Convertible and High Income Fund (CHY) 1Q19 Commentary

CALAMOS INVESTMENTS

FUND

- CHY is an enhanced fixed income offering that seeks to provide an attractive monthly distribution along with a secondary objective of capital appreciation.
- Invests in high yield and convertible securities issued primarily by U.S. companies.

Current Annualized Distribution Rate[1]	9.40%

ASSET ALLOCATION	%
Convertibles	56.6
Corporate Bonds	32.3
Common Stock	3.6
Bank Loans	3.6
Cash and Receivables/Payables	3.1
Preferred Stock	0.4
Synthetic Convertibles	0.3
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 $0.0850 per share. Based on our current estimates, we anticipate that approximately $0.0239 is paid from ordinary income or capital gains and $0.0611 of the distribution represents a return of capital.** Estimates are calculated on a tax basis rather than on a enerally 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 level rate 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.

Overview

The convertible and equity markets posted strong returns in the year's first quarter as the turmoil witnessed at the end of 2018 subsided. The convertible market, as measured by the ICE BofAML All U.S. Convertibles Index (VXA0), gained 10.25% during the quarter, while equities rose 13.65% as reflected by the S&P 500 index.

In the quarter, U.S. convertibles and equities benefited from increasingly dovish Federal Reserve policy, intermittent progress on U.S.-Chinese trade negotiations, and economic data pointing to a sustained expansion. The Federal Reserve changed its policy expectation to zero rate increases in 2019, and announced it would reduce the amount of balance sheet normalization, thus emboldening risk appetite across markets. Corporate earnings also fueled gains with most companies surpassing estimates, although these results were tempered by downward earnings revisions for the next quarter and relatively conservative guidance for the full year.

With interest rates at the intermediate and longer ends of the curve declining, the yield curve flattened. Two-year yields closed at 2.27%, down from 2.48%, and ten-year yields fell from 2.69% to 2.41%.

In this environment, consumer staples was the only economic sector within the convertible index to register a negative quarterly result (-4.13%). The technology (+13.60%), energy (+13.56%) and industrials (+13.34%) sectors led the convertible market higher, while financials (+6.05%) and consumer discretionary (+6.98%) sectors were positive but joined consumer staples in lagging the index result. In terms of credit quality, speculatively rated convertibles (+10.16%) strongly outperformed investment-grade issues (+6.91%). Convertibles with the most equity sensitivity (+15.94%) delivered stronger relative results than those with balanced risk/reward attributes (+11.61%) and those exhibiting the most credit sensitivity (+6.29%).

ANNUALIZED TOTAL RETURN AS OF 3/31/19

	QTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR	SHARE INCEPTION (05/28/03)
On Market Value	17.21%	2.26%	12.54%	5.84%	12.79%	7.74%
On NAV	12.81	6.56	11.32	5.15	12.43	8.27

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. All returns are in USD terms unless otherwise indicated.

Please refer to back page for important notes.

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The first quarter of 2019 saw $10.5 billion in domestic new convertible issuance, and $21.7 billion globally. While these numbers were slightly behind last year's pace, they marked a solid beginning to 2019, especially considering the market volatility that had occurred over the previous two quarters. At the same time, the market remained well distributed: convertibles with a balanced risk/reward return profile represented 40% of the overall market versus 35% credit sensitive and 26% equity alternatives.

The U.S. high yield bond market, as represented by the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index returned 7.26% in the first quarter, the best month being January when the index returned 4.52%. In fact, January alone nearly erased the losses the high yield market experienced during the previous quarter.

After widening by more than 200 basis points from the early October cycle tights at 303 basis points on an option-adjusted basis, high yield spreads retraced to tighten by more than 100 basis points to close the quarter at 391 basis points. The majority of the move occurred in January, as markets recovered from what could best be described as a liquidity crisis in December. In the first quarter risk-on market, returns among credit quality tiers were bunched in a tight range, with B rated credits returning 7.27%, while BB and CCC rated credits returned 7.19% and 7.12%, respectively.

The Federal Reserve met twice during the quarter, maintaining its benchmark overnight rate at 2.25% to 2.50% at the meetings in January and March. Expectations at the Fed for further interest rate hikes decreased from a median estimate of two hikes to a median estimate of no hikes. The futures market on the federal funds rate, however, is pricing in a greater than 50% probability that the Fed will reverse course and cut rates by the end of the year. Chair Powell's statements and rhetoric have taken on a decidedly more dovish tone, which has been echoed by other global central bank leaders. Details regarding a tapering of the Fed's balance sheet runoff were released in March, indicating a plan to end the reduction of balance sheet holdings in September, though the Fed intends to return to a balance sheet composition of entirely Treasury holdings as mortgage principal is returned.

