Phineus Long/Short Strategy

Market Overview

The Inverse of Goldilocks
The year 2022 has witnessed the worst start for the S&P 500 Index since 1970 and the worst for bonds on record. This kind of trauma is typically associated with an economic crisis or recession, causing investors therefore to believe one is imminent. Unsurprisingly, the mood is black. In contrast, we believe the journey from inflation anxiety to inevitable recession will be more prolonged. Markets will search for stabilization through summer as investors gauge the prospects for “peak inflation” and the inevitable pivot by the Federal Reserve.

Today’s setting is confusing and unsettling, yet fundamentals are generally supportive. There is no imminent return to Goldilocks, but the most deleterious risks for equities can be avoided. The true enemy of equities is not inflation, but deflation in output and profits. Recession is unlikely until late 2023 or 2024 at the earliest.

In the meantime, 2022 should be viewed as a financial repricing event rather than a precursor of economic collapse. Investors are nervous because they know they have lost the protection of central bankers, at least until something breaks. In our view, the resiliency of the economic cycle is what matters, and this is reflected in the strategy’s positioning.

The Case for a Soft Landing
Although real GDP was near zero in the first half of 2022, the National Bureau of Economic Research is unlikely to officially designate this period as a recession. For recession to be probable, we would need to see weak rather than strong employment, weak rather than elevated surveys of corporate activity, surging rather than controlled credit spreads, and an inverted yield curve. Recession has never occurred without 3-month money becoming more expensive than 10-year money in advance.

Housing is the greatest leading indicator of demand; its outsized role in the Great Financial Crisis has reinforced that perception.

Neither housing nor employment imply that recession is imminent. Households are cushioned by their accumulated savings and improvements in net wealth, which includes housing equity.

The horizon at which recession risk is elevated has drawn nearer, but material risk is unlikely until 2024 or 2025. A Fed policy mistake could bring this forward into late 2023, but inflation-induced recessions tend to be shorter and milder than balance sheet recessions.

The reversal by the Federal Reserve in Q2 has been so rapid and comprehensive that recession anxiety is inevitable. Meanwhile, the “soft landing” narrative requires financial conditions to become restrictive, just not excessively so.

Chair Powell is compelled to talk tough, but so he would at this sorry stage of the story. As a product of today’s generation of policymakers, it is only a matter of time before Powell convinces himself that he has done enough to slow inflation and thus avoid the painful prospect of recession. We see the Federal Reserve pausing to reassess its outlook by September.

Corporate Profitability: Cracks in the Wall
The true enemy of equities is not inflation but deflation in output and profits. We do not see deflation as likely until 2024. Currently, equity markets have been repriced for moderating growth, and the trajectory of corporate profits will determine if the bear market is

FIGURE 1. PHINEUS LONG/SHORT STRATEGY RETURNS (%)

<table>
<thead>
<tr>
<th></th>
<th>QTR ENDING 6/30/22</th>
<th>1-YEAR</th>
<th>3-YEAR</th>
<th>5-YEAR</th>
<th>10-YEAR</th>
<th>SINCE INCEPTION (6/1/02)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phineus Long/Short Composite</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross of Fees</td>
<td>-10.60</td>
<td>-5.39</td>
<td>9.20</td>
<td>6.55</td>
<td>9.91</td>
<td>12.23</td>
</tr>
<tr>
<td>Net of Fees</td>
<td>-10.88</td>
<td>-6.56</td>
<td>7.87</td>
<td>5.25</td>
<td>8.46</td>
<td>10.66</td>
</tr>
<tr>
<td>MSCI World Index</td>
<td>-16.05</td>
<td>-13.94</td>
<td>7.52</td>
<td>8.22</td>
<td>10.10</td>
<td>7.52</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>-16.10</td>
<td>-10.62</td>
<td>10.60</td>
<td>11.31</td>
<td>12.96</td>
<td>8.63</td>
</tr>
</tbody>
</table>

Source: Calamos Advisors LLC. Past performance is no guarantee of future results. Data as of 6/30/22.

All portfolio positioning and sector information is for a representative portfolio. All values are in USD terms unless otherwise indicated. Please see last page for additional information.
complete. Investor conviction in a soft rather than a hard landing will drive style and industry performance.

Corporate revenues are led by intermediate input prices. Profitability is therefore correlated positively to inflation and supply limitations. We anticipate a widening gap between sluggish real GDP and sustained corporate profitability. Healthy, nominal GDP of 7%–8% in 2022 implies that widespread fears concerning corporate profitability are premature. Of course, the profit cycle is transitioning from the sweet spot of 2021 to something more challenging, hence cracks in the wall are appearing.

