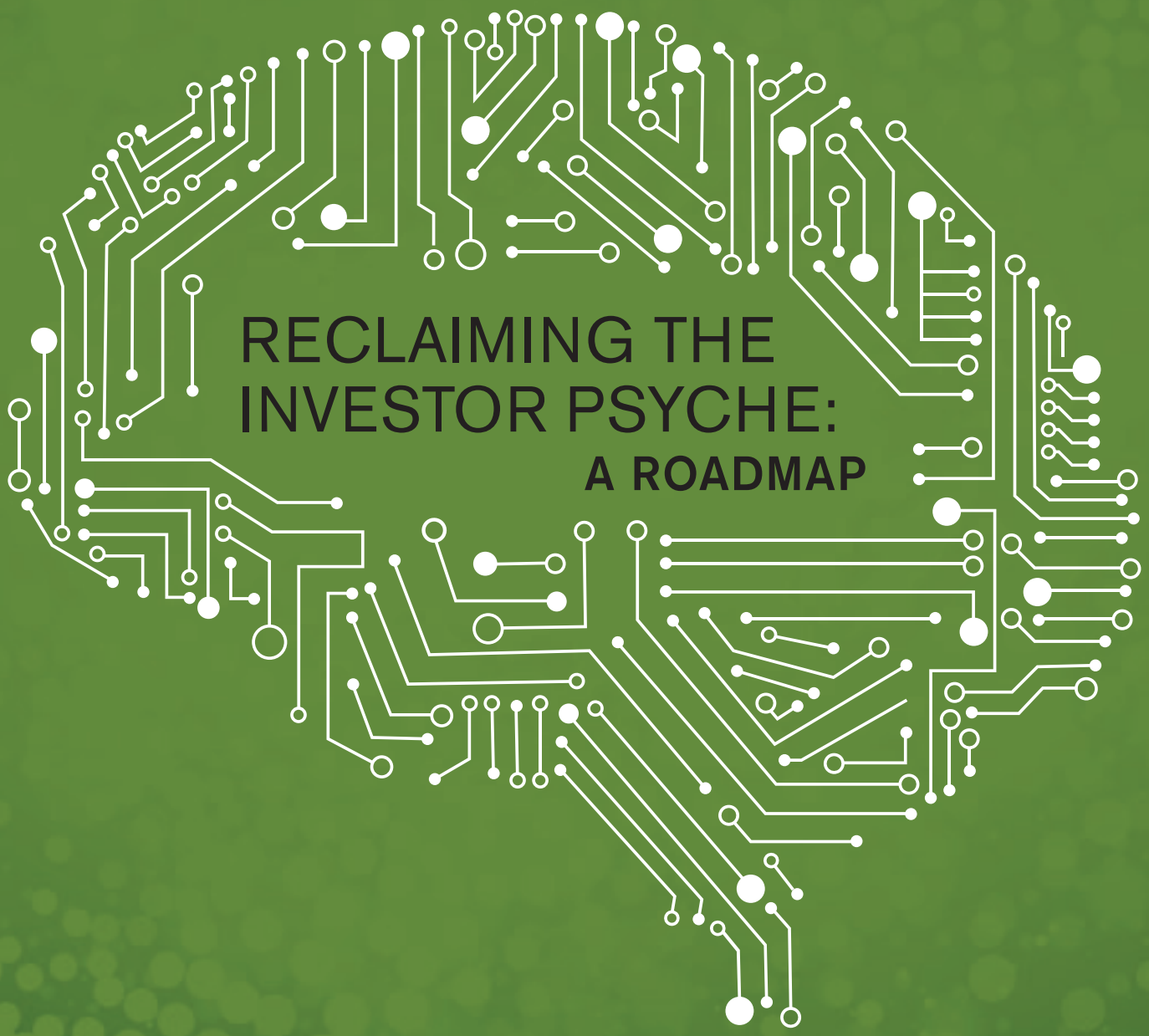
CALAMOS®
INVESTMENTS



RECLAIMING THE INVESTOR PSYCHE:
A ROADMAP

A SERIES OF GLOBAL LONG/SHORT PERSPECTIVES | **JULY 2018**

Reclaiming the Investor Psyche: A Roadmap

A SERIES OF GLOBAL LONG/SHORT PERSPECTIVES

Investment success requires taking on risk in exchange for return. Since John P. Calamos, Sr., founded Calamos Investments in 1977, our aim, as active managers, is not to avoid risk, but to engage it in a sensible and measured manner.

But the years since the Global Financial Crisis (GFC) have skewed how investors think about risk. In the interest of stability, governments and central bankers alike have pursued policies that have remapped investors' understanding of economic growth, corporate profitability and insolvency risk—and how all of these impact equity returns.

On the following pages we present Reclaiming the Investor Psyche: A Roadmap, the perspective of Michael Grant, Calamos Co-CIO, Head of Global Long/Short Strategies and Senior Portfolio Manager of Calamos Phineus Long/Short Fund (CPLIX).

The goal of the Roadmap is to help financial advisors think about how the investing landscape has changed, and what this implies for clients' pursuit of investment returns for the remainder of the investment cycle.

TABLE OF CONTENTS

Michael Grant

Co-CIO, Head of Global Long/Short Strategies

Michael Grant manages investment team members and leads the portfolio management teams responsible for our Calamos Global Long/Short and U.S. Growth 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. He joined Calamos in 2015 and has 32 years of investment industry experience.

Prior to joining Calamos, Michael founded Phineus Partners in 2002, where he launched a successful long/short strategy. Previously, he was a Managing Director of Schroder Investment Management with responsibilities over US equity mandates. During his tenure at Schroders, he also served as Head of the Global Technology Team and Head of the U.S. Equity Team in London. Prior to that, Michael was a portfolio manager for the National Investment Trust Co. in Taipei, Taiwan and a US equity analyst for the Principal Group in Canada. Michael earned a master's degree from the London School of Economics, where he specialized in International History. He has a Bachelor of Commerce from the University of Alberta, Canada.

