# Strategic Total Return Fund (CSQ) 4Q17 Commentary

CALAMOS INVESTMENTS

## Overview

Equities continued to enjoy strong performance in the fourth quarter with the U.S. market posting a 6.64% return, as measure by the S&P 500 Index. The index's quarterly gain marked the ninth-straight quarter of positive returns. Equally impressive, the rally was broad-based as all of the major U.S. equity indices hit new highs. Markets cheered a myriad of positives, including an upward revision to 3.1% for Q2 U.S. GDP. Strong corporate earnings and the successful passage of corporate and individual tax reform also boosted investors' positive view of equity markets. Additionally, markets reacted calmly to the Fed raising short-term rates for the third time in 2017, and to the announcement that Jerome Powell would replace Janet Yellen as Fed Chair. In support of U.S. multinationals, all 45 of the countries tracked by the OECD showed growth in 2017 and global leading economic indicators posted three-year highs.

Within the S&P 500 Index for the quarter, all 11 GICS sectors saw positive performance, led by consumer discretionary (+9.87%), information technology (+9.01%) and financials (+8.63%). Utilities (+0.21%), health care (+1.47%), real estate (+3.22%) and telecom services (+3.61%) lagged the overall market.

In terms of lower-risk capital markets, higher-quality bonds struggled during the quarter with the Bloomberg Barclays U.S. Aggregate Bond Index only inching up 0.39% to close out 2017 with a 3.54% gain.

## Distributions Remained Competitive.

The fund maintained a monthly distribution of $0.0825 throughout the quarter. The fund's current annualized distribution rate was 8.20% on market price as of December 31, 2017.

**ANNUALIZED TOTAL RETURN AS OF 12/31/17**

| | QTD | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR | SHARE INCEPTION (03/26/04) |
|---|---|---|---|---|---|---|
| On Market Value | 2.27% | 27.73% | 11.63% | 13.82% | 7.79% | 7.24% |
| On NAV | 5.22 | 21.41 | 11.56 | 13.71 | 7.44 | 8.11 |

Source: State Street Corporation

Returns of less than 12 months are cumulative returns. Returns for periods greater than 12 months are annualized returns. Total return measures net investment income and capital gain or loss from portfolio investments as an annualized average. In calculating net investment income, all applicable fees and expenses are deducted from the returns.

**Performance data quoted represents past performance, which is no guarantee of future results. Current performance may be lower or higher than the performance quoted. Portfolios are managed according to their respective strategies which may differ significantly in terms of security holdings, industry weightings, and asset allocation from those of the benchmark(s). Portfolio performance, characteristics and volatility may differ from the benchmark(s) shown.**

*You can purchase or sell common shares daily. Like any other stock, market price will fluctuate with the market. Upon sale, your shares may have a market price that is above or below net asset value and may be worth more or less than your original investment. Shares of closed-end funds frequently trade at a market price that is below their net asset value.*

*Please refer to back page for important notes. All returns are in USD terms unless otherwise indicated.*

### FUND

- CSQ is a total return offering that seeks to provide an attractive monthly distribution, as well as equity market participation.
- Invests in equities and higher yielding convertible securities and corporate bonds, issued primarily by U.S. companies.

Current Annualized Distribution Rate[1] 8.20%

| ASSET ALLOCATION | % |
|---|---|
| Common Stock | 62.6 |
| Convertibles | 15.1 |
| Corporate Bonds | 14.4 |
| Cash and Receivables/Payables | 2.7 |
| Other | 2.5 |
| Synthetic Convertibles | 2.0 |
| Bank Loans | 0.2 |
| US Government Securities | 0.2 |
| Preferred Stock | 0.2 |
| Warrants | 0.1 |
| Options | 0.1 |

The portfolio is actively managed. Holdings and weightings are subject to change at any time without notice. Asset Allocation Weightings are calculated as a percentage of Managed Assets.

