# Convertible Opportunities and Income Fund (CHI) 1Q16 Commentary

CALAMOS® INVESTMENTS

## FUND

- CHI is an enhanced fixed income offering that seeks to provide an attractive monthly distribution, 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] | 12.01% |

## ASSET ALLOCATION

| | |
|---|---|
| Corporate Bonds | 40.2% |
| Convertible Bonds | 35.3 |
| Convertible Preferred Stock | 17.7 |
| Common Stock | 0.4 |
| U.S. Government Securities | 0.1 |
| Cash and Receivables/Payables | 6.3 |

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 $0.0950 per share. Based on our current estimates, we anticipate that approximately $0.0000 is paid from ordinary income or capital gains and $0.0950 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 level rate distribution policy, distributions paid to common shareholders may include net investment income, net realized short-term capital gains and return of capital. When the net investment income and net realized short-term 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

While the S&P 500 Index finished a tumultuous quarter in positive territory, the broad U.S. convertible market posted a modest decline. The performance of the convertible market reflected a divergence between the returns of the largest cap stocks versus small- and mid-cap growth names, which dominate the ranks of convertible issuers. Highlighting this divergence, the Russell 2500 Growth Index fell 2.26%, while the S&P 500 returned 1.35%.

Although the convertible market declined during the quarter, convertibles demonstrated their structural benefits by providing a measure of downside resilience. The BofA ML All U.S. Convertibles Index, the broadest measure of the U.S. convertible market, declined 1.56%, while the underlying equities of the index dropped 4.77%, due in large measure to health care and information technology names.

Convertibles and equities initially declined sharply because of falling oil prices, declining global growth, geopolitical tensions and concerns regarding China's stability. At the bottom of the market on February 11, more than 70% of convertibles' underlying stocks were 20% or more below their one-year highs, which contributed to convertibles falling about the same amount as the S&P 500 Index. The markets reversed course after oil seemed to display signs of stability and the Federal Reserve lowered their forecast for 2016 interest rate hikes from four to two. From February 12 onward in the quarter, the S&P 500 Index rallied 12.95% while convertibles were up 10.06%, based on the BofA ML All U.S. Convertibles Index (VXA0).

**ANNUALIZED TOTAL RETURN AS OF 3/31/16**

| QUARTER | 1-YEAR | 3-YEAR | 5-YEAR | 10-YEAR | SINCE INCEPTION (6/26/2002) |
|---|---|---|---|---|---|
| On Market Price | | | | | |
| -2.17% | -18.68% | -0.17% | 2.50% | 2.37% | 7.51% |
| On NAV | | | | | |
| -1.96 | -9.72 | 2.59 | 4.98 | 5.69 | 8.64 |

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.*

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The U.S. high yield market gained in a volatile first quarter. The average credit spread started the quarter at 757 basis points above Treasurys, widened to as high as 920 basis points mid-quarter, and fell back to 753 basis points at the end of the quarter. The high yield market benefited from falling interest rates as the 5-year Treasury yield fell to 1.21% from 1.76% at the beginning of the year. While the Fed is now guiding towards only two rate hikes in 2016, the market is expecting a much more patient Fed and is pricing in just one rate hike much later this year.

**Distributions Remained Competitive.** The fund maintained a monthly distribution of $0.095 throughout the quarter. The fund's current annualized distribution rate was 12.01% of market price at the end of the quarter. We believe the fund's monthly distributions are very 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 1.77%, the S&P 500 was 2.19%, and the Credit Suisse High Yield Index was 7.74% at the end of the quarter.

## Performance Review

The fund lost 2.17% based on market price and 1.96% based on net asset value during the quarter, lagging the 3.11% return by the Credit Suisse High Yield Index.

The fund benefitted from our selection in utilities, namely electric utilities, relative to the Credit Suisse High Yield Index. Selection in consumer staples, namely with respect to packaged foods and meats, also contributed.

Conversely, our choices in information technology, notably semiconductors, semiconductor equipment and systems software, proved detrimental. In addition, selection in health care, namely biotechnology and pharmaceuticals, underperformed. On an asset class basis, our overweight to convertibles over high yield hindered performance as high yield outperformed convertibles.

## Positioning

In terms of credit-quality exposure, our heaviest weight of 33% is to the BB credit tier, which we believe has the best risk/return profile over time while taking income into consideration. We continue to take a very selective approach to CCC rated credits, in spite of the fact that they have seen marked improvement over the past quarter. From an economic sector perspective, our heaviest exposures are to information technology, consumer discretionary and health care, which represent more than half of assets. Our lightest exposures are to materials, utilities and consumer staples.

## Leverage

We believe this environment is conducive to the prudent use of leverage as a means of enhancing total return and supporting the fund's distribution rate. We believe our enhanced leverage facilities through employing BNP Bank and State Street Bank have been beneficial to the fund. This enhancement will continue to provide diversity and increased capacity to our borrowing capabilities and present the opportunity to reduce interest costs. Our total leverage was approximately 29% at the end of the quarter. We also use interest rate swaps to potentially protect the fund from a sudden rise in interest rates.

## Conclusion

We believe the U.S. is in a slow-growth economic phase and that convertibles will continue to increase through bouts of

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equity volatility. Fuel for possible volatility includes contentious politics ahead of U.S. November elections, the U.K.'s upcoming vote on a potential withdrawal from the European Union, uncertainty around oil prices and global demands, and China's efforts to stabilize its markets and economy. Investors believe that the Fed will continue to support the slow-growth environment given the central bank's focus on monitoring global developments when making interest rate decisions. We are investing with an eye to risk management because of the potential for volatile markets. Relative to stocks and traditional fixed income securities, convertibles can provide unique advantages in volatile markets as long-term investors may potentially benefit from narrowing spreads, a rebound in convertibles' underlying equities, and improving convertible valuations.

In high yield, we think volatile behavior will continue throughout 2016, with returns coming mainly from yield. European easing and negative interest rates in many parts of the world will help support demand for the asset class. We believe that strategic and risk-tolerant fixed income investors still will find the yields attractive relative to other fixed income securities. Wide credit spreads of 700 basis points and average prices at $90 appear attractive, but there are formidable challenges ahead. Some of these include a possible U.K. exit from the European Union, uncertainty in U.S. elections, global economic softness, increasing default rates and oil price volatility.

We favor higher credit quality in this environment, realizing that there may be periods when this strategy underperforms lower quality names. Careful selection will be paramount to success as we navigate through the challenging credit environment in 2016.

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**Important Fund Information**

The goal of the level-rate 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 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 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 **BofA ML All U.S. Convertibles Index (VXA0)** is comprised of approximately 700 issues of only convertible bonds and preferreds of all qualities. The **Credit Suisse High Yield Index** is an unmanaged index of high yield debt securities. The **S&P 500 Index** is generally considered representative of the U.S. stock 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.The **Russell 2500 Growth Index** measures the performance of the small to mid-cap growth segment of the U.S. equity universe.

**Terms**

**A Level Rate 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.

The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the sectors, securities and markets mentioned. The information contained herein, while not guaranteed as to the accuracy or completeness, has been obtained from sources we believe to be reliable. Opinions expressed herein are as of the date of publication and are subject to change without notice due to various factors and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

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