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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Seeking Companies with Sustainable, Underestimated Growth Profiles

BRANDON M. NELSON, Senior Portfolio Manager, is responsible for the portfolio management of Calamos Investments LLC's small- and smid-cap growth strategies. He draws upon more than 22 years of experience in small- and smid-cap growth equity investing, utilizing the same philosophy and process employed by Calamos Timpani Small Cap Growth Fund (MUTF:CTSIX) today. He is also a member of the Calamos investment committee, which is charged with providing a top-down framework, maintaining oversight of risk and performance metrics, and evaluating investment process. Mr. Nelson joined Calamos Investments following its 2019 acquisition of Timpani Capital Management, the company he co-founded in 2008, where he served as Chief Investment Officer and Portfolio Manager of the Timpani strategies since inception. Previously, he was a Managing Director and Senior Portfolio Manager at Wells Capital Management since 2005. Prior to that, Mr. Nelson was with Strong Capital Management, Inc. as a research analyst from 1996 to 2000 and as a portfolio manager from 2000 to 2005. He received his master's degree in finance from the University of Wisconsin-Madison and was selected to participate in the prestigious Applied Security Analysis Program. He also received his BBA in finance from the University of Wisconsin-Madison.

SECTOR — GENERAL INVESTING

TWST: You recently joined Calamos as part of its acquisition of the company you co-founded. Tell us a bit about Calamos' business and capabilities and what attracted you to join the company.

Mr. Nelson: Calamos is a great firm. I've known about them for my whole career. I started in the industry back in the mid-1990s, and when I worked on various growth investments, I could see Calamos was a holder in some of the same stocks that we trafficked in, so they've always been on my radar screen. I've always thought highly of them. Also, being based in the Midwest just outside of Chicago, not too far from where I've spent my whole career in Milwaukee, that also contributed to my awareness of their existence.

I think they have a lot of strengths. They have a lot of resources. It was attractive to me joining forces because I think our skill sets overlap really well in a lot of areas. We have good products. We have a small-cap growth strategy, a smid growth strategy, and that's where the bulk of our assets are.

Calamos also has great products that don't overlap with our products, and they have tremendous resources in other very important parts of a money management organization, namely marketing and distribution, compliance, HR, operations, all enabling departments that you need to have a strong money management firm. Not to mention, a lot of investment research, investment resources; that was also attractive.

So from a high level, it was synergistic for us. We're keeping our existing research team in place, but we're able to supplement that with additional investment resources that we can choose to tap into. I was doing the trading before, in addition to wearing a lot of other hats, and they're going to be able to take that off my plate so I can focus more on the portfolio and focus more on research and picking stocks for the portfolio.

They have risk-management folks and quantitative experts that will be able to slice and dice our portfolio, provide value-added commentary and analysis to help us better manage the portfolio. As a smaller firm on our own, we had some of that, but the depth of resources is greater at Calamos, and that's appealing.

I think, from a high level, it just makes a lot of sense. I think having all the resources I just mentioned is going to enable us to do our job even better, focusing more time and effort on the portfolio specifically. Most importantly, everything I'm saying I think is a win for our client base and our mutual fund shareholders. I think this should all be performance-enhancing, and that's critical to the partnership.

TWST: How would you describe your overall investment philosophy and process?

Mr. Nelson: Our philosophy is to invest in companies with fundamental momentum. We seek companies with a sustainable and underestimated growth profile, and then, we overlay that approach with an unemotional, value-added sell discipline. And the key is to find companies that have both sustainable growth and underestimated growth. One without the other can be OK, but both together tend to be much more powerful because valuation metrics usually expand when this happens.

To elaborate a little bit more, part of the reason I think the process is successful and repeatable is because we're exploiting some common behavioral errors that other investors and analysts make. For instance, most investors make the mistake of selling winners too early and holding losers too long. There's a behavioral finance term for this known as the disposition effect, and we exploit this and tend to do the opposite. We hold our winners for long periods and cut our losers quickly.

And speaking of cutting our losers, we consider our sell discipline to be one of our most value-added and differentiating features. When we sense fundamental momentum is diminishing, we generally take action and reduce exposure. We have a no-nonsense approach when it comes to tolerating stocks of companies with fatiguing fundamentals, and our sell discipline is objective and unemotional, which are key ingredients to outperforming in our opinion. We have a lot of options when it comes to choosing stocks. Why would we want to waste a spot in the portfolio, holding dead weight?

Highlights

Brandon M. Nelson discusses Calamos Investments LLC and its small-cap growth mutual fund. Mr. Nelson aims to invest in companies with fundamental momentum. He looks for companies with sustainable and underestimated growth. Mr. Nelson says these characteristics are powerful together because the valuation metrics tend to expand when a company has both sustainable growth and underestimated growth. He also has an unemotional, value-added sell discipline. Right now, the mutual fund's biggest exposures are in technology, health care and consumer discretionary because that's where Mr. Nelson tends to find the most secular growth. Mr. Nelson thinks that now is an opportunistic time to be looking at small caps.