[1] Current Annualized Distribution Rate is the Fund's most recent distribution, expressed as an annualized percentage of the Fund's current market price per share. **The Fund's most recent distribution was $0.0825 per share. Based on our current estimates, we anticipate that approximately $0.0650 is paid from ordinary income or capital gains and $0.0175 of the distribution represents a return of capital.** Estimates are calculated on a tax basis rather than on a generally accepted accounting principles (GAAP) basis, but should not be used for tax reporting purposes. Distributions are subject to re-characterization for tax purposes after the end of the fiscal year. This information is not legal or tax advice. Consult a professional regarding your specific legal or tax matters. Under the Fund's managed distribution policy, distributions paid to common shareholders may include net investment income, net realized short-term capital gains, net realized long-term capital gains and return of capital. When the net investment income and net realized capital gains are not sufficient, a portion of the distribution will be a return of capital. In addition, a limited number of distributions per calendar year may include net realized long-term capital gains. Distribution rate may vary.

There is no assurance that the Fund will achieve or maintain its investment objective.

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We believe that the fund's monthly distributions are highly competitive, given that low interest rates and yields remain the norm throughout much of the global marketplace. For example, the 10-year U.S. Treasury bond yield was 2.40%, the S&P 500 yield was 2.00% and the ICE BofAML High Yield Master II Index yield was 5.78%, as of December 31, 2017.

## Performance Review

For the quarter ending December 31, 2017, the fund returned 2.27% on market price and 5.22% on NAV. The S&P 500 Index returned 6.64% for the same period.

Contributing Factors. For the quarter, the fund's allocation to health care, notably in biotechnology, proved to be beneficial. In addition, our selection in utilities, specifically electric utilities, bolstered performance relative to the index.

Detracting Factors. The fund underperformed relative to the S&P 500 Index in part because of our selection in consumer discretionary where our picks in movies and entertainment were a drag on return. In addition, our selection in the information technology sector, particularly our overweight in communications equipment, underperformed relative to the index.

## Positioning

We continue to hold our highest allocation (29%) in the BB-credit tier, as we believe this exposure will offer investors a better risk/return dynamic over time while continuing to provide regular income. We have taken a very selective approach to CCC-rated credits. We are cognizant of the fact that rising interest rates and volatility can have an effect on longer-term fixed income securities. From an economic sector perspective, our heaviest exposures went toward the information technology, consumer discretionary and financials sectors, which collectively represent 48% of our holdings. Our lightest weights were in utilities, materials and real estate. Approximately 91% of our holdings are in the U.S.

## Leverage

We believe that this environment is conducive to the prudent use of leverage as a means of enhancing total return and supporting the fund's distribution rate. In spite of a cost increase due to rising interest rates, our use of leverage over the quarter enjoyed a favorable reinvestment outcome. We were able to borrow at rates we believe attractive, and invested the proceeds at levels in excess of the cost of the leverage. We believe leverage will continue to provide diversity and increased capacity to our borrowing capabilities, while presenting opportunities to take advantage of market dynamics. As of December 31, 2017, our total percent of assets leveraged was approximately 30%.

## Conclusion

We remain constructive on the U.S. equity market given our view that the U.S. economy and the global economy as a whole appear positioned for slow but steady growth. While monetary policy in the U.S. is tightening to some extent, this change is coming off an incredibly simulative stance, so we believe the effects of the change may be similar to discontinuing medication once a patient regains health. Globally, monetary policy continues to be simulative. The equity market's gains do not appear overly enthusiastic in our view and are supported by stronger earnings and sales growth, deregulation, and tax reform—a combination which the market has not seen in many years. Many investors have concerns about the length of the economic recovery and overall valuations for U.S. equities. We are less concerned with the length of the recovery, because the recovery should be measured on its strength, not age. As for valuations, we would agree that they are higher than a year ago, but in a relative sense, they may be wholly appropriate when considering the cost of capital and the improvements to earnings. However, the market has gone for a considerable time without a correction, and at no time last year was the

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equity market down 5% from where it began the year. We would remind investors that market pauses and corrections are actually quite normal. We see the Portfolio as an attractive way to help manage those concerns as blending common stocks with convertibles and fixed income may allow for varying equity sensitivity. Volatility, when it occurs, may prove supportive to the convertible holdings, as the value of the option typically appreciates as volatility increases.

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**Important Fund Information**

The goal of the managed distribution policy is to provide investors a predictable, though not assured, level of cash flow. Monthly distributions paid may include net investment income, net realized short-term capital gains, net realized long-term capital gains and, if necessary, return of capital. Maintenance of this policy may increase transaction and tax costs associated with the fund.

