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Perspectives on Value

Jeff Miller, SVP and Co-Portfolio Manager, Calamos Value Team

As a member of the Calamos Value Team, Jeff Miller contributes 20 years of investment industry experience. Below, he discusses his approach to value investing and the role of value strategies in asset allocation.

I. The Calamos Approach to Value

Q. What draws you to value investing?

Jeff Miller: Value investing makes sense to our team and fits our personalities well. The focus in our process is on cash flow and the stability of that cash flow. Once we have established what that base level of cash flow is, valuing it is often a fairly straightforward exercise for us, since we are conservative and really only value the near-term expected cash flows. While cash-flow growth is nice to have, it doesn't form a basis for our investment.

Q. Describe your value discipline. How does it differ from other approaches to value?

JM: First, value managers are not all the same. Some look for "deep value," or stocks selling at a steep discount to their true worth. Others look for "opportunistic value," or stocks that, while not the cheapest in the market, nonetheless appear to be bargains. Whereas deep value managers will focus on liquidation or asset plays—what can they get for selling off the pieces of the company—the Calamos Value Team utilizes an opportunistic value approach, looking for strong operating businesses that are temporarily undervalued by the market. We focus on the operations of the business: how it makes its money, its defensible barriers to entry and proprietary technologies, and the near-term outlook for those cash flows.

Q. What are some of the biggest misconceptions about value investing? How might they hinder an investor's long-term asset allocation performance?

JM: There are quite a few misconceptions about value investing. For one, we often get questions about our willingness to sell overvalued stocks. There's a common perception that value managers should be buy-and-hold investors and that an opportunistic approach is somehow inferior. I think this is due in large part to Warren Buffett's stated preference for his holding period as being "forever," and investors then mistakenly extrapolate this to other value strategies. In fact, Buffett

himself has stated that he could probably earn higher returns if he were willing to sell stocks more often, but this doesn't fit his personality, so he gives up that potential return to invest in a manner that suits him. But many investors missed this second part. Buffett's mentor Ben Graham was a strong advocate of only owning securities that were deeply undervalued, and then selling when they reached fair value. Being a "long-term" investor simply because it was more comfortable was not part of the original Graham-Dodd process.

II. Finding Value Opportunities

Q. How does your team avoid "value traps" — stocks that are cheap for good reason?

JM: We look for a catalyst in the next six to 18 months that will drive value realization. Because of our focus on strong operating companies, we do not buy a company simply based on valuation and then just hope the stock price goes up. A more typical situation is that a negative catalyst just occurred that caused the stock to drop, giving us an opportunity to buy a company we like cheaply. We call this situation a "broken stock, not broken company," and it is what we are looking for in the market—a strong company with a bad stock. We buy those and then when the company puts up strong numbers in the next quarter or two, the stock tends to follow the earnings higher.

The Calamos Value Team manages separately managed accounts as well as two mutual funds. For more information about our value investment capabilities, please visit www.calamos.com/value or call us at 800.582.6959 (Monday through Friday, 8 am to 6 pm central time).

Q. Based on your value discipline, what would you consider to be a good investment?

JM: An ideal investment opportunity would be a company with a strong brand that makes a product with a lot of pricing power—a product that is either "not optional" or close to it, that can't be easily replicated (if at all), and that engenders tremendous loyalty and nostalgia in its customers. Then we want the company's stock to get clobbered in the market to a ridiculously low price-to-cash ratio and have analysts on TV talking about how much the company messed up the most recent quarter or product launch. Then we'd buy it aggressively.

Q. What is an opportunity that you'd pass by but other value managers might seek?

JM: An asset play, where you are buying a broken company for the value of its real estate or patents in a breakup. There are many examples recently of companies that were once iconic American brands that fell on hard times and never recovered. Many value investors bought these because they looked cheap on a price-to-book ratio or price-to-asset ratio basis, but the company never recovered to become a viable ongoing business. In most cases, a lot of money was lost waiting for the breakup and fire sale. We try to avoid these value traps at all costs.

Q. Technology stock valuations have recently declined. What implications has that had for your strategy?

JM: With the attractive valuations of tech stocks currently, we have increased our investments in what we call "infratech"—companies that provide software or technology that is "not optional" or has high

switching costs (whether monetary or in disrupted operations). These companies tend to be mature technology companies with strong balance sheets and the ability to return capital in the form of dividends or stock buybacks. We are still avoiding speculative technology as those companies do not have the current cash flows we desire.

Q. Are there any differences in how you apply your investment discipline to non-U.S. stocks?

JM: The short answer is no, there aren't, so long as the accounting and reporting of the companies meet U.S. standards. However, there are certain countries that have little to no rule of law and regularly seize assets of foreign companies. Recently you have seen this happen in Argentina and Venezuela. We also avoid companies that have large high-tech operations in China, as we are concerned that the Chinese will just copy the technology (whether there is a patent or not) and start a competing company if the product is any good.

III. Value Strategies and Asset Allocation

Q. Where would your strategy fit into an asset allocation?

JM: Value and growth tend to oscillate quite a bit, shifting leadership from one market cycle to another. We believe a combination of value and growth strategies, if managed well, should produce strong long-term results with less volatility.

In addition to balancing a growth allocation, this strategy may complement other value strategies. Historically, our value approach has tended to perform

well during periods of higher market volatility, such as during the recovery of 2009. Our approach also declined less than the broad market during the 2008 sell-off. In our view, this is the by-product of our active and opportunistic approach. However, in the safety-seeking markets of 2011 and 2012, our approach lagged, as there were less market dislocations to take advantage of. When investors want safety (from utilities and staples, for instance), our approach may be less in favor in the market.

"Our approach naturally lends itself to being more of an 'all seasons' strategy."

Q. What's the strategic case for allocating to value over a full market cycle? Is there anything about your strategy that helps you weather the ups and downs of the value/growth rotation?

JM: We believe we sit in the sweet spot between deep value and core investing styles. Our flexibility in analyzing all companies regardless of their sector helps us avoid the cyclicalities inherent in a deep value strategy or a momentum growth strategy—in essence, we avoid the extremes in investing styles. Both deep value and momentum growth definitely have "seasons" in which one or the other is working. Our approach naturally lends itself to being more of an "all seasons" strategy.

ABOUT JEFF MILLER

Jeff Miller is a Senior Vice President and Co-Portfolio Manager, leading the Calamos Value Team. He is responsible for portfolio management and research. He joined the firm in 2012 and has 20 years of industry experience.

Prior to joining Calamos, Mr. Miller was the Chief Investment Officer of the Large Cap Value Equity Team and Portfolio Manager of the American Independence Stock Fund. Previously, he was Co-Founder and Co-Chief Investment Officer of Miller & Jacobs Capital, LLC (MJC) and served as Vice President of Equity Research at Keefe, Bruyette & Woods, Inc.

Mr. Miller received a B.A. in History and an M.B.A. from Cornell University. He is also a founder and member of the Board of Directors of The Maasai Wilderness Conservation Fund and is currently the Treasurer of the Contemporary Art Council of the Portland Art Museum.

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