The best-performing sectors in the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index were finance companies (+9.0%), energy (+8.3%) and electric utilities (+7.8%), while insurance (+6.3%), transportation (+6.3%) and REITs (+6.4%) represented the largest laggards. According to JPMorgan, the U.S. high yield default rate ended March at 1.02%, a decline of more than 1% year-over-year, and well below the 3% long-term average.

Distributions Remained Competitive

The fund offered a monthly distribution of $0.0850 throughout the quarter. The fund's current annualized distribution rate was 9.40% of market price as of March 31, 2019. We believe that the fund's monthly distributions are highly competitive, given that very 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 2.41% and the ICE BofAML U.S. High Yield Master II Index yield was 6.36% as of March 31, 2019.

Performance Review

For the quarter ending March 31, 2019, the fund returned 17.21% on price and 12.81% on NAV. In comparison, the ICE BofAML U.S. High Yield Master II Index returned 7.40% and the ICE BofAML All U.S. Convertibles Index returned 10.25% for the same period.

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Contributing Factors. This past quarter, the fund benefited from an overweight in the information technology sector relative to the indexes, namely an overweight in the application software industry. The fund also benefited from selection and underweight in the communication services sector, particularly the avoidance of wireless telecommunication services.

Detracting Factors. Our selection and overweight in healthcare, particularly our selection and overweight in pharmaceuticals, were a drag on return. In addition, our overweight and selection in the automobile manufacturers industry of the consumer discretionary sector impeded results.

Positioning

We continue to hold our highest allocation (approximately 40%) in the BB/B credit tier, as we believe this exposure will offer investors a better risk/reward dynamic over time while continuing to provide regular income. We continue to take a very selective approach to CCC credits, which represented less than 4% of the portfolio at quarter-end. We also hold a large percentage of unrated securities (approximately 44%), which offer good valuations and provide access to a large portion of the convertible bond universe in which we may optimize returns through our proprietary research capabilities. We are cognizant of the fact that rising interest rates and volatility can affect longer-term fixed income securities. From an economic sector perspective, our heaviest exposures were weighted in the information technology, communication services and health care sectors, which collectively represent approximately 52% of our holdings. Our lightest weights were materials, real estate and consumer staples. Approximately 87% of our holdings are in the U.S., which is consistent with our overall view of the domestic economy relative to the rest of the world.

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. Despite a cost increase due to rising interest rates, we believe that borrowing levels still allow for a favorable reinvestment dynamic, and we believe our recent leverage reallocation has been and will continue to be beneficial to the fund. We are confident this enhancement will continue to provide diversity and increased capacity to our borrowing capabilities, enabling us to take advantage of market opportunities. As of March 31, 2019, our total percent of assets leveraged was approximately 34%.

Conclusion

We continue to favor convertibles as a way to gain equity market exposure while managing downside risk. While the Fed's continued dovish pivot supports risk assets, continued macro and geopolitical uncertainties may result in heightened volatility. We are constructive longer term, given an expectation that geopolitical tensions will calm down, Fed policy will be flexible, global growth will stabilize and the near-term volatility could create favorable longer-term investment opportunities. In our view, the convertible market remains healthy, offering compelling opportunities in sectors that we favor, including technology, health care and consumer. Increased convertible issuance has expanded the opportunity set, while the secondary convertible market continues to offer an attractive array of balanced convertible structures, which the strategy emphasizes over the pure-equity or busted segments of the market.

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While we expect the rate of domestic economic growth to slow, Calamos views the risk of an imminent recession as low, and we expect the high yield default environment to continue to trend below the long-term historical average of 3% until domestic economic activity softens. We see mixed signs as to where we may be in the economic cycle, with “covenant lite” issuance that tends to signal a nearing of the cycle peak contrasted by healthy convertible bond issuance which often indicates an economy that is through a cycle trough. We would characterize the economy as being in the late innings of expansion, but corporate credit fundamentals are broadly stable. Given the strength of returns for the high yield market in the first quarter, we believe the asset class can produce low double-digit returns for calendar year 2019, delivering a coupon-like return over the balance of the year. We continue to adhere to our discipline as active management and rigorous fundamental analysis are paramount in striking the appropriate risk and reward balance.

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 25% 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. Please refer to the fund’s prospectus for a full description of risks.

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 **CBOE Volatility Index** or **VIX** (based on its CBOE ticker symbol) shows the market’s expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. The **ICE BofAML All U.S. Convertibles Index (VXA0)** is comprised of approximately 700 issues of only convertible bonds and preferreds of all qualities. **ICE BofAML U.S. 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. **The S&P 500 Index** is generally considered representative of the U.S. stock market.

The **S&P/LSTA U.S. Leveraged Loan Index** is designed to reflect the performance of the leveraged loan 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.

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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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