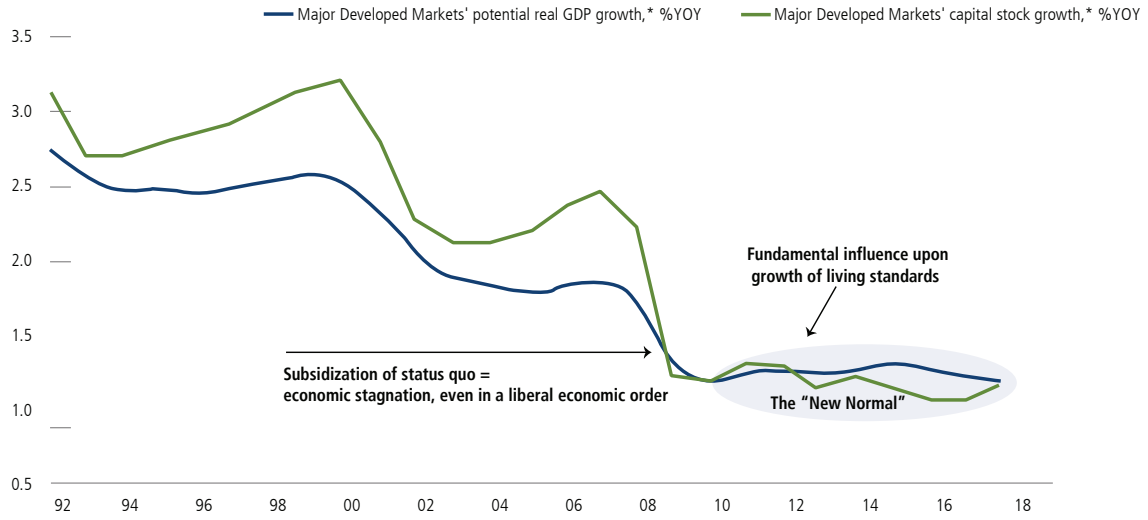
The U.S.: An Island of Economic Dynamism and Non-monetary Reflation

By some measures, the world has made a spectacular recovery from the Global Financial Crisis (GFC), including what Michael Grant considers "outsized" returns delivered by U.S. equities.

But Grant believes that years of Quantitative Easing (QE) have taken a toll. "Excessive monetary stimulus encourages malaise, misallocates capital and depresses productivity," he says. "We have seen the symptoms of this across most of the developed economies."

Grant notes the origins of QE were well founded and timely, with the leadership of the Federal Reserve playing a decisive role in the recovery of the U.S. economy. But "monetary super-stimulus should remain a palliative. Too much dependency for too long distorts the long-term health of the capitalist body," says Grant.

LIVING IN THE PSYCHOLOGICAL SHADOW OF 2008: PERMANENT CAPITAL SUBSIDIZATION IS ANTI-CAPITALIST



Source: CPA London, Vol 90, March 6, 2017, using data from Datastream, CPA London. Past performance is no guarantee of future results. *EZ Big 7, US, Japan, UK, Canada, Australia, Switzerland, Sweden, Norway

Nearly a decade has passed since the crisis. And still, Grant believes, we live in its "psychological shadow."

"The psyche of the financial community and policy-makers in the developed world is dominated by the suspicion of fragility and shared fear of relapse," he says.

> "One part of any investment approach should be its ability to anticipate discontinuity," says Grant. "This is the essence of an active strategy and contrasts with today's passive approaches, which assume continuity."

To be sure, this has been an unprecedented time, with the major economies continuing to surprise. But in the U.S., there is no longer an imminent source of systemic economic or financial risk on the horizon. A more normal monetary environment can be restored, helped along by the fiscal and tax reform initiatives of the Trump administration, insists Grant.

How do we recover from economic stagnation and financial repression? Grant's view: There needs to be a monetary "return-to-more normal," with an end to the destructive booms and busts that partly resulted from overreliance upon hyperactive monetary policy over the past quarter-century.

As a framework for understanding where we've been and the potential for future opportunities for financial advisors seeking to position clients' risk assets, Grant provides a multi-year roadmap through 2021.

RECLAIMING THE INVESTOR PSYCHE: A ROADMAP

Global structural trends—the deleveraging of Western economies and the deflationary investment return to mean in the East—will extend to at least the end of this decade, according to Michael Grant, Calamos Co-CIO and Head of Global Long/Short Strategies and Senior Portfolio Manager of Calamos Phineus Long/Short Fund (CPLIX).

2016	2017	2018	2019	2020	2021
The last of the 3rd deflationary shock of the past decade: collapse of global producer assets in the commodity and emerging economy space. The bond market climax initiates the monetary inflection. The election of Trump as U.S. president is a watershed, marking a new economic policy regime.	The start of (short-lived) global synchronized growth. "Growth without inflation" leads to collapse of volatility and a "Garden of Eden" for passive investment strategies. Eurozone "growth shock" and cyclical recovery of producer economy.	Equity volatility returns, with peak U.S. price multiples in January 2018. Consensus embraces normalization of U.S. monetary policy and "stronger for longer" economy. Trade-off between growth and inflation deteriorates. A 2018-2019 topping process: monetary transition is sufficiently advanced to create market turbulence, but insufficient to precipitate a bear market.	Credit leads equity: higher rates create market turbulence as price expectations rise and credit stresses emerge. Peak equity prices by summer 2019; by H2, the "hard pounding" begins.[1] Labor power should be restored, probably by H2 2019. Monetary normalization brings the great post-2008 asset inflation to a close by 2H 2019 or 2020.	Investment cycle ends: credit is the principal channel of transmission. Climax of U.S. corporate profitability combined with crisis trough of EM economies and China in particular.	New investment fashion: inflationary growth led by global consumer.

[1]As the Duke of Wellington remarked at a critical stage of the battle of Waterloo, "this is hard pounding."

The U.S. equity market since 2008 demonstrates the power of market leadership, according to Grant. "Leadership equities, in terms of sectors and styles, are those that are best suited to the specific features of the investment cycle," he adds.

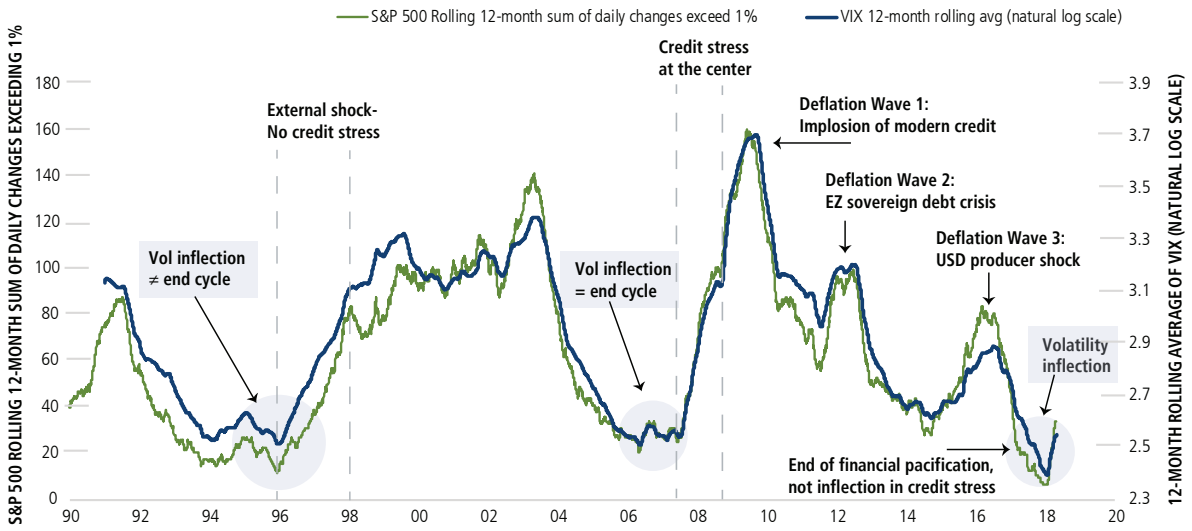
Grant highlights two factors to explain the outperformance of U.S. equities:

» First, the U.S. acknowledged and responded to the challenges of the deflationary shock from its inception, facilitating a "first-mover advantage." Reflecting American social preferences and "collective memory of the 1930s," the Federal Reserve was determined to avoid the errors of that earlier period. "This pro-business, pro-creditor outlook is a virtue in a deflationary setting," Grant says.

» The second edge was the resilient profitability of corporate America. The collapse of the U.S. corporate cost of capital amid sustained U.S. corporate profitability is described by Grant as the "organizing paradigm" of the post-2008 investment cycle. In particular, cash accretive growth companies become acutely valuable in a slowly expanding world of no inflation.

"The extraordinarily low cost of capital for corporate America was the twin of the decline of expected returns on investment," says Grant. "The falling cost of capital raised today's value of the future profits of comparatively safe growth stocks." No other major market can compete with U.S. leadership in this respect.

THE VOLATILITY REGIME OF US EQUITY: TREND REVERSAL IS BENIGN, NOT END-CYCLE



Source: Bloomberg. Past performance is no guarantee of future results.

This Growth Is Not 'Profitless'

Financial assets reprice when investors come to realize that their interpretation of significant features of the investment environment is mistaken, says Grant. In late 2016 investors recognized that the momentum of the global upswing had been underestimated.

> Reflation is economic growth associated with rising inflation expectations. So far, we have enjoyed growth, stronger for longer, but not reflation.

In most cycles, improved corporate profit margins should signal improved pricing power. The revival of corporate profitability and capital investment should translate sooner or later into upward pressure on output prices, Grant says.

Instead, he says, "expectations of sustained low inflation and modest growth in the developed world remain embedded in the investor psyche."

"Sooner or later, higher inflation should materialize. The setting of 'growth without inflation' has a sell-by date, at least in the U.S., and investors are awakening to this. The growth that is evident across the global economy is not 'profitless growth,'" insists Grant.

This link between the profitability regime and inflation expectations is a key debate for his roadmap.

The global upswing that started in 2017 was the most widespread revival of corporate profitability of the past decade because it included the recovery from the producer recession of 2015-2016. Profitability of almost all industries, across almost all regions improved in 2017.

And then came the first quarter of 2018, which Grant considers "a decisive inflection."

Q1 was the first setback in equities since 2008 that didn't benefit the defensive sectors. Neither quality debt nor defensive equity in the developed markets delivered outperformance in the first four months of this year. This was what he considers "a genuine discontinuity"—and implies the equity cycle has entered its late stage.

> "Equity follows credit in the macroeconomic world because the judgment of the credit crowd is invariably more reliable. This is why investors should focus on credit spreads and bond volatility, not just equity volatility."

