

It's the End of One-Way Markets



Solutions for the next decade: Finding income and risk-managed equity opportunities in a changed world.

Transcript of a video recorded 10/14/19.

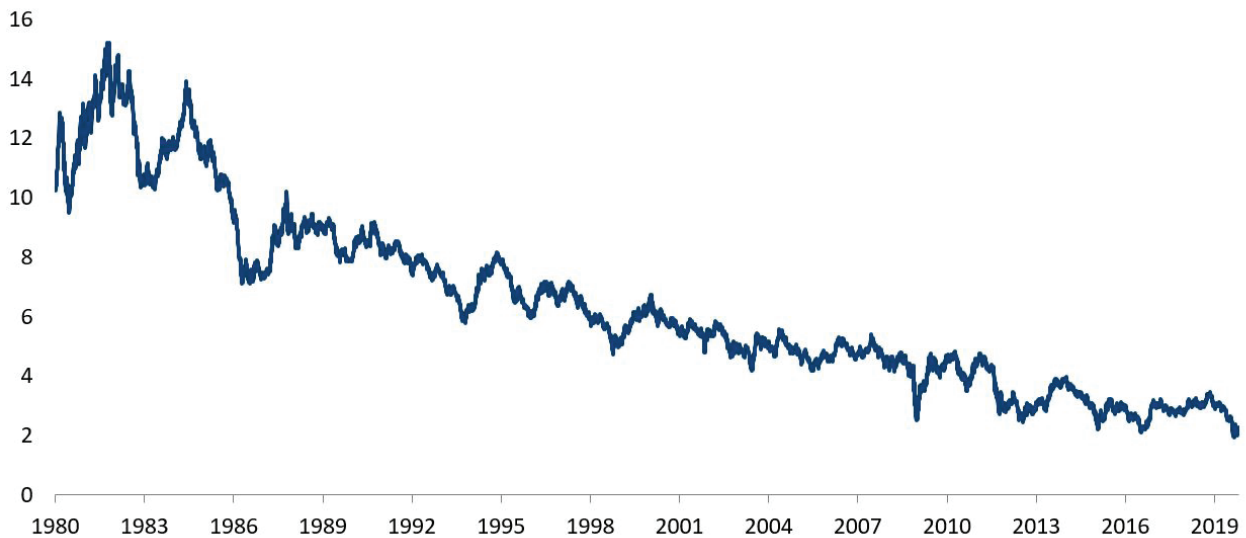
Investors face a forward-looking challenge. The search for income is a high priority, especially amidst today's prolonged low interest rate environment. However, wherever one looks across the financial world, in both equities and bonds, expected returns could be uniquely low while capital risks appear high.



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Historically low interest rate environment creates new capital risks

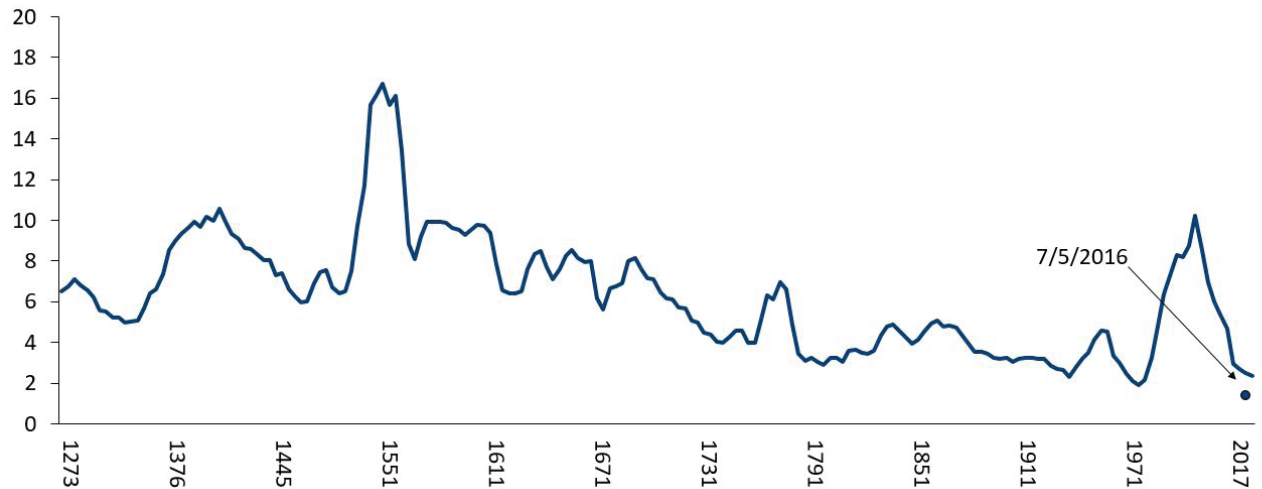
30-Year U.S. Government Yield (%)



Past performance is no guarantee of future results. Source: Calamos Investments using Macrobond.

