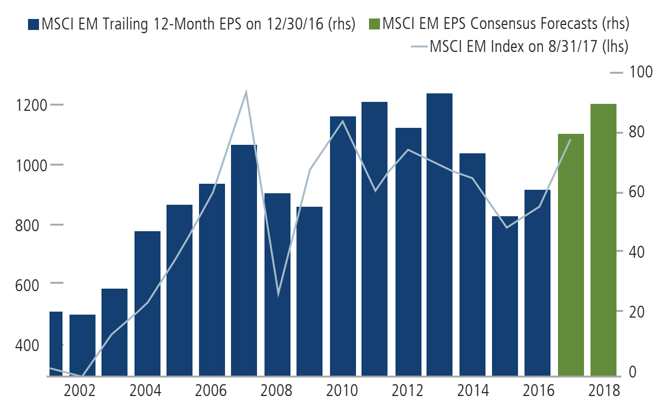
Looking At The Past As We Think About The Future:
The Longer-Term Opportunity in Emerging Markets

By Nick Niziolek, Todd Speed and Kyle Ruge

Higher economic growth, positive earnings trends, increased capital flows and rising currencies versus the U.S. dollar have fueled the outperformance of emerging markets during 2017. As investors look past geopolitical risks to focus on these more positive trends and improved global growth, emerging market equities have returned 30.5% year-to-date through September 15, rebounding 65% since their lows in January 2016. In light of these gains, some investors are increasingly considering if the bull case is already fully reflected in prices and if so, what the implications are for total return potential over the complete market cycle.

FIGURE 1. POSITIVE TRENDS IN EMERGING MARKETS' EARNINGS GROWTH



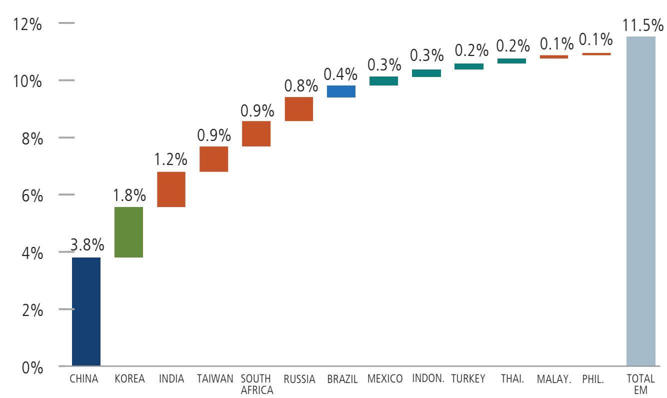
Source: Bloomberg. Data through 8/31/17.

Fundamental context: Positive growth, broad-based leadership and a weaker dollar

As we discussed in our recent blog, global economic growth is highly synchronized today, with improving demand providing support for major emerging market economies. According to a recent article in *The Wall Street Journal,* 45 countries tracked by the OECD are all expecting positive growth this year, with 33 economies poised to accelerate from a year ago.[1] This shared prosperity is boosting EM export growth and, in turn, supporting a pickup in domestic demand and nominal GDP growth in these economies. The IMF forecasts GDP growth in EMs rising from 4.3% in 2016, to 4.6% this year and 4.8% in 2018.

The boost to economic activity and company revenues is also showing up in corporations' bottom line results. Emerging markets struggled through a prolonged earnings recession from 2013 through 2015 and are now in the second year of a positive inflection in earnings. Emerging market stocks have outperformed global equities this year with much of the excess return attributable to an estimated 20% earnings growth in 2017 versus 12% estimated in developed markets.[2]

