

Market Neutral Income Strategy

CALAMOS[®]
INVESTMENTS

Performance Review

The portfolio had a positive return in an eventful quarter, as both covered call and convertible arbitrage strategies contributed to performance.

Cover Call Performance

Equities. The positive return of the S&P 500 Index (+4.48%) supported the covered call strategy performance in the quarter as the value of our equity basket advanced and the long calls purchased as part of our call spreads appreciated in value. The tracking error of the equity basket hovered near 0.15% during the quarter, significantly below our limit of 0.5%. Overall, the equity basket added slight value relative to the S&P 500 Index.

Volatility. The CBOE Volatility Index (VIX) finished the quarter at 9.51, lower than where it began at 11.181. Declining volatility was generally supportive from the standpoint that lower volatility meant option valuations trended lower, while everything else held constant. This allowed us to profit on options sold short relative

to options purchased long. Additionally, lower volatility allowed the portfolio to purchase more puts at a reduced cost. However, lower volatility also meant that premium capture opportunities were less plentiful.

Option Skew. As we have discussed recently, the covered call allocation has faced a head wind from unfavorable option skew. Option skew is illustrated by the Credit Suisse “Fear Barometer” (CSFB) index. Using premium captured by writing 90-day S&P 500 Index call options that are 10% out of the money, the CSFB’s value is determined by understanding how far out of the money 90-day index puts are purchased to construct a zero cost collar around the S&P 500 Index. The higher the CSFB value, the more skew in the options market. The CSFB began the quarter at 30.09 and finished the quarter at 25.54, still well above its long-term average of 19. While skew improved over the quarter, the elevated skew environment was challenging but also presented opportunities for the portfolio. The steep skew combined with

FIGURE 1. CALAMOS MARKET NEUTRAL INCOME STRATEGY RETURNS

	QTR ENDING 9/30/17	1-YEAR	3-YEAR	5-YEAR	10-YEAR	SINCE INCEPTION (1/91)
Calamos Market Neutral Income Composite						
Gross of Fees	1.07%	5.86%	4.51%	4.55%	4.24%	7.97%
Net of Fees	0.90	5.15	3.81	3.84	3.53	7.20
Bloomberg Barclays U.S. Government/Credit Bond Index	0.81	-0.01	2.83	2.10	4.34	6.03
Citigroup Treasury Bill - 30 Days	0.24	0.60	0.25	0.17	0.34	2.49
S&P 500 Index	4.48	18.61	10.81	14.22	7.44	10.15

Source: Calamos Advisors LLC

Past performance is no guarantee of future results.

Data as of 9/30/17.

Calamos Market Neutral Income Strategy

FIGURE 2. CHARACTERISTICS

	STRATEGY
Assets in Strategy	\$4.6 billion
# of Holdings	642

FIGURE 3. STRATEGY ALLOCATION %

Convertible Arbitrage	51.9
Covered Call	48.1

FIGURE 4. RISK/REWARD STATISTICS MARKET NEUTRAL INCOME COMPOSITE

	3-YEAR		5-YEAR		10-YEAR	
	STRATEGY	S&P 500 INDEX	STRATEGY	S&P 500 INDEX	STRATEGY	S&P 500 INDEX
Alpha	1.35%	N/A	0.51%	N/A	1.48%	N/A
Beta	0.29	1.00	0.29	1.00	0.34	1.00
Standard Deviation	3.09%	10.07%	2.91%	9.55%	5.43%	15.14%
Sharpe Ratio	1.37	1.05	1.50	1.47	0.70	0.46

lower volatility levels provided attractive opportunities using call and put spreads.

Covered Call Positioning. In the current low interest rate, low volatility and high option skew environment, we believe that a portfolio using call and put spreads can provide a more favorable risk/reward outcome than our traditional option positioning of writing 80% calls versus buying 40% puts. Our call spread positioning involves writing calls that are closer to the money while simultaneously purchasing out of the money calls. In addition to buying protective puts, we also are using put spreads to improve downside protection. We have sold deep out of the money puts and utilize the premium to purchase closer to the money puts.

At the end of September, our notional hedge positioning was 99% calls overwritten versus 109% puts purchased (excluding long calls and short puts). This reflects a snapshot of the portfolio on the last trade date of the quarter and is subject to change because the portfolio is actively managed. Positioning can change quickly dependent on market conditions.

Convertible Arbitrage Performance

Volatility. As mentioned, overall volatility declined from the beginning of the quarter and was low throughout. