CALAMOS INVESTMENTS

U.S. Convertible Strategy

Market Overview

The broad U.S. convertible market, as measured by the ICE BofAML All U.S. Convertibles Index (VXA0), returned 3.93% in the year's third quarter. In the context of the 7.71% gain by the S&P 500 Index, convertibles participated in the strong equity market performance and outpaced high yield bonds, as measured by the 2.44% return of the ICE BofAML U.S. High Yield Index. The convertible and equity markets were buoyed by strong economic growth and earnings data, which muted concerns of a potential trade war between the U.S. and China. In fact, U.S. Consumer sentiment strengthened to the point where the Conference Board Consumer Confidence Index hit its highest level since 2000. Coincidentally, initial Jobless Claims, measured weekly by the U.S. Department of Labor, fell to their lowest level since 2009.

The Fed announced another 25 basis point increase to the fed funds rate (now at 2.25%), and interest rates across all points of the U.S. Treasury Yield Curve increased. Two-year yields closed at 2.81%, up from a 2.52% close to 2Q, and ten-year yields closed at 3.05%, up from 2.85%. Additionally, according to JP Morgan data, high yield credit spreads narrowed 40 basis points to 366 basis points over Treasuries.

In terms of performance across economic sectors, convertibles with the strongest third-quarter results included those in telecommunications (+13.3%), healthcare (+9.2%), and materials (+8.1%). Convertibles most lagging the 3.9% index result were found in transportation (-3.5%), consumer discretionary (-3.3%), and energy (+1.8%). Investment-grade-rated convertibles (2.5%) significantly outperformed speculative-grade (+0.9%), while issues exhibiting more balanced risk/reward attributes (+3.9%) lagged the most equity-sensitive market segment (+6.7%) but outperformed those with the most credit sensitivity (+1.2%).

U.S. convertible market Issuance remained strong, with $11.6 billion of new convertibles coming to market in the third quarter. This level was lower than the first two quarters of the year, due to a seasonal slowdown, but was 25% higher than the third quarter of 2017. Year-to-date, $46.3 billion of new convertibles have been issued domestically, while $74 billion have been issued globally.

FIGURE 1. CALAMOS U.S. CONVERTIBLE STRATEGY RETURNS

	QTR ENDING 9/30/18	1-YEAR	3-YEAR	5-YEAR	10-YEAR	SINCE INCEPTION (1/91)
Calamos Institutional Convertible Composite						
Gross of Fees	3.21%	12.84%	11.39%	8.05%	8.88%	9.80%
Net of Fees	3.03	12.06	10.61	7.30	8.15	9.13
ICE BofAML All U.S. Convertibles ex Mandatory Index (V0A0)	4.02	12.92	13.13	10.07	11.38	10.17
S&P 500 Index	7.71	17.91	17.31	13.95	11.97	10.42

Source: Calamos Advisors LLC

Past performance is no guarantee of future results.

Data as of 9/30/18.

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FIGURE 2. REPRESENTATIVE PORTFOLIO PERFORMANCE VERSUS THE ICE BOFAML ALL U.S. CONVERTIBLES EX MANDATORY INDEX (V0A0)
THIRD QUARTER 2018

	CONTRIBUTORS (BPS)	DETRACTORS (BPS)
Health Care	41	
Energy	6	
Financials	6	
Consumer Staples	1	
Real Estate	1	
Utilities		-6
Materials		-7
Information Technology		-10
Industrials		-12
Telecom Services		-20
Consumer Discretionary		-49

Attribution represented in basis points and is based on gross of fee performance with dividends reinvested. Performance attribution excludes any government/sovereign bonds or options on broad market indices the portfolio may hold.
Past performance is no guarantee of future results.
Source: Calamos Advisors LLC. Data as of 9/30/18.

Performance Review

For the quarter ended September 30, 2018, the portfolio had a positive return of 3.21%, though it trailed the ICE BofAML All U.S. Convertibles ex Mandatory Index (V0A0) return of 4.02%.

» The portfolio's security selection in health care drove relative results. In particular, pharmaceuticals and life sciences tools & services represented major contributors.

» Leading security selection and an underweight position in energy added to the fund's performance, especially in the oil & gas equipment & services industry.

» Over the period, trailing selection and within the consumer discretionary sector weakened return, as holdings in the automobile manufacturers and the movies & entertainment industries lagged on a relative basis.

» Our lack of participation within the telecom services sector also dampened relative performance.

Positioning and Portfolio Changes

We have actively rebalanced portfolio positions, selling convertibles that become more equity sensitive as the market rises. The proceeds from these sales have been used to purchase convertibles we expect will provide stronger risk/reward characteristics. As a key tenet of our investment philosophy, we continue to favor the balanced segment of the convertible bond market, and new issues have provided ample opportunities for active management and rebalancing. In the technology sector, the portfolio's largest allocation, we have focused on prospects in internet security, cloud computing, software and big data, while trimming semiconductors exposure throughout the quarter. Our allocation to the Industrial group has not varied much over the quarter, as we see favorable opportunities in transportation equipment and related services.

We continue to maintain an active underweight to the defensive telecommunications, utilities, real estate and staples sectors. These performed well during the third quarter, as global investors sought defensive positioning when confronted with non-U.S. market underperformance and trade war uncertainty. However, the U.S. convertible market had relatively lower exposure to these defensive sectors, which offered less attractive opportunities. Overall, performance in the defensive sectors has declined relative to other areas. On a longer-term basis, many defensive positions, serving as bond proxies for the last 10 years, have underperformed with rising interest rates, a trend we expect to continue. To a limited extent, we have also sought to identify non-U.S. convertibles providing attractive risk-adjusted returns, given the correction witnessed in non-U.S. markets. For example, China's recent disposition not to devalue its currency, while injecting economic stimulus, may provide a catalyst for improved market returns. We are also eyeing domestic firms that derive significant revenues through their respective non-U.S. exposure.

All portfolio positioning and sector information is for a representative portfolio. Please see last page for additional information.

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FIGURE 3. SECTOR ALLOCATIONS VERSUS THE ICE BOFAML ALL U.S. CONVERTIBLES EX MANDATORY INDEX (V0A0)

SECTOR	REPRESENTATIVE PORTFOLIO %	ICE BOFAML V0A0 INDEX %	PORTFOLIO SECTOR WEIGHTING CHANGE SINCE 6/30/18 (PCT. POINTS)	UNDER/OVERWEIGHT %
Information Technology	39.1	39.4	0.2	-0.3
Health Care	16.4	17.7	0.0	-1.3
Consumer Discretionary	11.4	12.2	-2.7	-0.8
Financials	10.3	12.3	0.7	-2.0
Industrials	7.7	4.0	-0.7	3.7
Energy	5.5	5.0	1.2	0.5
Utilities	4.1	1.0	0.4	3.1
Real Estate	3.7	4.0	0.4	-0.3
Materials	1.2	1.2	0.5	0.0
Telecom Services	0.7	1.6	0.0	-1.0
Consumer Staples	0.0	1.6	0.0	-1.6

This strategy is actively managed. Holdings, weightings and allocations are subject to change daily. Sector weightings exclude cash or cash equivalents, any government/sovereign bonds or broad-based index hedging securities/options the portfolio may hold.
Source: Calamos Advisors LLC. Data as of 9/30/18.

Conclusion

Our constructive outlook for the U.S. economy and capital markets also extends to the convertible market. In a rising-interest-rate environment, convertible bonds generally post stronger relative performance than straight (nonconvertible) bonds. Most recently, since December 2016 when the Fed began to raise rates, that has been the case as well. With expectations that the Federal Reserve will raise its benchmark rate by 25 basis points in December and likely see fit to raise the rate more through 2019, we believe convertible securities can continue to outperform. In addition, with tax reform passing last year, the lower corporate tax rates have improved the relative attractiveness of lower coupon convertible bonds relative to straight bonds. Limits on interest expense deductibility can skew corporations to favor issuing a convertible bond rather than a more traditional straight bond. Finally, lower taxes combined with less regulation in a favorable economic environment contribute to a positive corporate climate where convertible securities make sense for growth. Although we may be in the mid-to-latter part of the business cycle, we still see many firms seeking growth capital for mergers and acquisitions, research and development, or capital spending.

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Calamos Advisors LLC
2020 Calamos Court
Naperville, IL 60563-2787
Attn: Compliance Officer

CALAMOS INVESTMENTS

Calamos Advisors LLC
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | www.calamos.com/institutional

Calamos Investments LLP
62 Threadneedle Street | London, EC2R 8HP, UK
Tel: +44 (0)20 3744 7010 | www.calamos.com

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