FIGURE 2. RISING TIDES: ALL MAJOR EM ECONOMIES ARE CONTRIBUTING TO 2018 ESTIMATED EARNINGS GROWTH



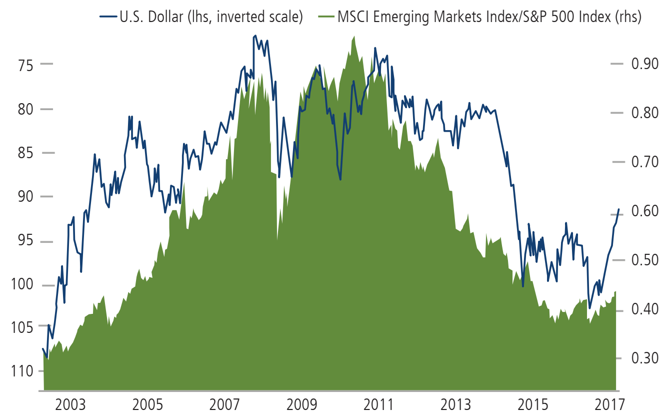
Source: J.P. Morgan Emerging Markets Research, September 8, 2017; using data from MSCI, DataStream and J.P. Morgan. Calculations as of August 15, 2017.

1. *The Wall Street Journal,* August 23, 2017, "Global Economies Grow in Sync," Josh Zumbrun.

2. J.P. Morgan Emerging Markets Research, September 8, 2017.

FIGURE 3. WEAKER DOLLAR AND IMPROVING GLOBAL GROWTH HAS SUPPORTED EMS

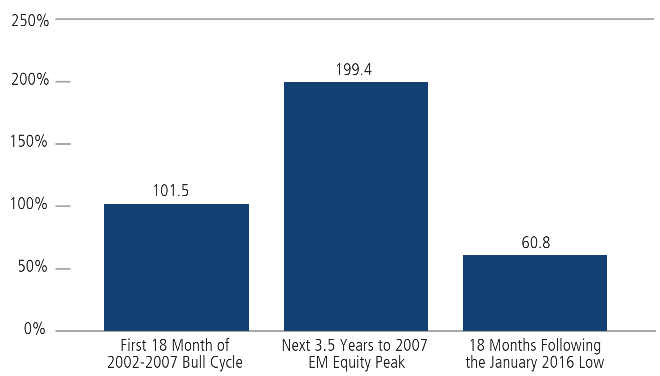
Emerging markets vs. S&P and the dollar, 2002 to 2007 EM bull market



Source: Bloomberg. Data as of 9/13/02 to 9/15/17. U.S. dollar represented by the U.S. Dollar Index.

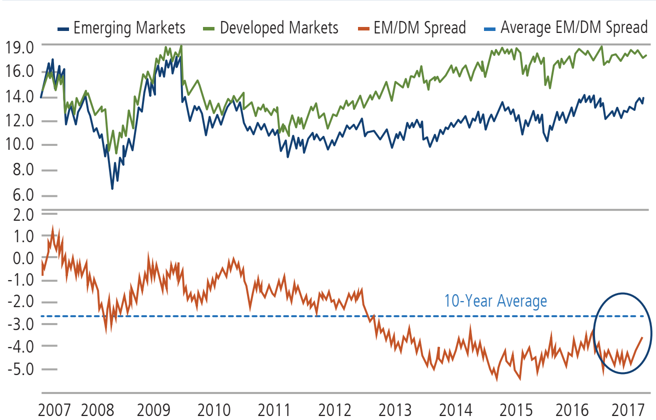
FIGURE 4. RETURNS COMPARISON: INITIAL PHASE OF THE EM EQUITY RALLY VS. LONGER-TERM CYCLE

MSCI Emerging Market Index total return



Source: Bloomberg. First 18 months of 2002-2007 bull cycle data from 10/10/02-4/9/04. Next 3.5 years data from 4/9/04-10/31/07. 18 months following January 2016 low data from 1/21/16-7/21/17.

FIGURE 5. EM AND DM FORWARD PE COMPARISON, 10-YEARS



Source: Bloomberg. Data as of August 31, 2017.

Currency: A weaker U.S. dollar is the rest of the world's stronger currency

Before this year, a strong dollar environment had prevailed, in part because of the "weak-euro" and "weak-yen" environment. With the euro zone and Japan recovering, their currencies are no longer pushing the dollar ever higher. President Trump has carried on his campaign focus of a U.S. manufacturing resurgence, which requires a weak dollar to support U.S. competitiveness, and has specifically called out the dollar as too strong or other countries as "currency manipulators." This would indicate he is not only comfortable with a weaker dollar but may actually be willing it lower. Meanwhile, Mario Draghi's and the ECB's limited commentary on the stronger euro and its potential impact on exporters, growth, and inflation in the euro zone could indicate the ECB is also comfortable with a stronger euro. A weaker dollar and improving global growth historically has supported strong emerging market returns, with the 2002 to 2007 EM bull market providing the most recent extended example (Figure 3).

