Convertible Opportunities and Income Fund (CHI) 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.

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 (06/26/02)</th>
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<tbody>
<tr>
<td>On Market Value</td>
<td>-16.72</td>
<td>-23.13</td>
<td>9.69</td>
<td>8.46</td>
<td>8.35</td>
<td>8.92</td>
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<tr>
<td>On NAV</td>
<td>-20.71</td>
<td>-26.03</td>
<td>7.20</td>
<td>7.85</td>
<td>8.08</td>
<td>8.97</td>
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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.

Please refer to back page for important notes.
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 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 10.63% 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 -16.72% on market price and -20.71% on NAV. In comparison, the blended comparative index (50% ICE BofA All US Convertibles Index, 50% Bloomberg US HY 2% Issuer Capped Index) returned -12.73% for the period.

**Contributing Factors.** This past quarter, the fund benefited from its selection in the consumer staples sector relative to the blended comparative index. Specifically, selection in the packaged foods and meats industry boosted results. The fund was also aided by selection in the industrials sector, particularly holdings in the trucking industry.

**Detracting Factors.** Selection in the communications services sector, particularly in interactive media & services industry, was a drag on return. In addition, our overweight and selection in the consumer discretionary sector, namely within the hotels, resorts and cruise lines industry, impeded performance.

**Positioning**
We continue to hold our highest allocation, approximately 64%, in convertible securities and 25% in corporate bonds. Approximately 56% 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 sizable 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 52% 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 were 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 this 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 38%, 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.
Important Fund Information

The goal of the managed distribution policy is to provide investors a predictable, though not assured, level of cash flow. Monthly distributions paid may include net investment income, net realized short-term capital gains, net realized long-term capital gains and, if necessary, return of capital. Maintenance of this policy may increase transaction and tax costs associated with the fund.

A credit rating is a relative and subjective measure of a bond issuer’s credit risk, including the possibility of default. Credit ratings are assigned to companies by third-party rating agencies, such as Standard & Poor’s. Ratings are based on an issuer’s credit risk and are referred to as “investment grade” while those in the lower tiers are referred to as “non-investment grade” or “high-yield.” Ratings are measured using a scale that typically ranges from AAA (highest) to D (lowest).

Leverage creates risks which may adversely affect return, including the likelihood of greater volatility of net asset value and market price of common shares, and fluctuations in the variable rates of the leverage financing. The ratio is the percent of total managed assets.

The fund may invest in foreign securities and invest in an array of security types and market-cap sizes, each of which has a unique risk profile. As a result of political or economic instability in foreign countries, there can be special risks associated with investing in foreign securities. These include fluctuations in currency exchange rates, increased price volatility, and difficulty obtaining information.

There are certain risks associated with an investment in a convertible bond such as default risk—that the company issuing a convertible security may be unable to repay principal and interest, and increased rate risk—that the convertible may decrease in value if interest rates increase.

Investments by the fund in lower-rated securities involve substantial risk of loss and present greater risks than investments in higher-rated securities, including less liquidity and increased price sensitivity to changing interest rates and to a deteriorating economic environment. Fixed income securities are subject to interest rate risk; as interest rates go up, the value of debt securities in the fund’s portfolio generally will decline. Owning a bond fund is not the same as directly owning fixed income securities. If the market moves, losses will occur instantaneously, and there will be no ability to hold a bond to maturity.

The fund may invest in derivative securities, including options. The use of derivatives presents risks different from, and possibly greater than, the risks associated with investing directly in traditional securities. There is no assurance that any derivative strategy used by the fund will succeed. One of the risks associated with purchasing an option is that the fund pays a premium whether or not the option is exercised.

The fund may seek to purchase index put options to help reduce downside exposure; however, the effectiveness of the fund’s index option-based risk management strategy may be reduced if the fund’s equity portfolio does not correlate to the performance of the underlying option positions.

The fund also risks losing all or part of the cash paid for purchasing index options. Unusual market conditions or lack of a ready market of any particular option at a specific time may reduce the effectiveness of the fund’s option strategies, and for these and other reasons the fund’s option strategies may not reduce the fund’s volatility to the extent desired. From time to time, the fund may reduce its holdings of put options, resulting in an increased exposure to a market decline. Please refer to the fund’s prospectus for a full description of risks.

Parties entering an interest rate swap trade on exposure to a given interest rate; the exposure can be long or short depending on whether a counterparty is paying or receiving the fixed rate. At the same time, each party takes on the risk—known as counterparty credit risk—that the other party will default at some time during the life of the contract.

The Bloomberg US High Yield 2% Issuer Capped Index measures the performance of high yield corporate bonds with a maximum allocation of 2% to any one issuer. The CBOE Volatility Index or VIX (based on its CBOE ticker symbol) 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. The Russell 2500® Index measures the performance of the small to midcap growth segment of the US equity universe. The index is published and maintained by FTSE Russell.

The ICE BofA All US Convertibles Index (VXA40) comprises approximately 700 issues of only convertible bonds and preferreeds of all qualities. ICE BofA US High Yield Master II Index consists of below investment grade US dollar denominated corporate bonds that are publicly issued in the US domestic and Yankee bonds. Issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Ba3, but are not in default. The index includes domestic high-yield bonds, including deferred interest bonds and payment-in-kind securities. Source: ICE Data Indices, LLC, used with permission. ICE permits the use of ICEBofA 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 BofA Indices or data included in, related to, or derived from them, 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. The S&P 500 Index is generally considered representative of the US stock market. The S&P/LSTA US Leveraged Loan Index is designed to reflect the performance of the leveraged loan market. Unmanaged index returns assume reinvestment of any and all distributions and, unlike fund returns, do not reflect fees, expenses or sales charges. Investors cannot invest directly in an index.

Terms

A Managed Distribution Policy is an investment company’s commitment to common shareholders to provide a predictable, but not assured, level of cash flow.

Market Price refers to the price at which shares of the fund trade in the market. NAV or Net Asset Value refers to the net value of all the assets held in the fund. IPO Price refers to the initial public offering price for shares of the fund.

The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the sectors, securities and markets mentioned. The information contained herein, while not guaranteed to be accurate or complete, has been obtained from sources we believe to be reliable. Opinions expressed herein are as of the date of publication and are subject to change without notice due to various factors and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.