Companies discussed: ShotSpotter (NASDAQ:SSTI) and Chegg (NYSE:CHGG)

The last thing I'll add on this idea of the sell discipline is, it's one thing for me to talk generically about it, but we've taken the extra step and done analysis that shows stocks that we sell from the portfolio tend to persist as losers well after being sold. We consider this a critical risk control since it provides key potential downside protection to overall portfolio returns.

A lot of people talk about how great their buy discipline is and their sell discipline, but in my experience, very few have actually put meat on the bones and done that follow-up analysis on the sell discipline. I think it's important confirmational data that essentially proves that there is value in the sell discipline. The fact that those stocks persist as losers after we've sold them, that's a good litmus test of whether the sell discipline is really adding value or not. The analysis we've done shows a very strong pattern that it is value added.

TWST: Would you give us a snapshot of the small-cap growth fund — a bit more about your investment criteria, number of holdings, what you use to benchmark performance?

Mr. Nelson: In the small-cap growth mutual fund, we're benchmarked against the Russell 2000 Growth. We hold 80 to 120 stocks; right now, we're on the low end of that range. It is diversified by sector. The biggest exposures are to technology, health care, consumer discretionary. That is where you tend to find the most secular growth, and that's really what we focus on. At our core, we are secular growth investors. We're trying to find stocks that don't need the economy to be booming, don't need the Fed to be cutting, don't need growth to be beating value.

Really, what we're trying to do is get in front of positive revisions in the analyst community, find what we call positive growth gaps, which essentially is another way of saying underestimated growth — find those situations and invest in stocks where the world is going to have to be chasing expectations higher for the next several quarters, where the companies are in beat-and-raise mode, where the $1 in earnings per share estimate is going to get revised to $1.20, to $1.70, to $2 throughout the course of the year.

The idea is, if you can find stocks that have that profile, you're probably going to outperform your benchmark, and you're probably going to outperform a lot of other benchmarks along the way. Whether value is beating growth or vice versa, or the Fed is raising or cutting interest rates, if you find stocks that are in their own bull market like what I'm describing, that's a pretty positive backdrop for performance. So that's really what we're trying to do.

It's those two things coming together: find companies that have a sustainable growth profile but also an underestimated growth profile. That's really where you get the magic, so to speak. It's finding both of those. And to have that sustainable growth profile you have to have something special — a good or service that you're selling that has some sort of tailwind to it, where you have competitive protection, where you're going to be able to grow for the next several years.

But if you're clumsy when it comes to communicating with investors and setting expectations, and you're reporting earnings quarter after quarter, but you're continuously falling short of your own guidance or whatever expectations happen to be, that's a problem, and your stock is probably going to struggle even though you've got a good, sustainable growth profile. A lot of small companies especially are not so good at the communication part of it and not so good at setting expectations. And so we try to find companies that are good at both, where they've got that special good or service that they're selling, but they're also sensitive to setting expectations and have a mindset to be in a position to have underestimated growth and not just strong, sustainable growth.

I'm speaking from a high level, but hopefully you get that the magic is when you get both of those going in the same way. You asked what characteristics we're seeking in the companies we invest in, and from a high level, it's those two things. We're indifferent about which sectors that takes us to, but the three I called out before are where we tend to traffic the most. But we will dabble in other areas, such as financials, industrials and energy. It is a diversified portfolio, and that's intentional. We think we have broad appeal by having that diversification.

1-Year Daily Chart of ShotSpotter

Chart provided by www.BigCharts.com

1-Year Daily Chart of Chegg

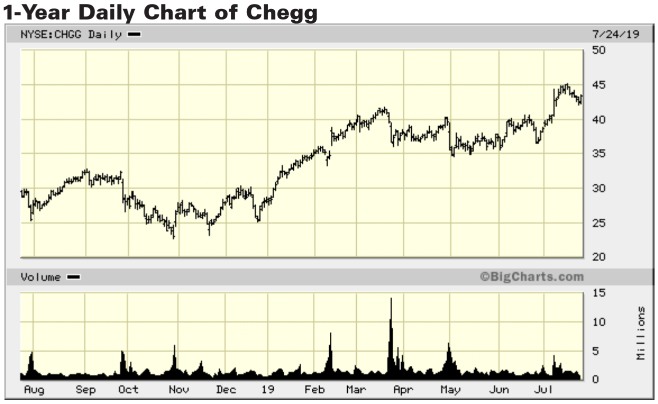

Chart provided by www.BigCharts.com

TWST: So you're not necessarily driven by sector or industry, but are there any broad themes or trends influencing your investment decisions or reflected in your decisions?