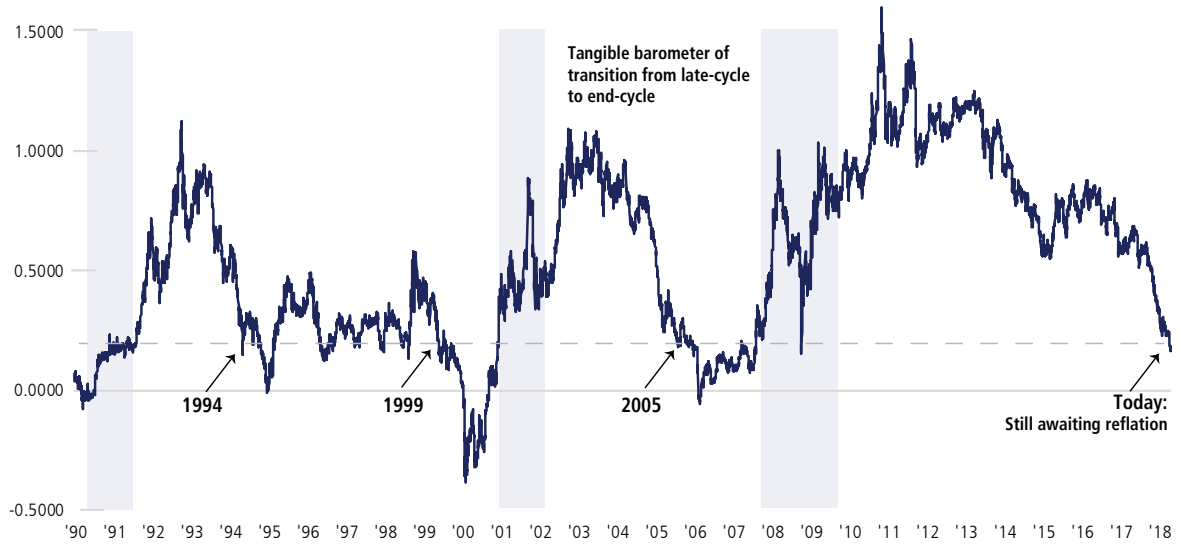
"Most investors assume that higher equity volatility implies lower returns. Wrong," says Grant.

"A transition to a more normal equity volatility does not necessarily imply lower returns for equities. The end of the investment cycle will be preceded by an increase in financial volatility led by trouble in the bond market." This is why the late-cycle debate is best viewed through the eyes of the credit community.

For now, Grant and the Global Long/Short Team's view is that late-cycle is not yet end-cycle.

And for Grant this is the central debate today: Will higher rates be a problem for U.S. equities, as they often have been over the past three decades? Or do they signal the end of unease and apprehension after a long deflationary experience, creating a window for the bull market to continue?

US YIELD CURVE SINCE 1990: EQUITY FOLLOWS CREDIT



Source: Fundstrat, Bloomberg. Past performance is no guarantee of future results

Entering the Twilight Zone

Bond markets are not yet signaling the end of the low inflation world. But, Grant says, the post-2008 bull market is entering its "twilight zone"—the beginning of the end.

A window of excess returns opened after 2016 because the initial phase of higher interest rates is beneficial for risk assets. This signaled the relaxation of deflation anxiety, he says.

Higher bond yields are the principal barometer of reflation, a requirement for the extension of the equity bull market. The question is the degree to which higher yields reflect easing deflation and stronger growth on the one hand, versus rising credit risk and rising inflation expectations. In Grant's view, the latter would generate a much more "disturbed" setting for equities.

Breaking Out of Economic Stagnation

Grant is most positive about the U.S. prospects for breaking out of economic stagnation.

The Quantitative Tightening ("QT") being undertaken by the Federal Reserve is a true advantage for U.S. assets as it reverses what Grant calls the "economically distortive and socially fractious" effects of Quantitative Easing (QE). He looks for the return-to-mean of interest rates in the developed world to occupy the next several years.

The policy agenda of the Trump presidency is a pro-business message and signals that reflation will continue by non-monetary means. In the context of sub-4% U.S. unemployment, this mix of fiscal initiatives, tax reform, trade and deregulation implies the long awaited turn in the labor share of national incomes is near.

In short, the foundation for higher inflation led by wage growth, likely by 2019, has been set.

"Trump's non-monetary reflation marks the end of the overreliance upon monetary policy in the U.S.," says Grant. The Fed will not raise rates aggressively but it is explicitly telling us that monetary policy will become "modestly restrictive" by the end of the decade.

> **Normalization defined:** The end of chronic stress associated with US housing, banking system and market value of American labor. Labor is the last piece, to normalize by H2 2019.

Since 2008, deflation anxiety has fed the long bull market in risk assets. Its comparative absence today is a warning of discontinuity, according to Grant. It suggests more disturbed markets into 2019-2020, including the return of the old axiom: what's good for Main Street is not always good for Wall Street.

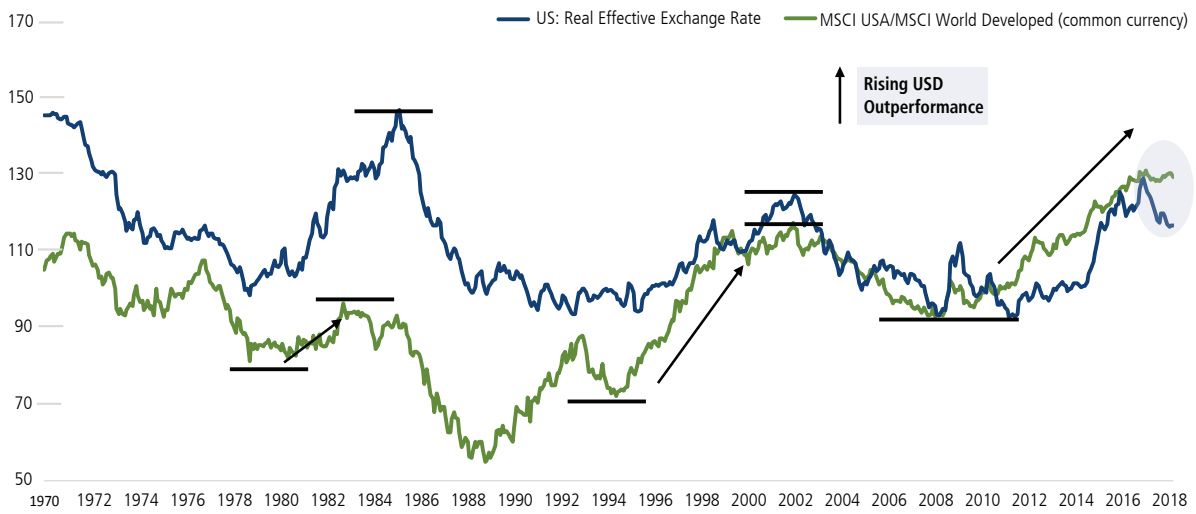
This "late-cycle" diagnosis of financial markets implies that profit growth will slow into 2019, because corporate costs will rise, even as the monetary environment becomes gradually less friendly. The trade-off between growth and inflation is starting to deteriorate, he says, and is the basis for his presumption for more disturbed markets.

