

Global Economic Review and Outlook

CALAMOS®

BY JOHN P. CALAMOS, SR.
CEO AND GLOBAL CO-CIO

"Reports of my demise are greatly exaggerated."

Sincerely, the Global Economy

January 2013

In this Commentary:

The Calamos Investment Committee maintains its cautiously optimistic outlook.

We expect the U.S. economy to continue its slow growth path, supported by consumer and corporate strength.

China and other EMs look positioned to make continued significant contributions to global growth.

Although the weakness and imbalances in the euro zone remain troubling, the tail risk of breakup appears to be mitigated.

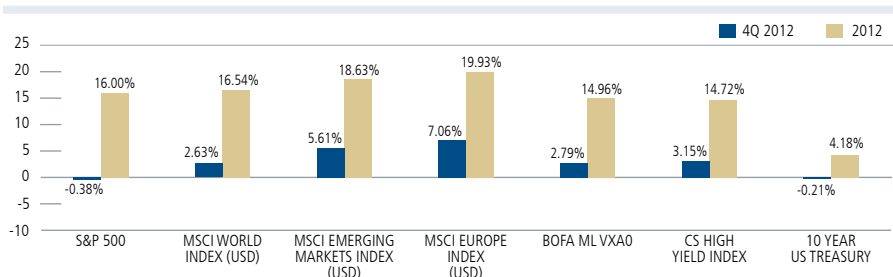
We see indications that the markets are again focusing on company fundamentals, and de-emphasizing "risk-on, risk-off" timing.

We believe political volatility will persist, but economic recovery, valuations, and secular trends support the case for longer-term opportunities in the equity, equity-linked and corporate bond markets.

From the Mayan calendar to the fiscal cliff, worst-case scenarios dominated the headlines during the fourth quarter. We are pleased to report that we are still standing. Before anyone thinks the Calamos team is wearing rose-colored glasses or has drunk too much holiday punch, we do see risks and uncertainties ahead. High debt levels in developing nations and the potential consequences of political decisions (and indecision) are chief concerns. The outcome of the debt ceiling debates in the U.S. and the implementation of euro zone austerity measures are among the macro influences that could create headwinds for global economic growth in 2013, potentially contributing to a further slowdown in earnings growth.

Yet we believe that there are many supportive factors in the global economy, and these create a compelling environment for long-term investors. Among them, we see signs that equity markets are returning to more of a bottom-up focus, with greater emphasis on fundamentals. There will continue to be near-term issues (there always are), but in our view, investors will be well served by not letting short-term political volatility dominate investment decisions. As we have observed in the past, bull markets do not announce themselves and have often begun in periods of heightened uncertainty.

FIGURE 1. ASSET CLASS PERFORMANCE, 2012 AND Q4



Past performance is no guarantee of future results. Source: Bloomberg

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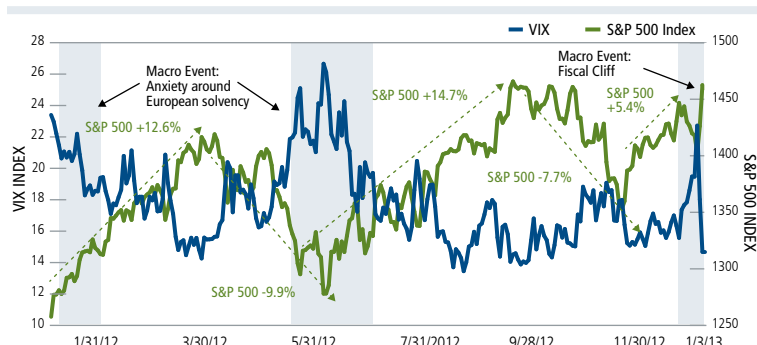
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Market Review

Overall, it was a good year for risk assets (Figure 1), but the markets vote every day. During the fourth quarter, investors made clear their frustration with political brinksmanship. The U.S. equity markets ended the year with a whimper, as fiscal cliff inaction unnerved Wall Street. The concerted efforts of euro zone members to hold the union together contributed to better performance in European equities, while emerging markets rose as concerns about China waned.

