Economic Review & Outlook

CALAMOS®

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IN THIS COMMENTARY

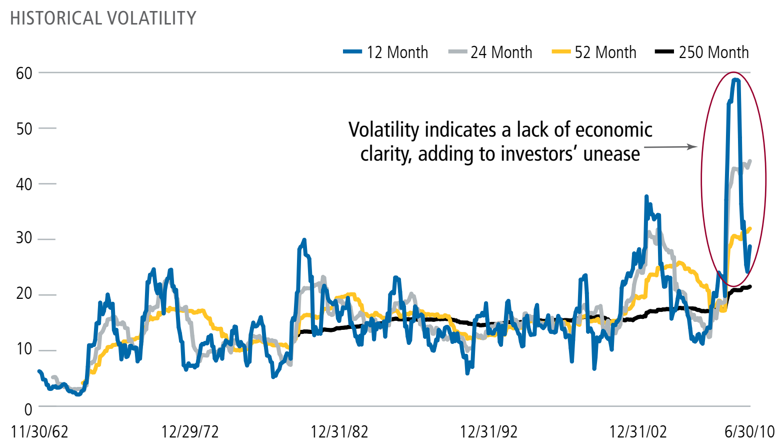
- **Global equity and bond markets reflect a high degree of apprehension.**
- **We remain "short-term bullish, long-term scared."** Corporate America is in good shape, and emerging markets continue to show signs of economic progress and strength. High private and public debt levels in developed nations remain of paramount concern to us. Stimulus spending and easy monetary policy cannot support the global economy forever. A slow growth environment is likely until the private sector gets motivated again.
- **A case can be made for a bull or bear market over the next decade.** A bear market scenario unfolds if debt in developed markets is not addressed, emerging markets keep their currencies artificially low. A bull market scenario would be predicated on correcting global trade imbalances (increased exports to emerging markets), and developed countries curtailing their spending.
- **We believe there are many opportunities in the global economy, particularly in quality growth companies with global brands and know-how. Growth company valuations are very compelling.**
- **We are managing risk in a variety of ways**—emphasizing quality balance sheets, purchasing protective puts and maintaining our disciplined approach to valuations.

Investment management can be a gloomy career. We spend much of our time trying to figure out what can go wrong with a company, industry or economy. Our focus is often on the risks and potential pitfalls in our investment thesis and on the cyclical and secular changes that produce shocks to businesses, industries or economies. At Calamos, we believe that our returns are a by-product of risk management. So, looking for the bad news is an essential part of our job. As long as there are risks, we will always be focused on trying to manage them.

The recent markets have given us plenty to think about. We have included a few charts that illustrate the recent unease and confusion of the markets. These charts tell the story of an uncertain economic outlook with unclear prospects for financial assets. A lack of conviction and transparency make it difficult for businesses to risk capital and for investors to stay with a plan. Confidence is fragile and the fear of an unsound financial system hangs over the markets.

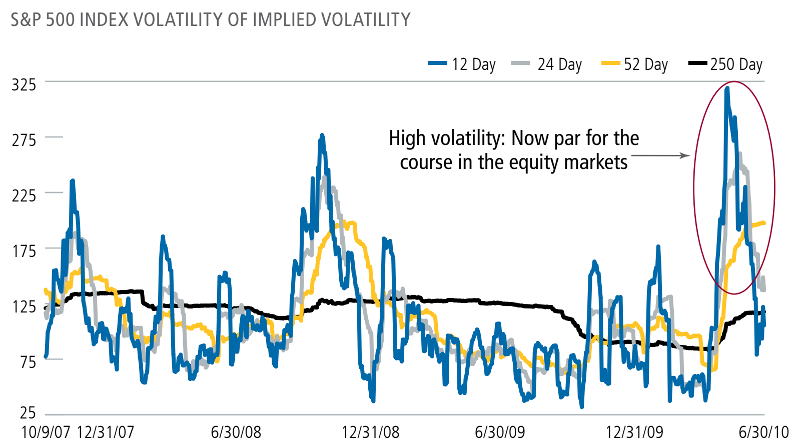
Figure 1 shows the extreme volatility in the government bond markets. We've chosen the 10-year Treasury Bond, but all maturities looked this volatile. We lately have been in uncharted waters in regard to Treasury market volatility. With yields approaching zero and negative real returns for a large portion of the curve, "risk-free" assets sure look risky to us. Since risk-free assets are volatile and may lock you into negative real returns for a long time, it may be time to increase risk-asset exposure instead. Cash is the exception, because you can roll cash into higher-yielding points along the curve if the opportunity presents itself.

