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Calamos Market Neutral Income
FUND UPDATE

Adding Value Through Opportunistic Use of SPAC Arbitrage

Calamos Market Neutral Income Fund is designed for investors seeking income and the potential for steady performance. The fund blends two primary strategies—convertible arbitrage and hedged equity—to pursue these goals. In addition, the fund's investment team may also employ opportunistic strategies, such as investing in special purpose acquisition companies (SPACs). Following a thorough assessment of the interests of the fund's shareholders and market conditions, Calamos Market Neutral Income Fund recently updated its prospectus, raising the limit of SPACs to 10% from 5% of net assets.

In the following interview, Robert (Bob) Behan, Chief Distribution Officer at Calamos Investments, sat down with Eli Pars, CFA, Co-CIO, Senior Portfolio Manager and Head of Alternative Strategies, to discuss how this added flexibility can add value to the fund shareholders, consistent with the fund's long-standing risk/reward parameters.

This interview has been edited and condensed for clarity.

ELI PARS, CFA
Co-CIO, Head of Alternative Strategies and Co-Head of Convertible Strategies, Sr. Co-PM

ROBERT F. BEHAN, CFA
Executive Vice President, Chief Distribution Officer

Bob Behan: Eli, let's start with a definition of SPAC arbitrage. What is it? How does it work?

Eli Pars: Similar to how we seek to isolate cheap options in Calamos Market Neutral Income Fund's convertible arbitrage strategy, we're using the SPAC structure to isolate cheap options in a different way. We like to buy SPACs at the $10.00 issue price or lower. At these prices, we don't feel like there is a lot of downside other than the risk related to the time value of money. We can participate in the upside optionality of the stock if the SPAC does a good deal, There's also the theoretical cheapness of the structure, with the shares and warrants paired together.

The warrants could be $0.40 to $0.50 of value on a $10.00 SPAC. So, we're just trying to create those cheap options and then trade the book around. Ideally, we're buying SPACs at $10.00 or less, and trading out of them at $10.50 or $11.00. With this sort of strategy, we think we create a risk/reward profile that's pretty similar to what we're getting from the convertible arbitrage strategy of Calamos Market Neutral Income Fund.

Bob Behan: Tell us a little bit about how the warrant is a potential optionality similar to the optionality of the convertible. How does that work?

Eli Pars: The typical structure of a SPAC is a $10.00 unit issue that includes a five-year warrant struck at $11.50. This is not that far out of the money, giving it a lot of theoretical value. Initially when the SPAC becomes public, you don't know if it is actually going to get an acquisition or not. If the SPAC's management team doesn't get a deal within two years and returns the $10.00, the SPAC and warrant expire worthless.

It is important to build that into your equation of when you're trying to get value. But once the company announces the deal, then you really start to see the value of the warrant structure and its upside potential.

Bob Behan: Tell us a little bit about how and why you were attracted to SPAC arbitrage, especially in context of how it can enhance Calamos Market Neutral Income Fund.

Eli Pars: Some members of our team had experience trading SPACs when they were popular in the mid-2000s. As things have ramped up over the last year or two, we saw SPAC arbitrage as another venue to create cheap options similar to what we do in the convertible arbitrage strategy we use in Calamos Market Neutral Income Fund. Issuance this year in SPACs has been very strong, and the opportunity has been a little deeper and more persistent than we even thought when we launched this strategy in January.

Bob Behan: We have a provision that we can allocate up to 5% of the total fund assets to SPAC arbitrage. We're raising that to 10%. Tell us a little bit about our opportunistic bucket—which we've had over the years in different types of strategies to benefit our shareholders—and why we think it makes sense now and the risk/reward potential for our shareholders.

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Eli Pars: While we are raising the cap from 5% to 10%, it doesn't mean we're going to allocate up to 10% in SPACs tomorrow. We have been adding to the SPAC book systematically over the last six months. It's now at 4.5% in Calamos Market Neutral Income Fund, getting close to that 5% cap. We don't know if the opportunity is going to persist for us to grow the SPAC book to 6%, 7% or 10% down the road. But right now, we want to have a little more flexibility to continue taking advantage of the opportunity if we can find cheap SPACs. Currently, we're finding cheap ones in the market every day.

Bob Behan: Walk us through what happens when a SPAC becomes public. How do you get interested? At what price should you get interested? How do you execute?

Eli Pars: Value shifts around based on the marketplace just like any other asset class. We've seen in the last couple of months that issuers are overfunding the trust account a little bit. Instead of $10.00 at maturity, you get $10.10 or $10.20, which is real money. When you're talking about the returns of a market neutral strategy with a 3% to 5% return, that extra kiss there is helpful. The amount of warrant coverage has increased a little bit. And some SPACs have shortened their terms from 24 months to 18 months or even 12 months. That combination of value has been attractive to us.

We also look for opportunities to buy SPACs just below $10.00. We've had success buying some SPACs that haven't traded well on day one at $9.85 or $9.90 and getting a discount to the structure right away. Similar to buying $10.00 on a new issue that's got an overfunded trust at $10.10 or $10.15, we're creating that value through the secondary market.