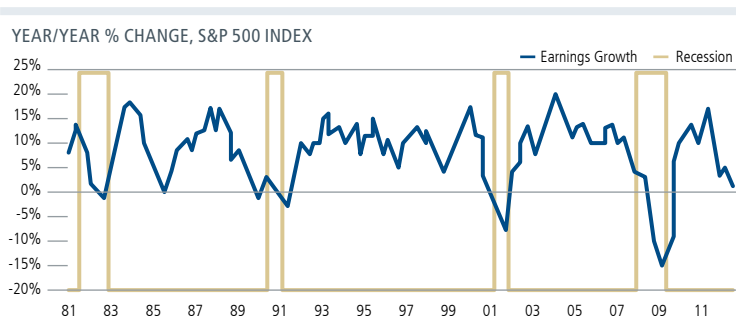
The ride was anything but smooth. Investors struggled in the face of macro events and we saw vacillating sentiment feed into volatility (Figure 2). However, although volatility persisted, there was increasing market de-sensitization to macro events, as upward volatility spikes were quickly followed by declines.

FIGURE 2. U.S. EQUITIES RISE IN THE FACE OF VOLATILITY



Past performance is no guarantee of future results. Source: Bloomberg

FIGURE 3. EARNINGS GROWTH HAS SLOWED



Source: Barclays Research

Outlook: Cautiously Optimistic

In hindsight, our outlook as we entered 2012 was too cautious, reflecting our concerns about political uncertainties and the potential for systemic financial crises. We are more positive moving into 2013, and our global economic outlook is cautiously optimistic. There are many favorable signs, including accommodative monetary policy around the world and a U.S. fiscal cliff in the rear-view mirror. And long-term secular growth trends, such as those related to emerging market (EM) consumers, can support growth opportunities for companies across sectors and around the world.

Although we see many positives, the overhang of debt in developed nations and ongoing impact of political decisions will likely continue to rein in growth and stoke volatility in the financial markets. Debt ceiling debates in the U.S. could prove uglier than those seen in the run-up to the fiscal cliff, and the impact of fiscal austerity programs in the euro zone remain unknown. Year-over-year earnings growth for the S&P 500 has slowed (Figure 3), and depending on the rate, continued deceleration could present a hurdle to global economic expansion.

United States. The U.S. economy appears set to maintain its slow growth path. We have seen 13 consecutive quarters of positive, albeit at times quite modest, annualized GDP growth (Figure 4), most recently including a third-quarter upward revision to 3.1%, driven by exports and consumer spending.

Yet it is the consumer that remains at the center of the U.S. economic recovery. Consumer confidence dipped in the run-up to the fiscal cliff deadline, but consumers

have demonstrated resilience on the whole. The strong consumer is a lynchpin, as the consumer represents more than two-thirds of U.S. GDP.

Post 2008, all eyes have been on the housing market and its role within a recovery. After many false starts, we are now seeing the emergence of favorable trends (Figure 5). This recovery, combined with equity market performance, have sustained consumer confidence. We have seen this improved sentiment carry over to other areas, such as auto sales, with 2012 marking the largest gain in vehicle sales in nearly 30 years. Unemployment data is inching in the right direction, ever so slowly; recent job gains in the construction sector further the case for recovery.

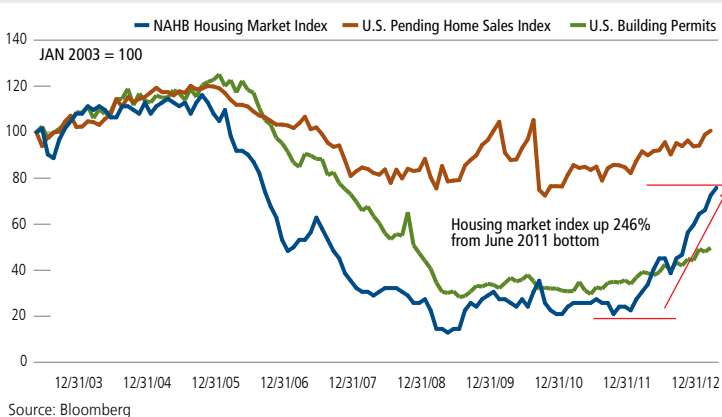
Additionally, corporate operating margins remain near historic highs and balance sheets are strong. In 2012, initial public offering activity took on new life, with the most money raised in over a decade. With the fiscal cliff behind us, we are likely to see more capital spending and acquisition activity. Cash on balance sheets is high, with more than a trillion dollars on the books for U.S. non-financial companies. This could support future capital expenditures, which remain low to date.