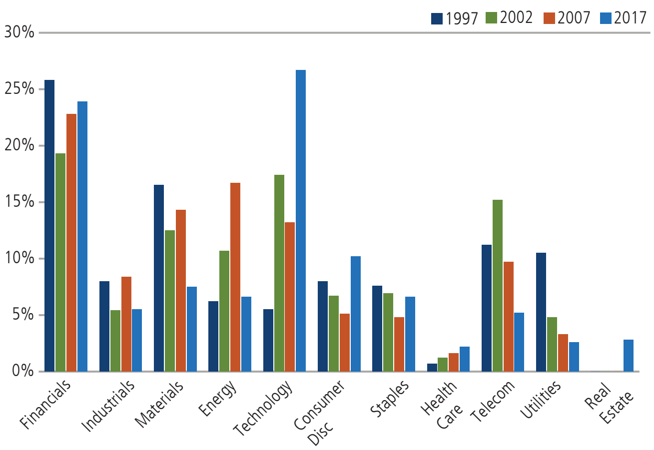
Over the 18 months following the January 2016 low, emerging markets delivered strong gains (60.8%). However, if dollar strength remains contained, the second leg of this rally (the current environment) could last much longer than the 2009 to 2011 recovery. The dollar was fairly range-bound and rallied into late 2011, with growth slowing globally—the opposite backdrop of today. Today's macro conditions and relatively attractive valuation landscape may ultimately present the opportunity for a cycle more reminiscent of the 2002 to 2007 period, which saw rapid and robust initial gains, followed by sustained above-average return potential in emerging markets. In the first 18 months of the 2002 to 2007 bull cycle, investors saw gains of 102%. This was followed by an additional 199% over the next three-and-half years until the 2007 EM equity peak—a 36% annualized return during this three and a half year stretch (Figure 4).

Evolution of EMs: Supporting the long-term potential

While aspects of today's EM investing landscape echo the growth and valuation opportunities of the past decade (Figure 5), there are critical differences that may drive further capital compounding. For example, leading EM businesses are much more reflective of a dynamic global economy versus the 2002 to 2007 period when "old economy" leaders dominated benchmarks.

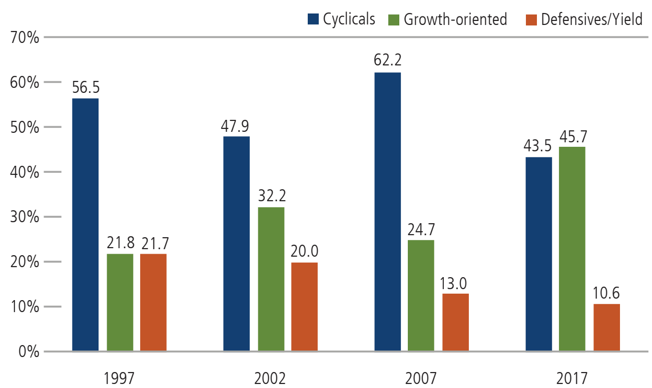
The changing sector composition of the MSCI Emerging Market Index illustrates the evolution of emerging economies from a commodity-intensive, export-led growth model to a more consumer-driven model. Today, there is greater exposure to areas such as technology and health care innovation, e-commerce, fintech, education, and mobile payments (Figure 6). As shown in Figure 7, the weight in traditionally growth-oriented sectors now exceeds the weight in cyclicals.

FIGURE 6. INDIVIDUAL SECTOR WEIGHTS OVER 20 YEARS REFLECT THE EM DEVELOPMENT EVOLUTION



Source: MSCI, data as of 8/31/17.

FIGURE 7. EM INDEX SECTOR GROUP WEIGHTINGS HAVE EVOLVED OVER TIME



Source: MSCI, data as of 8/31/17, using Calamos groupings (Growth: Tech, Discretionary, Staples, Health Care; Cyclicals: Financials, Industrials, Materials, Energy; Defensives: Utilities, Telecom, Real Estate).