Investors are rightly wary of rising borrowing costs, but this is not a major driver of margins over short horizons. This will evolve slowly as corporations have locked in low rates for years. At the same time, it makes sense that equities are derated as liquidity wanes and the long tailwinds that have supported rising margins (low interest rates, low input costs, low taxes and globalization) fade.

Bloated inventories across the “Covid bubble” winners will also be a problem, especially across durable and nondurable goods. The pull forward of consumer durable demand was material and will take years to digest. The portfolio’s individual shorts emphasized this theme. In contrast, the recovery in the services sector is early and resilient. Compared with the goods sector, services are a more stable, larger and less profitable source of economic activity.

Today’s risk is not a collapse of earnings, but an ongoing derating of defensive bond proxies and long duration growth stocks that dominate the major benchmarks. In both cases, valuations are still high, and profitability is maturing. Across industries, quality and profitability styles will win as long as investors believe a recession is only a matter of time.

**Places to Hide**

The rules of a bear market are straightforward. Capital preservation prevails above all else. At the start of 2022, the risks were skewed negatively. Today, the mix of opportunity versus risk is more balanced. This shift is reflected in our portfolio hedges that assume the shock of financial repricing has climaxed and, thus, further market lapses should be bought through summer. Sector and style biases will be key.

Our judgment that recession is not imminent is critical. The down move in equities has been orderly and consistent with an inventory-driven sluggishness in the real economy and the goods sector in particular. But a harder landing has not been discounted. A genuine recession in output and profits, one that drives earnings lower by 20%, implies a downside for the S&P 500 Index to the 3000 level. One silver lining is that there is no precedent for losing money over the five years following a 20% bear decline in equities. However, results can be lackluster and worse when compared with inflation, while volatility can translate to poor risk-adjusted returns. Avoiding losses in highly overpriced areas of the equity world will be key.
Interpreting the events of 2022 requires nuance. Clearly today’s setting is radically different from the aftermath of the Global Financial Crisis. The investment landscape is being reconstituted, challenging the experience of most investors. Without inflation, things happen slowly, and momentum-based strategies can work. With inflation, things happen fast. Asset and style allocation matter more.

The pandemic is like a comet tail whose shadow extends across much of the economy, clouding our ability to assess the economic body. Even as this fades, investors will have to grapple with the aftereffects of excessively low interest rates. This new era should eventually become synonymous with instability.

**Strategy Exposures and Positioning**

*See back page for additional details regarding securities referenced*

The strategy maintained a net equity exposure (delta-adjusted) near 50% for much of Q2 and ended June at 51.5% versus 50.3% at the end of March. Through May, healthy alpha generation in the long position largely overcame the long equity bias and the impact of arduous markets. In June, there was “no place to hide” and the portfolio absorbed the full brunt of the risk-off mood.

Despite the severity of equity turmoil, the repricing of financial risk has been orderly and centered largely upon the derivatives of long duration and speculative growth stocks in particular. Selling pressure turned broader as fears of recession replaced anxiety over excessive growth. This impacted many of the portfolio's cyclical positions.

Most of our cyclical positioning can be considered shorter duration (lower multiples on near-term earnings) with business prospects that are healthy or improving. Nonetheless, investors chose to tread warily around economy-sensitive businesses, especially those with asset-intensive balance sheets and those whose cost of financing could be relevant for capital projects, fleets of planes or cars or hotels, and so forth.

Of our top performance detractors in the quarter, the majority are asset heavy or employ substantial leverage as part of their business model. Names here include Caesars Entertainment Inc., Boeing Company, Air Lease Corp, Bank of America Corp, Delta Air Lines Inc. and Hilton Worldwide Holdings Inc. In most cases, the impact of higher financing costs upon margins will not be apparent for years. For some of the banks and leasing companies, it is potentially positive.

We have reviewed these stock detractors with a heightened emphasis upon quality, profitability and valuation. In 7 of the 10 instances, we added to positions on June weakness. We exited Boeing after it declined through our put structure; we sold Twilio Inc. and replaced it with a new position in Snowflake Inc. Caesars is under review and we await its earnings release in July.

Entering 2022, our cautious view on the equity derivatives of long duration translated into a preference for more profitable, higher quality and understandably valued cyclical businesses versus those with less support from earnings and cash flow, though cycicals have absorbed their share of the turmoil. This sheltered the portfolio from some of the most egregious stock disappointments of the past six months.