We remain concerned about the headwinds that U.S. businesses could face due to government policies, taxation and regulation. Also, the velocity of money remains lackluster. The better news is that businesses have had greater success securing loans, with total loan value reaching toward pre-recession levels. Moreover, many companies have successfully turned to the capital markets to raise money, with robust issuance in the high-yield corporate bond market. And as

FIGURE 4. U.S. ECONOMIC RECOVERY, SLOW AND STEADY



FIGURE 5. THE HOUSING MARKET IS ON THE MEND



economic recovery continues, firms in areas including homebuilders, consumer cyclicals and the financial sector have chosen to issue convertibles.

As we noted, when we consider the potential risks to the U.S. economy, our foremost concerns relate to the potentially deleterious effects of government policies. For example, while the resolution of the fiscal cliff was welcomed, it brought with it provisions that will likely cause GDP to slow, potentially by about 1% in the first half of 2013. We have seen an increase in the marginal tax rates and the end of the payroll tax holiday. As a result of the latter, 80% of U.S. households will see a

tax increase of 2%, resulting in budget tightening for many middle-class households.

We expect the upcoming debt ceiling debate will produce more volatility and uncertainty. Even so, we believe that Washington theatrics aside, Congress recognizes the U.S. must pay its bills for programs already approved by legislation. However, over the next one to two months, we would not be surprised to see declining markets as both parties dig in their heels.

Euro zone. We are encouraged by the direction the euro zone is moving, but a long road lies ahead. Deficits as a percent of GDP may be moving in the right direction for some of the most troubled economies (Figure 6), but improvements have come at high cost and will continue to. Concerns about economic weakness in core and neighboring economies have increased. The downward trend in manufacturing in France and Germany illustrates that euro members will rise and fall together, a fact underscored by a recent uptick in German unemployment.

The ECB must find a way to lead the euro zone to fiscal integration while addressing imbalances, such as

those related to economic growth (Figure 7), surpluses, deficits and low reserves. Bank reforms must continue, with the goal of unified supervision and government. Additionally, elections in Italy, and more importantly in Germany, could have significant impact. Still, the commitment and resolve of euro zone members to hold the union together has mitigated the tail risk of break-up. We have seen balanced efforts to restore fiscal discipline in select European markets, with concerted actions to preserve liquidity and a single currency.

Japan. We are also watching Japan with great interest. There could be a real game changer here. It's well recognized that 2012 was highly consequential for global elections and leadership transitions, and Japan exemplifies this with the re-election of Prime Minister Abe. In the days following the vote, then Prime-Minister-Elect Abe challenged the Bank of Japan (BOJ) to boost stimulus efforts, and the central bank heeded the call.

With more aggressive measures to reverse deflation on the horizon, reflecting continued pressure on the BOJ, we could see an important shift to pro-growth policies and more favorable market conditions. Chief among these would be a weakening yen. Given that the global

FIGURE 6. A LONG ROAD AHEAD

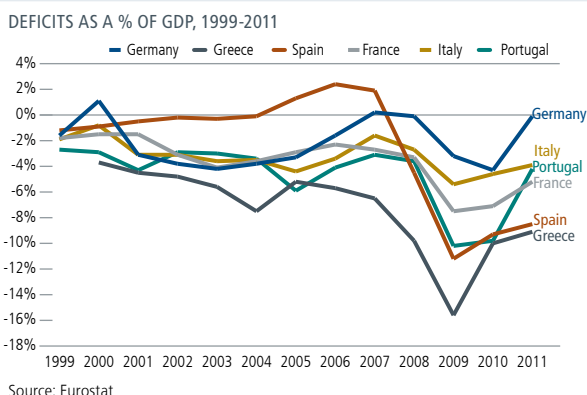
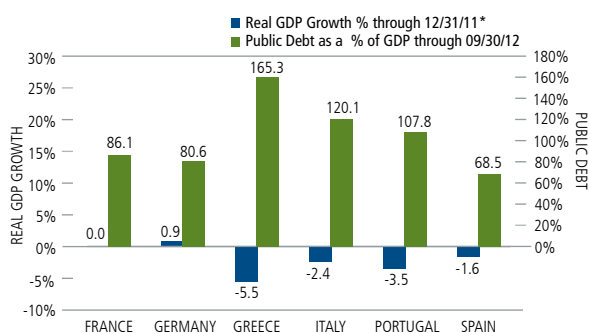