QUESTION: HOW MUCH SHOULD LONG-TERM INVESTORS ALLOCATE TO EMERGING EQUITIES?

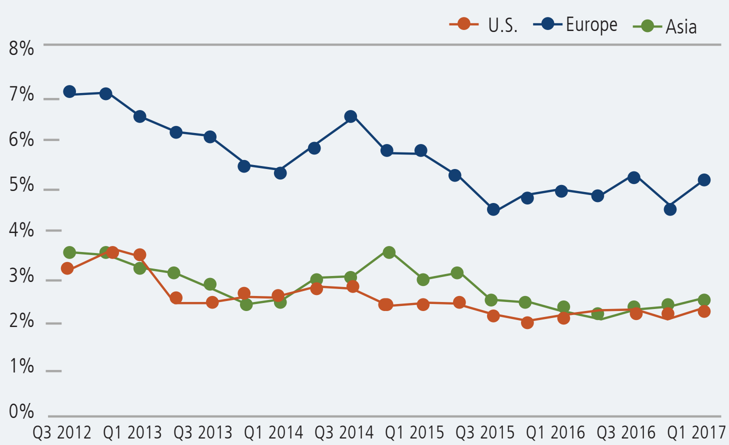
ANSWER: PROBABLY MORE THAN THEY HAVE TODAY.

Both U.S. institutional and retail investors are likely underweight emerging market equities. Many U.S. institutions have shifted growth capital to private equity, real estate, and venture capital, reducing equity holdings and reflecting a regional bias toward the U.S. These equity allocations have benefited from above-trend returns and below-average volatility in U.S. stocks over the past seven years versus non-U.S. investments.

However, this trend has resulted in significant under-investment in emerging market equities relative to the global investment universe. According to eVestment, EM equity comprises less than 3% of U.S. institutional investors' long-only assets, with only modestly higher levels in Europe. Many retail investors are also underweight to EM equities. Only 3% of mutual fund assets are invested in EM equity funds, but EM companies make up 11% of the global equity market and EM and developing countries represent more than 50% of the global economy, based on a measure of GDP growth that accounts for purchasing power.

FIGURE 8. SIGNIFICANT UNDER-INVESTMENT IN EM EQUITIES

EM equity AUM as a % of total long only AUM by investor domicile



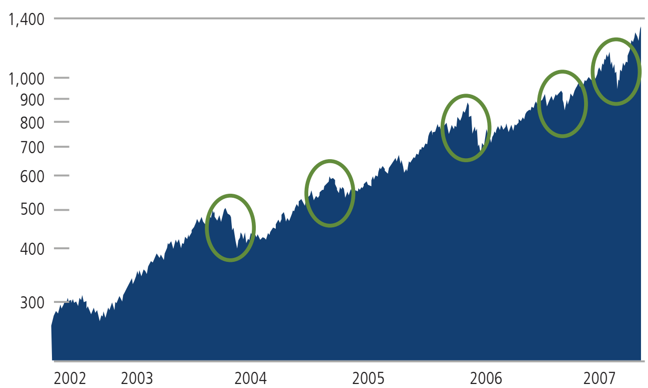
Source: eVestment, Trends in Long-Only EM Strategies, 8/24/17.

Further capital appreciation may be punctuated with volatility

Bolder EM investors have been rewarded with compelling gains over recent quarters, but the capital appreciation opportunity for patient investors may be even more rewarding as the complete market cycle progresses. It is critical to underscore that in EM investing, risk and return are especially close bedfellows. Even if an extended bull cycle unfolds, emerging markets will experience significant sell-offs – often quick and volatile drawdowns that test our resilience to invest in a context of uncertainty, leaning on a sound investment approach and underlying fundamental view. The 2002 to 2007 bull cycle challenged investors with five such corrections of 10% or more, with an average drawdown of 17%, as reflected in the chart below.

FIGURE 9. EM SELL-OFFS HAVE OCCURRED DURING BULL CYCLES

MSCI Emerging Markets Index, Daily Price, October 2002 to October 2007



Source: Bloomberg. Data as of 10/10/02 to 10/31/07.