The "emotional climax" of January marked the peak of the high momentum bullish phase, often associated with the peak of equity valuations. However, he says, we have not yet reached the end-cycle in terms of equity prices because corporate fundamentals are robust and the deterioration of the monetary environment is not sufficiently advanced.

"We are still some distance from the point where any central bank can be described as restrictive," he says.

The U.S. dollar is a symbol of the revival of "domestic America" and the credibility of monetary normalization, according to Grant. Every extended period of U.S. dollar strength since the 1970s has been associated with the leadership of U.S. equities, measured in common currency. This is playing out again today.

THE USD: SYMBOL OF THE REVIVAL OF "DOMESTIC AMERICA" AND THE CREDIBILITY OF MONETARY NORMALIZATION



Source: Calamos Investments with data supplied by Macrobond; and CPA London. Index: 2010 = 100. Past performance is no guarantee of future results.

Grant believes global capital flows are turning markedly in favor of the U.S. economy after decades of the opposite, when capital flowed into the emerging world after the collapse of the Soviet Union and the opening of China. Trump's trade policies are reinforcing this, as will the gradual splintering of the world into major economic blocs.

The same cannot be said of European equity. Grant says, "Europe's markets cannot bear for long the pressure of euro appreciation because there are few alternative, particularly domestic, sources of profitability. This overreliance on external markets is Europe's Achilles heel."

A Global Long/Short View: Why Europe Is In Trouble

The excitement attached to European equity in 2017 is unlikely to return anytime soon, according to Michael Grant. In fact, he says, there's a rising risk of the "Japanisation" of Europe's equity future.

Structural outperformance of European equity awaits a different investment cycle, one more favorable to the value style of investing. For now, Europe cannot inspire confidence, he says, cautioning investors to "avoid enthusiasm."

Europe lags well behind the U.S. trajectory, he notes, adding there is "no constituency for non-monetary reflation or deregulation of the American kind and, thus, some risk that Europe fails to exit its monetary experiment." Grant views the legacy of deflation in the eurozone as a "disastrous" divergence of conditions across its member economies that is arduous to reverse.

EARNINGS GROWTH IN US, EUROPE AND JAPAN

12-Month % Change in 12-Month Forward EPS Earnings Forecasts, 90-day moving average

Source: Calamos using data supplied by Macrobond; and CPA London. Past performance is no guarantee of future results.

Europe's largest established companies have underinvested in the future, he says, and represent what he calls "legacy capitalism"—overdependence on protected domestic markets that are stifled by an unfriendly regulatory, overtaxed culture that discourages innovation.

Its established companies are like "over-regulated utilities"—saved from insolvency, but where is the growth, asks Grant. "Where are the Facebooks and Googles of Europe? What's left is more of an open-air museum than a vibrant economy."

The European predicament, according to Grant, "reflects an enviroment in which capital has been subsidized, insolvency is suppressed and regulation has expanded to justify a Brussels technocracy. Across the political spectrum, there is a German-led preference for stability at the expense of risk-taking and capital expansion."

What follows is what Grant has to say, specifically, about Brexit and the UK, Germany and the Economic Union, and France.

Brexit and the UK

Much of the commentary concerning the British withdrawal from the European Union has been overexcited conjecture, according to Grant.

"We used to hear how Brexit would be the impetus for the revitalization of the Euro project. What we see is ideological rigidity and institutional inertia," he says. "Europe's leaders are trapped in the mental version of a foxhole."

For Grant, the barometer of the Brexit risk premium is the behavior of the GBP, which has stabilized versus the euro. However, Grant says there is little evidence that global investors have begun to revise their negative view of UK equities. "The prevailing suspicion across continental Europe is that the UK is committing some kind of economic suicide," he says.

> "American exceptionalism is its instinct for non-monetary reflation. No other developed economy is willing or able to emulate U.S. policies, yet."

The Brexit saga highlights the leadership deficit that frustrates any conversation about the future of Europe. Grant describes it as "a testament of institutional inflexibility and how political considerations hamper the rise of economically advantaged outcomes."

In Grant's view, the structural weaknesses of the euro system remain. There is neither convergence nor rebalancing along the direction that China is pursuing, he says, where the limitations of export-led growth are fully acknowledged.

At the same time, Grant dismisses the view that Brexit and the election of U.S. President Donald Trump marked the beginning of the disintegration of the European Union. This kind of reckoning ignores the political capital invested in the European project by its leaders, and by Germany above all.

Today's contradictions imply small incremental fixes rather than the emergence of a more dramatic vision. "If the EU ceased to exist it would have to be renewed in some form," says Grant, as close cooperation between European states is essential.

"The tragedy has been the drift away from cooperation amongst sovereign countries, towards a sort of United States of Europe, which overlooks the fundamental differences of national self-image and stages of economic development," he says.