FIGURE 7. IMBALANCES IN THE EURO ZONE



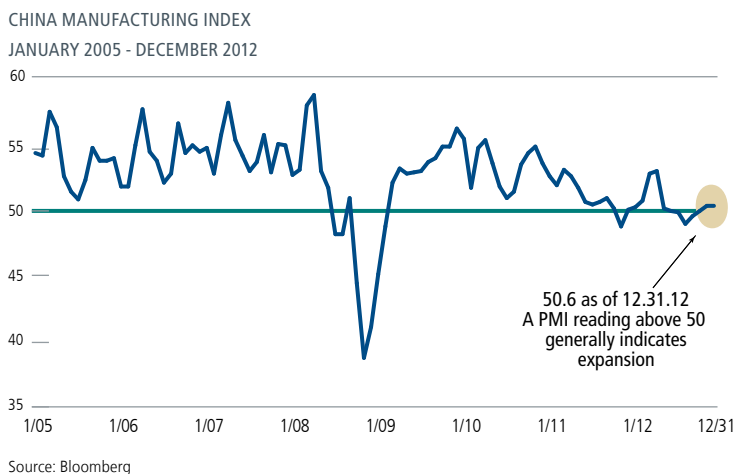
economic recovery has been a measured one, every incremental positive matters. Japan is the fourth largest economy and as such even marginal improvements could bode well for the global economy as a whole.

Emerging Markets. We believe that China and other EMs will continue to make growing contributions to global GDP. The middle-class expansion in China and other EMs has long taken root and is a momentous secular trend that can drive long-term global growth. Central banks across EMs have taken steps to stimulate growth, for example, by reducing interest rates and lowering reserve requirements. With healthier balance sheet data (such as public debt-to-GDP levels) versus developed markets, many EMs also have more tools at their disposal to navigate their economies. For example, this flexibility can help China navigate a soft landing within its real estate sector.

It has taken some time for China's accommodative policies to ripple through the economy, but the country appears to be back on track. China's growth rate may have slowed, but it remains positive and robust in absolute terms. Improvements in manufacturing activity are particularly encouraging (Figure 8) and infrastructure spending continues.

Over the past year, there has been considerable attention given to the changes in China's economic growth rate. However, as investors focus on the rate, they may lose sight of the sheer size of China's economy, which is about 50% of the U.S. economy, as measured by projected 2012 GDP data. Even a 7% growth rate means the Chinese economy would double in 10 years.

FIGURE 8. CHINA ON THE MEND



Interestingly, the services sector in China expanded at its fastest pace in more than four months, with a PMI reading of 56.1 in December. This is particularly important because as we have noted in previous commentaries, the evolution of the Chinese economy and the rise of its middle class should lead to a continued shift from manufacturing to services. Despite this recovery, inflation does not appear to be a concern, which provides the government with more policy latitude to spur growth.

As we noted, the growth story in China remains intact and exciting, based on what we see today. However, if it is to be sustained, we would look for a continued shift toward services and domestic consumption, as well as increased economic freedoms. In regard to the former, it is well known that exports make up a disproportionate slice of the Chinese economy (30% versus 15% in the U.S.). China has made steps toward a more balanced economy, but more needs to be done in this regard (Figure 9). Over 90% of China's exports are related to the manufacturing of goods. In contrast, U.S. exports are more diversified, with only 65% reliant upon manufacturing, with greater allocations

to resources and agriculture. Although China has more policy latitude it is at present potentially more vulnerable to other nations. The U.S. represents more than 15% of China's exports, while China represents only 7% of the U.S. export market.

In India, a rebound also looks to be underway. After weakening GDP growth in 2012, the IMF forecasts a pick-up in 2013, with GDP expanding at a healthier clip of 6.0%. Managing growth against inflation concerns has been a challenge, but there have been indications that India's central bank may be softening its stance of containing inflation at the expense of growth. We have seen positive steps toward reform, such as measures that encourage foreign investment; this could boost economic, corporate and market prospects.