Conclusion

We continue to invest with an eye toward rising global growth, while also considering the path toward global monetary policy normalization, moves we expect to follow a gradual course. Emerging markets are better positioned than a few years ago, with stronger currencies, improved current account balances and healthy debt markets. In our view, EMs should be evaluated more on the merits of their own fundamentals and less as a blunt proxy for global liquidity. Emerging markets are experiencing better macro conditions broadly and improving corporate fundamentals with rising earnings, higher return on equity, and attractive equity valuations versus history and peer markets. We believe this set of conditions supports the potential for sustained outperformance in emerging markets over the next three to five years.

The Role of Calamos Emerging Economies Strategy

A risk-managed approach provides the potential to reduce downside volatility, diversify a multi-manager allocation, and contribute to smoother return profile over time – supporting long-term capital appreciation and growth opportunities.

Calamos Emerging Economies Strategy:

» Employs a risk-managed approach to access growth opportunities in EMs

» Emphasizes companies with higher quality growth fundamentals and durable secular themes

» Widens the opportunity set (via revenue mapping and multinationals) to unlock more opportunities to target growth themes, enable active management and exploit relative value

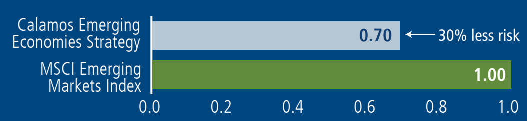
» Utilizes an advantaged pool of securities, including convertibles to manage the risk/reward profile

» Emphasizes investment in economies enacting structural reforms and with rising economic freedoms

» Delivers access to EM growth and the potential for capital preservation using a rational approach

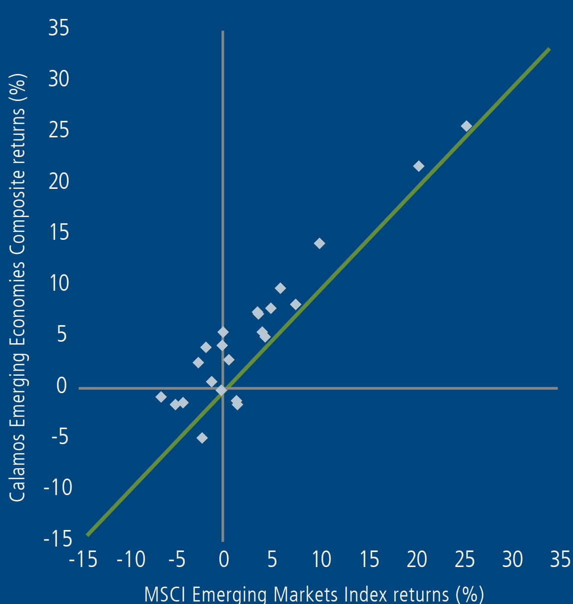
» Has outperformed the broad index with less risk since inception in December 2008, as measured by beta, a popular statistic for gauging historically volatility

BETA SINCE INCEPTION



OUTPERFORMANCE SINCE INCEPTION

Since its inception in December 2008, the Calamos Emerging Economies Strategy has navigated over almost nine years and multiple market phases. Our risk-aware approach to investing in dynamic growth opportunities in emerging markets outperformed the index with lower volatility. The chart below shows the rolling three-year returns for the Emerging Economies strategy and the MSCI Emerging Markets Index for each quarter since the strategy's inception through June 30, 2017. The x-axis shows the index returns and the y-axis shows the strategy's returns for the corresponding time period. Dots above the bold diagonal line are periods when the portfolio outperformed and below the line are periods in which the portfolio underperformed. Since its inception, the strategy has outperformed its benchmark in 87% of the rolling three-year periods, gross of fees.



Source: Calamos Investments and Mellon Analytical Solutions, LLC.
Past performance is no guarantee of future results. Data is through 6/30/2017. Performance shown since inception of the Calamos Emerging Economies strategy 12/2008. Gross of fee returns. Returns are calculated from monthly returns and shown for every three-month interval.

