Core Plus Fixed Income Strategy Quarterly Commentary

CALAMOS® INVESTMENTS

Market Overview

The US investment-grade bond market, represented by the Bloomberg US Aggregate Bond Index, returned 5.20% during the third quarter of 2024.

A proactive Fed surprised the market in September by cutting its overnight lending rate by 50 basis points rather than the 25 basis points the market expected following Chairman Powell's Jackson Hole appearance. It did so in the face of surprisingly strong GDP growth, a resurgence in business investment, and consumer activity that remains robust. One could argue that the Fed's decisive cut was particularly unexpected given the soft-landing narrative that had picked up steam through the quarter.

Service PMIs are well above 50, growth is still above trend, and consumer sentiment is consistent with the levels of 2020 and 2021 when Covid stimulus had the greatest impact. We have previously mentioned how immigration and the resulting US population growth have spurred consumption and sales, and we point to that dynamic again this quarter as having a powerful impact on a broad range of activity measures and consumer-related company earnings announcements.

As always, there are pockets of weakness to highlight. Labor markets softened and moved into closer balance; unemployment claims rose gently, and the unemployment rate crept up, reflecting job losses and people being added to the labor force. Meanwhile, manufacturing is contracting, although the rate of deterioration is shallow.

All this resulted in an environment where the Fed felt comfortable delivering its first rate cut since 2020. The committee sees the neutral rate of interest (r* that neither aids economic growth nor restricts it) to be around 2.9%. If correct, that would leave even the resulting 4.875% target rate quite restrictive. And given the lag with which changes in policy rates impact economic activity, the Fed is likely trying to skate where the puck is going, as opposed to where it is. Often, easing cycles have a more immediate effect than hikes. However, with 80% of consumer mortgages locked into rates of 5% or below, we believe the Fed has considerable wood to chop before reaching a level of rates that will stimulate consumer demand.

In its statement, the Fed indicated that risks to employment and price stability are now roughly balanced. If it is being intellectually honest, balanced risks would imply that the committee wants to be much closer to the neutral rate. However, this objective introduces the problem of figuring out what r* actually is. We will learn what the neutral rate is as the Fed cuts and we approach it, but for now, we are taking the cautious view that neutral is somewhere between 2.5% and 3.5%.

As it has done repeatedly in this cycle, the market is pricing in more aggressive easing than the Fed's estimates. At the beginning of the year, futures markets priced in a hefty seven cuts to the fed funds rate in 2024, then shifted to expectations of no cuts during the early part of summer. Following the 50-basis points cut in September, the market now sees eight additional cuts through year-end 2025, with a terminal funds rate of 2.8%, agreeable with the long-run Fed dot.

All portfolio positioning and sector information is for a representative portfolio. Please see additional information that follows commentary.

One of the quarter's most surprising developments was the unanticipated vigor in corporate revenue and EBITDA. For the first time since 2021, companies in leveraged finance markets saw both measures improve year-over-year versus 2023 levels when the fed funds rate was at its 5.5% peak. Still, there are pockets of weakness, and idiosyncratic risk is a critical factor that needs attention.

Risk markets delivered robust positive returns as strength in topline consumer spending and the expectation of easier monetary policy fueled rallies across market capitalizations and asset classes. Following mixed results in the second quarter, the S&P 500 gained 5.9%, and the Russell 2000 rallied 9.3%, while the high-yield market returned 5.9% as spreads and Treasury rates moved substantially lower. At ~23x forward earnings, stocks are trading richer than 90% of historical observations, while credit spreads are near cycle tights.

High-yield spreads closed the quarter 14 basis points tighter at 295. The combination of lower rates, tighter spreads, and current income pushed the total return of the high-yield market to 5.3% during the quarter. Investment-grade spreads were also slightly tighter over the period, closing at 89 basis points following the previous quarter's close of 94. Trailing 12-month defaults decreased to 1.6% in September, less than half the long-term average of 3.4%. In the loan market, trailing 12-month defaults are at 3.8%. The differential between bond and loan defaults is the greatest since 2000.

The best-performing sectors in the investment-grade credit market were electric utilities (+7.1%), natural gas utilities (+6.7%), and transportation (+6.6%), while finance companies (+4.5%), banks (+5.1%) and consumer cyclicals (+5.3%) represented the largest laggards.

