Economic Outlook

CALAMOS INVESTMENTS

July 2019

CALAMOS INVESTMENT COMMITTEE

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Stocks, convertible securities and high yield bonds advanced during the quarter, but there were notable ups and downs along the way as Federal Reserve policy, trade negotiations, geopolitics, and concerns over the global economy drove sentiment (Figure 1). After a brisk start to the quarter, markets came under increased pressure in May, but recovered in June as the Federal Reserve held short-term interest rates unchanged and validated market expectations of renewed monetary accommodation. Market participants were also encouraged by new indications of progress in U.S.-China trade discussions at the G20 meetings. Looking to the remainder of the year, we believe:

» U.S. GDP growth will remain healthy and stable. Global growth is more concerning, but benign inflation, accommodative monetary policy and a weaker dollar support the case for subdued expansion.

» Markets can grind higher, but volatility will remain elevated. This creates a favorable backdrop for defensive equity market participation (such as strategies that employ convertibles, as well as global long/short equity and hedged equity approaches).

» Growth-oriented companies are positioned to outperform, with opportunities across the market cap spectrum. Valuations are fair on the whole, although selectivity is essential.

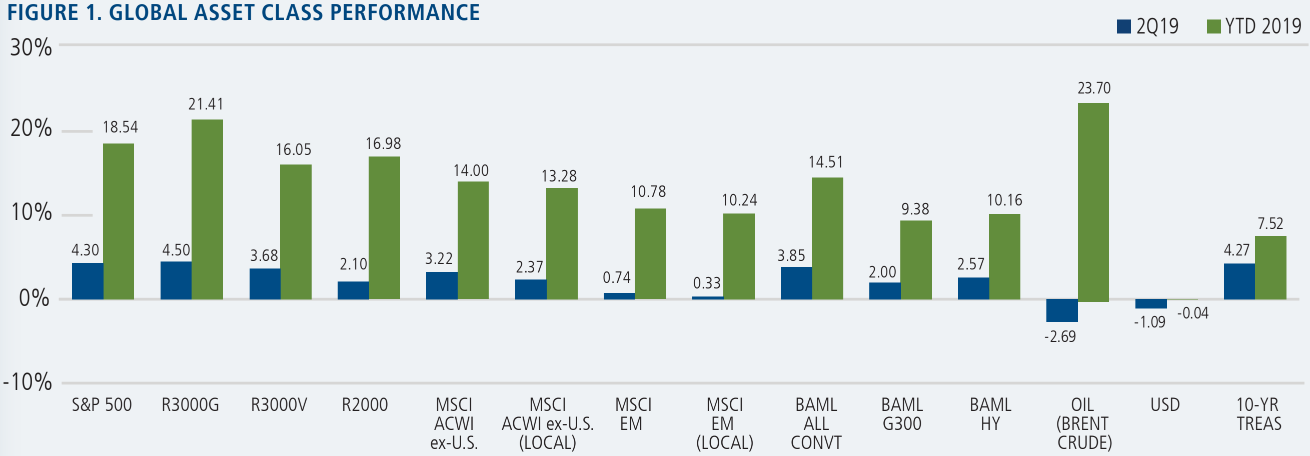
» In a global low rate environment, economically sensitive high yield debt and fixed income alternatives remain attractive.

» The key risks to our outlook and positioning include political uncertainties that will grow as the 2020 election nears, trade tensions, and shifts in monetary policy, which could result in either an acceleration or sharp downturn in economic growth.

MARKET REVIEW

During the quarter, risk assets moved higher. U.S. equities led, and the S&P 500 has notched its strongest first half year performance since 1997. Growth-oriented stocks outperformed value amid expectations of continued steady economic growth and accommodative monetary policy. Convertible securities captured a healthy measure of the equity market upside, both in the U.S. and globally. High yield bonds benefited from their economic sensitivity and a global search for income in a low-rate environment.

