High Income Opportunities Strategy

CALAMOS INVESTMENTS

Market Overview

The U.S. high yield bond market, as represented by the Bloomberg Barclays US Corporate High Yield 2% Issuer Cap index, returned -0.86% in the first quarter.

Economic data across a variety of measures in the labor market, industrial, service, retail and wholesale sectors continued to point toward growth in the United States economy through the first quarter. Concerns over building inflation pressures and higher interest rates and their impact on risk assets led to increased volatility and weakness in equity market and credit spreads beginning in the first week of February. As stocks experienced the first 10% market correction in two years, President Trump announced a series of tariffs that raised concerns of an escalating international trade war, which could truncate the economic cycle.

These events led to higher volatility and a moderately wide trading range of 58 basis points for high yield option-adjusted spreads, marked by two individual periods within the quarter. Performance was positive through January, as spreads declined from the 2017 year-end close of 343 basis points to a cycle low of 311 basis points on January 26. As the concerns of early February took hold, spreads moved briskly wider, touching 369 basis points before closing the quarter at 354 basis points, a quarter-on-quarter change of only 11 basis points wider. Coupled with the spread volatility came higher interest rates across the U.S. yield curve, which put further pressure on high yield bond prices, especially in the most interest rate-sensitive BB category. We classify most of the recent market moves as technical in nature, because fundamental aspects of the economy and company operations remain stable.

Several developments related to the Federal Reserve occurred in the first quarter. The torch was officially passed from Chair Yellen to Chair Jerome Powell, who conducted his first meeting in March, followed by a press conference during which he fielded many questions about inflationary pressure and tightening financial conditions. The meeting brought about an anticipated 25 basis points increase of the federal funds rate to 1.50-1.75%. In addition, the so-called “dot plot,” which tracks Fed governors’ individual expectations of future changes to the federal funds Rate ticked up slightly for each of the next few years. Many market participants take that as an indication of a

FIGURE 1. CALAMOS HIGH INCOME OPPORTUNITIES STRATEGY RETURNS

	QTR ENDING 3/31/18	1-YEAR	3-YEAR	5-YEAR	10-YEAR	SINCE INCEPTION (11/99)
Calamos High Income Opportunities Composite						
Gross of Fees	-1.11%	4.09%	4.13%	4.32%	6.76%	7.52%
Net of Fees	-1.29	3.31	3.35	3.55	5.98	6.73
BBgBarc U.S. HY 2% Issuer Capped	-0.86	3.78	5.18	5.00	8.32	7.27

Source: Calamos Advisors LLC

Past performance is no guarantee of future results.

Data as of 3/31/18.

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FIGURE 2. REPRESENTATIVE PORTFOLIO PERFORMANCE VERSUS BLOOMBERG BARCLAYS U.S. HIGH YIELD 2% ISSUER CAPPED INDEX
FIRST QUARTER 2018

	CONTRIBUTORS (BPS)	DETRACTORS (BPS)
Consumer Non-Cyclical	11	
Insurance	5	
Consumer Cyclical	1	
Other Financial	1	
Technology	1	
Finance Companies	1	
Transportation		-1
Electic		-1
Other Industrial		-1
Brokerage Assetmanagers Exchanges		-1
Banking		-1
REITs		-2
Capital Goods		-3
Communications		-4
Energy		-15
Basic Industry		-18

Attribution based on gross of fee performance with dividends reinvested.
Past performance is no guarantee of future results.
Source: Bloomberg. Data as of 3/31/18.

more hawkish Fed stance, but Chair Powell cautioned against the market's overreliance on the measure, as policymakers "don't have the ability to see that far into the future." We continue to see the most likely scenario as two additional fed funds rate hikes in 2018 with a Chairman's choice for another at the December 2018 meeting dependent on economic developments. With two-year yields closing at 2.27% up from 1.88%, and ten-year yields closing at 2.74%, up from 2.41%, the yield curve flattened 5 basis points during the first quarter, closing at 47 basis points which is the lowest level since 2007.

With higher Treasury rates across the curve, the yield to worst of the high yield market increased 47 basis points during the quarter to close at 6.19%. Gross new issuance totaled $72.7 billion during the quarter, nearly identical to the fourth quarter total, and below the $98.7 billion total through March of last year.

