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> “We’re **not** going back to 2019.”

Preparing for a New Era of Reflation… And the End of Central Bank Leadership

A GLOBAL LONG/SHORT PERSPECTIVE | JUNE 2021

MICHAEL GRANT, CALAMOS CO-CIO, HEAD OF LONG/SHORT STRATEGIES AND SENIOR CO-PORTFOLIO MANAGER

Introduction

As spring turns into summer, most Americans are ready to get back to a post-pandemic life. The vaccinated are returning to the office, eating in restaurants, attending big events, and hopping on flights and cruises to travel.

But while the world in 2021 will more resemble life in the year prior to the pandemic of 2020, as far as the investment regime is concerned, "we're not going back to 2019,"according to Michael Grant, Calamos Co-CIO, Head of Long/Short Strategies and Senior Co-Portfolio Manager.

"Reflation is the new order," Grant says. "The lessons investors learned in 2008 as they became conditioned to deflation must now be unlearned in 2021 and beyond."

This represents a critical shift in how investors should be looking at markets going forward, as well as what will be the primary influencers in the future.

Grant believes 2020 brought the end of:

» The deflationary era and central bank leadership
» A policy orthodoxy since 2008 that favored fixed income over equities
» The dominance of growth-oriented, long-duration stocks, which has influenced investor psychology and behavior for the last several years.

While 2021 presents the strongest economic backdrop in the last 30 years, it also presents the most imbalanced global cycle in decades. The following pages highlight some of the changes Grant sees and is anticipating—and where he parts ways with consensus views.

Bullish for the remainder of 2021, Grant admits to a growing apprehension for risk assets beyond into next year, after the exceptional conditions created by the pandemic have begun to fade, and the impact of government tax and spending policies takes hold.

Today's circumstances are unprecedented. All of us at Calamos appreciate the trust and confidence you place in us as together we navigate what's ahead.

Cyclicals Will Continue to Lead

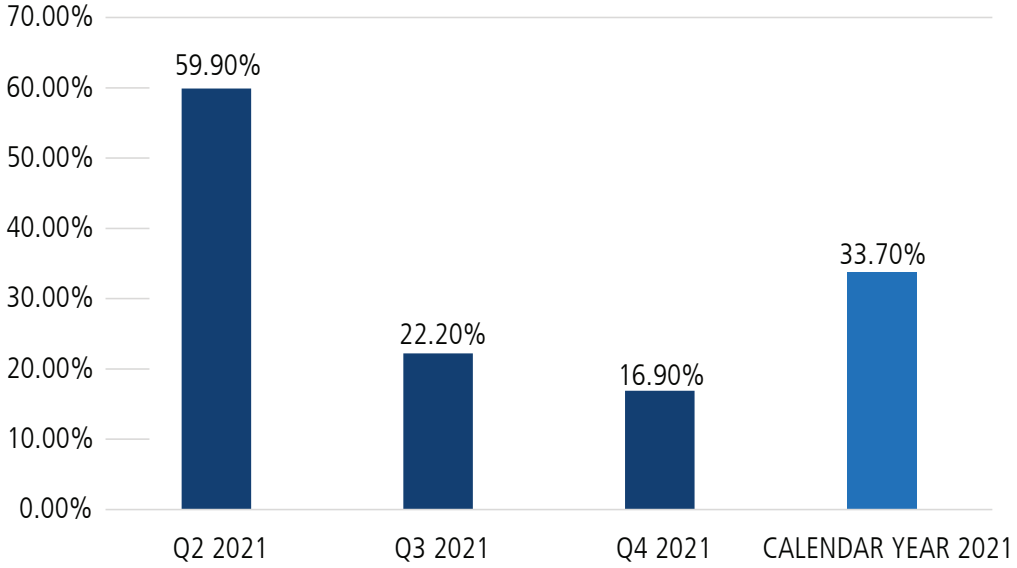
Have investors embraced the magnitude of the recent resurgence of cyclical stocks? Grant isn't so sure. He suspects that the power of the consumer recovery and what it means for a range of cyclical sectors is being underestimated.