FIGURE 1. GLOBAL ASSET CLASS PERFORMANCE



Past performance is no guarantee of future results. Source: Bloomberg and Morningstar. Data shown in USD unless otherwise noted.

U.S. Equities

We do not see a U.S. recession on the near-term horizon. We expect continued GDP expansion to be supported by contained inflation, favorable financial conditions, and extremely low unemployment. The U.S. consumer remains strong, as evidenced by good income and spending data, debt levels and confidence measures. Corporations have continued to beat reduced earnings estimates and small and mid-size companies are still in growth mode. We believe these factors can offset near-term signs of pressure in the U.S. economy, including yield curve inversion and slower manufacturing growth.

In an environment characterized by slow growth but a low probability of near-term recession, we believe the case remains strong for U.S. growth companies.

Although we anticipate stable economic growth, we do not expect the markets to maintain an even keel. Short-term volatility will remain formidable through this phase of the cycle. The extreme shifts in investor sentiment over recent months illustrate how sensitized market participants are to changes in fiscal or Federal Reserve policy, whether actual or anticipated. Additionally, investors will be increasingly nervous about the political and geopolitical landscape as 2020 election rhetoric heats up.

In an environment characterized by slow growth but a low probability of near-term recession, we believe the case remains strong for U.S. growth companies, especially those tied to the U.S. consumer. Our emphasis on quality fundamentals has also led us to companies in technology and communication services. In contrast, we are more cautious about companies exposed to global trade headwinds and low interest rates.From a market cap perspective, our teams are identifying attractively valued stocks across market capitalizations. These opportunities include small and mid cap growth companies, areas of the market where we see more room to run.

Global and International Strategies

Economic conditions outside the U.S. have been more tepid, as trade issues between the U.S. and China have had a negative effect on global business. Manufacturing and industrial production data points to a growth slowdown in Europe and China, while Japan struggles against persistent lukewarm economic data. Despite this softening, we believe the most likely scenario for the global economy is low growth against a benign inflation backdrop. Central banks have continued to manage soft landings, and the high probability of additional accommodative policy from central banks around the world gives emerging markets more room to maneuver.

We remain focused on identifying solid growth businesses at reasonable prices, which we believe can outperform in a disinflationary and subdued growth environment. However, political uncertainty is formidable, and the dynamics of growth and inflation could certainly shift with policy changes, leading to market volatility and rotation. Consequently, our positioning also reflects vigilance toward other scenarios—either a potential further slowdown in global growth (should trade or monetary policy pressures increase) or a reflationary growth environment (should Chinese stimulus, easing U.S. monetary policy, or trade resolution spark a more rapid acceleration).

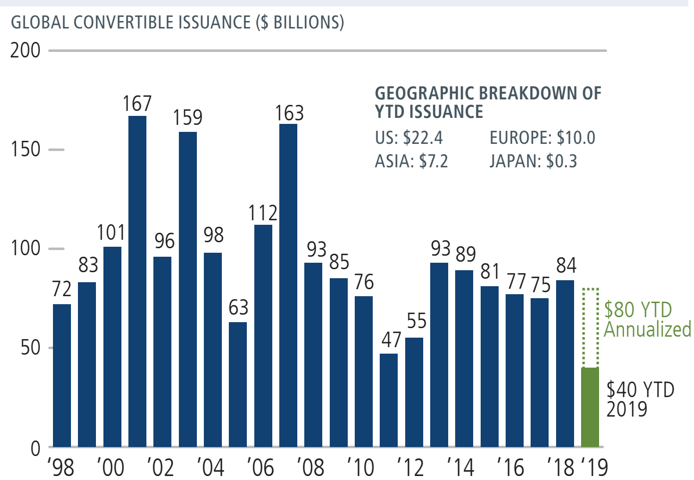
Our outlook has led us to favor a combination of core and secular growth companies, in addition to a set of more cyclical opportunities. This positioning reflects our anticipation of moderate economic growth but also the potential for a pickup in demand conditions in the coming quarters. Our quality criteria include earnings growth catalysts, solid cash flow generation and return on invested capital, and healthy balance sheets. We are seeking out innovators and disruptors with strong competitive positioning as well as companies positioned to benefit from secular growth themes, such as the rise of global digital payment systems. We have found many companies around the world that are capitalizing on this trend, including credit card companies, payment processors, banking institutions, omni-channel retail, and software and service providers. Finally, in a number of our strategies, we continue to include convertible securities as a way to achieve risk-managed exposure to the equity markets.