FIGURE 1. 10-YEAR TREASURY BOND REALIZED VOLATILITY



Source: Bloomberg

FIGURE 2. S&P 500 DAILY VOLATILITY SINCE MARKET TOP (10/9/07)



Source: Bloomberg

We all know that the equity markets have been volatile, but Figure 2 brings the point home. Figure 2 shows the "volatility of the volatility" in the U.S. equity market, as represented by the S&P 500 Index. It indicates near-extreme levels of confusion and a lack of conviction—levels often representative of a market bottom, not a market top. Although these extreme levels of volatility don't appear to be good predictors of future direction, they do highlight chaos in the economic and business outlook.

Many factors have contributed to the recent spike in volatility. Mounting sovereign risk concerns, proposed financial regulation, geopolitical concerns relating to North Korea, and Spain's bank bailouts have added to the unease that permeates risk assets. Meanwhile, attempts to stop the debt crisis in the G3 (the United States, Japan and the euro-zone) resemble attempts to clean up the BP oil spill—just spread around the damage and add some dispersements. Even so, the leak (deficit spending) continues!

The Asian economies are fighting asset bubble and inflation concerns with higher interest rates, currency appreciation, increased reserve requirements and tighter credit. In a show of strength and co-operation with the G20, China allowed the yuan to appreciate further and claims to have broken the U.S. dollar peg. These moves are also an attempt by China to reduce the gap between its rich and poor as worker strikes and discontent have increased. China has been the low-cost producer to the world, and has been able to accomplish this by paying its workers low wages. The appreciation of the yuan may indicate that this old model is changing. A shift, although slow, would be good news for the new world economy and a necessary change for global economic stabilization.

The monetary policies of the emerging Asia economies are completely different than those of the G3—emerging Asia still has the fiscal flexibility to maneuver, if necessary. But global equity markets love liquidity and the Asian economies currently are reining liquidity in. At the same time, China's industrial production indicator has dropped to levels suggestive of a slowdown in its manufacturing sector. We believe that slowing growth in Asia and a European economy balancing on the ledge of recession make the potential resurgence of the U.S. economy a more daunting challenge—especially as the training wheels of housing stimulus, full fiscal stimulus and financial asset purchases come off.

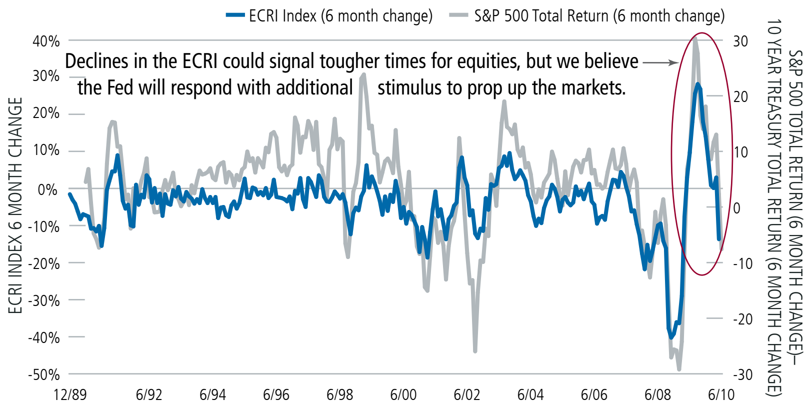
OUR OUTLOOK

In "Signs of Life and Hope for a New Recovery" (July 2009), we said we believed the economic recovery will be uneven and at times we won't know if we are in a recession or not. We expect that future business cycles will be shorter than those of the past 25 years. High private and public debt levels, combined with a very competitive global environment, weak demographic trends and heavy government taxation, regulation and debt monetization via monetary debasement, lead us to conclude wealth creation will not be easy and business planning more difficult. We have been very vocal about our concerns regarding the long-term sustainability of the G3 economies, and therefore of the financial markets. We have operated under the "short-term bullish and long-term scared" banner for a number of quarters.

Looking to the nearer-term, we expect a challenging economic backdrop in the second half of 2010 as the reflation recovery decelerates and fiscal conditions in the developed world deteriorate further. The ECRI Weekly Leading Index has declined sharply, suggesting an economic slowdown and potential headwinds for the equity markets (Figure 3).

While this indication of a decelerating recovery runs counter to our "short-term bullish" position, we believe the Fed would respond to a significant slowdown with additional stimulus, and that this would provide near-term support to

FIGURE 3. SHORT-TERM BULLISH IN QUESTION?



Source: Bloomberg. The ECRI Weekly Leading Index is a measure of leading economic indicators.

the equity markets. Moreover, we believe the prospects are sound for many companies, providing potentially brighter prospects for equities. U.S. corporate profits are still in very good shape and profit margins are above the long-term average. Capital spending is strong and, at some point, we would expect employment to improve and follow the strong spending cycle. Monetary policy will remain the main stimulus policy tool employed to keep debt deflation from taking hold in the U.S. and Europe. The European Central Bank (ECB) has restarted quantitative easing and may be in the mood to purchase as much debt as necessary to stabilize European sovereign risks in the short term. Financial market participants are well aware of these issues, and valuations again reflect these concerns.

