Economic Outlook

CALAMOS INVESTMENTS

October 2019

CALAMOS INVESTMENT COMMITTEE

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In the third quarter, political uncertainties, trade tensions, softening global economic data and Fed rate cuts resulted in shifting market leadership, sharp equity selloffs and falling bond yields. This volatility has continued into the fourth quarter, as market participants confront weaker-than-expected U.S. manufacturing data, softer U.S. retail sales and geopolitical challenges. This will be a challenging environment, but we see many opportunities and believe:

» The global economy will continue to expand, buoyed by accommodative monetary policy, low inflation and resilient U.S. consumption. However, a global industrial recession and trade disputes will temper the pace of growth and make market conditions feel fragile.

» In the U.S., the probability of a near-term recession is low, but growth will be more subdued over coming months.

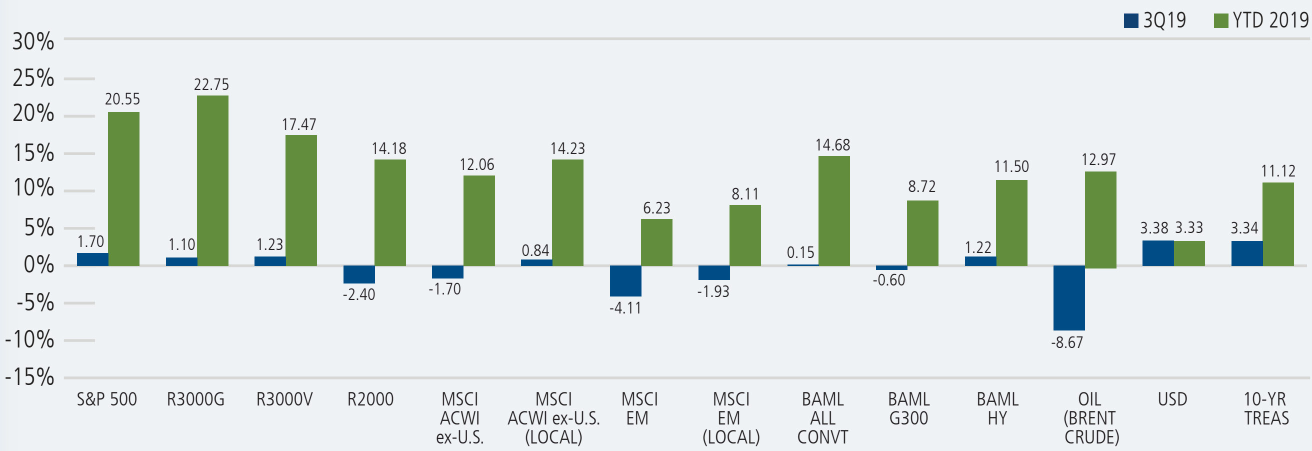
» In this phase of the economic cycle, we are likely to see episodic selloffs due to any number of headlines relating to a slowing global growth outlook, evolving central bank policies and an increasingly contentious political climate in the U.S.

» Elevated equity market volatility supports the case for selective, risk-managed approaches to investing (for example, convertible allocations and liquid alternative strategies). Even in a low interest rate environment, a diverse market of bonds offers opportunities for experienced investors, as well as important diversification benefits.

MARKET REVIEW

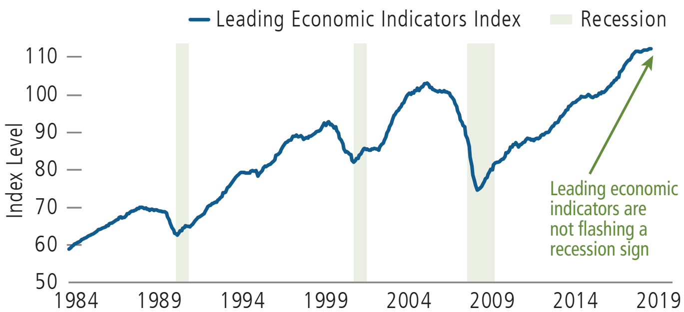
Equities, convertibles and high yield bonds produced muted to lackluster returns during the quarter due to a mix of political uncertainty, trade policy tensions, and sluggish global economic data, while long-term Treasury bonds rallied. Toward the end of the quarter, the market made a rotation into yield and cheaper stocks and away from higher growth stocks and prior winners.