Yields are historically low over centuries

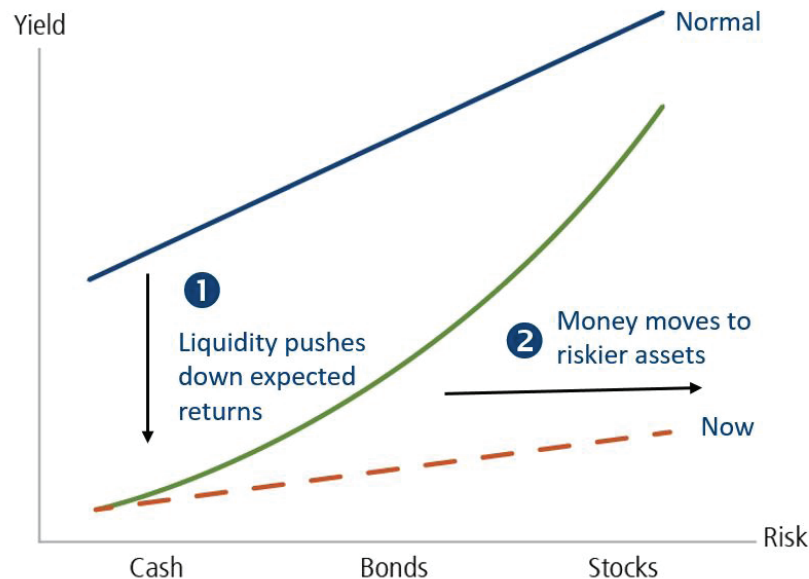
Global Nominal Government Bond Rates (%), 8-Year Moving Averages, 1273 through 2017



Past performance is no guarantee of future results. Source: Paul Schmelzing, 2017. "Eight Centuries of the Risk-Free Rate: Bond Market Reversals from the Venetians to the 'VaR Shock'," Bank of England, Staff Working Paper No. 686, Empirical Research Partners Analysis.

The source of this dilemma is well understood. Hyperactive monetary policies of the past decade have morphed into a multiyear distortion of capital allocation, implying investors should rethink their traditional assumptions for asset returns.

Liquidity has lowered expected returns of assets



Source: Bridgewater, Calamos Investments.

The initial years of these unconventional policies were effective because they raised asset prices and added to future returns—better future economic and earnings outcomes, for example. The leadership of the Federal Reserve and its suppression of interest rates played a decisive role in the sustained recovery post-2008. The U.S. system survived and prospered.

But these policies are approaching limits because rates can't be lowered much more and the stimulatory impact becomes elusive at the end of a long expansion. At this point, capital subsidization—the suppression of rates, credit risk and the corporate cost of capital—is the monetary equivalent of opioids.

In other words, investors feel good about the collapse in bond yields because they are paying more attention to the price gains that result from falling interest rates rather than the future falling rates of return on capital. Asset prices that rise solely as the consequence of lower discount rates are ultimately stealing returns from the future.

Meanwhile, the rising anxiety about recession in the developed world reflects a growing awareness of the exhaustion of monetary policy. Fear of policy failure is gaining ground, with the added fear of its consequences for social and political fragmentation.

One glaring example of this is the \$17 trillion of negative-yielding bonds. To put that into perspective, this compares to \$12 trillion in U.S. mortgages at the peak of the '08 housing bubble, and \$4.5 trillion in technology companies at the peak of the dot-com bubble in 2000.

The concern of investors is that the Federal Reserve is no longer leading financial markets—it is following them. The Fed is fearful of how volatility in credit markets could be transmitted with negative impact to the broader economy. This is why the Fed has become a prisoner of the asset price inflation created by its own extended policies of capital subsidization.

In our view, we are witnessing the end of central bank supremacy. Looking into the 2020s, we believe policymakers in the West will take us into new, unexplored territory led by non-monetary tools. Prepare for much more debate around fiscal expansion, trade and tariffs, currency management and new ideologies like Modern Monetary Theory.

Whatever one's view of how this plays out, the scale of the systemic change in the economic system of the West implies the future will not look like the past. This is the end of one-way markets.

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Videos recorded 10/14/19.

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