A credit rating is a relative and subjective measure of a bond issuer's credit risk, including the possibility of default. Credit ratings are assigned to companies by third-party groups, such as Standard & Poor's. Assets with the highest ratings are referred to as "investment grade" while those in the lower tiers are referred to as "noninvestment grade" or "high yield." Ratings are measured using a scale that typically ranges from AAA (highest) to D (lowest).

Leverage creates risks which may adversely affect return, including the likelihood of greater volatility of net asset value and market price of common shares; and fluctuations in the variable rates of the leverage financing. The ratio is the percent of total managed assets.

The fund may invest up to 35% of its assets in foreign securities and invest in an array of security types and market-cap sizes, each of which has a unique risk profile. As a result of political or economic instability in foreign countries, there can be special risks associated with investing in foreign securities. These include fluctuations in currency exchange rates, increased price volatility, and difficulty obtaining information.

There are certain risks associated with an investment in a convertible bond such as default risk—that the company issuing a convertible security may be unable to repay principal and interest, and interest rate risk—that the convertible may decrease in value if interest rates increase.

Investments by the fund in lower-rated securities involve substantial risk of loss and present greater risks than investments in higher-rated securities, including less liquidity and increased price sensitivity to changing interest rates and to a deteriorating economic environment.

Fixed income securities are subject to interest rate risk; as interest rates go up, the value of debt securities in the fund's portfolio generally will decline.

Owning a bond fund is not the same as directly owning fixed income securities. If the market moves, losses will occur instantaneously, and there will be no ability to hold a bond to maturity.

The fund may invest in derivative securities, including options. The use of derivatives presents risks different from, and possibly greater than, the risks associated with investing directly in traditional securities. There is no assurance that any derivative strategy used by the fund will succeed. One of the risks associated with purchasing an option is that the fund pays a premium whether or not the option is exercised.

The fund may seek to purchase index put options to help reduce downside exposure however, the effectiveness of the fund's index option-based risk management strategy may be reduced if the fund's equity portfolio does not correlate to the performance of the underlying option positions. The fund also risks losing all or part of the cash paid for purchasing index options. Unusual market conditions or lack of a ready market of any particular option at a specific time may reduce the effectiveness of the fund's option strategies, and for these and other reasons the fund's option strategies may not reduce the fund's volatility to the extent desired. From time to time, the fund may reduce its holdings of put options, resulting in an increased exposure to a market decline.

Parties entering an interest rate swap take on exposure to a given interest rate; the exposure can be long or short depending on whether a counterparty is paying or receiving the fixed rate. At the same time, each party takes on the risk —known as counterparty credit risk—that the other party will default at some time during the life of the contract.

The **S&P 500 Index** is generally considered representative of the U.S. stock market. The **Russell 3000 Growth Index** measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. The **Russell 3000 Value Index** measures the performance of those companies in the Russell 3000 Index with lower price-to-book ratios and lower forecasted growth values. The **ICE BofAML All U.S. Convertibles Index (VXA0)** is comprised of approximately 700 issues of only convertible bonds and preferreds of all qualities. The **BofA Merrill Lynch High Yield Master II Index** consists of below investment grade U.S. dollar denominated corporate bonds that are publicly issued in the U.S. domestic and yankee bonds. Issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Baa3, but are not in default. The index includes domestic high-yield bonds, including deferred interest bonds and payment-in-kind securities. Source ICE Data Indices, LLC, used with permission. ICE permits use of the ICE BofAML indices and related data on an 'as is' basis, makes no warranties regarding same, does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the ICE BofAML Indices or data included in, related to, or derived therefrom, assumes no liability in connection with the use of the foregoing and does not sponsor, endorse or recommend Calamos Advisors LLC or any of its products or services. 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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**Terms**

A **Managed Distribution Policy** is an investment company's commitment to common shareholders to provide a predictable, but not assured, level of cash flow. **Market Price** refers to the price at which shares of the fund trade in the market. **NAV or Net Asset Value** refers to the net value of all the assets held in the fund. **IPO Price** refers to the initial public offering price for shares of the fund.

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