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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Adding Alpha at the Front End of the Yield Curve

Matt Freund, CFA, is Co-Chief Investment Officer, Head of Fixed Income Strategies and Senior Co-Portfolio Manager at Calamos Investments LLC. He is responsible for oversight of investment team resources, investment processes, performance and risk. Earlier, he was Chief Investment Officer of USAA Investments, leading the teams responsible for the portfolio management of USAA's mutual funds and affiliated portfolios, including P&C and life insurance products, and overseeing more than $140 billion in assets. Previously, he was a senior investment analyst for MetLife in the Capital Markets Group. He received a B.A. degree in accounting from Franklin & Marshall College and an MBA from Indiana University.

Christian Brobst is Vice President and Co-Portfolio Manager at Calamos Investments LLC. He is responsible for portfolio management and investment research. His areas of specialization include investment analysis within the securitized products sector. Additionally, he communicates the fixed income team's investment strategy, performance, and outlook with external clients and prospects. Earlier, he worked at Wells Fargo as a fixed income portfolio manager and at Mercer Investment Consulting as a manager research consultant for fixed income. Previously, he also held roles at William Blair and Lehman Brothers Asset Management. He received a B.S. degree in finance from the University of Illinois Urbana-Champaign and an MBA from Cornell University.

SECTOR — GENERAL INVESTING

TWST: Could you tell me about the firm?

Mr. Brobst: Calamos Investments was founded in 1977. John Calamos is still our active Chair of the Board and Global Chief Investment Officer. He has been involved since the company's founding. We have about $40 billion in total AUM spread across multiple asset classes.

Matt has multiple responsibilities from an asset class perspective, and contributes and oversees all of our fixed-income strategies. And that is my area of expertise as well. Our fixed income AUM is about $3 billion of the $40 billion in terms of total AUM. Much of that is in closed-end fund strategies, though we also offer both open-end '40 Act mutual funds, as well as institutional and retail separately managed accounts.

TWST: Do you want to discuss opportunities for investors?

Mr. Freund: Well, I think one of the interesting opportunities today is actually in the front end of the yield curve. If you're a longer-term investor, there are opportunities in high yield and converts.

But one of the things that we've noticed in talking to RIAs and clients is that they're very heavy in cash. There was a fear of recession. There was a fear of all these geopolitical events and the global macro picture looking uncertain. And the combination of all of the above caused money market assets to swell. And we think that is a significant mistake now that the front end of the yield curve is offering opportunities that weren't there even 12 months ago. You had to be in certain asset classes because there was no alternative. One of the things that we came back with was a new acronym, CINDY.

Mr. Brobst: That stands for "credit is now delivering yield." Obviously, the environment has changed substantially and there are more income opportunities available than we've seen in recent years.

Mr. Freund: Everybody is focusing on the more aggressive parts of their portfolio. If there is a way to beat the S&P or to be at an equity benchmark, that gets the headlines. It's also very hard to do. I wear two hats here, and oversee some equity portfolios as well. But from a client perspective, the math is the same. If I can add alpha on the fixed income part of the portfolio and do it in a risk-managed way, while staying true to the style box the investors want us in, that drops to the bottom line.

So, one of the funds that we think has value right now is the Calamos Short-Term Bond Fund. The Short-Term Bond Fund is a little bit different. When you think about short-term bonds, a lot of our competitors are exceptionally high quality. They stay in Treasuries or near Treasury securities. They're very liquid. And they really view that part of the portfolio as ballast. We do not. If we can provide alpha, it drops to the bottom line just as much as that would drop to the bottom line if you outperform in a stock or a higher-risk investment. We have a fund, which has an above-average SEC yield, which is currently yielding north of 3%. And we really take a very credit-heavy, opportunistic approach.

There really isn't a single bond market out there. It's really a market of individual bonds. All bonds have different risk and reward characteristics. And you're really paid to take the time to analyze your risks — where you're being well paid for the risks to take positions. And that's what we do.

We launched the fund a little bit over three and a half years ago. We've been very fortunate we've been performing well right out of the gate. We have a four-star rating from Morningstar. We think the most important thing is having a very disciplined and repeatable investment process.

