Convertible and High Income Fund (CHY) 2Q22 Commentary

Overview

The second quarter saw turbulence in the equity and convertible markets, which continued to be pressured by concerns related to high inflation, central bank policy, rising interest rates, the war in Ukraine, and supply chain disruptions. US convertibles declined -15.65% in the quarter, as reflected by the ICE BofA All US Convertibles Index, though held up well relative to the average performance of their underlying stocks, which were down -30.50%. This means that convertibles participated in just 51% of their underlying stocks’ downside. Convertibles also held up slightly better than the S&P 500 Index down -16.10%.

Convertibles across all economic sectors experienced negative quarterly results. Convertibles in telecommunications (-5.3%), utilities (-5.4%) and energy (-7.4%) held up best, whereas the materials (-25.0%), consumer discretionary (-22.5%) and technology (-18.1%) sectors most lagged the index result. Investment grade convertibles (-7.7%) held up better than speculative grade issuers (-20.3%), though it should be noted that roughly 78% of the US convertible market was unrated during the second quarter.

As measured by ICE BofA, convertibles with the most bond sensitivity (-12.4%) held up better than convertibles with balanced risk/reward attributes (-16.9%) and those with the most equity sensitivity (-19.5%). At the end of the quarter, convertibles with the most bond sensitivity represented 55% of the market, exceeding those convertibles with balanced risk/reward (27%) and equity-sensitive (18%) attributes. The US convertible market saw $2.8 billion in new issuance, while $3.3 billion in convertibles came to market globally. This brought the year-to-date global total to $11.2 billion with the US accounting for $8.3 billion.

High yield credit spreads were substantially wider. Having drifted from post-Covid averages at the close of the previous quarter, credit sold off aggressively into quarter end as the market repriced

**ANNUALIZED TOTAL RETURN AS OF 6/30/22 (%)**

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<th>QTD</th>
<th>1-YEAR</th>
<th>3-YEAR</th>
<th>5-YEAR</th>
<th>10-YEAR</th>
<th>SHARE INCEPTION (05/28/03)</th>
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Source: Calamos Investments

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. All returns are in USD terms unless otherwise indicated.

Please refer to back page for important notes.
higher recession risk. The move wider in investment grade spreads was more moderate and orderly. Performance by rating category within the high yield market was directional, with the move to wider spreads driving negative returns across the credit spectrum. BB rated bonds returned -8.4%, whereas B rated issuers delivered a loss of -10.8%, and CCC rated paper returned -13.0%. Defaults had begun trending higher in the first quarter and continued to do so following several anticipated defaults. The trailing 12-month default rate doubled to 1.1%, still well below the long-term average of 3.6%. After closing the first quarter with option-adjusted spreads on high yield bonds at 328 basis points, the market waned this past quarter, closing at 570 basis points. The best performing sectors in the Bloomberg US Corporate High Yield 2% Issuer Capped Index were electric utilities (-7.0%), energy (-8.0%) and transportation (-8.2%) while brokers/asset managers/exchanges (-12.6%), finance companies (-11.4%) and consumer non-cyclicals (-11.4%) represented the largest laggards.

Distributions increase and Remain Competitive
The fund’s current annualized distribution rate was 10.74% of market price as of June 30, 2022. We believe that the fund’s monthly distributions are highly competitive, given that low interest rates and yields remain the norm throughout much of the global marketplace. For example, the 10-year US Treasury bond yield was 2.98% and the ICE BofA US High Yield Master II Index yield was 8.88% as of June 30, 2022.

Performance Review
For the quarter ending June 30, 2022 the fund returned -18.47% on market price and -20.94% on NAV. In comparison, the blended comparative index (50% ICE BofA All US Convertibles Index, 50% Bloomberg US HY 2% Issuer Capped Index) which returned -12.73% for the period.

Contributing Factors. This past quarter, the fund benefited from selections in the industrials sector relative to the blended comparative index. Specifically, selections in the trucking industry boosted results. The fund was also aided by an underweight in the real estate sector, particularly an underweight and holdings in the real estate services industry.

Detracting Factors. Selections in the health care sector, particularly in the health care technology industry, was a drag on return. In addition, our overweight and selections in the consumer discretionary sector, namely within the apparel, accessories and luxury goods industry, impeded performance.

Positioning
We continue to hold our highest allocation, approximately 65%, in convertible securities and 26% in corporate bonds. Approximately 57% are in unrated securities. We believe that our proprietary research can extract value and offer investors a better risk/reward dynamic over time while continuing to provide regular income. We continue to take a very selective approach to CCC credits, which represented 2% of the portfolio at quarter-end. We also hold a large percentage in the BB credit tier (approximately 19%); these securities offer good valuations and provide access to a large portion of the convertible bond universe where we have the ability to optimize returns through our proprietary research capabilities.

We are cognizant of the fact that rising interest rates and volatility can affect longer-term fixed income securities. The weighted average duration of our bond holdings is 2.8 years. From an economic sector perspective, our heaviest exposures were weighted in the information technology, health care and consumer discretionary sectors, which collectively represent approximately 53% of our holdings. We believe that these areas are best positioned to recover from the economic impacts of Covid. The reopening of society and the economy notwithstanding, technology will continue to be sourced to enhance the greater demand for online events, content and commerce. We believe that pent-up demand and higher employment rates will inspire consumer spending, and health care will be a primary focus as disease prevention and welfare maintenance are emphasized for the foreseeable future in the wake of the Covid pandemic. Our lightest weights are consumer staples, materials and real estate. Approximately 93% of our holdings are in the US, which is consistent with our overall view of the investment opportunities available in the domestic economy versus the rest of the world.

Leverage
We believe that environment is conducive to the prudent use of leverage as a means of enhancing total return and supporting the fund’s distribution rate as corporate earnings continue to reflect pent-up consumer demand in many sectors. As of June 30, 2022, our total percent of assets leveraged was approximately 39%, which falls within the higher end of the range of our historical level.
Outlook

The debate over inflation, economic growth and the path of future monetary policy continued to dominate headlines near quarter end. However, we think this environment has placed the convertible market in an interesting spot. Convertibles are hybrid securities that can act like equities or bonds, depending on movements in the markets. Declining equity prices and wider credit spreads have pushed the overall equity sensitivity of the convertible market toward the lower end of its historical range. When coupled with the majority of convertible bonds trading below par and closer to their bond floor, this should structurally impede downside going forward. At the same time, reduced equity valuations, positive yield to maturities, and longer-term optionality embedded in the convertible structure can be powerful drivers for future upside returns.

After back-to-back years of record totals, new convertible issuance remains subdued this year and continues to be affected by overall market volatility. The year-to-date $11.2 billion of new convertibles brought to market around the globe is well below the amount we typically see by this time of year. While we anticipated a deceleration in the annual new convertible volume, we think the heightened global uncertainty has materially affected totals, and we expect that an eventual calming in the overall markets will spur new issuance back up to a more traditional pace.

Ultimately, only time will tell how the macro uncertainty plays out, but as we have seen over prior market cycles, actively managing the changing dynamics of convertibles and high yield bonds through times such as these can serve as a useful means to navigate short-term volatility and position for long-term opportunities.
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