Convertible Securities

Reflecting our outlook that volatility will rise as the economy continues through its cycle, we believe investors will be well served by strategies that provide risk-managed equity exposure, such as convertible securities. As we have often discussed, with active management, convertible securities can provide upside equity market participation with less exposure to downside.

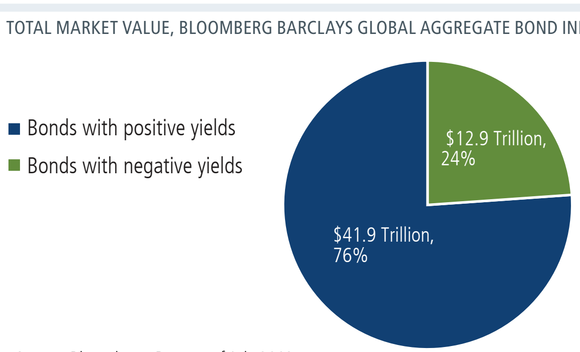
The characteristics of individual convertible issues and the convertible market as a whole change over time. Presently, the market offers many securities that have the fundamentals we favor. We are encouraged by issuance trends, particularly in the U.S., as companies seek growth capital at a brisk clip to fuel expansion. During the second quarter, U.S. companies brought $11.8 billion of convertible securities to market, contributing to a global total of $18.1 billion. For 2019, issuance stands at a healthy $40 billion, including $22.4 billion in U.S. securities (Figure 2).

FIGURE 2. A HEALTHY GLOBAL CONVERTIBLE MARKET



As of June 30, 2019. Source: BofA Merrill Lynch Global Research.

FIGURE 3. A CLIMATE OF NEGATIVITY: GLOBAL BOND YIELDS



Source: Bloomberg. Data as of July 2019.

In our convertible positioning, we seek out issues that offer superior downside protection and an asymmetric risk/reward profile. The most equity sensitive convertibles may capture a greater measure of market rebounds, but they lack the potential downside protection that we believe will be increasingly important.

> Within this market of bonds, we are identifying attractive opportunities in high yield securities.

From a sector standpoint, we have identified opportunities in select areas of technology, health care and consumer sectors where we believe thematic tailwinds coupled with solid corporate fundamentals support outperformance in a volatile period. We remain selective toward cyclical areas of the market that are more policy path dependent as well as traditional defensive areas such as utilities and REITs where valuations have risen as investors seek income in a low-rate environment.

Fixed Income

Following several months of deteriorating manufacturing data around the globe and dovish posturing from several central banks, both the amount and percentage of global debt with negative yields has hit new highs (Figure 3). Leverage in the investment grade universe has increased to new cycle highs and interest coverage has weakened over the past few years. Market projections around Fed interest rate moves have changed dramatically since the fourth quarter, when rate hikes were considered likely. Two rate cuts from the Federal Reserve this year seems reasonable, and we expect the 10-year Treasury yield to close the year around current levels, albeit with some risk to the upside.

Fixed income remains an important component within asset allocations, offering valuable diversification benefits and income. While conditions have created challenges for sovereign debt and investment grade investors, they provide opportunities for active portfolio management. Indeed, the good news for investors is that it is not a bond market, but a market of bonds.

Within this market of bonds, we are identifying attractive opportunities in high yield securities, one of the more economically sensitive areas of the fixed income market. We believe economic growth coupled with low inflation and supportive financial conditions should set the stage for future gains. In addition to our positive but selective view of high yield, we are constructive on preferred securities.