Germany and the European Union

Grant is critical "of the rules-based, monocultural" order that the EU has built under German leadership. "It is undynamic and oversheltered: plainly vulnerable in a Trump world," he says. It overvalues stability at all cost.

> "Investors have lost their enthusiasm for the concept of Europe, are rightly suspicious of its sustainability and its failed promise of prosperity."

According to Grant, free trade in goods is sacrosanct in Germany, where Trump's calls for "free and fair trade" are rejoined with moral indignation. Since the creation of the euro, the share of exports in German GDP has nearly doubled from about 26% to 47%—an "amazing" imbalance for an economy of its size.

Not surprisingly, Germany's trade surpluses have become a source of irritation worldwide. According to Grant, Germany's business sector is especially threatened by Trump, for his demands are more credible and insistent even though his message is the same of prior U.S. administrations.

Together with France, the Angela Merkel government is open to policy initiatives to restore the momentum of European integration. According to Grant, the catalyst has been the UK's exit from the EU and a Trump administration that is questioning aspects of the post-war settlement under which Germany has prospered.

"Despite talk of Trump's new American isolationism, it is Europe that has displayed parochialism from a geopolitical and policy perspective for many years," says Grant. He describes Europe's claim to moral superiority in the trade dispute as "grotesque."

European unity will predictably emerge when there is the perception of an external threat, Grant says. Trump fulfills this role of the external enemy, adding that Trump is especially loathed in Germany. But again, he says, the current U.S. president is sending a message to Germany that is not new.

France

The eurozone is handicapped not only by its structural weaknesses and political instability that plague neighboring countries. A core weakness, according to Grant, has been the chronic underperformance of the French economy.

The French economy is one of the principal beneficiaries of Europe's economic return-to-normal, and Germany needs a partnership with France in order to restore political cohesion within the eurozone. "Growth without inflation" is an accurate description at the moment, according to Grant. Investors were surprised by the economic recovery in 2017 because growth has been so unfamiliar for so long.

> **What to watch:** For Europe to outperform world stocks, European banks must outperform European stocks, says Grant.

But Grant doubts that the region's equity markets can sustain international outperformance. More generally, a degree of reflation—which implies higher levels of inflation—is required to unlock the value in the region's equity assets.

Grant describes the presidential election of Emmanuel Macron as "symbolic of the technocratic elite that will not confront the fundamental burden: an oversized French state." He asks, "How credible are reforms when they start with the replacement of French for English as the official language of Brussels?"

Grant sees few signs that a Merkel-led Germany is prepared for the concessions that might remedy the structural imbalances within the euro system. Still, economic and political developments are converging to restore a degree of confidence in a European order under Franco-German leadership.

"In Europe economic confidence can never be separated from politics," Grant adds. "In this sense, the culture wars across the West destabilize Europe. However, it also offers a way out of the region's stagnation. The question is when and at what cost?" The social pressures and popular discontent that have given rise to Trump are equally apparent in Europe, he says.

The distortions of monetary super-stimulus are especially visible in Europe, where the central bank has been a major purchaser of corporate bonds, according to Grant. With the exit of the UK as political ballast against the French instinct toward protectionism and intervention, he worries that Europe will be unable to exit its monetary experiment for years or longer.

Most investors assume that political risk in Europe is exemplified by the challenges to the status quo, which now include almost every election in the region. Instead, Grant says, investors should focus on the consequences of the conservative, ineffectual nature of the economic orthodoxy that prevails today.

The status quo is noxious for investors, Grant believes. If Europe's political mainstream is incapable of responding to the discontent caused by people migration and the deflationary bent of the euro system, then investors should not fear political change. After all, "the moribund status quo is likely worse."

The Eventual Opportunity: UK Equities

The eventual opportunity across the Atlantic may be UK equities, which have become the most under-owned asset within the global equity universe. In contrast to consensus, Grant expects Brexit to unfold as a positive demand shock for the UK economy.

"Leadership always matters," he says "but reflation optionality for Sterling-based assets widens considerably after Brexit."

Three decades ago, the political tide of the former U.S. President Ronald Reagan and former UK Prime Minister Margaret Thatcher revolutions emerged first in the Anglo-Saxon economies, much as Brexit and Trump have today. This is not chance, says Grant, "but reflect the deep roots of liberal democracy in these societies. Their political elites bend earliest to social tensions and popular discontent."

"The protest against today's economic orthodoxy is just the beginning, just as it was under Thatcher and Raegan, and investors should consider the long-term implications," he says.

Winds of Change: Will Anti-Globalization Lead to a World Less Favorable for Capital?

Investors at the halfway mark of 2018 are entering the late stage of the post-2008 investment cycle. What comes after late-cycle is "end-cycle" and the proverbial bear market. A bear market, as defined by Michael Grant, is "the discontinuity that marks a shift in the investment setting that disrupts the leadership assets of the cycle in question."

Michael Grant detects foreboding among investors that the end of the equity cycle is near, for reasons that go beyond the simple longevity of the U.S. expansion.

"One can discern the signs of change," says Grant. "The most obvious is the fractious wave across the Western world which has transformed democratic expression into event risks for markets."

In his view, the U.S. 2016 presidential election and the UK's Brexit referendum can be understood as challenges to the existing orthodoxy: outsiders versus an establishment that became too identified with the costs of globalization.

"The investment world has sensed that politics are becoming less favorable for capital. The conversations about immigration and the movement of capital, the revival of worker wages and trade—all have implications for corporate profit margins, eventually."

In this context, Grant says the wariness of the financial world for U.S. President Donald Trump is about more than his peculiar style and personality. "Trump is symbolic of the popular revolt against the political and economic orthodoxy of globalization, which has been a disaster for the developed working class," he says.

Not surprisingly, he adds, this political mood feeds perception of vulnerability. "We estimate about one-quarter of the structural improvement in U.S. corporate profitability of past decades is related to the manufacturing shift to the low-cost emerging world. Politics do matter."