Mr. Nelson: Most of the stocks in our portfolio are one-off stocks that don't fall within a theme per se, but there definitely are themes you could point out in our existing portfolio. I'd call out software as a theme within technology. The bulk of our technology weight is in software, and there's been a lot of documentation and publicity about subscription-model software companies, SaaS companies, that are in a lot of different verticals of the economy. There are software companies that are enhancing productivity and causing companies to ultimately generate more revenue and lower costs.

There are other themes I could point to; home health care is a theme. In many instances, it's more beneficial to treat patients in the home. It's less costly for the health care payers, and patients like it more.

Education is another theme we could point to. We've got a few different names in the portfolio that are exposed to the education theme. Online education has been a big secular trend in the last few years, and we own some companies that offer online degrees, enable online education program management or sell online educational tools to students to help them perform better.

Other miniature themes you could point to — defense spending has been picking up over the last couple of years. We've got a couple of names that are exposed to that trend but also have their own stock-specific merits that we're excited about as well. Within technology, we own a couple of stocks that are exposed to public safety technology, where technology is being used to provide mass notification to citizens within a country or employees within an enterprise. Another stock we own provides gunfire detection technology so that police departments can zone in more accurately to find where gunfire is taking place within a city, and they can send officers to the scene quickly to gather evidence and resolve any sort of hostile situation. So lots of one-offs but also a lot of themes and mini themes I could point to.

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TWST: Could you tell us more about a couple of examples of either current top holdings or your favorite investment ideas right now and why they're attractive to you and fit with your strategy?

Mr. Nelson: Sure. I was just talking about gunfire detection; the stock I was referring to specifically is called **ShotSpotter** (NASDAQ:SSTI), and it's a good example of a stock that has scored pretty well with how we think. It's grown rapidly in recent quarters, and it's generally exceeded analyst expectations. Like I said before, they sell gunfire detection technology, mostly to police departments throughout the United States.

As it turns out, about 80% of gunfire goes unreported. Police departments can use **ShotSpotter's** technology to accurately identify the location of gunfire and, like I said, proactively send officers to the scene to try to resolve situations that might be hostile or to gather evidence and really just to show the community they've got their back and that they're present. It really helps with community relations.

If you think about our two key criteria — sustainable growth and underestimated growth — one thing we like about **ShotSpotter** is it's being sold in about 100 U.S. cities today, but in theory, it could be used in closer to 1,500 U.S. cities. That's a lot of runway for them to have a sustainable growth profile, and so that's very attractive to us. We want to find stocks where there's a sort of open-ended situation like that where they can, at least theoretically, grow for many years going forward.

I mentioned education as a theme. **Chegg** (NYSE:CHGG) provides educational tools, mostly to undergraduate college students, and in recent quarters, it's grown rapidly, and it's generally exceeded analysts' expectations. They have a subscription model, and they've got about 2 million undergraduate student subscribers, and that's out of 15 million undergraduate students in the United States in total. So there, again, two out of 15 is fairly low penetration.

Now, they're probably never going to get 15 million undergraduate subscribers, but you've got a long runway in front of you to take that 2 million to something hopefully much higher. We like those types of situations, where the opportunity for the company to further penetrate the market is there.

TWST: You mentioned tariffs impacting industrials. Are there any other macroeconomic factors or indicators that you are paying close attention to that you find influencing your investment decisions, especially where we are in this cycle?

Mr. Nelson: We do pay attention to the macro indicators. It's important to know what's going on with the Federal Reserve. In this case, the tariff situation is something we're watching closely. But where we think we add the most value is in the bottom-up stock selection process — meeting with companies, studying company financials, talking to industry contacts and really doing deep-dive analysis at the company-specific level. That's where we spend the bulk of our time, while still keeping an eye on the macro.

You don't want to bury your head in the sand on that stuff. It's important, but it's not as much of a focus. The things we pay attention to at the macro level are a lot of the same things you hear people talk about in the media, a lot of the same economic factors that people look at. It's the jobs reports, the housing data, the GDP figures, Federal Reserve commentary and action, etc. All that is factored into the equation for us, but it's not as important to us as the bottom-up stock situations.

We do our best when the market is less focused on the macro and more focused on the micro. We're pretty good at sniffing out fundamental momentum at a company-specific level, and we do our best when the market appreciates that — when a company is displaying positive fundamental momentum and the market is rewarding that company or that stock with outsized performance. That's when we tend to do well.

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TWST: Are there any areas that you're particularly cautious about right now?

Mr. Nelson: That gets back to where there is not such great fundamental momentum; that's where we're going to probably stay away from or at least have less exposure. A lot of industrials are struggling right now. There are various headwinds. They're more in the crosshairs of all the tariff noise. Global GDP has shown some sluggishness, and a lot of these industrial companies have either direct international exposure or indirect international exposure, where some of their customers have international exposure, and therefore, they get caught up in the slowing food chain.

