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A touch of convertibles spice to global equities

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(Pictured: Gary Black (l) and John Calamos)

One of the legacies of the financial crisis is that many investors are looking to have greater surety of investment outcomes and limit their downside risk. While new products have been built to satisfy this demand, many well-established strategies are also coming to the fore. One of these involves the use of convertible notes in equity portfolios.

Calamos Investments, a US-based global equity manager which has recently been introduced to Australian institutional investors, has been specializing in investing in convertible notes since its inception in the 1970s. In fact, the founder, John P. Calamos, is scheduled to visit Australia this week to speak with potential clients and advisors.

Over the years the firm has morphed into a traditional global equity manager but it has retained its heritage in convertible notes as a value-add for investors, especially, but not solely, those who are more risk averse.

The firm, which manages a total of US$26.6 billion, now has a range of equities strategies, including an emerging markets capability, that can be dialled up or down the risk spectrum through the use of convertibles and with concentrated or more standard portfolios.

Three Calamos executives were also in Australia last week: Gary Black, the global co-CIO; Nicholas Niziolek, the co-head of international research and a co-portfolio manager; and Craig Mauri, senior v.p in global institutional services. They were ushered around town by their new third-party marketing firm, Axius Partners, which is run by John Maragiannis and George Giovas.

Black says the four main points of differentiation for the firm which give it an edge over other international equity managers are: its marriage of top-down and bottom-up processes; the fact that portfolio managers and researchers are charged to look across the capital structure of companies they invest in; the team management approach; and the mix of high-conviction and low-volatility strategies, all of a growth orientation.

Calamos is, itself, going through a strong growth phase. Apart from the appointment of Axius to represent it here, it is also in the process of expanding its London office, which include three-five new investment professionals, and this will likely be followed by a Hong Kong office. The non-US team has gone from five to 13 in the past 18 months, with the total headcount of investment staff increasing by 20 to 78 during that time. The firm is based in Naperville, Illinois, which is about 45km from Chicago.

Maragiannis says that three products which Axius is concentrating on for the Australian market are emerging market equities, global equities growth and the lower-volatility global opportunities, which includes convertibles. The global equities growth portfolio is managed to the ACWI benchmark, including 12 per cent emerging markets.

The addition of convertible notes to an equities portfolio provides interesting new characteristics. Not only can the manager typically reduce volatility due to the coupons being paid by the notes, it can also arbitrage across the capital structure of the stocks, using its specialist knowledge.

The low interest rate environment in most countries has meant that convertible note issuance has been at low levels in the past few years, but this will likely change as US rates head back towards normal, followed by the rest of the world. Companies will typically be paying 2-3 percentage points above normal corporate debt rates to access this market, so in a low-rates environment they would usually prefer to issue standard debt instruments.

The emerging markets portfolios have been Calamos's best-performing funds over the past five years. Niziolek says that the downside protection from the convertibles and the firm's country selection calls have paid off. It's two main leanings in country selection for these portfolios are Mexico and the Philippines. It also remains positive about China.

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CALAMOS®

Calamos Investments LLC
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | www.calamos.com | www.caminfo@calamos.com

Calamos Investments LLP
No. 1 Cornhill | London, EC3V 3ND, UK
Tel: +44 (0) 20 3178 8838 | www.calamos.com/global

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