Cyclical companies aren't like long duration or growth companies that today's investors have come to know as they've become favorites over the past decade.

Cyclical stocks generally don't anticipate growth in the far future. Instead, they tend to move coincidentally with improvements in economic data points. This is the prevailing dynamic as the global economy recovers from COVID-19.

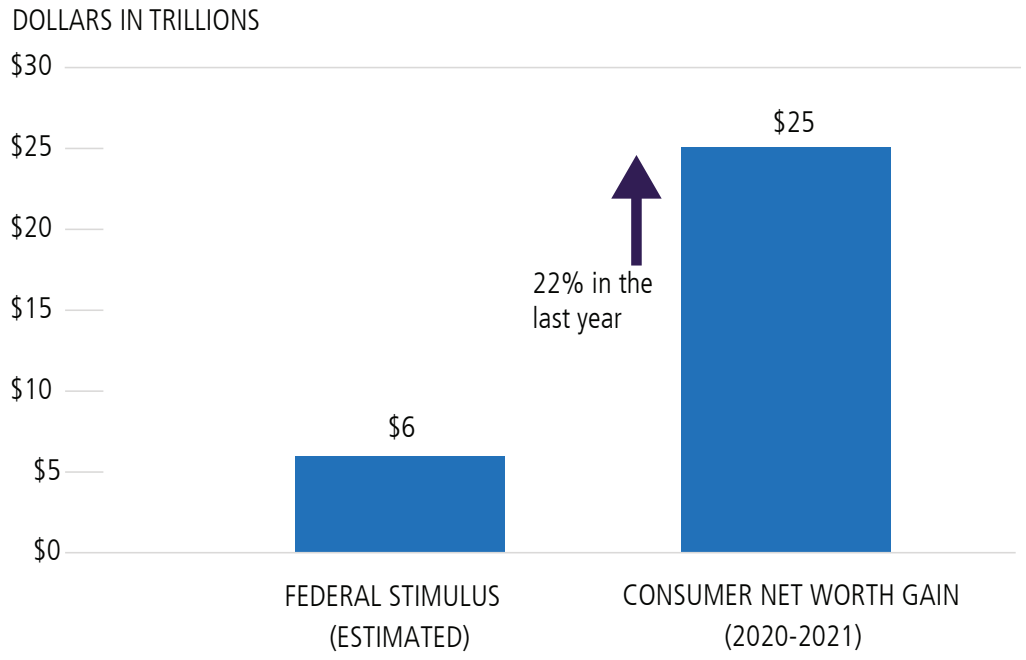
So, when will cyclicals yield their leadership? Not until economic data peaks, relative earnings weaken and bond yields stop rising. And that, Grant says, isn't likely to happen until closer to autumn or early 2022. Until then, he says, "Don't fade the cyclicals."

S&P 500 PROJECTED GROWTH IN EARNINGS



Source: FactSet, May 21, 2021. S&P 500 Index is generally considered representative of the U.S. stock market.

Consumers Have Yet to Fully Lift GDP

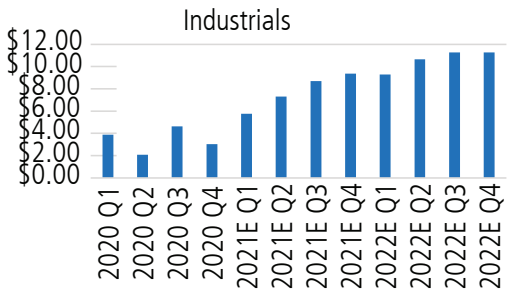


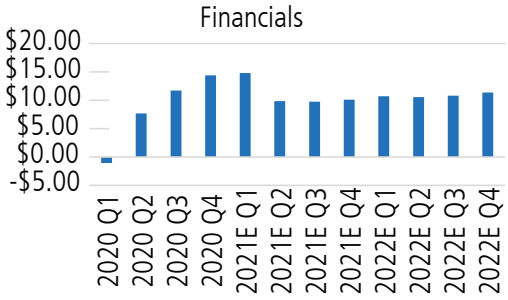
While much has been made of what the federal stimulus will cost, even at the highest end of estimates, the amount is dwarfed by the 22% growth in consumer net worth—totaling $25 trillion—in the last year. Such a gain can't be overlooked when considering the potential for increased valuation of financial assets.