Performance Review

For the quarter ended September 30, 2024, the portfolio generated a positive return of 5.12% (gross of fees) and 5.01 (net of fees) compared to the Bloomberg US Aggregate Bond Index return of 5.20%.

Positive Influences on Performance

- With interest rates falling by 40–100 basis points across the yield curve, security selection among Treasury positions, where the strategy owns primarily long-dated maturities, was the largest positive contributor to performance.
- Additionally, given the spread compression over the quarter, the underweight allocation to Treasuries also supported returns.

Negative Influences on Performance

- Security selection among non-financial corporate debt weighed on performance, as the strategy's positions have shorter durations than the benchmark and did not experience the full weight of the Treasury rally or spread compression.
- Similarly, the strategy's selection among financial institutions also missed these tailwinds and saw performance lag.

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Positioning and Portfolio Changes

As we noted, futures markets are pricing an additional eight rate cuts before year-end 2025. While the Fed's projections drag those eight cuts out to 2026, expectations for the terminal rate are similar between the market and Fed policymakers. Our team sees the odds of a soft landing or stagflation as equally probable and more likely than recession. In either case, we believe growth moderates and inflation remains above target, led by housing prices, because of the definitive and growing shortage of units.

We believe the interest-rate implications for either scenario are similar: a rate-cutting cycle that fails to deliver what the market has priced. As such, we want to be positioned with shorter durations than our peers. However, peers have extended durations significantly longer than their benchmarks. The strategy is positioned in the middle ground—with durations near the benchmark but still short of peers, as we anticipate the Fed will be challenged to cut as many times as the market and committee project.

Duration/Yield Curve

Positioning

The team shortened portfolio duration during the quarter, closing at 5.9 years on an option-adjusted basis against the index's 6.1 years. The short is largely expressed in the long end of the yield curve.

Market Activity

With two-year yields closing at 3.64%, down from 4.75%, and 10-year yields closing at 3.78%, down from 4.40%, the 2y10y curve closed with a positive slope for the first time since mid-2022.

Results

Slightly shorter duration positioning hurt relative performance during the quarter.

Security Type

Positioning

The strategy was overweight to corporate bonds, mortgage-backed securities, and asset-backed securities while underweight Treasuries. The largest overweights within the corporate bond asset class were in the consumer cyclical and technology sectors.

Market Activity

Within the Bloomberg US Aggregate Bond Index, the four primary market components had positive returns, led by those benefiting from spread tightening and the interest-rate-driven rally. Corporate bonds were the best performing with a return of 5.8%, followed by the securitized sector at 5.4%, Treasurys returning 4.7%, and government-related positions trailing at 4.6%.

Results

The portfolio overweights outside of Treasuries were generally positive drivers, except the asset-backed securities overweight, which detracted from returns because of the sector's short duration.

Credit Quality

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Positioning

The credit-quality breakdown of the Bloomberg US Aggregate Bond Index changed substantially with the US Treasury's downgrade from Fitch Ratings in 2023. After Treasury issues were reclassified to reflect the new AA-rating categorization, the portfolio is largely underweight in the AA-rated category and overweight in A and BBB-rated positions.

Market Activity

Spreads were modestly tighter during the quarter. Therefore, performance among rating categories was largely directional, with lower-rated credits underperforming. BBB and A-rated categories led with returns of 5.8%, while AA and AAA components of the benchmark returned 5.0% and 4.4%, respectively.

Result

The team's inclusion of out-of-index BB and B-rated positions dragged on the quarter's performance. Duration is not as large a driver of returns in the below-investment-grade market, and high-yield bonds did not realize the type of rallies experienced by investment-grade investments.

Outlook

In its statement, the Fed indicated that risks to employment and price stability are now roughly balanced. If it is being intellectually honest about the exercise, balanced risks would imply that the committee wants to be much closer to the neutral rate. This objective introduces the problem of figuring out what r* actually is. We will learn what the neutral rate is as the Fed cuts and we approach it, but for now, we are taking the cautious view that neutral is somewhere between 2.5% and 3.5%.