There is a silver lining, however.

Grant says that China's "great power mercantilist ambitions" are incompatible in the long run with an open global economy. "To some degree," he says, "Trump has recognized the climax of the old order, and is creating a new source of profitability to replace the old: a revitalized 'domestic America.'"

2018: Messages of the Market

One inflection for investors entering 2018 has been higher equity volatility. Grant views it as a rehearsal for greater upheavals to come. Q1 was the first setback in equities since 2008 that didn't benefit the defensive sectors, reflecting what he considers "a real discontinuity."

"In Q1, investors finally acknowledged trend reversal in the organizing paradigm of the post-2008 era: prolonged U.S. monetary super-stimulus and the secular bull market in bonds."

The "game of rate suppression and capital subsidization" is now over, he says, helped along by the end of fiscal austerity. This is the end of a long era in which the economic process has been dominated almost exclusively by central bank.

Today's politics of protest include central banking as part of the order that's being disrupted. "After all, who elects the central bankers?" Grant asks.

> Central banking is part of the world being disrupted, reinforcing the bias toward conservatism. Expect the inflection in interest rates to be slow and prolonged.

The policy message of Trump is that reflation must continue by non-monetary means. This implies that the extraordinary return on capital will drift lower in coming cycles—"largely to the benefit of labor," he adds.

"We are already seeing the consumption content of economic growth rise at the expense of investment. In the next downturn, we expect the Western consumer to be a refuge."

A key turn of Grant's roadmap is the transition from global-to-domestic, in terms of investment themes and sources of profitability.

"Politics is splintering the global economy into blocs. And the distribution of profit growth in coming years will reflect this," he says.

The underperformance of emerging equities is another piece of this puzzle, reflecting what Grant says is "oversupply and overcommitment to producer assets" at the expense of consumer-led models of growth. Calling the end of the "globalization boom," Grant believes the emerging economies will need to compete much harder for international capital.

End-cycle Defined

The capacity of the U.S. economy to progress toward monetary normalization is critical, according to Grant. No other economic bloc has addressed the legacy of the GFC as successfully as the U.S., he argues.

The current investment cycle will not end with deflation, he says. Instead, he says, it will end with the normalization of U.S. interest rates, which "naturally comes down to judging when enough is enough."

As the 10-year Treasury yield approaches 4%, the leading asset of this investment cycle—U.S. growth stocks—becomes vulnerable, Grant says.

> All of this translates into comparative advantage for one major bloc in particular: the U.S.

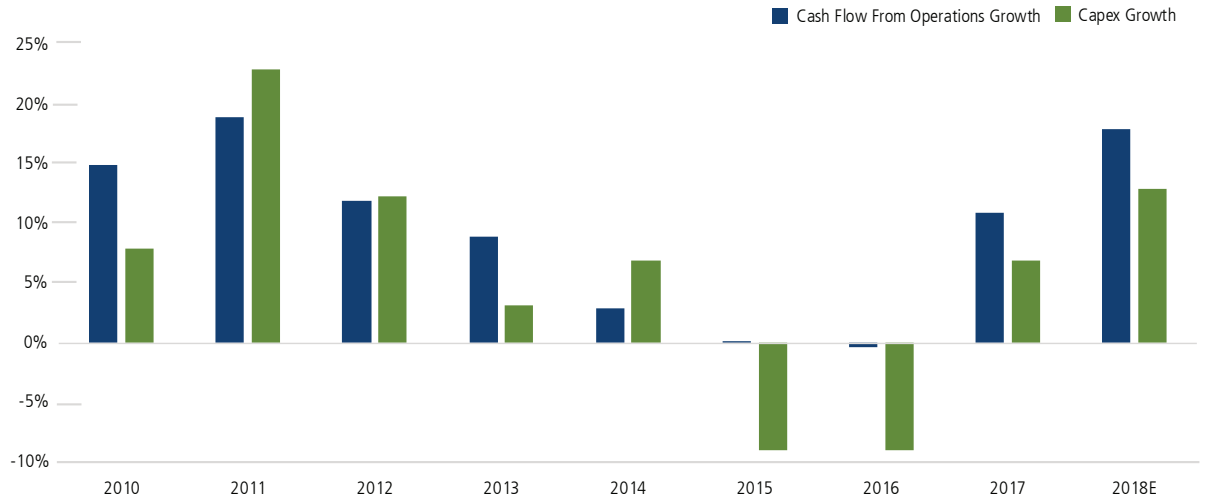
For now, the U.S. economy is enjoying robust cash flows and the consumer backdrop is what Grant considers "strikingly benign." The late-cycle boost to U.S. corporate profitability, aided by tax reform, is unprecedented. He doesn't see the rising leverage of corporates as an imminent threat to the expansion.

Acknowledging the unusually long expansion, Grant notes something that's different this time: the cyclical leadership of U.S. technology, whose margins and balance sheets are very different from the traditional industrial sectors.

Given that technology has led, Grant expects technology's eventual stumble to be "more macro than micro in character."

WHAT'S DIFFERENT THIS TIME: US CAPEX IS LED BY TECHNOLOGY AND CLOUD SPENDING IN PARTICULAR

Cash Flow from Operations YoY Growth vs Capex YoY Growth



Source: Goldman Sachs Equity Research., "The Ups (Capex) and Downs (Value)" June 15, 2018, using Compustat, FactSet, Goldman Sachs Global Investment Research.

"The pervasive theme of the build-out of cloud infrastructure implies that the risk, when it arrives, will be top-down, contagious and self-reinforcing." The Global Long/Short Team's "granular analysis of cloud spending implies another large step-up is required in 2019 to support today's valuations of these companies," Grant adds.