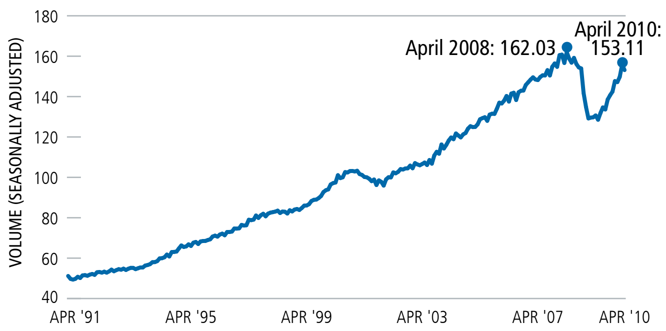
The global expansion appears to be slowing, but we have had a remarkable recovery in world trade volume (Figure 4). The recovery has brought world trade volume only slightly behind the peak reached in early 2008. ***This resurgence testifies to the strength in the emerging economies and their potential to lift the world economies.***

Another positive we see is that the U.S. electorate appears to be very concerned about the debt and deficit spending path that the U.S. is on. The November elections may be a game changer. The euro-zone and most of the G20 have rejected the Obama Administration's call for further deficit spending to stimulate growth. Confidence in government as the solution seems to be waning around the globe, as the welfare-state economies move ever closer to fiscal demise.

With the monetary tool as the weapon of choice against the debt deleveraging cycle, we should expect a full-scale effort to reflate assets again. We anticipate further expansion of the Fed's and ECB's balance sheets, as they purchase the debt of troubled countries and states as well as other troubled assets. The good news is that consumer inflation rates are not a concern, and excess global productive capacity should ensure against consumer inflation risks in the immediate future. The "don't fight the Fed" agenda may still rule the day in the stock and bond markets over the near term, while building a sound foundation for a new secular bull market will have to wait.

FIGURE 4. WORLD TRADE VOLUME

JAN 1991–APR 2010



Source: Netherland Bureau for Economic Analysis

WHY WE STAY "LONG-TERM SCARED"

"Long-term scared" kicks in when we consider how the out-of-sight spending and monetary stimulus could come home to roost. That said, a bad outcome is not inevitable, but a better one requires a change in fiscal policy or global rebalancing.

It is normal for private debt to climb during prosperity. It is also normal for recessions to occur. During past recessions, debt levels would be cleansed and the economy could begin anew with lower debt. Over the past 25 years or more, however, the debt cleansing phase of the business cycle has been stopped in its tracks. The G3 has turned to government deficit spending to re-stimulate their economies. The U.S. has also relied on the dollar's status as the world's reserve currency to inject liquidity into the markets.

Despite the rhetoric and policy intervention over recent years, the debt deleveraging cycle has not yet begun. In fact, the total debt level now in the global markets is higher than when the financial crisis began! How much debt needs to be restructured? At last count, the U.S. economy needs to purge $10 trillion in debt. The ***fiscal debt deterioration is secular not cyclical*** when 65% of government spending is mandated and expected to grow to 72% in a few years. Also, with almost 48% of U.S. citizens paying no federal income taxes—and only 10% shouldering more than three-quarters of the burden—a reduction of spending becomes a less likely proposition. The voting block favors those receiving government benefits over the minority that pays most of the taxes.

Governments have a difficult time stepping aside if it means that markets and asset values will collapse—even though government involvement has historically prolonged financial crisis and adversely influenced economies more than the "tough love" approach has. But, we do not believe the cleansing can be forestalled forever. When the next debt cleansing does come, we believe it will be forced upon the global economy with a vengeance unless the fiscal policy path is reversed soon.

> The recovery has brought world trade volume only slightly behind the peak reached in early 2008. This resurgence testifies to the strength in the emerging economies and their potential to lift the world economies.

Balance sheet recessions don't end until the balance sheets of the crisis economies are completely repaired. One common sign of a balance-sheet and leveraged-led crisis is that even zero or near-zero interest rates do not stimulate spending and borrowing. Does that sound familiar?

BRACED FOR BUBBLES

The financial markets are concerned that the next stage in the credit crisis will be the sovereign debt crisis, municipal debt crisis and new asset bubbles.

The purchase of assets and further quantitative easing by monetary authorities will likely cause future asset bubbles; and unfortunately, the large amount of debt in the global economy will be destabilizing once again. We believe the next asset bubble will occur because of too much money and easy credit at low costs. It may be early for asset bubbles to occur in the United States or Europe as credit is not expanding and the velocity of money is low. Emerging markets equity, emerging markets debt, Asian real estate and global commodities are more probable candidates, as the credit and monetary picture in most emerging markets is a mirror opposite of the G3.