Bob Behan: Similar to how we look to clip small amounts of money in our convertible arbitrage strategy, when do you decide if a trade has made the fund enough money, and if it is moving into a high-risk bucket and it's no longer attractive?

> *“We’re not looking to add a lot of equity sensitivity to the book.*

Eli Pars: We’re not looking to add a lot of equity sensitivity to the book. When you start getting above $11.00 in a SPAC, then you’re really talking about more of a small-cap equity and less of a SPAC-arbitrage-type structure. At that point, we’re going to look to exit. Or, we own ”XYZ SPAC,” which announces it is going to buy a company and provides the terms. At that point, we may split up the unit into its component parts which is one share and a fraction of a warrant.

We may split up the unit and either sell the share if it’s trading above $10.00 or redeem it, which we’re allowed to do as part of the merger transaction. Then, you basically create the warrant for free. The warrant may be worth $1.00 or $1.50 on that transaction. We may sell it in the market if we think it’s trading at a fair value. Or, we may hang on to it post-the-transaction closing and hedge it with either the SPAC stock or with the option market. There’s a lot of optionality there.

Bob Behan: Do you believe the beta of a SPAC arbitrage is same, lower, or higher than convertible arbitrage?

Eli Pars: For the way we’re doing it—buying SPACs at $10.00 or less and trading out of them at $10.50 to $11.00 without adding a lot of equity sensitivity to the book—we think it’s a similar risk profile, maybe even a little lower than convertible arbitrage.

Bob Behan: This supports why we’re taking advantage of this opportunity, but sometimes news flow in SPACs is not positive. Obviously, we want to clear up what you’re not doing in terms of investing in SPACs.

Eli Pars: The important thing to understand is the difference between a SPAC and de-SPAC. A company issues a SPAC. They’re looking to make an acquisition. They announce the acquisition and close it. That closing is called a de-SPAC process. At that point, the SPAC is a small-cap equity. Most of these companies have a market cap of a billion, two billion or five billion when they launch and de-SPAC. That’s a very different risk profile than what we’re looking to do in Calamos Market Neutral Income Fund.

Bob Behan: Is the risk profile changing within Calamos Market Neutral Income Fund whatsoever?

Eli Pars: No, not at all. We’re not looking to hang on to those companies after they have gone through the de-SPAC process. In fact, those are a lot of the ones that you read about in the paper that are really volatile.

Churchill Capital IV is a SPAC that bought Lucid, the electric car company. It’s been a great investment for people who bought at $10.00. It’s trading at approximately $25.00 or $27.00 now in the market. It traded as high as $60.00 before it went back down to the $20s. That’s not the kind of volatility we’re looking for. We probably would have been out of that at $11.00. You can look at it and say, wow, you’re leaving a lot of money on the table, and you should have ridden it all the way up. Obviously, you can say that in retrospect. But that’s not what we’re trying to do with the strategy. We’re trying to create cheap options with very minimal equity risk. It’s the same reason we hedge convertibles in our convertible arbitrage strategy. We have equity exposure in the convertible, if the equity rises, the convertible might go to $200.00.

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Bob Behan: Often we hear from advisors that what they love about Calamos Market Neutral Income Fund is that it’s very consistent. We say what we do, and we do what we say. We just want to make sure we’re reinforcing that the strategy is not changing at all. Using SPACs is an opportunistic bucket that has really added value to the strategy that we have, and we think it can continue to do so.

When you think about the Fund’s overall risk profile, I know we are certainly adding this opportunistic bucket to make money for our clients, but one question we are often asked is if it is related to capacity.

Eli Pars: No, it's because we think we can make money at it. We look at what's going on in the SPAC market and feel like we're leaving money on the table by not increasing the limit. We actually see a lot of our convertible arbitrage competitors being active in the SPAC market because it does line up so similarly and look a lot of ways like a convertible arbitrage trade. SPAC arbitrage has the benefit of allowing us to invest money in a different asset class. But that's not the motivation behind it.

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The motivation behind this is to make money for our clients. We think if we sat down with every investor and walked them through how we're doing SPAC trades, they'd look at it and go, yeah, I want you to do that.

Bob Behan: In terms of our access to SPACs, we are one of the largest convertible shops in the country, maybe even in the world. Where are SPACs traded? How do you get access to these deals? It seems like it's something that's right in our power alley.

Eli Pars: Yes. They're exchange-traded. Once SPACs become public, they become public with underwriters—banks we transact with normally. Curiously, a fair amount of these get transacted over the convertible desk. So, our relationship with the convertible desk where we're actively trading in the convertible market every day definitely helps us in that regard.

Bob Behan: **In summary, we're supplementing Calamos Market Neutral Income Fund with SPAC arbitrage up to a limit of 10%. We may never get there. Nothing is changing in terms of the risk profile. We believe this is a great way to enhance value for our clients.**

For additional information on the Calamos Market Neutral Income Fund and how our alternatives work, visit **www.calamos.com/cmnix** and **www.calamos.com/insights/alternatives.**

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