GLOBAL ASSET CLASS PERFORMANCE



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

FIGURE 1. SLOW AND SUSTAINED U.S. EXPANSION



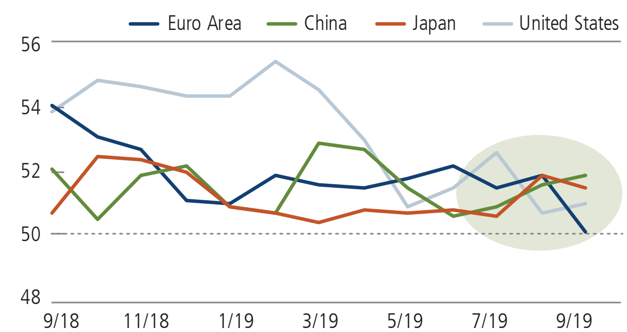
Source: Bloomberg.

FIGURE 2. GLOBAL VALUATIONS
AS OF 10/17/2019

	FWD P/Ex	TRAILING P/Ex	EPS CAGR 2020-2021	FWD Px/SALES	TRAILING Px/SALES	SALES CAGR 2020-2021
U.S.	17.5	20.2	10.2%	2.1	2.2	4.6%
Japan	13.2	14.2	6.3%	0.8	0.8	2.4%
Europe	14.2	18.8	8.2%	1.2	1.2	3.2%
EM	13.2	13.6	13.0%	1.2	1.2	7.4%

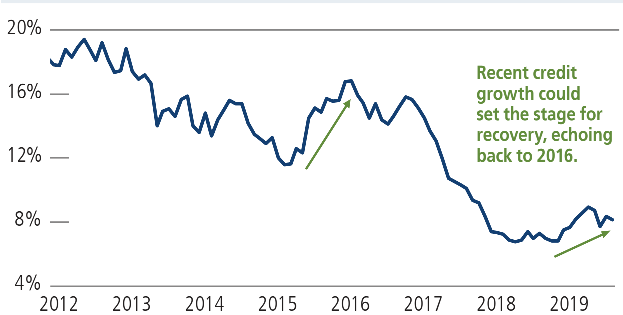
Past performance is no guarantee of future results. Source: Bloomberg. Data in USD terms.

FIGURE 3: COMPOSITE PURCHASING MANAGER INDEXES



Source: Macrobond, Markit. Levels of above 50 are indicative of expansion.

FIGURE 4: Y/Y GROWTH OF CREDIT IN CHINA



Source: Macrobond.

U.S. Equities

We are vigilant to the signs of pressure in the U.S. economy, such as manufacturing data, the yield curve, and high levels of corporate leverage. Moderating sentiment in the service sector and employment and retail data warrant close monitoring, but we are balancing our view of the recent slower growth in these areas against the longer-term strength we've seen.

In our view, softer conditions more likely imply slowdown than imminent recession. The U.S. economy can continue to grow, supported by benign inflation, accommodative Federal Reserve policy, and a still-healthy consumer. Unemployment is at a 50-year low and leading economic indicators are trending upward (Figure 1). Earnings season has gotten off to an encouraging start, with optimistic expectations for 2020.

In an environment of low and stable economic growth, the case for investing in growth companies is more compelling. We have identified higher quality businesses, such as those with strong cash flows and healthier balance sheets. We remain highly mindful of valuations and the "crowded trade" in the most popular names. We are also identifying select opportunities that could benefit from a cyclical pickup. Bond proxies and defensive sectors rallied in September on global growth concerns, but we believe they should be approached with care, as many lack sustainable growth characteristics but carry high price tags.

