

The Opportunity of Convertible Securities

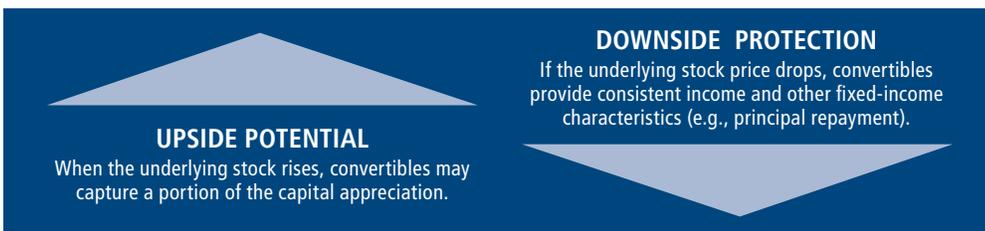
Convertible instruments offer investors unique opportunities for managing risk and pursuing returns. They combine characteristics of stocks and traditional fixed income securities. Like stocks, convertibles typically offer upside appreciation in rising equity markets. Like bonds, convertibles provide income and potential downside protection in declining markets.¹

WHAT IS A CONVERTIBLE?

A convertible security is a bond or preferred stock that can be exchanged—or converted—into a specific number of shares of the issuer’s common stock. The “conversion ratio” is determined at the time of issuance, and typically can be acted upon by the holder at any time. Convertible bonds are technically classified as debt instruments because they pay interest and have a maturity date. They are most often issued as subordinated debt and have default risk.²

“It is not simply the inclusion of convertibles that make a strategy work, but how convertibles are managed to achieve a particular investment objective.”

*John P. Calamos, Sr.
 Founder, Chairman
 and Global CIO*



FIXED-INCOME CHARACTERISTICS

Like any other bond, convertibles represent a loan to the issuing company. They are typically issued at a par (face) value of \$1,000. During the life of a bond, interest is paid at a stated rate called the coupon. When the bond matures or is redeemed (also referred to as “called”) by the issuing company, investors are paid back the \$1,000 face value. Convertible bonds may also carry credit ratings assigned by a rating agency. Unlike traditional bonds, convertible securities offer the added attraction of upside potential due to their equity sensitivity (see below). Because of this, convertibles typically have lower coupons than equivalent non-convertible bonds.

EQUITY CHARACTERISTICS

Because convertibles can be exchanged for a specific number of shares of stock, they tend to gain or lose value along with the underlying stock. When the price of the underlying stock rises, the price of the convertible tends to rise as well. When a stock price falls, however, the convertible bond price typically declines only so far before its bond-like attributes establish a “floor” even if the stock price continues to decline. While convertibles are sensitive to their underlying equities’ price movements, convertible investors—as bond holders—still receive the interest income and the principal repayment that bonds offer.

ACTIVE MANAGEMENT AND ASSET ALLOCATION

Because the attributes of convertibles are complex and can change over time, active management is essential for capitalizing on their potential benefits. However, with active management, convertibles’ hybrid characteristics make them a compelling choice for a variety of asset allocation needs. Convertibles can be included in a core allocation to pursue lower-volatility equity exposure over full market cycles. They can also be used in enhanced fixed income and alternative strategies.

¹ Note: Different types of bonds have varying levels of risk. For example, the principal and interest of government bonds and U.S. Treasury bills are guaranteed by the full faith and credit of the United States; convertible bonds are not backed by this guarantee.

² In the case of an issuer’s insolvency, the convertible bond holder’s claim would be subordinate to the claims of holders of senior debt (for example, a non-convertible bond).

Illustrations are theoretical and are not representative of any convertible investment.

VALUING THE CONVERTIBLE

The value of a convertible security is affected by many factors, including the performance of the underlying stock and its volatility and coupon. The “Convertible Price Track” illustrations below show the theoretical relationship between a convertible bond’s price and the par value of the bond as the underlying stock price rises or falls.