The best performing sectors in the Bloomberg Barclays US Corporate High Yield 2% Issuer Cap index were transportation (+0.06%), brokerage/asset managers/exchanges (-0.17%) and consumer non-cyclical (-0.38%), while banking (-2.49%), consumer cyclical (-1.15%) and REITs (-1.13%) represented the largest laggards. Across the credit spectrum CCC-rated credits led the way (+0.50%), while B (-0.57%) and BB (-1.53%) credits finished in the red. According to JPMorgan, the U.S. high yield default rate ended March at 2.21%, a 93 basis points increase in the first quarter, still below the 3% long-term average. While the total defaults figure of $28.3 billion is the sixth-highest quarter historically, many of the companies involved were long known to be headed toward default.

Overview

Both the portfolio (-1.11% gross of fees) and the benchmark index (-0.86%) were down for the quarter per Bloomberg PORT.

Performance Review

During the quarter, areas that had a significant impact on performance included:

Positive Influences on Performance

- Security selection in the consumer non-cyclical sector (pharmaceuticals and food and beverage) provided contributions.
- Security selection in the insurance sector also proved beneficial.

 All portfolio positioning and sector information is for a representative portfolio. Please see last page for additional information.

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SECTOR ALLOCATION

SECTOR	REPRESENTATIVE PORTFOLIO %	BBGBARC U.S. HIGH YIELD 2% ISSUER CAPPED INDEX %	UNDER/OVERWEIGHT %
Basic Materials	6.1	6.7	-0.6
Communications	17.7	19.9	-2.3
Consumer, Cyclical	11.2	14.3	-3.0
Consumer, Non-cyclical	23.0	16.6	6.5
Diversified	0.0	0.2	-0.2
Energy	17.1	14.2	2.9
Financial	15.0	10.2	4.8
Industrial	5.3	9.5	-4.2
Technology	2.0	5.5	-3.5
Utilities	1.7	2.9	-1.2

This strategy is actively managed. Holdings, weightings and allocations are subject to change daily.
Source: Bloomberg. Data as of 3/31/18.

YIELD

	REPRESENTATIVE PORTFOLIO %	BBGBARC U.S. HY 2% ISSUER CAPPED INDEX %
Current Yield	6.79	6.45
Yield to Worst	6.61	6.28
Average Coupon	6.48	6.35

Negative Influences on Performance

» Security selection within the basic industry sector (metals and mining) detracted from relative performance.

» Security selection in the energy sector (midstream) weighed on the result.

Positioning and Portfolio Changes

The team continues to focus on building meaningful overweights in "best idea" issuers with improving fundamentals and debt-service capabilities. Our bond-by-bond, bottom-up approach includes a process for selecting preferred individual issues based on bond structure and yield curve positioning.

From an economic sector perspective, the portfolio holds overweight positions in the consumer non-cyclical and energy sectors. Portfolio underweights include communications and capital goods.

Over the course of the quarter, notable sector changes to the portfolio included:

Consumer Cyclical. The allocation to the consumer cyclical sector was reduced, most notably in the automotive industry.

Consumer Non-Cyclical. The allocation to the consumer non-cyclical sector was increased, most notably in pharmaceuticals.

Outlook

Several large, well-telegraphed distressed situations are expected to default in 2018. These have been anticipated for some time and are not expected to dramatically change an otherwise positive fundamental environment. We expect the default environment to continue to trend below the long-term historical average of 3%. However, we do anticipate gradual, further softening in high yield credit spreads, but believe some out-of-favor areas could also provide idiosyncratic opportunities. High yield bond spreads are trading well below long-run averages, and we see limited opportunity arising from price appreciation over the next six to twelve months. During that period, the market may continue to face challenging technicals, but we do not see an immediate risk of deteriorating fundamentals. In the current environment, however, active management and rigorous fundamental analysis is crucial, as investors need to pick their spots wisely to balance risk/reward.

Calamos Advisors LLC
2020 Calamos Court
Naperville, IL 60563-2787
Attn: Compliance Officer

CALAMOS®
INVESTMENTS

Calamos Advisors LLC
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | www.calamos.com/institutional

Calamos Investments LLP
62 Threadneedle Street | London, EC2R 8HP, UK
Tel: +44 (0)20 3178 8838 | www.calamos.com

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