History has taught us that the clearing of markets and the creation of a new sustainable recovery is predicated on two factors. First, bubble asset prices must fall to values that will bring in new buyers; and second, excessive debt must be purged. In this case, the bubbles and excessive debt are in housing, banks, and governments.

Today's misallocation of resources is the result of price supports, buyers' incentives, and no reduction in leverage. This misallocation complicates transparency and proper capital risk pricing. The Fed's balance sheet expansion is in full swing again, with purchases of asset-backed securities, mortgage-backed securities and other debt. The ECB is starting another round of expansion. According to a recent McKinsey Global Institute* study of past debt crises, debt deleveraging takes six to seven years and starts two years after the financial crisis. On average, the deleveraging results with a 25% reduction in debt to GDP. We are trying in vain to stop this cycle from taking hold but at some point the economic reality will emerge and a sustained economic slowdown will take hold. Prices of the bubble assets need to be allowed to fall and adjust to the level that supports them based on economics and societies' earning power.

* Charles Roxburgh, Susan Lund, Tony Wimmer, Eric Amar, Charles Atkins, Ju-Hon Kwek, Richard Dobbs, James Manyika, "Debt and deleveraging: The global credit bubble and its economic consequences," http://www.mckinsey.com/mgi/publications/debt_and_deleveraging/index.asp (January, 2010)

HOW COULD THE CYCLE PLAY OUT?

Even while we remain highly concerned about bubbles and debt, we do not believe a doom-and-gloom scenario is inevitable. When we consider what the years ahead might hold, there's a case to be made for either a bear market or a secular bull market, which we'll outline here. You can judge for yourself the more likely outcome. As investment managers, we operate with both scenarios as possibilities as we manage capital in this new world economy. On an ongoing basis, our team is interpreting data and the changing landscape to determine the implications for both the bull and bear scenario.

THE CASE FOR A BEAR MARKET

The Obama administration has significantly reduced spending for NASA programs, but we say keep funding NASA because our blue planet needs more consumers to soak up the excess global capacity and government bond issuance in the coming years. Maybe we can find an underserved planet that can help close the output gap while all of us on Earth compete for export business, weakening our currencies to get a relative advantage.

All kidding aside, our bear scenario plays out like this: The debt load in the developed world stifles growth as high taxes and government spending weigh heavy on the private sector. Job creation is next to nothing, and youth are unemployed and angry. The welfare state is breaking: Promises made by dead politicians about Social Security and Medicare cannot be kept. State and local government pensions are restructured to offset large funding gaps. As a result, living standards decline for many in the developed world.

Concerns about the U.S. government debt burden, constant refunding needs, and a smaller role for the U.S. dollar in the reserve currency basket combine to cause a sharp rise in yields and a funding crisis for the government. Inflation takes hold as the money stimulus continues because the weak credit demand cannot be restarted. Debt monetization accelerates in an attempt to reduce the real burden on the borrowers. Consumers act in their own best interest and move to repair balance sheets by avoiding credit and increasing savings.

Still too dependent on export growth to developed nations, emerging markets fall into recession and debt as aggressive stimulus spending starts to accelerate again. At the same time, the emerging markets try in vain to keep their currencies from appreciating relative to the developed world and usher in higher inflation and more worker unrest.

> The opportunity in growth stocks today is compelling. The growth premium is near a low and the quality of many companies' balance sheets continues to improve.

Meanwhile, G3 nations are all suffering from too much debt and slow growth. Welfare-state economies have now pushed themselves to the brink. Monetary debasement has run rampant as each nation has weakened its currency in futile attempts to make their export economies most competitive. Fiscal stimulus spending has not created growth, just more debt (think: Japan), so monetary stimulus has been in full swing in an attempt to stimulate growth, inflate out of debt and to support an export advantage through low-priced currency. The initial asset bubbles propped up by the expansion of the Fed and ECB balance sheets finally collapse to market-clearing values. The long-awaited debt deleveraging cycle is finally unleashed. Along with it comes a secular bear market in all risks assets. A generation passes before the merits of investing or debt financing are accepted again.

THE CASE FOR A BULL MARKET

The case for a cyclical bull market is easy—print more money and increase stimulus spending!

All growth appears fragile and subject to many competitive factors, any of which can change or even reverse. It can be more difficult to see how an optimistic scenario could play out because a new economy is often based on some technological breakthrough or creative destruction. The move from agriculture to the Industrial Age or from the Industrial Age to Information Age was not easy to time or predict. Similarly, we cannot predict precisely what would drive the next wave of secular bull market prosperity. But, it seems plausible that a move to a more economically balanced world—one driven by emerging markets' consumer and technology—could be the foundation of a secular bull market.

Our bull market case goes something like this: Global consumption increases as emerging nations' rapid growth and middle-class consumption provide significant export growth for the developed nations. Asset price recovery and increased savings help to repair balance sheets and to lessen state and local deficits. U.S. productivity remains high while new job formation ramps up as entrepreneurship and risk taking increases. Debt-to-GDP declines to 60% while consumer income levels outpace inflation, furthering debt reduction. The government sells assets and privatizes functions that can be handled by the private sector, easing debt strains even more. Corporate spending drives investment and job creation while housing markets start growing again. Politicians gain the will to means test and restructure Social Security, Medicare and all healthcare spending.

The high levels of U.S. productivity remain intact as the unemployment rate recedes to 5% and corporate profits and wages increase dramatically. Inflation is under 2% as global capacity is balanced with global demand; and the Fed and other central banks carefully remove the monetary stimulus from the economy.

BULL OR BEAR—WHICH WILL IT BE?

Our case for a bull market for the next decade depends upon the emerging economies becoming consumption driven and less focused on exports. Meanwhile, the developed world must become better at saving and debt reduction while increasing exports to correct the great imbalances. Admittedly, many things would need to go right for our bull market scenario to unfold. It would be a very unusual outcome given global debt levels, deficit spending and the political environment. But, we cannot and should not discount the possibility that major technological or structural changes could occur that would move the world into a new secular growth phase.

Most likely, reality falls somewhere between the bull and bear outcomes. We believe government actions will have a significant impact on which scenario plays out.

MEASURING THE PACE OF SUCCESS

To understand the opportunities and risks in the global economy, we will focus on changes in wages, salaries, savings, imports and exports, and consumer trends around the world. More specifically, we will monitor:

Developed nations

1) Real wages and salaries increase at a rate that outpaces credit expansion
2) Higher savings rate
3) Declining household debt as a percentage of income
4) Improved employment picture
5) Exports grow more quickly than imports

Emerging market nations

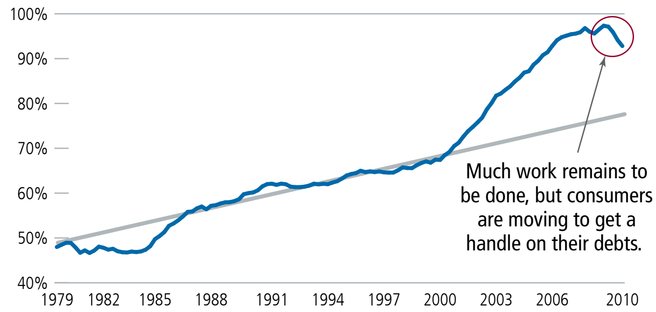
1) Real wages and salaries grow at a reasonable rate
2) Savings rate declines and consumption in the private sector increases
3) Imports grow more quickly than exports
4) Currency appreciates vs. developed nations
5) Consumer credit expands

At this point, we see some positives. These include a slight increase in real wages and savings in the developed nations along with a reduction in private sector debt. Although it may be a number of years before U.S. consumers' debt levels reach the long-term trend (thereby implying that consumers are no longer inhibiting spending), the growth in household debt is declining (Figure 5).

The level of U.S. business debt is also declining slightly and should reach a more manageable 35% to 40% of GDP in a few years. Even though the debt retrenchment is underway in the private sector, this decrease has been more than offset

FIGURE 5. U.S. HOUSEHOLD DEBT AS A % OF NOMINAL GDP

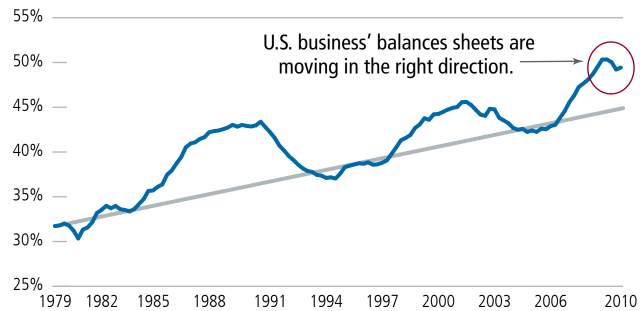
1Q1980 - 1Q2010



Source: Bloomberg

FIGURE 6. U.S. BUSINESS DEBT AS A % OF NOMINAL GDP

1Q1980 - 1Q2010



Source: Bloomberg

with the expansion of public sector debt. The next stage in a secular recovery will be signs that the public sector debt levels are starting to decline and the "unfunded liabilities" we face as a nation are restructured to sustainable levels.

The employment pictures in the United States, Europe and Japan are still very poor, and their fiscal outlooks remain very weak. The U.S. trade deficit is expanding once again (Figure 7). Meanwhile, emerging markets are showing some progress but are still very dependent on export growth, and the savings and consumption trade off is not yet favorable. We are seeing some currency appreciation and wage concessions so improvements are occurring on some fronts, but not as quickly as the developed world needs. These factors lead us to conclude that an unbridled secular bull market in the immediate future is unlikely.

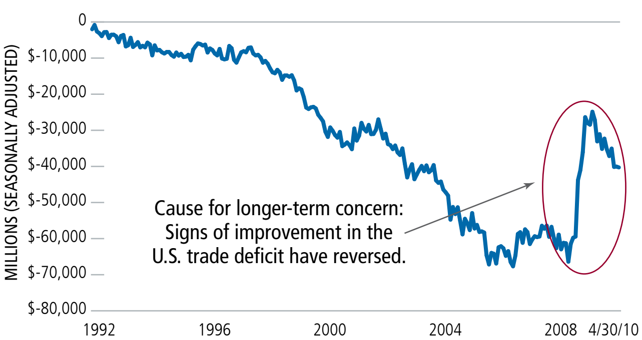
Nonetheless, even if we do not find ourselves in a secular bull market, we believe there are many investment opportunities. Great businesses will find ways to adapt to the new world economy. For example, on June 25, 2010, the *Wall Street Journal* ran a front-page article entitled, "Danone Expands Its Pantry To Woo the World's Poor." The article noted that "last year, 42% of [Danone's] sales were from emerging markets—up from just 6% 10 years ago." Danone's transformation is one that we believe many companies around the world will make. These shifts will help build the foundation of a more balanced world market.

REVISITING (COMPARISONS TO) THE PAST: GREAT RECESSION VS. GREAT DEPRESSION

Last year, we compared the current crisis to the Great Depression through a series of charts, which we revisit here. As we assess the "bull versus bear" question, we are encouraged to see that some key economic factors, such as the world industrial production and volume of world trade, are rebounding strongly. Figure 8 shows that the current trend of world industrial production has significantly diverged from what was seen during the Depression. Similarly, the

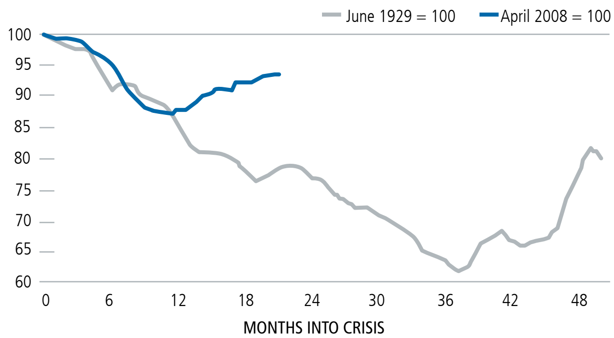
FIGURE 7. U.S. TRADE DEFICIT

JANUARY 1992–APRIL 2010



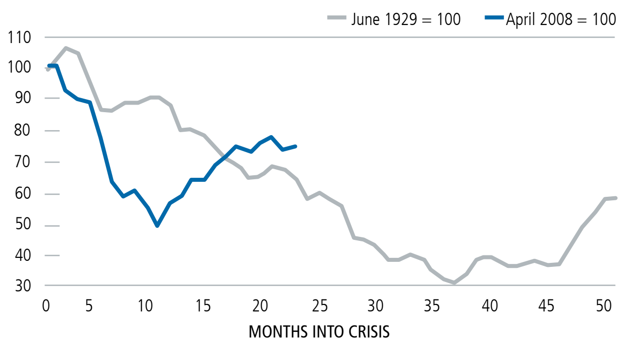
Source: U.S. Census Bureau

FIGURE 8. WORLD INDUSTRIAL OUTPUT, NOW VS. THEN



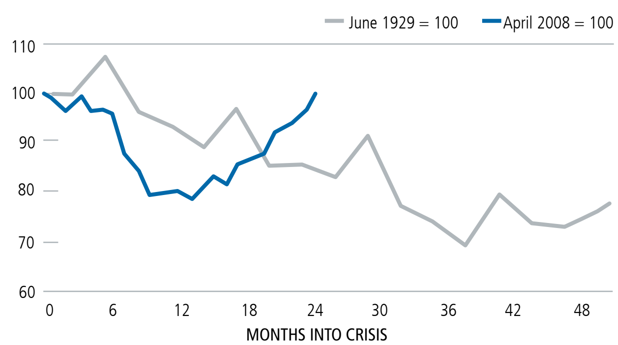
Source: Barry Eichengreen and Kevin H. O'Rourke © voxEU.org.