The collapse of growth stock mania validated our wariness of stocks whose value depends largely upon assumptions about the far future, or what we judge as long duration. That said, recession anxiety combined with negative real interest rates argue for stabilization of the quality growth style for now. We have selectively re-engaged opportunities that we view as QGARP, or quality growth at a reasonable price.
Our long book is balanced and diversified across investment themes, yet underweight the growth sector relative to the major US benchmarks. This highlights one of the key conundrums for investors. The level of benchmark concentration across sectors, styles and regions is near historic highs. The concentration is correlated internally and correlated to duration.

Many investors have flocked to alternative investments in the hope of adding diversification, yet these alternatives have high and increasing correlation to stocks and will struggle in a more reflationary setting.

One prudent response is active and diversified allocations to quality and profitability. Heightened emphasis on valuation is equally important.

Many of our cyclical themes anticipate the shift from goods to services as the world slowly emerges from the pandemic. This implies a sustained recovery in travel and entertainment along with businesses that benefit from a return to the office. In contrast, producers and retailers of goods will struggle with less volume and less pricing power into 2023 as the “stay at home” bubble pulled forward years of demand.

Our conviction that the economic expansion will survive the repricing of risk assets underpins our preference for cyclicals with operating leverage in a post-pandemic world versus outright defensives such as utilities and consumer staples. The latter are historically expensive and have a higher risk of derating, whereas many staple businesses are low margin and cost instability will prove problematic.

Portfolio positioning is typically framed in the language of industries and styles. In the absence of the monetary drugs, the more relevant distinction is between profitable and quality versus unprofitable business models. Although unprofitable businesses can have windows of outperformance, this has been limited to those periods in economic history when money was “free.” Those days are over.

**Stock Positioning**

A key debate is what to do with the mega cap growth leaders that dominate the major benchmarks. After selling Meta Platforms Inc. and reducing Alphabet Inc. in late 2021 (both had been major features of the long portfolio for years), we tactically added to Meta in June with put protection through its Q2 earnings release. We modestly increased Alphabet with a similar hedge.

Investors are rightly worried that the greater market share today of Meta and Alphabet in the total ad market implies advertising-based internet companies are more at risk than they were in the 2008 downturn. In the absence of recession, the vulnerability is equally that total spending available for online advertising is diluted from share gains by competitors such as Amazon.com Inc., TikTok Inc., Apple Inc. and Netflix Inc.

Valuations discount some of this risk, but further clarity awaits Q2 earnings releases. Apple (-2.32% short) was added as a mega cap hedge because of its vulnerability to a slowdown in consumer durable spending and currency headwinds. Apple over earned during the pandemic, and 2023 estimates could be too high. Its business is highly transactional, with only around 10% of revenues recurring.

Amazon has been derated in the wake of post-pandemic shortfalls in online retail. Sales growth peaked near 45% during the pandemic.

Investors expect growth of only 6% for Q2. Yet, the latest Prime Day enjoyed an estimated 18% growth versus 8% the prior year, suggesting the trough of the “stay at home” distortion may be near. Amazon retains many unique advantages of scale and competitive positioning. The stock is intriguing at today’s levels.

Alphabet should be one of the first companies to lean into on further weakness given its culture of innovation, solid cash generation and an understandable price multiple relative to its potential. Alphabet has historically shown little discipline in its core operating business where the competitive moats are high; management has misspent on moonshot opportunities. The company has material potential for margin discipline when its core business enters maturity.

The portfolio established new long positions in select semiconductor names. The group has been derated materially, yet revenue and earnings estimates have moved higher. The issue has been the higher pace of capital spending and the magnitude of the coming inventory correction. In our view, the group’s GARP attraction remains intact. We established positions in Advanced Micro Devices Inc., Analog Devices Inc. and Micron Technology Inc. To crystalize tax benefits, we swapped Lam Research Corp for Applied Materials Inc.

We prefer semiconductors to the duration risk inherent in the fast growing but unprofitable SaaS (Software-as-a-Service) companies, where the competitive moats can be lower. The dramatic share weakness has provided an opportunity to upgrade the quality of our limited positioning.

We crystallized the tax loss in Twilio and replaced it with Snowflake, a company with a less controversial business model. We continue to own...
**Phineus Long/Short Strategy**

**Paycom Software Inc.**, a well-executing and steady growth SaaS payroll provider.

Although Snowflake has been among the poster children for SaaS valuations divorced from reality, one can make a case through growth adjusted comparisons. Despite its multiple derating by 75% to 15x sales and management guiding to a 16% adjusted free cash flow margin, the stock is still not cheap. Yet if Microsoft Corp can trade at 30x free cash flow that grows 20%, Snowflake is not egregious at 40x on 2024 free cash flow (FCF) estimates that are growing twice as fast.

