2Q22 Insurance Portfolio Review and Outlook: Historic Inflation Leads to Uptrending Treasury Yields

» GDP quarter over quarter growth fell abruptly from 6.9% in 4Q21 to -1.6% in 1Q22. GDP growth is expected to be weak for the remainder of the year and well into 2023.

» Headline CPI hit a 41-year peak of 9.1% YoY in June extending its streak above 4% to 15 straight months. CPI is expected to remain near peak levels in 3Q22 because of base effects, but trend toward 6% in the fourth quarter.

» The jobs market remains at all-time highs.

» The Misery Index (CPI YOY + U-3 Unemployment) hit 12.7%, just under the 13.0% reading after the housing crisis of 2008, but still well below the record high of 22.0% in June 1980. This may explain why consumer confidence is so low despite a favorable jobs market.

» Despite the worst first half of fixed income total returns on record, we outperformed our benchmarks for all insurance composites for the ninth quarter in a row.

Capital Markets See Recession as Inevitable

Risk premia are back. Investors are demanding a higher level of compensation for any level of assumed risk across asset classes and securities, including higher requirements for equity investments in the form of lower multiples, higher spread compensation for credit risk, and higher term premia for duration risks. Some of these shifts were bound to happen as the Fed unwinds years of extraordinarily easy monetary policy pursued during the Covid-19 pandemic. In addition, a surprisingly fast slowdown in growth, a hot labor market, plus very high inflation pressured risk assets. We expect the uncertainty and associated higher levels of compensation to endure.

The probability of left-tail risk (for example, a recession, supply chain issues, a return to Covid lockdowns) is increasing along with the median expectation for growth moving materially lower from artificially high levels. So far, we believe little of the Fed’s activity has transmitted to the real economy. Even if we apply the shortest of historical lags, we are barely three months removed from the first step higher in overnight rates, and even less so from the moves of greater magnitude. However, the market has moved in anticipation of these events and done a lot of tightening of financial conditions on its own.

Inflation is rotating away from goods and toward services as more consumer dollars are spent on experiences outside the home post pandemic, including travel. This is a negative development from our perspective because goods are largely produced outside the United States while services are almost entirely produced and consumed domestically, leading to a greater likelihood of a price-wage spiral. Additionally, the massive moves higher in “stickier” shelter components of the Consumer Price Index will continue to

### CALAMOS DYNAMIC INTERMEDIATE TAX-EFFICIENT STRATEGY RETURNS (%)

<table>
<thead>
<tr>
<th></th>
<th>QTR ENDING 6/30/22</th>
<th>1-YEAR</th>
<th>3-YEAR</th>
<th>SINCE INCEPTION (7/17)</th>
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</thead>
<tbody>
<tr>
<td>Calamos Intermediate Bond Tax-Efficient Insurance Composite</td>
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<tr>
<td>Gross of Fees</td>
<td>-2.29</td>
<td>-6.38</td>
<td>0.66</td>
<td>1.82</td>
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<tr>
<td>Net of Fees</td>
<td>-2.35</td>
<td>-6.58</td>
<td>0.45</td>
<td>1.60</td>
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<tr>
<td>Bloomberg US Aggregate Intermediate Index</td>
<td>-2.93</td>
<td>-7.91</td>
<td>-0.60</td>
<td>0.88</td>
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</tbody>
</table>

Source: Calamos Advisors LLC
Past performance is no guarantee of future results.
Data as of 6/30/22.
play out over the next year as those measurements are gradually included in the calculation. The Fed’s inflation fight is likely to be more difficult and longer than most market participants are acknowledging. We believe the elevated volatility associated with risks inherent from a wide range of potential outcomes will likely persist.

The Treasury market is looking past a resilient jobs market to focus on the Fed’s accelerated response to inflation. The Fed is squarely focused on bringing inflation under control because the risk of damage to the economy is much greater from ingrained inflation expectations than a recession. The market’s stance may be reflected in a Treasury curve inversion as the market tries to anticipate the eventual pivot in Fed policy.

**Second Quarter Treasury Rates Complete Worst Yearly Start in History**

Short Treasury rates moved higher again in the second quarter in response to the FOMC’s increasingly robust actions. Looking forward, the Fed Funds Futures market is indicating that the Fed will continue to raise rates past 3.5% by year end.

After 10-year Treasury rates broke the upper-end of a 35-year channel, they may have peaked in June at 3.5%. It is surprising that 9%+ inflation readings could only push long maturity yields this far.

Recession fears pushed credit spreads wider again during the quarter. We have not seen any material deterioration in the credit quality of any of our holdings. Intermediate A-rated corporate option-adjusted spreads (OAS) widened to 110 basis points in the second quarter from 74 and 47 basis points the previous two quarters. BBB-rated corporate OAS widened to 172 basis points from in the second quarter from 113 and 77 basis points the previous two quarters.

**2Q22 Sector and Index Performance**

The second quarter of higher Treasury yields and widening credit spreads produced the worst first half of any year on record. Credit spread widening hurt performance across all portfolios since we are overweight credit and underweight Treasuries. However, our duration underweight offset the underperformance of the corporate and municipal bond overweights.
Bloomberg Intermediate US Aggregate Index Performance

Intermediate corporate bonds underperformed again during the quarter due to credit spread widening. Securitized bonds also underperformed again due to spread widening and a 0.61-year duration extension. Slowing prepayments pushed securitized bond duration a full year longer so far this year. The yield-to-worst of the Bloomberg Intermediate US Aggregate Bond Index increased from 2.81% to 3.60% and is almost 2% higher for the year.

Investment Strategy Update—Size and Pace of Fed Rate Hikes Necessitate Modest Strategy Change

The Fed is behind the inflation curve and needs to act decisively to regain control, but increasingly larger rate hikes decrease the probability of a soft landing. Higher recession concerns are being reflected in lower yields on intermediate and longer Treasury maturities.

Our long-term strategy is to overweight credit by favoring issuers we are confident can survive cycle downturns and mature as scheduled. We continue to surveil all holdings and remain comfortable that yields are attractive for the risks taken. We expect credit impairments and defaults to be milder this cycle, but investment grade spread product yields are biased to go higher. The Treasury curve will likely invert before year end, but credit curves should stay positively sloped to reflect higher overall risk until the depth of the recession is known. If credit spreads continue wider, credit will underperform Treasuries over the short-term, but should compare more favorably over longer time frames due to their higher yield advantage.

Markets are volatile and credit conditions can change. We proactively trade to improve portfolios which may include selling corporate securities to buy longer-maturity Treasuries or very high quality taxable municipal bonds. We continue to underweight structured securities due to negative convexity.

We appreciate your confidence in the ability of our experienced team and time-tested process to manage through tax regime changes, credit cycles and other market uncertainty.
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.

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Returns and Risk/Reward statistics presented reflect the Calamos Intermediate Bond Tax Efficient - Insurance Composite, which is an actively managed composite that invests in a broad range of US dollar-denominated intermediate maturity, investment grade fixed-income securities, including corporate bonds, municipal bonds, Treasuries, agencies, mortgage-backed securities and asset-backed securities. The Composite was created July 1, 2017, calculated with an inception date of July 1, 2017.

The Bloomberg US Aggregate Intermediate Index is an unmanaged index that measures the performance of the US investment-grade bond market while removing the longer-maturity portions of the broad market benchmarks. 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.

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