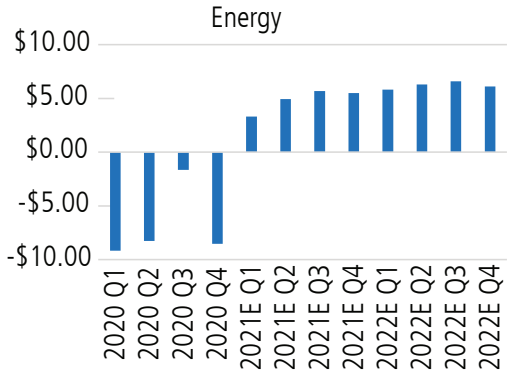
These rises in consumer net worth tend to lift GDP with a six-month lag. This is why Grant and his team expect the economic momentum to continue to drive corporate fundamentals at an extraordinary pace through the rest of this year, continuing into 2022.

‘Managed Markets’ Favor Cyclicals

OPERATING EARNINGS PER SHARE BY S&P 500 ECONOMIC SECTOR







Source: Standard & Poor’s

Cyclical winners: The rise in S&P 500 earnings estimates is being led by Industrials, Financials and Energy companies. Those sectors, which were the underperformers in 2020, are at the center of the cyclical resurgence.

What doesn’t win now: long duration, high growth and “concept” stocks that have been overbought.

And it’s not just about interest rates, Grant says. “Managed markets” have amplified the rotation to value-oriented, more cyclical equities. “In a world of excess liquidity, repression of interest rates, speculation and leverage, and the dominance of passive strategies, financial markets discount fundamentals,” he says.

Reflation Not Deflation

The deflationary era is over. The pandemic, followed by the fiscal and monetary coordinated fix, ended it, Grant says.

And here's what else is over: The markets relied on the Fed for direction in the post-2008 era of deflation. This will not be the case in the post-pandemic reflationary era. As evidence, Grant says, note the 10-year U.S. Treasury's performance this year. Despite the Fed keeping short-term rates low, the 10-year yield has advanced markedly year to date, to 1.61% by the end of May, up 90 basis points from one year ago.

The most lasting impact of the pandemic may be its "resuscitation" of the role of big government. According to Grant, this entails giving into the impulse for more public spending, higher debt and greater government interference in the economy. While taxes will rise for many, he says, this expansion of the public sector role in the economy will be financed largely by debt rather than taxes. Concerns over increased government deficits are no longer a political or economic issue.

Rates Could Rise and That Should Be Fine

It's possible that U.S. bond yields will move higher, with the 10-year breaking 2% in the next six months. Equities will respond positively to higher rates as they're accompanied by rising expectations of economic activity.

Real yields have been deeply negative through the pandemic. As the fear of deflation subsides, investors have little incentive to accept a negative real return on U.S. 10-year bonds. The current real yield is below the post-2008 average despite a very different economic and policy setting. Simply put, interest rates can rise without inflation, requiring only the expectation of deflation to accomplish this.

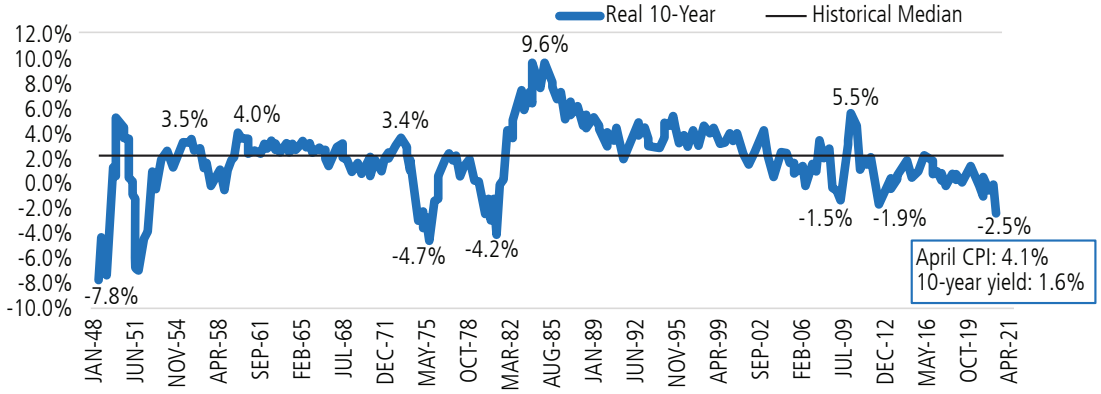
The inflation that's been seen so far this year is the primary result of unprecedented fiscal stimulus to mitigate the economic impact of the pandemic. "Aggressive" inflation is a higher risk today than at any point in recent decades. But for now, the team considers it a tail risk that shouldn't jeopardize equities in the near to mid-term.