Beta considers a portfolio's historic volatility versus the market, which is assigned a beta of 1.0. A portfolio with half the volatility of the market would have a beta of 0.5, while a portfolio with a beta of 2.0 would have been twice as volatile as the market. Strategy data is since composite inception on 12/1/08 through 6/30/17.

For more information, please visit www.calamos.com.

About the Authors

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As a Co-Chief Investment Officer, Nick Niziolek is responsible for oversight of investment team resources, investment processes, performance and risk. As Head of International and Global Strategies, he manages investment team members and has portfolio management responsibilities for international, global and emerging market strategies. He is also a member of the Calamos Investment Committee, which is charged with providing a top-down framework, maintaining oversight of risk and performance metrics, and evaluating investment process. Nick joined the firm in 2005 and has 15 years of industry experience, including tenures at ABN AMRO and Bank One. He received a B.S. in Finance and an MBA from DePaul University.

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As a senior member of the firm's portfolio specialist team, Todd focuses on our global, international and emerging market equity strategies. Todd is responsible for communicating our investment process and strategy, macroeconomic perspectives, strategy performance, positioning, and risk attribution to clients, consultants, and other stakeholders and investors in the firm's strategies. In addition, Todd supports the co-portfolio managers and co-chief investment officers with the analysis of portfolio activity, positioning, and risk attribution. Todd joined the firm in 2010 and has 19 years of industry experience, including roles at Bainco International Investors, CFRA LLC and Deutsche Bank. Todd received a B.A. in Economics and Political Science from Duke University and an MBA from the Fuqua School of Business. Todd holds Series 7 and 63 registrations.

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Kyle Ruge is a member of the international and global investment team and is responsible for fundamental research as well as for assisting in the portfolio management of the firm's global, international, and emerging market equity strategies. He joined the firm in 2006 and has 13 years of industry experience. Kyle began his career with Broadview Advisors and McCarthy, Grittinger and Weil Financial Group. Kyle graduated magna cum laude from Marquette University with a B.S. in Finance.

ANNUALIZED TOTAL RETURNS (6/30/17)

	1-YEAR	3-YEAR	5-YEAR	SINCE INCEPTION (12/08)
Calamos Emerging Economies (gross of fees)	13.46%	-1.18%	3.70%	10.36%
Calamos Emerging Economies (net of fees)	12.26	-2.32	2.50	9.11
MSCI Emerging Markets Index	24.17	1.44	4.33	10.85

Past performance does not guarantee or indicate 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.

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Indexes are unmanaged, not available for direct investment and do not include fees and expenses. The S&P 500 Index is considered generally representative of the U.S. equity market. The MSCI Emerging Markets Index is a measure of the performance of emerging market equities. The MSCI World Index is a market capitalization weighted index composed of companies representative of the market structure of developed market countries in North America, Europe, and Asia/ Pacific region. The U.S. Dollar Index measures the value of the U.S. dollar relative to a basket of foreign currencies, including the euro area, Canada, Japan, United Kingdom, Switzerland, Australia, and Sweden. Earnings per share (EPS) is a company's profit divided by its number of common outstanding shares. CAGR, or compounded annual growth rate, measures year-over-year growth.

The results portrayed on the preceding pages are for the Calamos Emerging Economies Composite. Representative holdings and portfolio characteristics are specific only to the portfolio shown at that point in time. Other portfolios will vary in composition, characteristics, and will experience different investment results. The representative portfolio shown has been selected by the advisor based on account characteristics that the advisor feels accurately represents the investment strategy as a whole.

The Calamos Emerging Economies Composite is an actively managed composite investing in a globally diversified portfolio of equity, convertible or debt securities, with at least 35% of constituent portfolio assets are invested in securities of issuers that are organized in emerging market countries. Investments in securities of developed market companies are generally limited to those companies which derive 20% or more of assets or revenues from emerging market countries. The Composite was created December 1, 2010 calculated with an inception date of December 1, 2008 and includes all fully discretionary fee-paying accounts, including those no longer with the Firm.

Fees include the investment advisory fee charge by Calamos Advisors LLC. Returns greater than 12 months are annualized.

Chart Data Sources: Mellon Analytical Solutions, LLC and Calamos Advisors LLC.

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