Perspectives on Opportunity

Earlier, we acknowledged our positioning entering 2012 was too defensive, and this hindered some of our strategies. Reflecting our commitment to continually improve our process and discipline, we have revisited a number of our portfolios and made adjustments. As we noted, with the fiscal cliff behind us and a slow recovery maintaining its steam, we believe greater

optimism is in order. In our view, political volatility will continue, but we expect it to be offset by an increased recognition of fundamentals by the marketplace.

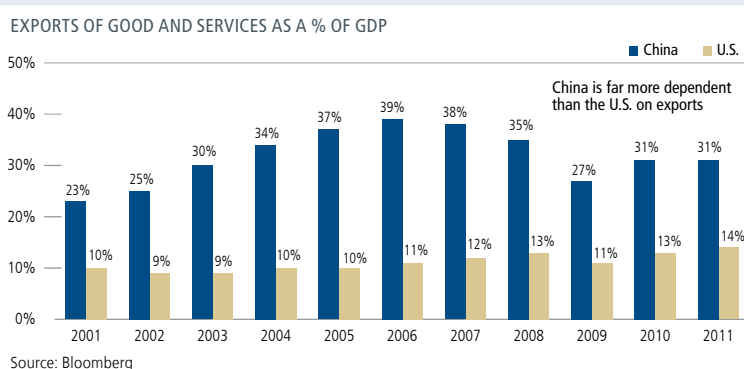
Our investment teams are finding opportunities across sectors and countries, based on our identification of secular growth trends. For example, the expanding role of the EM consumer within the global economy is reflected in our portfolios, through investments in diverse areas including consumer staples and agricultural products.

We also believe that businesses and individuals will remain focused on productivity enhancements, stimulating ongoing demand for a wide range of technology goods and services, from networks and big-data solutions to tablet computers, smart phones, online retailers and software providers. Global demographic trends, such as increased longevity worldwide, are providing opportunities for health care equipment providers and bioscience innovations. As the financial sector stabilizes, we are revisiting potential opportunities there, as well.

We are maintaining a focus on multinationals. As we have observed in the past, the sources of a company's revenues are more important than the location of its headquarters. As some governments make public policy mistakes and others make better decisions, capital will continue to go where it is treated best. Multinationals have the flexibility to take advantage of the shifting landscape.

From an asset class standpoint, we believe that equities remain the asset class of choice. As noted, our view is that short-term events (often political) have prevented

FIGURE 9. THE ROLE OF EXPORTS: CHINA VS U.S.



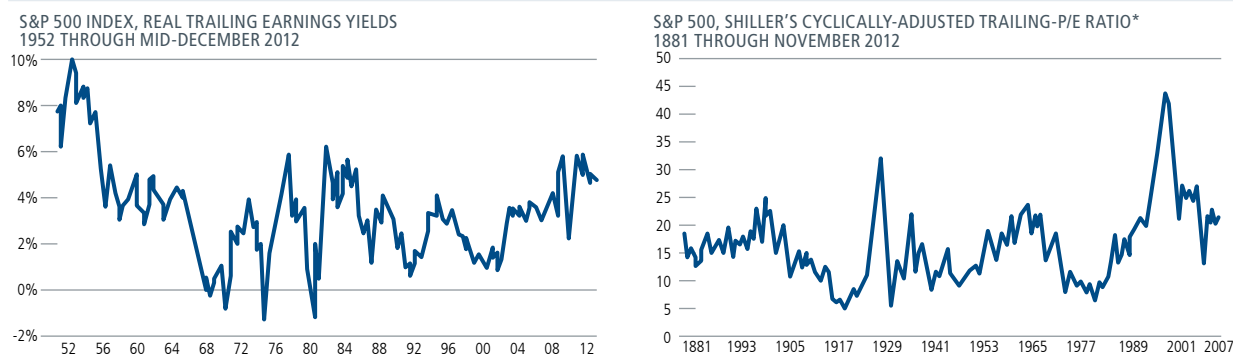
investors from appropriately valuing the equity markets. By many of our measures, equities are attractively valued, particularly growth equities. U.S. equity risk premia (expected returns on equities versus government bonds) are in the top decile based on rates over the past 50 years. Also, on the basis of trailing earnings and P/E ratios, equities look attractive (Figure 10).