Energy has been hit or miss. It's been a struggling sector fundamentally, as oil prices and natural gas prices have been generally under pressure from where they had been a few years ago. It's been a choppier area. We'll still pay attention to these areas and pick our spots and pick our moments to be exposed, but those are a couple that come to mind that have been areas of fundamental sloppiness.

Materials is another one. It doesn't mean we won't be there; we've got some exposure, but it's pretty selective. Where we do have exposure, it's in names that have some sort of company-specific situation that's causing them to buck the trend of whatever negative industry headwinds there might be. Financials have been hit or miss, I'd say, as a sector fundamentally.

"So my advice is to have professional managers overseeing your small-cap portfolio. I think it's an asset class that can provide tremendous performance, so even though it's higher risk than large caps and midcaps most of the time, it's also higher reward. And I think there is a place for small caps in a lot of different portfolios."

Sometimes you get periods like coming out of the Great Recession; the market was so fixated on macro factors that it really wasn't placing as much importance on those company-specific situations. We were finding some companies that were doing all the things we wanted them to do, but the market was so fixated on macro, it just wasn't paying that much attention to the bottom-up company specifics. That can be frustrating. Sometimes you're finding the right companies and the right stocks, but you're just not getting paid for it. But that's more the exception than the rule. Most times, the market does care about those company-specific reports, and that's when we thrive.

At the end of the day, fundamentals do matter, and the market will come back to them. Even if it's temporarily ignoring them, which it does once in a while, it eventually comes back to them. We know that, and that's why we just stick to our knitting and stay focused on finding that fundamental momentum, and we will get paid eventually for it. Usually, we are getting paid for it, but once in a while, you have to wait a little longer than you want to.

I gave you an example — coming out of the Great Recession — but 2016 was another year when the market didn't really care as much. It wasn't rewarding stocks that had fundamental momentum. It was rewarding stocks that had different characteristics, like high yield or low valuation, and we struggled a little bit in that environment.

TWST: Given that small-cap stocks can be an area of greater volatility, what's your advice for clients and investors in terms of thinking about how to fit small-cap growth into their overall investment portfolio and how to manage that volatility?

Mr. Nelson: It's important to have diversification because these individual stocks can be squirrely — that's a term I often use — and the cost of being wrong on an individual stock can be pretty high. So my advice is to have professional managers overseeing your small-cap portfolio. I think it's an asset class that can provide tremendous performance, so even though it's higher risk than large caps and midcaps most of the time, it's also higher reward. And I think there is a place for small caps in a lot of different portfolios. But I would use professional management to get you that exposure.

If you're an individual investor looking for small-cap exposure, you can buy an ETF that gives you passive exposure to small cap as an asset class, or you can hire an active manager that will hopefully provide you better performance than what a passive approach would do. And I think that it's reasonable to expect an active manager to outperform the small-cap indices over time because there is so much opportunity to exploit small-cap situations. If you're buying a passive product to get you that exposure, yes, you're getting small-cap exposure, but you're also getting all that dead weight within that index.

Hopefully, with an active manager like us, we're going to minimize the amount of exposure you'll have to that dead weight and still get you that exposure to the small-cap asset class. Also, we'll hopefully have bigger exposures than the index to stocks with more upside. Bottom line, a skillful active manager should be able to get investors more exposed to the good and less exposed to the bad.

That's the allure of using an active manager like us. This is 100% of our focus, and we're hopefully going to be able to detect early improving fundamental situations and get exposure to those and reduce our exposure to deteriorating fundamental situations. If you're trying to do it on your own, you may not be as on top of it. This is probably true with any asset class you're investing in, but I think it's especially important in small caps because they can be pretty volatile at the stock-specific level. You can't just buy and hold and check out and disappear and come back a couple years later and think that everything's fine. Typically, there have been some drastic changes, either for the better or for the worse.

TWST: Is there anything else you'd like to add to wrap up?

Mr. Nelson: I think it's a very interesting time right now for small caps in particular, relative to large caps. The valuation of small caps overall is at a big discount relative to large caps overall, so there's probably a catch-up trade coming, where small caps are going to outperform large caps. History would suggest the likelihood of small caps beating large caps from here is pretty high because they've been such laggards over the last several months. I think it's always worth taking a look at the asset class, but I think now is an especially opportunistic time to be looking at small caps.

TWST: Thank you. (MN)

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Small-growth portfolios focus on faster-growing companies whose shares are at the lower end of the market-capitalization range. These portfolios tend to favor companies in up-and-coming industries or young firms in their early growth stages. Because these businesses are fast-growing and often richly valued, their stocks tend to be volatile. Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as small-cap. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

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