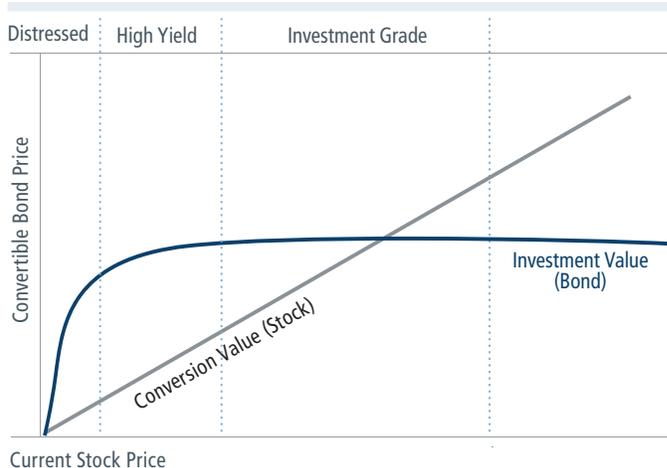
INVESTMENT VALUE

Investment value is the value of the convertible bond as if it were simply a straight bond without a conversion feature. The value of the bond at maturity is fixed. Hypothetically, holding everything else constant, the bond value stays relatively consistent over time and is not affected by changes in the issuer’s stock value unless the issuer approaches insolvency.

CONVERSION VALUE

The conversion value (sometimes called the equity value) is the stock’s current price times the pre-specified number of shares for which the convertible bond can be exchanged. The conversion value will move in tandem with changes in the stock price.

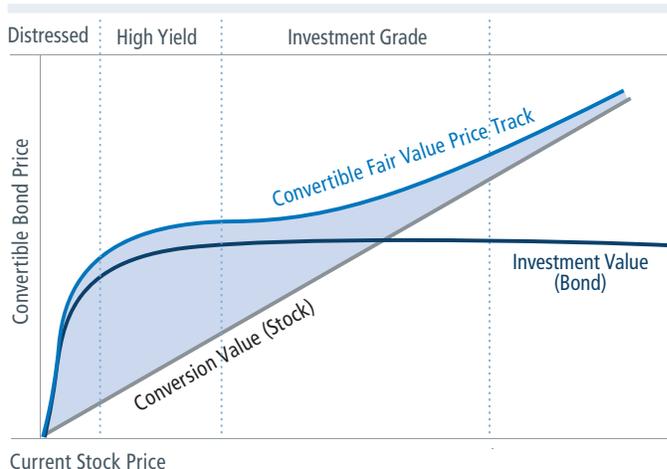
A CONVERTIBLE’S INVESTMENT VALUE AND EQUITY VALUE



CONVERTIBLE PRICE TRACK

The convertible price track is the line representing the theoretical value of the convertible bond. It tracks the upward changes in the price of the underlying stock, yet is cushioned by the bond floor as the stock price declines. Should equity prices get quite high, the convertible is priced very similarly to its underlying equity. Conversely, when the underlying stocks are far below conversion value, convertibles are said to be “busted” and perform more like straight bonds. Convertibles generally provide the greatest advantage to investors when they are in the middle range of the fair value price track, offering the potential for a combination of equity upside and bond-like downside protection.

CONVERTIBLE PRICE TRACK AND CONVERSION PREMIUM



CONVERSION PREMIUM

The conversion premium is represented by the shaded area between the equity value and the convertible’s fair value price track. This “conversion premium” is the premium an investor will pay over a “straight” bond price, representing the value offered by the convertible’s option to be converted into common stock.

The figures depicted above are for illustrative purposes only and do not represent the past or future performance of any security or Calamos portfolio. Diversification and asset allocation do not guarantee a profit or protect against loss. Alternative strategies entail added risks and are not suitable for all investors.

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

This report has been prepared by Calamos Advisors LLC for informational purposes only and should not be considered investment advice.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

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