Taking a closer look at high yield, defaults are likely to remain below their long-term average of 3% until U.S. growth softens. In contrast to investment grade issues, high yield leverage peaked in 2016 and has been on a slow decline since, and high yield interest coverage is showing modest improvement. Corporate credit fundamentals have shown some early signs of weakening, but the market continues to offer ample liquidity for the great majority of high yield issuers. As long as the liquidity environment persists, we expect credit spreads to remain well behaved.

We believe our risk-managed, bond-by-bond approach will serve our portfolios in good stead. We maintain strict discipline to our rigorous, fundamentally driven investment process as we believe it is critical to pick spots wisely and appropriately balance risk and reward.

Alternative Strategies

For many investors, we believe the evolving investment landscape supports an expanded strategic role for liquid alternatives, within both equity and fixed income allocations. As we have discussed in the past, alternative strategies can capitalize on market volatility in ways that traditional equity strategies cannot, while also offering innovative ways to address the search for income.

With the global low-rate environment unlikely to end anytime soon, strategies that are not reliant on interest rates to generate income, such as our market neutral income approach, can provide investors with an attractive diversifier to a traditional fixed income allocations. Our portfolio management team employs complementary strategies—primarily convertible arbitrage and hedged equity—to seek steady returns over time as well as income from sources not tied global interest rates. Our approach has historically demonstrated low correlations to fixed income asset classes.

Additionally, having the flexibility to adjust overall equity market exposure can serve investors well—over full market cycles and especially during choppier periods. Both our risk-managed hedged equity and global long/short strategies employ time-tested investment processes that can potentially limit downside while maintaining a level of equity market participation.

Conclusion

There will be winners and losers at this mature stage of the economic cycle, with the potential for rolling recessions in certain industries. Volatility and sideways moving markets will expose the limits of passive strategies and asset allocations invested exclusively in long-only strategies. We believe tested, fundamentally driven investment processes and risk-management disciplines will have the advantage. This is an environment that sets up well for our actively managed, risk-adjusted and long-term approaches. We thank our clients for their continued trust.

Diversification and asset allocation do not guarantee a profit or protect against a loss. Alternative strategies entail added risks and may not be suitable for all investors.

Indexes are unmanaged, not available for direct investment and do not include fees and expenses. The **U.S. Dollar Index** measures the value of the U.S. dollar relative to a basket of foreign currencies, including Euro Area, Canada, Japan, United Kingdom, Switzerland, Australia, and Sweden. The **Russell 3000 Growth Index** and **Russell 3000 Value Index** measure U.S. growth and value equities, respectively. The **Russell 2000 Index** measures U.S. small cap stock performance. The **S&P 500 Index** is considered generally representative of the U.S. equity market. The **MSCI All Country ex U.S. Index** represents the performance of global equities, excluding the U.S. The **MSCI Emerging Markets Index** is a measure of the performance of emerging market equities. The **ICE BofAML U.S. High Yield Index** is an unmanaged index of U.S. high yield debt securities. The ICE BofAML All U.S. Convertible Index (VXA0) is a measure of the U.S. convertible market. The **ICE BofAML G300 Index** measures the performance of 300 global convertibles. Oil is represented by current pipeline export quality Brent blend. The **Bloomberg Barclays U.S. Aggregate Bond Index** and **Bloomberg Barclays Global Aggregate Bond Index** are a broad based benchmarks of the U.S. investment grade and global investment grade bond market, respectively. They include Treasury, government-related, corporate and securitized fixed-rate bonds. ICE Data: Source ICE Data Indices, LLC, used with permission. ICE permits use of the ICE BofAML indices and related data on an `as is' basis, makes no warranties regarding same, does not guarantee the suitability, quality, accuracy, timeliness, and/or completeness of the ICE BofAML Indices or data included in, related to, or derived therefrom, assumes no liability in connection with the use of the foregoing and does not sponsor, endorse or recommend Calamos Advisors LLC or any of its products or services.

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