I started in research. I think that research really is the tip of the spear in making sure that we're being well paid for the risks we're taking. The first step of that is identifying the risks. And in fixed income, credit risk is the majority of the risk that you're bearing in that part of the curve. There's generally not a lot of duration and convexity, meaning the idea that they're going to pay you back early or late — it doesn't really come into play. So we focus on being well paid for the risks. We take a bond-by-bond approach. And what we found is that this approach over time will allow us to generate a higher income than peers with less drawdown, with less volatility.

TWST: Did you want to talk about some of the holdings and types of holdings that you have?

Mr. Freund: Sure. Our approach is to take a very holistic and unconstrained view of the market within the style box that our investors are purchasing. So for the Short-Term Bond Fund, they want us to be short, so that generally means maturities inside of three years. And they want us to be generally liquid. People want to be able to take their money out of the fund at any time. And you want it to be generally high quality, having a quality bias, so that you're not subject to economic downturns. With those goals in mind, we take a holistic approach. And again, right now, we are very heavy in leveraged loans. When they're expensive, we will allow the Street to take our paper.

The other thing that we do is we'll look at high-yield securities. We have a very talented and experienced high-yield team. And we will look at securities that the rating agencies may not believe are investment grade, but that we think are appropriate, where the risks are being misunderstood.

And here's just a really important part: When you think about credit risks, when the rating agencies, Moody's, S&P, Fitch or the other big ones, when they rate a security, they rate it for the life of the bond. So it could be a 10-year security, and it might have a below-investment-grade rating, a BB rating. So that encompasses the fact that conditions over the next 10 years can change, economies can strengthen, economies can weaken, and there are risks associated with that issuer. However, if we're buying a bond that matures in six months, if we're buying a bond that matures in 12 to 18 months, the risks are very, very different. They're much more quantifiable, and some of the long-term concerns that are embedded in the rating don't apply. And we think that those are attractive opportunities that we take advantage of.

We also use a lot of asset-backed securities, and that's something that Christian is our lead on. So we're 16% in asset-backed securities currently. That number will go up or down, depending on the market, depending on how well we're being paid for the risk.

Mr. Brobst: The engagement of this broader investment universe, while staying true to the style box, as Matt referenced before, allows us part of our opportunity to enhance the income at the shareholder experience level. And all of these asset classes that he's referenced are tactically allocated too, so there's no hard and fast allocation rule that we're setting. The intention is to migrate the money over time to the areas that provide the best value and compensation for the risk.

TWST: And why would somebody want to include this kind of fund in a diverse portfolio, especially with what's going on now in the economy?

Mr. Freund: Well, I think that's the exact reason why you would. Money market funds are finally starting to offer an attractive return, but based on what we can do, extending very, very modestly in duration, we think the pickup is really attractive right now. So again, the SEC yield after fees is a little over 3%. It's 3.25% (as of 7/31/22) and rising as interest rates rise and as loans reset higher. Compare that to where money market rates are.

And even though rates have gone up, they're actually surprisingly slow to react. So that pickup — being able to gain 100 basis points by accepting what we feel is a very modest incremental amount of risk — we think that makes sense.

And again, the math is such that getting an extra 100 basis points in an equity portfolio, you have to work really hard to do it. You have to pick the right stocks, have skilled managers, your timing has to be right and you generally have to have a longer-term time horizon. As we've seen, as you referenced, the market has been very volatile. It's sold off in the weeks ahead of the Fed hike. Then, it went crazy after the Fed hike because of the Fed comment. So you need to take a longer-term view.

We are running a very balanced and diversified short-term fund where we're really focused on being paid for the risks. We can add extra yield into cash-heavy portfolios from day one. We're introducing more risk to be sure, but we think we're being well paid to do it. And we think that today cash-heavy portfolios are making a mistake, because by

Highlights

Matt Freund and Christian Brobst discuss the Calamos Short-Term Bond Fund. They note that currently many investors are cash heavy, fearing rising interest rates and market volatility. They say that investing at the front end of the yield curve has the potential to add alpha to the more conservative part of a portfolio in a risk-managed way. According to Mr. Freund and Mr. Brobst, the Calamos Short-Term Bond Fund outperforms peers by analyzing risk on a bond-by-bond basis and focuses on being well compensated for those risks. They say they look at maturities of under three years and may include leveraged loans, asset-backed securities, and high-yield securities. With regard to high-yield bonds, they say that the ratings agencies look at the life of a bond, which allows them to take advantage of the fact that risks are more easily quantified over shorter durations.

the time that money market rates catch up to short-term bonds, it is quite possible that the Fed is going the other way. And when that happens, money markets are going to reset lower and lower very quickly.