As it has done repeatedly in this cycle, the market is pricing in more aggressive easing than the Fed's estimates. At the beginning of the year, futures markets priced in a hefty seven cuts to the fed funds rate in 2024, then shifted to expectations of no cuts during the early part of summer. Following the 50-basis points cut in September, the market now sees eight additional cuts through year-end 2025, with a terminal funds rate of 2.8%, agreeable with the long-run Fed dot.

For additional information please visit the strategy's profile page:
https://www.calamos.com/strategies/core-plus-fixed-income/

DATA AS OF 9/30/24

CORE PLUS FIXED INCOME AVERAGE ANNUAL RETURNS (%)

	QTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR	SINCE INCEPTION (7/07)
Core Plus Fixed Income (gross of fees)	5.12	12.62	-0.29	1.27	2.66	4.01
Core Plus Fixed Income (net of fees)	5.01	12.12	-0.74	0.80	2.14	3.47
Bloomberg US Aggregate Bond Index	5.20	11.57	-1.39	0.33	1.84	3.23

Past performance does not guarantee or indicate 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.

For Institutional Use Only

The information portrayed is for the Calamos Institutional Core Plus Fixed Income Strategy. Representative holdings and portfolio characteristics are specific only to the portfolio shown at that point in time. Other portfolios will vary in composition, characteristics, and will

experience different investment results. The representative portfolio shown has been selected by the advisor based on account characteristics that the advisor feels accurately represents the investment strategy as a whole.

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Returns and Risk/Reward statistics presented reflect the **Calamos Institutional Core Plus Fixed Income Composite**, which is an actively managed composite that invests primarily in a diversified portfolio of investment-grade debt securities that generally have a dollar-weighted average portfolio duration between three to ten years. The Composite was created December 1, 2010, calculated with an inception date of July 1, 2007. The Composite results include all fully discretionary accounts, including those no longer with the Firm.

Fixed Income Risk: Portfolios that invest in fixed income securities are subject to several general risks, including interest rate risk, credit risk, and market risk, which could reduce the yield that an investor receives from his or her portfolio. These risks may occur from fluctuations in interest rates, a change to an issuer's individual situation or industry, or events in the financial markets.

Interest-Rate Risk: The value of fixed-income securities generally decreases in periods when interest rates are rising. In addition, interest rate changes typically have a greater effect on prices of longer-term fixed-income securities rather than shorter-term fixed-income securities. A strategy is subject to the risk that the market value of the bonds in its portfolio will fluctuate because of changes in interest rates, changes in supply and demand for investment securities, or other market factors. Bond prices generally are linked to the prevailing market interest rates. In general, when interest rates rise, bond prices fall; and conversely, when interest rates fall, bond prices rise. The price volatility of a bond also depends on its duration. Duration is a measure that relates the expected price volatility of a bond to changes in interest rates. The duration of a bond may be shorter than or equal to the full maturity of a bond. Generally, the longer the maturity of a bond, the greater its sensitivity is to interest rates. Bonds with longer durations have more risk and will decrease in price as interest rates rise. For example, a bond with a duration of three years will decrease in value by approximately 3% if interest rates increase by 1%. To compensate investors for this higher interest rate risk, bonds with longer maturities generally offer higher yields than bonds with shorter duration. If interest rates increase, the yield of a strategy may increase and the market value of the strategies' securities may decline, adversely affecting the strategies' net asset value ("NAV") and total return. If interest rates decrease, the yield of a strategy may decrease and the market value of the strategies' securities may increase, which may increase the strategies' NAV and total return.

The **Bloomberg US Aggregate Bond Index** covers the US denominated, investment-grade, fixed-rate, taxable bond market of SEC registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed rate and hybrid ARM pass throughs), ABS, and CMBS sectors.

Unmanaged index returns assume reinvestment of any and all distributions and do not reflect any fees, expenses or sales charges. Investors cannot invest directly in an index.

Fees include the investment advisory fee charged by Calamos Advisors LLC. Returns greater than 12 months are annualized. Chart Data Sources: Calamos Advisors LLC and Bloomberg.

Average annual total return measures net investment income and capital gain or loss from portfolio investments as an annualized average assuming reinvestment of dividends and capital gains distributions.

Calamos Advisors LLC is a federally registered investment advisor. Form ADV Part 2A, which provides background information about the firm and its business practices, is available upon written request to:

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