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A Time to Rethink International Allocation

We believe a changing global regime will result in a redistribution of wealth toward developing nations. It appears that investors' allocations have shifted toward international stocks, international small caps and emerging markets. However, investors have not taken as quickly to international growth. We believe now may be the time.

We believe that as investors look further out in assessing business value and opportunities for companies going forward, the quality of that company's growth will be of utmost importance, which we believe should work well for the stocks of growth businesses. The economic landscape still appears volatile and less predictable than in the recent past, but we believe that companies with better balance sheets and strong management will be able to take advantage of their competitive positioning. We still see many growth companies priced attractively relative to the free cash flows they generate in today's market environment.

Given what we believe is the promising trend in international growth stocks, investors' allocation toward the category appears

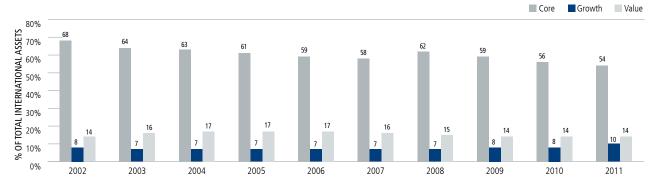
underrepresented. Figure 1, based on Morningstar data, shows that 10% of international equity assets were in international growth at the end of 2011. That is about the same as 10 years earlier and has stayed below the international value allocation since 2002. We believe investors may be better served with a higher or new allocation toward international growth to better take advantage of the more promising areas of this asset class.

The Trend Toward Growth over Value

From the 1970s through the mid-1990s, growth and value investing* styles rotated into and out of favor every few years. However, over the past decade or so, periods of one style outperforming the other have lasted for longer time periods. In

FIGURE 1. GROWTH UNDERREPRESENTED





Data source: Morningstar

The percentages are based on Morningstar U.S. mutual fund category assets in the International Stock broad asset class. Core represents the combined assets of World Stock and Foreign Large Blend categories, Growth represents the combined assets of Foreign Large Growth and Foreign Small/Mid Growth categories, and Value represents Foreign Large Value and Foreign Small/Mid Value categories. International Stock regional and emerging market categories, which represented a combined 22% of International Stock assets, are not included, so percentages for each year do not add up to 100%.

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*The growth style of investing focuses on companies and industries with higher sales and profit growth than the economy. Value investing focuses on companies that appear to be priced significantly lower than their intrinsic values.

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the mid-late 1990s, growth beat value due to the tremendous performance in growth sectors such as telecom, media and technology. Investors were more than willing to pay up for the growth of companies that touted innovative products and "new world" visions, and the equity bubble was created.

When the bubble finally burst, the momentum shifted with a vengeance. The plunging market exposed excessive prices of growth stocks and the willingness by investors to previously finance marginal companies. Growth's attractiveness faded as many earnings growth claims failed to materialize. Poor investment results from many growth companies convinced most investors to shun growth stocks altogether, switching instead to value stocks.

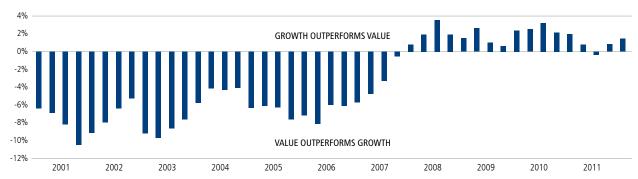
Value has convincingly beaten growth for most of this decade. While many have discussed the length of value's outperformance this decade—the longest period of one style outperforming the other within the past 30 years—few seem to have paid attention to the magnitude of this outperformance (see Figure 2).

From 2003 to 2006, as we first came out of a recession and then the economy was experiencing strong growth, investors were happy to invest in companies that in many ways had earnings that were more cyclical and in many cases of lower quality. Following the recession of the early 2000s, investors favored cyclical stocks and the low quality stocks that got hit hardest during the recession.

In the current environment, we believe investors are likely to seek out companies that have more stable and visible earnings growth, and their ability to grow is not as contingent upon access to easy credit, but instead on their own strong balance sheets and the ability to fund their own growth through cash flow. We believe this stability can be found in those securities that provide attractive secular growth opportunities, namely growth equities, both internationally and in the U.S.

FIGURE 2. GROWTH OPPORTUNITIES

3-YEAR ROLLING RETURNS: MSCI EAFE GROWTH INDEX MINUS MSCI EAFE VALUE INDEX, DECEMBER 2000 THROUGH DECEMBER 2011



Source: Morningstar

Performance data quoted represents past performance, which is no guarantee of future results. Current performance may be lower or higher than the performance quoted.

Index Definitions

The MSCI EAFE® Growth Index measures developed market growth equity performance (excluding the U.S. and Canada). The MSCI EAFE® Index measures developed market equity performance (excluding the U.S. and Canada). Lipper International Multi Cap Growth Funds invest in a variety of market capitalization ranges without concentrating 75% of their equity assets in any one market capitalization range over an extended period of time. International multi-cap growth funds typically have an above-average price-to-cash flow ratio, price-to-book ratio, and three-year sales-per-share growth value. Morningstar Foreign Large Growth funds focus on high-priced growth stocks, mainly outside of the United States. Most of these portfolios divide their assets among a dozen or more developed markets, including Japan, Britain, France, and Germany. These portfolios primarily invest in stocks that have market caps in the top 70% of each economically integrated market (such as Europe or Asia ex-Japan). Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields). These portfolios typically will have less than 20% of assets invested in U.S. stocks.

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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