Mr. Brobst: One additional factor is the uniqueness of the current environment such that the yield curve is very flat or even inverted in several places. What that allows investors to do is to take out duration risk, if they're concerned about the possibility for further rate volatility and still earn a very comparable or healthy yield on a net-of-fees basis.

So I'll use a data point. We track the differential between the U.S. aggregate benchmark, which of course is the broad market index that all funds within the asset class track from a core and core-plus perspective. The Agg has got a 6.6-year duration right now. So the 1-3 Year Gov. Credit Index, which is the benchmark that most short-duration funds reference, has about a two-year duration. And the interesting thing is that the yield differential between those two benchmarks is only 30 basis points as of 8/31/22. What I mean by that is, you can take four years of duration risk out of your portfolio right now. And the cost to do so is the lowest it has been in the last 20 years, essentially at 30 basis points.

Mr. Freund: And our approach in the Short-Term Bond Fund actually makes that give up even smaller. Also, duration risk is the risk or the benefit of interest rates moving, so the way to think about it — bond math is unforgiving. If interest rates rise, prices fall. As interest rates rise, prices fall. So if you have a five-year duration and interest rates rise 1%, you should generally think that your portfolio would fall 5%. Again, it's an inverse relationship. When rates are falling, it works to your benefit. When rates are rising, it works to your detriment.

So what Christian was saying is that you can take a lot of your interest rate risk off the table, while maintaining a yield very close to those broad aggregates. And again, our approach, we focus on being well paid for the risk. And we've narrowed that give-up even further. So, again, I think this is a great time to think about moving cash-heavy portfolios out on the curve.

TWST: As you talk with clients now, what are some of their concerns as they look to the rest of this year and into next year?

Mr. Freund: I think clients' worries are really inconsistent. Again, for 10 years there was no alternative. Now credit is delivering yield again. The window is open, but people are very hesitant to take it. And they're very hesitant to take it because the headlines talk about interest rates going up. And they're worried about that. At the same time, they're worried about the economy weakening. We actually had a negative GDP print this morning, which by some traditional measures, two negative quarters indicates an economy that's contracting or in recession. And so, those are two somewhat incompatible fears.

In general, when the economy weakens, you see interest rates coming down. It doesn't have to this time. There have been enough unusual things in this post COVID world. But generally when that happens, you see inflation moderate, you see interest rates coming down. And so again, I think the fear of rate increases and I think the fear of recession are inconsistent. But investors seem to be holding both at the same time. I don't think you have to take that bet in the front end of the curve. I think the front end of the curve is going to outperform cash and outperform money markets, whether we go into recession or not.

But I think investors, they're seeing what's happening in the broader equity markets, which again, we have to put that in context. Stocks have had a rough start to the year, but when you look back over the last 12 months, it's not really all that meaningful. The stocks are down, but they're not down dramatically. Over the last year, the S&P is off about 7%. That's not great. If you had an equal weighted portfolio, it's off about 4%. Again, it's not great. No one likes losses. But statistically, it's not significant.

I think those are the fears. They're focused on volatility, which really has been much more normal than I think people remember. They're focused on the fear of rates going up, which again, bond math — if rates go up, prices are going to fall — but then they're also having a fear of economic contraction/weakness. And again, that kind of dispels the fear of rising rates.

TWST: Any advice for investors who are saving for retirement, or in retirement years?

Mr. Freund: I think the first advice I'd give is that you have to know your time horizon. If you're making long-term investments, you need to judge them on a long-term basis. If you're making shorter-term investments, then you should be using shorter-term metrics. So that's number one.

Number two, my philosophy and the one that we've instituted here on the fixed-income side, is to make sure that you understand the risks. You understand what can go wrong and that you're being compensated for those risks. The third thing I'd say is, you need to be diversified. Being diversified means owning some things that make you uncomfortable. And then, the most important thing, I think, from our standpoint is to realize that cash has a cost.