The opportunities we see in the U.S. growth equity market extend across the capitalization spectrum, including small and mid-cap U.S. growth names. Although it may take time for a full recovery from the valuation correction of the third quarter, our team continues to find companies with strong business fundamentals and momentum. Many of these small and mid-sized companies are domestic in their focus, and thus benefit from less direct exposure to the U.S.-China trade impasse.

Global and International Strategies

Outside the U.S., economic conditions are weaker but at current market valuations, this may well be a situation of dry powder waiting for a spark (Figure 2). China's recent GDP growth data rekindled market anxiety, but after several sluggish years, Asia and Europe could be approaching inflection points. Over recent months, we have seen more positive economic surprises and a bounce in composite purchasing manager indexes for China and Japan (Figure 3). Additionally, China is in the midst of highly targeted stimulus programs focused on technology infrastructure and housing. This stimulus and a ramp-up in credit growth (Figure 4) remind us of the conditions that set the stage for China's 2016 recovery. (See our post, "China's Stealth Stimulus: Part 2?" for more on this topic.) Improvements in China's economic conditions would have positive knock-on effects across Asia, followed by Europe. Furthermore, clarity on any of the major unknowns troubling the markets—for example, trade or Brexit—could provide a catalyst for global equity markets.

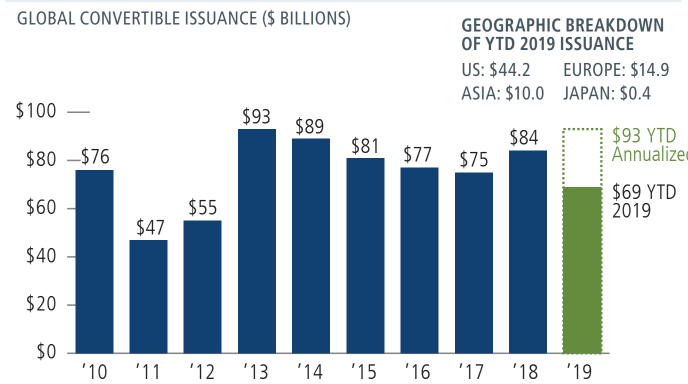
In our global and international strategies, our team is focusing on finding great growth businesses at reasonable prices. From a top-down perspective, our portfolios include secular growth names, which we expect to perform well in a low-growth, benign inflation backdrop. However, we are selectively increasing positions in cyclical growth names, reflecting the potential for re-acceleration in China and globally. We are also positioned to capture country- and region-specific growth tailwinds. For example, in Asia, we have invested in companies that are benefiting from China's 5G buildout.

Convertible Strategies

Convertible issuance closely follows economic growth conditions. During the third quarter, convertible issuance soared as growth-oriented companies continued to seek capital in a growing economy (Figure 5). Global issuance for the quarter was $29 billion. U.S. companies led, bringing $21 billion to market.

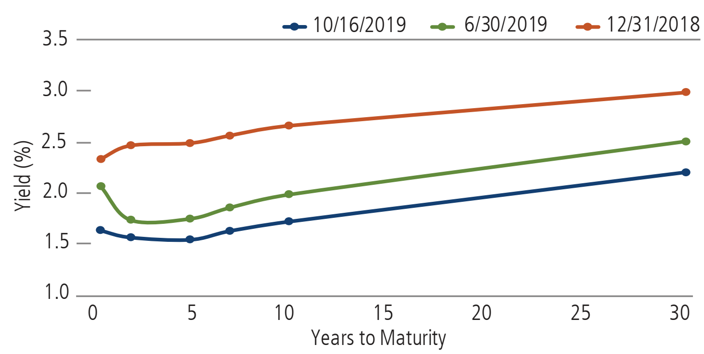
In volatile markets, we believe convertible securities provide an attractive way to pursue risk-managed equity participation. Convertible securities have varying levels of equity sensitivity and credit sensitivity; because of these differences, active management is essential. To capitalize fully on the benefits of the asset class, we have emphasized convertibles with well-balanced risk/reward characteristics versus structures that are overly sensitive to either interest rates or equity market downside. We have invested in companies positioned to benefit from long-term thematic tailwinds, which can provide a boost during market turbulence or as economic growth ebbs and flows. Given our economic outlook, we are avoiding areas of the market that are more policy-path dependent or exposed to deteriorating cyclical forces.