Eventually, interest rates are the link between "U.S. normalization in all its forms" and the extended credit cycle in the emerging world and China in particular. "China's problems do not arise amidst deflation and rate suppression," he says. "They will appear when the developed world confronts a 4% U.S. Treasury yield."

And, that's when conditions change again for investors. As Grant says, "A context of rising interest rates alters the conception of a 'defensive asset' for a diversified portfolio and for equities in particular."

Looking ahead, Grant expects the climax of U.S. profitability in 2019-2020 to converge with the end of the credit cycle in the emerging world. "The transmission mechanism is credit, which is why the end-cycle should be understood through the eyes of the debt people."

From that perspective, the "threshold of disruption" is probably somewhere above 3.5% on the 10-year U.S. Treasury, he opines. "Much above that level and returns for all risk assets fall to very low levels."

In summary, Grant anticipates a more disturbed setting for financial markets:

- Revival of financial volatility is the consequence of fading deflation risk, at least in the U.S. The world economic upswing will extend through 2019, possibly 2020, but globalization becomes splintered into economic blocs.
- In H1 2018, investors acknowledged the transition: the organizing paradigm of the long bull move in risk assets, driven by a declining cost of capital and unprecedented Central Bank intervention, has climaxed.
- The Quantitative Tightening inflection (2016-2020) is a return to a more normal cost of debt, particularly in the U.S. The inflection will be slow and prolonged but is significant because it signals discontinuity for the investment cycle.
- Rising interest rates suggest multiple disturbances and phases of consolidation in bond markets. The constraint is the tension between the U.S. economy, which can absorb policy normalization versus Europe and the emerging world, which have only suppressed insolvency, not resolved it.

- The U.S. is an island of comparative economic dynamism and non-monetary reflation in a still deflationary world. Led by the developed consumer, profitability will increasingly diverge across regions in coming years.
- Both Europe and China will remain the object of suspicion for many in the investment industry. In both there is a perception of structural unsustainability. This foreboding is well founded, but the end of the credit cycle can be delayed amid policies of rate suppression.
- Grant recommends investors favor countries that require less dependence upon Central Bank "monetary alchemy" in all its forms. "Permanent capital subsidization is anti-capitalist and noxious for equity owners," Grant believes.
- The investment world is no longer the derivative of a single "globalization" narrative. This raises the value of regional asset allocation: investors are advised to avoid those countries with high exposure to the "return-to-mean" of producer assets.
- Grant's dual imperatives of the next downturn: domestic and defensive. "Domestic versus global may be as relevant to performance outcomes as quality versus risk," he says. As importantly, cash resumes its traditional role as an active portfolio tool.

The Fading of Passive Management, Another Legacy of 2008

As detailed in this series, the next several years will be characterized by discontinuities. This, according to Grant, argues against buy and hold, which has faded in 2018. He expects the advantage to shift from passive investing to active long/short management in coming years.

For Grant, faith in passive investing is another legacy of 2008.

"Think about the basic difference between passive and active. Passive is money and opinion that follows price. It is momentum by nature and maintains its semblance of control with an analysis of what happened yesterday. It is logic by looking backwards."

"Active, at its best, anticipates discontinuity. Many fundamental strategies are more passive than active because they do not acknowledge the role of discontinuity in the investment cycle," he says.

> "The investment industry is aligned to the momentum of trade and transaction flows—there is less career risk with this thinking. Thus, discussion of discontinuity is contentious."

QE pushed investors out of cash in their search for yield, Grant says. But there was a side effect, which he identifies as blurriness over what a "riskless" asset is.

"Some part of the monies in passive products has no vocation in equities," he says. "Today, passive monies reflect exuberance, which is why we anticipate corrections that become shorter in time but more erratic in price."

"Even if the bull market continues into 2019," Grant concludes, "we can imagine a more disturbed setting for equity investors that will require the breadth of skill of active management."

About Calamos Phineus Long/Short Fund (CPLIX)

Seeking strong risk-adjusted and absolute returns across the global equity universe. The fund uses a global long/short strategy to invest in publicly listed equity securities.

- Compelling results through different market cycles
- Consistently executed with a sustainable competitive edge and continuous leadership
- Return objectives defined by available opportunities, not benchmark composition
- Blend of top-down/bottom-up considerations within a pragmatic, comprehensive process
- Continuation of Calamos' commitment to the alternative asset class
- Complete alignment among Calamos, the investment team and our clients

Learn more at www.calamos.com/CPLIX.

Financial advisors, for more information about the Global Long/Short Roadmap, Michael Grant or CPLIX, talk to a Calamos Investment Consultant at 888-571-2567 or caminfo@calamos.com.

Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The views and strategies described may not be suitable for all investors. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, accounting, legal or tax advice. References to future returns are not promises or even estimates of actual returns a client portfolio may achieve. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation.

Past performance is no guarantee of future results.

The principal risks of investing in the **Calamos Phineus Long/Short Fund** include: equity securities risk consisting of market prices declining in general, short sale risk consisting of potential for unlimited losses, foreign securities risk, currency risk, geographic concentration risk, other investment companies (including ETFs) risk, derivatives risk, options risk, and leverage risk.

The **S&P 500 Index** is considered generally representative of the U.S. stock market. Indexes are unmanaged, do not entail fees or expenses and are not available for direct investment.

The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

The **VIX (CBOE volatility index)** is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which 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.

Before investing carefully consider the fund's investment objectives, risks, charges and expenses. Please see the prospectus and summary prospectus containing this and other information which can be obtained by calling 1-800-582-6959. Read it carefully before investing.

CALAMOS®
INVESTMENTS

Calamos Financial Services LLC, Distributor
2020 Calamos Court | Naperville, IL 60563-2787
866.363.9219 | www.calamos.com | caminfo@calamos.com

PLSPSYBRO 801184 0718O