While central banks are pushing against rising yields, Grant expects the Fed to become increasingly comfortable with the recovery and more tolerant of higher rates by late summer. Here, too, this change would be an acknowledgement by the Fed that its activities are ultimately subordinate to market forces in a reflationary environment.

Inflation of 3%, interest rates of 3% and sustained GDP growth of 3% is possible. In fact, Grant and team are operating on that assumption.

U.S. 10-YEAR TREASURY REAL YIELD

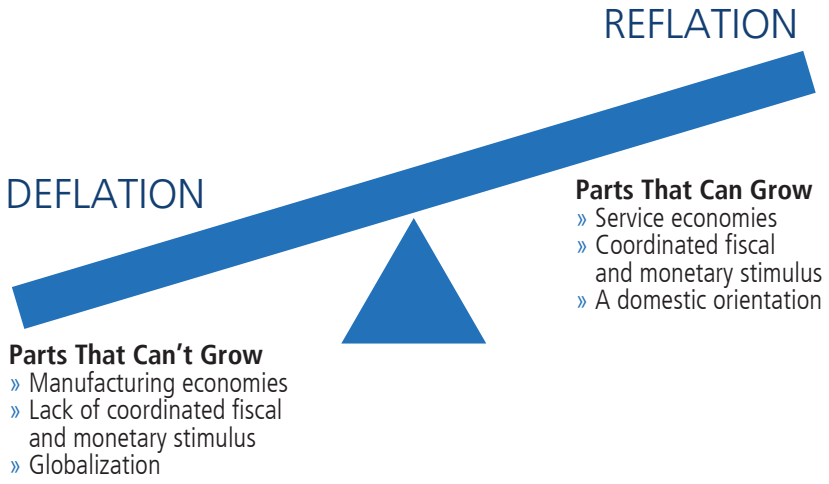
1948-2021 | REAL YIELD = NOMINAL YIELD MINUS INFLATION



Source: Compound Capital Advisors

Globalization Is Over. Focus on the U.S.

THE POST-PANDEMIC WORLD



Most investment professionals believe that a global cycle is unfolding. Grant thinks it will be the most imbalanced global cycle seen in most careers.

The United States came through the pandemic at the top of what Grant calls the "international hierarchy of corporate profit growth." The U.S. continues to outpace the rest of the world in corporate profits.

Unlike prior global revivals, service industries—which tend to be more domestic—have been at the epicenter. Previous recoveries were in manufactured goods and commodities, which tend to disperse demand more worldwide. Because of this dynamic, Grant expects the U.S. to maintain the pole position.

In addition, he notes the rush of capital to return to the U.S. and build manufacturing capacity here—an effective reversal of much of the last 20 years when the capital went out to China and other EM countries. What was a tailwind for China then will provide additional boost to the U.S. economy now as the allure of economic globalization has faded in the post-COVID environment.

U.S. Reflation Will Favor the Dollar

Other parts of the world face real risk of stagnation, according to Grant. They include:

China. Unlike the U.S., China is not "experimenting" with the policy of reflation via stimulus. What's more, China faces significant debt and demographic constraints, as well as the fading of the reality of globalization.