FIGURE 9. WORLD STOCK MARKETS, NOW VS. THEN



Source: Barry Eichengreen and Kevin H. O'Rourke © voxEU.org.

FIGURE 10. VOLUME OF WORLD TRADE, NOW VS. THEN



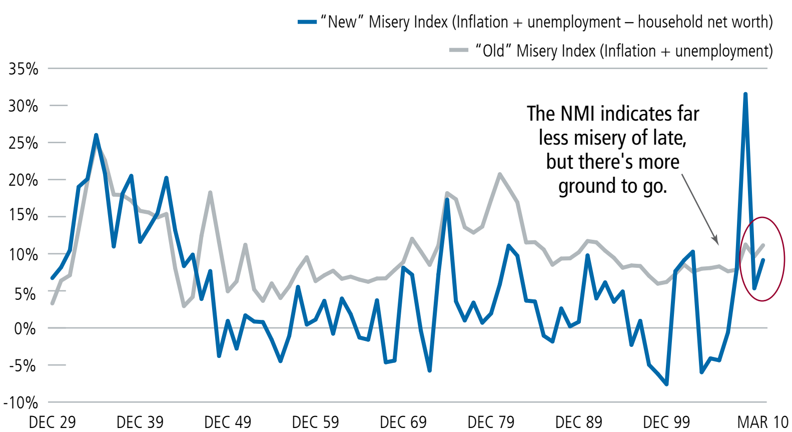
Source: Barry Eichengreen and Kevin H. O'Rourke © voxEU.org, Netherland Bureau for Economic Analysis.

world stock markets are telling a more upbeat story at this point in the crisis (Figure 9) than at a comparable point in the Depression. Moreover, Figure 10 shows that world trade volume is substantially better now than it was at the same point during the Depression, even if the equity markets are near the same point as the Depression cycle comparison. Have the equity markets overreacted? Perhaps.

Last year, we unveiled our "New Misery Index" (NMI). Unlike the traditional Misery Index, our new version included not just the inflation and unemployment rate, but also changes in household net worth. The NMI has risen sharply over recent months, thanks to a rebound in financial markets. However, there is much more ground left to go (Figure 11). To provide a strong sign that misery was abating, the Index would have to drop to zero or below to offset the huge loss in wealth from this crisis. If the index stayed below 7% for three to five years, we would see that as an indication of relief and better times for consumers.

FIGURE 11. MISERY INDEX: "NEW" VS. "OLD"

ANNUALLY 1929-2009 WITH 1Q2010



Sources: For household net worth data: For 1929-1941 (billions of 1958 dollars), Frederic S. Mishkin, "The Household Balance Sheet and The Great Depression," Journal of Economic History 38 (December 1978), p. 920; 1928, 1942-1944 data is estimated; 1945-2008 data from the Federal Reserve. For CPI and unemployment: Bureau of Labor Statistics.

CPI and household net worth track year-over-year percentage change; unemployment is expressed as a flat rate.

WHY STAY INVESTED IN EQUITIES AT ALL?

Many clients ask why they should stay invested in equities if the world has so many problems. The answer is that the world has always had a very long list of problems and issues to deal with. If investors waited until there was nothing to worry about, then perhaps they would wait forever. Or, they would invest only at market tops, when the concerns seem smaller than the opportunities.

Investing in equities during the 1950s and 1960s would not have been easy. The threat of communist expansion, the Korean War, the Bay of Pigs, the Kennedy and King assassinations, the Vietnam War, the drug culture, the A-Bomb—all were reasons to stay on the investing sidelines. Yet, while this was a period of great unease, it was also a time that offered significant wealth creation opportunities. All decades are filled with chaos and concern, and the positives are rarely emphasized on the news or in the press.

As investment managers, we must ask several questions. What do the markets know? (Answer: all that you or I know and then some.) What assumptions are priced into asset classes? Do prices discount enough of the concerns to allow for a respectable return on our investments? In our April 2010 commentary, "Clear Skies Ahead?" we made the case that the markets were pricing in a "normal business recovery," but that we did not believe the recovery looked normal. We hedged portfolios, where appropriate, to reduce the risk of a correction to a more benign growth outlook and to improve the risk/reward scenario for risk assets. During the second quarter, we saw a significant correction in stock values while interest rates declined. The net result is that the markets are

continued on page 12

SECTOR OUTLOOK AND POSITIONING

Broadly, we are favoring high-quality multi-national companies that offer excellent brands, knowledge or pricing for the global markets. From a sector perspective, we outline our general positioning below:

SECTOR	POSITIONING*	KEY CONSIDERATIONS
Financials	Equal/ Underweight	Banks will be under pressure to pay for the FDIC's huge insurance liability, while new regulations, lower ROEs and ROAs continue to make the banking sector less attractive. Current 20-25% correction has improved the risk-reward in the money center banks but they most likely present utility like business models in the future. Mid-size banks should benefit from local bank consolidation and government loss share. Asset managers and insurers look reasonable from valuation- and business-model perspectives while offering better balance sheets and equity risk/reward.
Technology	Significant Overweight	Capital spending as a percentage of GDP is near a 40-year low, and we expect that this trend will reverse. Technology companies are positioned well for a rebound in the capital spending cycle and are very used to competing in a deflationary environment. Productivity enhancement and cost controls should help technology spending. We see consumers remaining willing to purchase certain "special" products such as cell phones, laptops and flat-screens. The sector will benefit from global infrastructure stimulus spending. Stock valuations are attractive and the risk/reward is compelling. The sector may be re-establishing its leadership position in the equity market for the first time since last decade's collapse.
Consumer Staples	Equal weight	We favor low-cost producers with global reach and brand focus. Recent weakness presents buying opportunity.
Industrials	Equal/ Overweight	Valuations again imply a weak economic cycle for the next decade. Global infrastructure stimulus spending will benefit many companies in this sector, so we expect that overall growth should be above the average global growth rate.
Materials	Underweight	As commodity prices have declined, valuations are reasonable again but near-term economic weakness in Asia may present headwinds. We favor commodity businesses over raw material businesses. Further U.S. dollar devaluation and global stimulus spending should help boost commodity prices over the long term.
Energy	Equal Weight	U.S. dollar devaluation should help support energy prices long term. Mid-East turmoil adds to the attractiveness of this sector as it can hedge unforeseen energy price spikes. BP oil spill and global slowdown has devastated stock prices in the sector. As heavy liability risks and global slowdown weigh on valuations, we are looking to selectively add
Consumer Discretionary	Underweight	Stocks offer significant discrepancies in values and opportunities, with a widening divide between winners and losers. High end and trendy products still selling well.
Health Care	Equal weight	This sector may be undergoing some significant changes with the government taking on a more activist approach, and becoming a major player and insurer. It is important to follow government actions and adjust accordingly. Valuations in most industry groups reflect utility like pricing environment so the risk reward is reasonable.

* Sector overweights and underweights are general indications for the broad sectors. Each portfolio may hold different overweights or underweights due to characteristics particular to individual asset classes utilized.

now pricing in a low-growth to no-growth scenario with some expectation of higher interest rates.

The opportunity in growth stocks today is compelling. The growth premium is near a low and the quality of many companies' balance sheets continues to improve. Over the past two years, the cash flows and earnings of top growth companies have grown while the price you pay for them has not. We still see volatility and are concerned about the global markets, but we also see the opportunity to invest in great global growth businesses at good prices. In our view, the best hedge and way to build wealth is to own a well-run business.

CONCLUSION

The debt crisis has yet to play out and is on hold for the interim. If the time is used wisely, we can increase the probability that a bear market will be avoided. The longer we can hold on, the better the chances that we will see global trade rebalancing on the back of emerging market consumers. The debt burden of the G3 economies could be reduced if we are able to achieve this growth in emerging markets, against the backdrop with tempered inflation.

At this juncture, we also strongly believe that downside risk should be reduced in most asset classes. We utilize many strategies to lower exposure to potential risks, including disciplined valuation analysis, an emphasis on high-grade balance sheets and the addition of put protection, where appropriate. In the case of lower-grade companies, we are favoring short maturity debt.

The markets are not a comfortable place to be, but generally discomfort and investment results go hand in hand. There are many things to worry about, but time is improving the odds of a successful outcome. Additionally, the markets are discounting trouble and this is creating opportunities for experienced investors with long-term perspective.

Earlier, we mentioned that investment management is a gloomy pursuit. It's also an invigorating and exciting one, as we get to focus much of our time and efforts on understanding the innovations and progress in the global economy. Bull, bear or somewhere in between, we are still excited about globalization and the opportunity it holds for long-term entrepreneurs and investors.

S&P 500 Index-Is generally considered representative of the U.S. stock market. 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.

Example company name mentioned in the discussion of emerging market consumption has been chosen solely on to illustrate macroeconomic concepts. Use of this name does not constitute a recommendation to buy or sell any security or product.

The purchasing of put options does not guarantee against a loss within a portfolio. The purchasing of put options may not reduce the portfolio volatility to the extent desired. A reduction in holdings of put options could result in an increased exposure to a market decline. A strategy risks losing all or part of the cash paid for purchasing put options.

The information in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in any account's portfolio at the time you receive this report. The securities discussed do not represent any account's entire portfolio and in the aggregate may represent only a small percentage of any account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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