We are wary of being premature in re-engaging much of this growth opportunity. Yet there is a legitimate case to be made for shifting from not wanting to own them to debating whether the bear market in SaaS names has gone far enough in both price and time. The impetus to get this right reflects the likelihood that these names can run 20%–50% just on hopes of the Fed slowing its pace of monetary tightening.

Technology stocks have been materially derated, yet few of their management teams have embraced conservatism, despite data points that imply a demand slowdown is unfolding. As usual, the debate is the magnitude and timing of the cuts relative to investor positioning. Until forward estimates come down broadly and the stocks can stabilize in the face of this, we are reluctant to engage names that are not supported by quality earnings and cash flow.

In payment services, we increased **Visa** and added a new long position in **TransUnion Company** near its lows in June. Both are reasonably valued with still solid growth prospects; both are higher quality than many of their industry peers. **Visa** is better managed and less controversial than **PayPal** and a net beneficiary of the cross-border recovery in travel spending. We own **Fidelity National Information Services Inc.**, given its more stable software business.

Outside technology, we favor more cyclical names with global or domestic recovery potential into 2023. The broadest exposure here is diversified industrials and transports, and then financials. Examples of industrials include Honeywell International Inc. and **Siemens AG**. After trimming **CSX Corp** and **Union Pacific Corp** near their highs, we returned to these names on weakness. The railroads are US-centric beneficiaries of supply chain normalization and onshoring, with limited exposure to labor or energy costs.

Elsewhere in industrials, we focused on aerospace, airlines, and defense names. Aircraft lessors like **Air Lease Corp** and **AerCap Holdings NV** as well as aftermarket servicers such as **Raytheon Technologies Corp** are benefiting from higher plane values and lease rates. Both face losses on ~3% of their fleets that have been seized by Russia. These losses should be recovered through insurance, which both carry on their planes at more than book value to account for future loss of income.

The robust and nascent recovery in leisure air travel will be followed by a slower but sustained increase in corporate and international travel later this year and into 2023. Airlines are constrained for capacity expansion because of labor and plane shortages. The pricing environment should remain firm for the foreseeable future. We prefer the higher quality carriers with lower leverage ratios like Delta Airlines and **Southwest Airlines Company**. Lower oil prices will be a key catalyst for the industry into autumn.

Recovering travel volumes are also benefitting ride hailing companies where we prefer **Uber Technologies Inc.** to **Lyft Company** and hotels where we own **Hilton**, **Accor SA** and Caesars Entertainment. We added further to **Booking Holdings Inc.** on weakness. Finally, we increased our position in the food service vendor **Sysco Corp**, which is now among the portfolio’s larger positions. It should benefit both from further growth in online takeout ordering and a multiyear recovery for indoor dining at restaurants.

Energy was a big contributor to performance in 2021 and the top contributor in the first quarter of 2022. However, positions have been reduced as any further upside to crude prices appears limited. While fundamentals are supported by years of industry underinvestment, Chinese economic disruption and war-related inventory hoarding point to lower oil prices on a short horizon. The portfolio maintains modest positions in **Shell PLC** and **Baker Hughes Co.** Financials are a conflicted group. Revenue and earnings are benefiting from the high growth rates of nominal income, which is also generating macro fears of a harder economic landing. The group has been derated on misplaced recession anxiety, whereas conviction in a softer landing will return the group to favor.

We like the regional banks, in particular **Huntington Bancshares Inc.** and **Truist Financial Corp** whose fundamentals are more correlated to strong wages and income. The portfolio’s core position in **Morgan Stanley** was increased near its low. We continue to be impressed both by the firm’s nimble execution in capital markets and ongoing initiatives to improve profitability in the wealth management business. Abroad, we prefer **NatWest Group PLC** and **Lloyds Banking Group PLC** over their continental peers because the Bank of England has signaled that it will raise rates more aggressively. We believe both stocks will benefit from material capital return.
EXPOSURES FOR HOLDINGS NOT INCLUDED IN LARGEST POSITIONS AS OF JUNE 30, 2022

All returns are net of commission and other similar fees charged on securities transactions and include reinvestment of net 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. Unmanaged index returns assume reinvestment of any and all distributions and do not reflect any fees, expenses or sales performance. Performance of developed markets. The is considered generally representative of the US equity market. The S&P 500 Index was created September 30, 2015, calculated with an inception date of June 1, 2002. On October 1, 2015 Calamos acquired Calamos Phineus Long/Short Composite Returns and Risk/Reward statistics presented reflect the performance of the securities discussed herein. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. Past performance does not guarantee or indicate future results. Current performance may be lower or higher than the performance quoted. Holdings and weightings are subject to change daily. Holdings are provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned.