FIGURE 5. A HEALTHY GLOBAL CONVERTIBLE MARKET



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

FIGURE 6: FLAT YIELD CURVE: SIGNS OF PRESSURE, NOT NEAR-TERM RECESSION



Source: Bloomberg.

Fixed Income Strategies

Yields have declined significantly since year-end 2018, but the three-month/10-year and the two-year/10-year curve have been nudged out of mid-year inversion territory (Figure 6) in the wake of the Fed's latest two rate cuts and a slightly better outlook.

Low interest rates and record high levels of negative yielding sovereign bonds create unprecedented challenges for central bankers. We expect continued volatility in corporate credit and interest rate markets. However, these unusual conditions underscore the importance of experienced risk management and a bond-by-bond approach.

As we have noted in the past, the fixed income asset class is a market of bonds, not a bond market. There are significant differences among bonds, due to issuer fundamentals, maturities and interest rates. For example, while much of the world is caught in a market of negative yielding bonds, U.S. investors can access some of the highest interest rates in the world, even if they have trended lower.

We continue to favor equity-sensitive high yield bonds, as issuer fundamentals maintain a favorable trend, particularly in comparison to investment grade debt. Default rates have ticked up, but are still low. Our positioning favors companies with stable debt servicing capabilities, as well as those that we expect to de-lever balance sheets in a macro environment with fewer tailwinds. We have found select opportunities to invest in distressed credit where we are confident that we are being well compensated for the risks taken.

Preferred Securities

A number of our strategies include opportunistic positions in preferred securities, a global market of approximately $300 billion. Preferred securities fall below bonds and above stocks in the capital structure. Typically, they are issued by companies with healthy balance sheets seeking to support the bonds in their capital structure. Preferred securities can provide tax-advantaged income with dividends that may be treated as qualified dividend income. Also, when spreads tighten, a preferred security may deliver better total return than the investment-grade debt of the same company, with lower volatility than the common stock. In the preferred universe, we are identifying issues with compelling credit fundamentals, as well as attractive yields.

Alternative Strategies

In the face of equity market volatility and low interest rates, we encourage investors to consider alternative strategies to diversify equity and traditional fixed income allocations. For investors who wish to maintain equity participation with the flexibility for a more defensive stance, our hedged equity and long/short strategies have an array of tools for adjusting market exposure designed to benefit from market volatility.

As an alternative to traditional bond strategies, our market neutral income strategy seeks to derive returns from sources that are less dependent on interest rates. Our team takes a long-term view and focuses on being prepared for a variety of market scenarios. Currently, our positioning includes incrementally more defensive hedges that were established when potential downside protection was less expensive than it is today.

Conclusion

High levels of geopolitical and monetary policy uncertainty will fuel apprehension about the global economy and markets. Trying to trade off of short-term headlines is not a wise strategy. Especially in sideways and volatile markets, investors who try to time the market can end up with the worst of both worlds—catching the downside and missing the upside. Instead, investors should focus on ensuring that their asset allocation reflects their risk tolerance and liquidity needs.

There will be no shortage of noise but we encourage investors to maintain a long-term perspective. The global economy offers many opportunities, and we look forward to pursuing them on behalf our clients.

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** is 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.

Earnings per share (EPS) is a company's profit divided by its number of outstanding shares. **Price-to-earnings ratio (P/E)** is a valuation ratio of a company's current share price compared to its per-share earnings; forward P/Es are based on forecasted earnings. **CAGR**, or compounded annual growth rate measures year-over-year growth. **Price-to-sales** ratio measures a company's stock price versus its revenues.

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