Europe. Although Europe is pursuing quantitative easing and a range of monetary support, its experience is more similar to Japan's experience in the last 20 years. Grant believes continental Europe faces significant growth challenges. It's why he and his team favor the UK rather than the continent. They expect the fruits of Brexit and the shedding of the directives of the European Union will finally begin to be realized in a post-pandemic economy.

Grant does not agree with the consensus view of a declining U.S. dollar. For now, he says, investors are mistaken to conclude that a risk-on economic cycle should catalyze a weaker U.S. dollar, at least while the cycle is dominated by U.S. reflation and growing U.S. corporate earnings relative to the rest of the world.

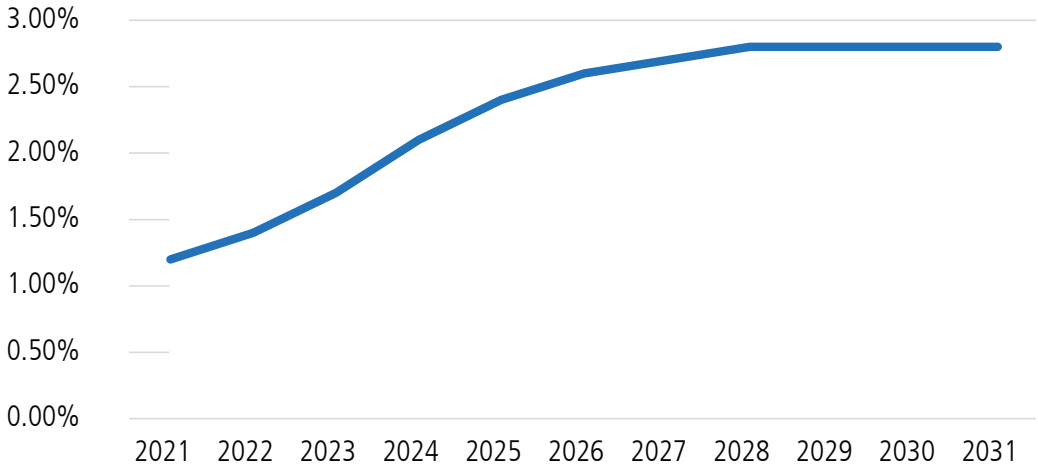
A Swing Back to Equities

According to Grant, 2020 will be remembered as the decisive end of a policy orthodoxy that favored fixed income over equities through the post-2008 era.

He thinks this policy shift will be as symbolic as the policy shift in 1980-1981 under Fed Chairman Paul Volcker—but in the opposite direction.

The future direction of the U.S. 10-year yield will be the barometer of how true or not this transition ultimately becomes.

BIDEN ADMINISTRATION'S 10-YEAR TREASURY FORECAST



Source: Economic Budget Analyses underlying the Administration's 2022 Budget

What Happens After 2021?

Here's why Grant says 2022 is looking much less clear. He's concerned about the "abandonment of any belief in financial discipline."

To be sure, investors have been benefitting from what Grant calls the "politics of stimulus:" risk assets have demonstrated they can do very well in an environment where expediency—as opposed to intellectual conviction—relaxed all constraints on liquidity.

But he says there's a cost to be paid for the current "debt does not matter" ideology.

Unpredictability, greater variability—instability even—and volatility may well be what investors will need to contend with in the next cycle, Grant says.

> "An expanded and invasive state supported by higher taxation, higher public spending and more restrictive regulation?
>
> "We can think of no examples in the past where this has led to improved corporate profitability," Grant says."

The Turmoil Accompanying Regime Change

The kind of regime change that Grant expects rarely happens in a straight line. It can be debated for years before the full effect of the transition is visible in the economic and social character of the times.

That said, Grant imagines a very different investment cycle ahead. This next cycle will be characterized by the growing interventionism of the public sector, the acceleration of technological change and the fragmentation of the global economy amidst rising international tensions.

At minimum, he says, "investors should prepare for the sector and style turmoil that appears inevitable."

For navigating the changes anticipated in 2022 and beyond, consider the global long/short strategies employed by Michael Grant and the Global Long/Short Strategies team.

Investment professionals, for more information, contact your Calamos Investment Consultant at 888-571-2567 or caminfo@calamos.com.

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.

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