

Convertible Arbitrage 101

Objective

Convertible arbitrage is designed to enhance income and to hedge (or reduce) equity market risk while still providing the potential for upside returns through an asymmetric risk/reward profile.

How it works

Convertible arbitrage involves purchasing a mispriced convertible bond (long position) and simultaneously short-selling a calculated number of shares of the stock. As the manager waits for the prices to converge, the portfolio is insulated from price movements of the underlying stock. Using this technique, a manager seeks to enhance income and to hedge (or reduce) equity market risk.

Potential benefits

Mitigate volatility. Convertible arbitrage strategies can help mitigate the potential impact of equity market volatility. Consider a hypothetical scenario wherein a convertible bond declines in value. Typically, the underlying common stock would also decline. This would benefit a manager who had shorted the stock, offsetting the decline in the convertible.

Generate returns. Convertible arbitrage can generate returns from many sources, including:

1. Convertible yield advantage: Income from coupons or dividends from convertible bonds
2. Short interest credit: Potential income from rebate of the portion of interest charged by the lender to the short seller on short stock positions
3. Capital appreciation from undervalued securities
4. Rebalancing/trading (see next page for a closer look at gamma trading)



Convertible Arbitrage Risk. If the market price of the underlying common stock increases above the conversion price on a convertible security, the price of the convertible security will increase. The portfolio's increased liability on any outstanding short position would, in whole or in part, reduce this gain. Convertible securities entail interest rate risk and default risk.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Convertible Arbitrage 101

A closer look at convertible arbitrage gamma trading

- Market volatility can provide opportunities to profit through what is referred to as gamma trading.
- A manager buys convertible bonds and sell short shares of the underlying stock as a hedge. If the stock rises, they will lose money on the shares they are short, but will make money on the bonds they own as the bonds appreciate in value.
- As the stock price changes, the manager adjusts their hedge and shorts or covers shares. As a result, they are mechanically buying as prices fall and selling as prices rise. The more volatile the stock, the more opportunities there are to buy low and sell high.

Gamma Trading Hypothetical

XYZ closing stock price



Source: Calamos Investments. The above example is not meant to represent the performance of any given security. It is a hypothetical illustration of general investment themes.

Convertible Bonds: An Overview

- Convertible bonds are securities that can be converted into a predetermined number of shares.
- Like fixed income securities, convertibles provide income through coupons and have seniority in the capital structure over equities. As a result, the prices of convertible securities tend to fall less than underlying equities on the downside (and rise less on the upside). This is a non-linear relationship that can be potentially exploited.
- In convertible arbitrage, convertible securities are purchased primarily and equities are sold short. The amount of shares sold short is calculated with the aim of making the equity and convertible holdings largely offset each other when the equity price moves up or down.

For more information, please
visit www.calamos.com or
contact us at 800.582.6959.

This material is distributed for informational purposes only. The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the information mentioned, and while not guaranteed as to accuracy or completeness, has been obtained from sources we believe to be reliable. Opinions, estimates, forecasts, and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. The views and strategies described may not be suitable for all investors. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations. Outside the U.S., this presentation is directed only at professional/sophisticated investors and it is for their exclusive use and information. This document should not be shown to or given to retail investors.

Calamos Investments LLC
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | www.calamos.com | caminfo@calamos.com

Calamos Investments LLP
62 Threadneedle Street | London EC2R 8HP
Tel: +44 (0)20 3744 7010 | www.calamos.com/global

©2017 Calamos Investments LLC. All Rights Reserved.
Calamos® and Calamos Investments® are registered trademarks of Calamos Investments LLC.

CVARB101SS 030447 11170 C