We expect continued volatility in the financial markets, and thus believe defensive equity strategies using equity-linked convertible securities remain a good choice for potentially lower-volatility access to the equity markets. We are finding new opportunities in the convertible market, consistent with our more positive economic outlook. Convertible issuance is about companies gaining access to capital and is fueled by improving economic growth. As noted, homebuilders and companies in other improving sectors have recently issued convertibles. We have also seen increased convertible securities issuance from European companies, outpacing that of U.S. companies in 2012. We view this as an exciting step in the global evolution of the convertible market.

Volatile markets also make the case for market neutral strategies, including long-short equity, and more broadly, for diversification.* For example, we believe that U.S. investors should think more globally, revisiting the role of international equities, where our analysis indicates that many companies are attractively valued and provide different access points for participating in secular growth trends.

Within the fixed income markets, we share in the concerns surrounding government bonds. In this low-interest rate environment, dividend strategies may prove compelling. Additionally, compared to government bonds, the mid-grade corporate bond sector looks far more appealing, in terms of providing competitive income and more attractive risk/reward characteristics. As with the equity market, it is not enough to simply buy a credit category; individual security analysis must be the lynchpin. Additionally, our view is that there may be more opportunities emerging in a broader range of credit tiers, and we have increased our focus accordingly.

FIGURE 10. ATTRACTIVE VALUATIONS IN THE EQUITY MARKETS



Source: Empirical Research Partners, December 2012. Robert Shiller, Standard and Poor's, Bureau of Labor Statistics, Corporate Reports, Empirical Research Partners Analysis, December 2012. *Average ten year earnings compared to current price. Both are measured in 2012 dollars.
 *Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Over recent years, we have seen significant improvements in balance sheets. Corporations have taken advantage of accommodative policies and against the backdrop of a low-rate environment, global corporations have brought **nearly three trillion dollars** of issuance to market in 2012. However, while the Fed has stated its intention to keep rates low until employment targets are reached, we remain wary of taking on high interest rate risk. History has shown that interest rates can rise rapidly when they do turn.

Conclusion

We began this commentary with a nod to Mark Twain, so it would be fitting to end with one. One of our favorite sayings, “History doesn’t repeat, but it rhymes” is popularly attributed to Twain. History shows volatility, uncertainty and unknowns have always been a part of the investing landscape. Economies expand and contract, and new problems are always surfacing just as the previous ones seem to be going away. In this environment, investors should continue to think globally and long term.

This is because while the negatives rhyme, it is the positives that produce the more resounding rhymes. These positives are what we believe investors should focus on through the short-term volatility. Acrimonious debates about the structure and role of government have occurred for thousands of years. They are a cornerstone of democracy. Even as political bickering grows tiresome, progress and prosperity continue around the world. The rise of the EM middle class, following the example of the American middle class on a grand scale, may be one of the greatest rhymes in human history.

Increasingly, market observers are heralding a return to the “old normal.” As the Great Recession moves further back into the pages of history, we expect market participants to focus more clearly on the positives that exist within the global economy and among individual companies. We are encouraged by the prospect of a more fundamentally driven market, and look forward to capitalizing on the attractively valued opportunities we are finding in a number of asset classes.

The S&P 500 Index is considered generally representative of the U.S. equity market. The MSCI World Index is a market capitalization weighted index composed of companies representative of the market structure of developed market countries in North America, Europe and Asia Pacific regions. The MSCI Emerging Markets Index is a free float adjusted market capitalization index cited as a measure of the performance of emerging market equities. MSCI Europe Index is a market capitalization weighted index composed of companies representative of the market structure of Europe. The BofA Merrill Lynch VXA0 Index is considered generally representative of the U.S. convertible market. The Credit Suisse High Yield Index is considered generally representative of the U.S. high yield market.

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CALAMOS®

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

Calamos Investments LLP
No. 1 Cornhill | London, EC3V 3ND, UK
Tel: +44 (0) 20 3178 8838 | calamos.com/global

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