economies continue to age. The number of people expected to enter the middle class in emerging economies has the potential to far outnumber the middle classes in developed economies. These trends are already influencing consumption patterns. In January 2009, there were more cars sold in China than in the U.S. for the first time ever (see Figure 1). And, in mid-2009, it was estimated that there were more Chinese Internet users than the entire population of the United States.

Economic Freedom and Wealth Creation

So, why is this good? We believe continued economic growth and a growing middle class can be powerful catalysts for advancing economic freedoms and democracy, which in turn has important implications for wealth creation. For developed and emerging markets alike, our view is that the most conducive environment for wealth creation is one in which economic freedoms and principles are in place and encouraged. These include:

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Past performance is no guarantee of future results. Investing involves risk, including potential loss of principal. Diversification does not insure against market loss.

Not FDIC Insured	May Lose Value
No Bank Guarantee	

- > Business freedoms (ease of starting a business, obtaining licenses, and dissolving a business)
- > Trade freedom (free trade)
- > Fiscal freedom (tax rates)
- > Government size and spending
- > Monetary freedom (price stability and inflation)
- > Investment freedom (amount of foreign investment allowed)
- > Financial freedom (are the banks controlled by the government)
- > Property rights
- > Freedom from corruption
- > Labor freedom (labor market flexibility)

There is a positive correlation between how economically free a country is and its per capita GDP, or standard of living (see Figure 2). In other words, the more economically free a country is, the more wealth creation can potentially take place, not only for the people of that country but also for investors like us.

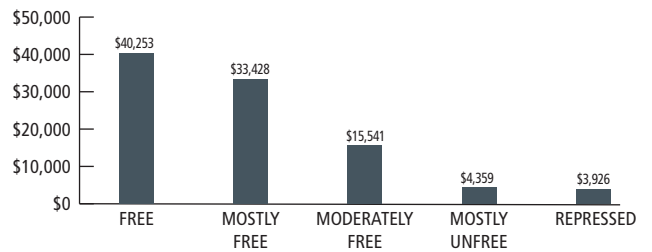
We believe both developed markets and emerging markets will reap benefits from changing demographics in emerging markets. As economic freedoms become more entrenched and standards of living rise, we expect emerging markets will become more consumption-driven and less reliant on exports for growth. This will provide opportunities for developed countries to increase exports to meet increased consumption demands. Emerging markets can thus potentially become a source of growth for developed economies—and a way to help developed economies pay down their debts.

Chile: A Case Study

While we do not presently have direct exposure in Chile, that country exemplifies the supportive economic conditions we favor. Recently, Investors Business Daily (IBD) published an article “How Chile Got Rich” (December 4, 2009), that speaks to the power of economic freedoms. Chile is expected to gain entry into the Organization for Economic Co-operation and Development (OECD), a group that includes 30 countries committed to democracy and the market economy. The OECD is dominated by leading developed nations. Entry into OECD represents a significant accomplishment for Chile, which would be the first South American country to join. IBD notes, “in a symbolic way, [Chile’s] OECD membership card seals its exit from the ranks of the Third World to the First.”

So how did the star of Latin America increase its per capita GDP from \$1,300 thirty years ago to \$15,000 currently? The answer: Chile has embraced the principles of economic freedom. According to the 2009 Index of Economic Freedom,

Figure 2. Correlations Between Economic Freedom and Living Standards



Source: 2009 Index of Economic Freedom (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2009) at <http://www.heritage.org/index>; International Monetary Fund, World Economic Outlook database, April 2007, at <http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/index.aspx>.

Chile is ranked as the eleventh most free country in the world, right behind the United States, Canada, Denmark, Switzerland and the United Kingdom, among others. Over the years, Chile has emphasized free trade, “and has signed no fewer than 20 trade pacts with 56 countries, giving its 19 million citizens access to more than 3 billion customers worldwide,” according to IBD. Other reforms include fiscal freedoms (tax cuts), a small and fiscally sound government, strong protection of property rights, and business freedoms (reduction of red tape). This consistent focus on economic freedoms and principles has paid dividends—in the form of wealth creation—for the Chilean people.