LARGEST POSITIONS (CASH BASIS), LONG AND SHORT AS OF 6/30/22 (% OF NET ASSETS)

<table>
<thead>
<tr>
<th>Security</th>
<th>Long</th>
<th>Short</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Lease Corp. - Class A</td>
<td>3.8%</td>
<td></td>
</tr>
<tr>
<td>Raytheon Technologies Corp.</td>
<td>3.5%</td>
<td></td>
</tr>
<tr>
<td>Sysco Corp.</td>
<td>3.2%</td>
<td></td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>3.1%</td>
<td></td>
</tr>
<tr>
<td>Union Pacific Corp.</td>
<td>3.1%</td>
<td></td>
</tr>
<tr>
<td>SPDR S&amp;P 500 ETF Trust</td>
<td>-41.1%</td>
<td></td>
</tr>
<tr>
<td>Walmart, Inc.</td>
<td>-2.4%</td>
<td></td>
</tr>
<tr>
<td>Apple, Inc.</td>
<td>-1.6%</td>
<td></td>
</tr>
<tr>
<td>SPDR S&amp;P 500 ETF Trust - Put Option</td>
<td>-0.4%</td>
<td></td>
</tr>
<tr>
<td>SPDR S&amp;P 500 ETF Trust - Put Option</td>
<td>-0.3%</td>
<td></td>
</tr>
</tbody>
</table>

Holdings and weightings are subject to change daily. Holdings are provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned.

EXPOSURES FOR HOLDINGS NOT INCLUDED IN LARGEST POSITIONS AS OF JUNE 30, 2022

Accor SA, 1.75%; Advanced Micro Devices Inc., 2.81%; AerCap Holdings NV, 2.49%; Alphabet Inc., 1.94%; Amazon.com. Inc., Options traded intra-quarter; Analog Devices Inc., 2.01%; Applied Materials Inc., 1.92%; Baker Hughes Co., 1.60%; Bank of America Corp, 2.81%; Boeing Company, Sold; Booking Holdings Inc., 2.95%; Caesars Entertainment Inc., 2.45%; CSX Corp, 1.88%; Delta Air Lines Inc., 2.51%; Fidelity National Information Services Inc., 1.88%; Hilton Worldwide Holdings Inc., 2.41%; Honeywell International Inc., 3.04%; Huntington Bancshares Inc., 2.42%; Lam Research Corp, Sold; Lloyds Banking Group PLC, 0.98%; Meta Platforms Inc. - Class A, 3.31%; Micron Technology Inc., 1.86%; NatWest Group PLC, 2.79%; Paycom Software Inc., 1.17%; PayPal Holdings Inc., Sold; Shell PLC, 1.63%; Siemens AG, 2.36%; Snowflake Inc. - Class A, 1.97%; Southwest Airlines Company, 2.83%; TransUnion Company, 1.05%; Truist Financial Corp, 2.71%; Twilio Inc., Sold; Uber Technologies Inc., 2.06%; Visa Inc., 3.04%

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. The information portrayed is for the Calamos Phineus Long/Short 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. The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice. The information provided in this report should not be considered a recommendation to purchase or sell any industry, sector or particular security. There is no assurance that any industry, sector or security discussed herein will remain in a client’s account at the time of reading this report or that industry, sectors or securities sold have not been repurchased. The industries, sectors, or securities discussed herein do not represent a client’s entire account and in the aggregate may represent only a small percentage of an account’s holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. Returns and Risk/Reward statistics presented reflect the Calamos Phineus Long/Short Composite which is an actively managed composite primarily investing in long and short positions of global publicly listed equity securities. The Composite was created September 30, 2015, calculated with an inception date of June 1, 2002. On October 1, 2015 Calamos acquired Phineus Partners, LP which has managed the strategy since its inception in 2002. The Composite results include all fully discretionary accounts, including those no longer with the Firm. The MSCI World Index is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed markets. The S&P 500 Index is considered generally representative of the US equity market performance. 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. All returns are net of commission and other similar fees charged on securities transactions and include reinvestment of net realized gains and interest. Chart Data Source: Calamos Advisors LLC.

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: Calamos Advisors LLC 2020 Calamos Court Naperville, IL 60563-2787 Attn: Compliance Officer