Our strong advice to investors, young and old, large and small, is that they maximize the returns for every part of their portfolio. So, again, I'm delighted that competitors consider the front end of the curve, short-term bond funds, ballast. Our goal is to provide alpha and outperform in that sector of the curve, and the bond and that portfolio math is the same. If you can outperform in your conservative allocation that drops to the bottom line, the exact same way as outperforming in your more aggressive allocation.

TWST: Anything we haven't talked about you care to bring up?

Mr. Freund: I think there's been a lot of headlines about volatility in the market. Today, we had a negative GDP report. Yesterday, we had the Federal Reserve raising interest rates. We've had headlines about COVID. We've had headlines about the war in Europe. We've had drama in Washington, D.C. with Congressional bills that are going to be passed or aren't going to be passed. And I think through all of it, again, you have to look at the bedrocks of what you're trying to do. So understand your time horizon, spend some time understanding the risks, understand that a portfolio means owning diverse asset classes, and adding value by outperforming in each of those segments or buckets of your portfolio will generate better long-term total returns of the aggregate.

TWST: Thank you. (ES)

MATT FREUND, CFA
Co-Chief Investment Officer & Sr. Co-Portfolio Manager
CHRISTIAN BROBST
Vice President & Co-Portfolio Manager
Calamos Investments LLC
(630) 245-7200
www.calamos.com
email: caminfo@calamos.com

Before investing carefully consider the fund's investment objectives, risks, charges and expenses. Please see the prospectus and summary prospectus containing this and other information which can be obtained by calling 1-800-582-6959. Read it carefully before investing.

The 30-day SEC yield is 3.25% as of 7/31/22.

16.2% in asset-backed securities as of 7/31/22.

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An investment in the Fund(s) is subject to risks, and you could lose money on your investment in the Fund(s). There can be no assurance that the Fund(s) will achieve its investment objective. Your investment in the Fund(s) is not a deposit in a bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. The risks associated with an investment in the Fund(s) can increase during times of significant market volatility. The Fund(s) also has specific principal risks, which are described below. More detailed information regarding these risks can be found in the Fund's prospectus.

The principal risks of investing in the **Calamos Short-Term Bond Fund** include: interest rate risk consisting of loss of value for income securities as interest rates rise, credit risk consisting of the risk of the borrower to miss payments, high yield risk, liquidity risk, mortgage-related and other asset-back securities risk, including extension risk and prepayment risk, US Government security risk, foreign securities risk, non-US Government obligation risk and portfolio selection risk. As a result of political or economic instability in foreign countries, there can be special risks associated with investing in foreign securities, including fluctuations in currency exchange rates, increased price volatility and difficulty obtaining information. In addition, emerging markets may present additional risk due to potential for greater economic and political instability in less developed countries.

Morningstar Short-Term Bond Category funds invest primarily in corporate and other investment-grade US fixed-income issues and typically have durations of 1.0 to 3.5 years. Short-term is defined as 25% to 75% of the three-year average effective duration of the MCBI.

Morningstar Ratings™ are based on risk-adjusted returns and are through 7/31/22 for the share class listed and will differ for other share classes. Morningstar ratings are based on a risk-adjusted return measure that accounts for variation in a fund's monthly historical performance (reflecting sales charges), placing more emphasis on downward variations and rewarding consistent performance. Within each asset class, the top 10%, the next 22.5%, 35%, 22.5%, and the bottom 10% receive 5, 4, 3, 2 or 1 star, respectively. Each fund is rated exclusively against US domiciled funds. The information contained herein is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Source: ©2022 Morningstar, Inc.

Morningstar Overall Rating™ Among 550 Short-Term Bond funds. The Fund's risk-adjusted returns based on load-waived Class I Shares had 4 stars for 3 years out of 550 Short-Term Bond Funds, respectively, for the period ended 7/31/2022.

S&P 500 Index is generally considered representative of the US stock market.

Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

The **Bloomberg US Government/Credit 1-3 Years Index** includes all medium and larger issues of US government, investment-grade corporate, and investment grade international dollar-denominated bonds that have maturities of between 1 and 3 years and are publicly issued.

Calamos Financial Services LLC, Distributor

2020 Calamos Court | Naperville, IL 60563-2787

800.582.6959 | www.calamos.com | caminfo@calamos.com

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