Short-term valuations vs. long-term opportunity

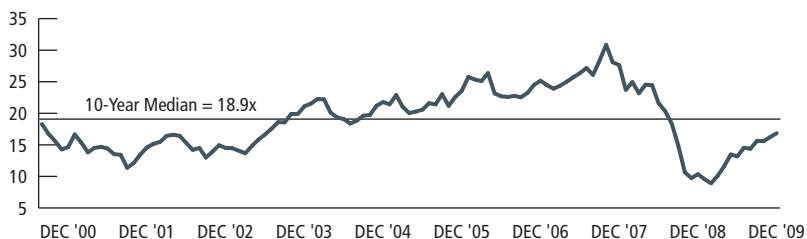
After getting pummeled in 2008, the MSCI Emerging Markets Index rose more than 79% in 2009. This gain has prompted some to question if now is the time to invest in emerging markets. Our view is that emerging market stocks are fairly valued overall (see Figure 3); but we would not be surprised to see a little bit of a pullback for the asset class as a whole, given the strong recent run-up. Even so, we believe the current environment offers considerable opportunities for selective, long-term investors and we continue to find attractive investments. We expect the secular trends in emerging markets to play out over many years; and we believe it is these trends, not short-term valuations, that make the case for including emerging markets in long-term asset allocations.

Our Approach

As Chile illustrates, economic freedoms and principles can provide the best backdrop for wealth creation. This is why we emphasize these principles in our investment process. We believe that by embracing these principles, many emerging market countries will not be “emerging” forever.

Figure 3. Valuations in Emerging Markets Rebounded in 2009

MSCI Emerging Markets, Price-to-Earnings Ratios on 5-Year Normalized EPS*



Source: The Leuthold Group. *Each data point represents the price level of the index, divided by the average earnings per share of the companies within the index for the preceding five years.

Most emerging market countries are not as economically free as some of the more developed countries. However, it is the moves at the margin that we look for, both good and bad, when we assess a country's attractiveness. India and Brazil are two countries where we have made investments, encouraged by similar trends as we've observed in Chile. For example, the Indian elections of 2009 were a significant positive as it appears that the new coalition government will not have to partner with the communists and the small anti-growth parties. As a result, we believe that this coalition government is better positioned to advance economic freedoms and principles in India. Meanwhile, rather than relying exclusively on government spending, Brazil cut tax rates in 2009—in our mind, this is a much better way to stimulate the economy.

Emerging markets have demonstrated high volatility, and are subject to increased political and economic risks. We expect this to continue. Nonetheless, we believe it is possible to invest in emerging markets in a risk-managed way. First, we invest in different asset classes, with varying risk/reward characteristics. We also invest in companies based in developed markets that serve or supply emerging markets as an additional way to get emerging market exposure. Second, we have historically avoided the "frontier markets," due to our focus on economic freedoms, transparency and availability of information. Third, we feel our thematic approach (for example, investing in companies positioned to benefit from demographic shifts) provides a tailwind for achieving growth, even in difficult markets. Fourth, we seek to manage risk by utilizing a highly selective approach that focuses on companies with healthy balance sheets, good cash flows and strong management teams. Finally, we focus on maintaining thorough diversification among countries, sectors and securities.

All portfolios are actively managed. Holdings, sectors and weightings are subject to change daily. Country weightings are provided for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the countries mentioned. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report. The country weightings discussed do not represent the account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings.

As a result of political or economic instability in foreign countries, there can be special risks associated with investing in foreign securities, including fluctuations in currency exchange rates, increased price volatility and difficulty obtaining information. These risks may be greater for investments issued by companies in emerging markets; these may present additional risk due to the potential for greater economic and political instability in less developed countries.

MSCI Emerging Markets Index—is a free float adjusted market capitalization index, including 22 emerging markets. Unmanaged index returns assume reinvestment of any and all distributions and do not reflect fees, expenses or sales charges. Investors cannot invest directly in an index.

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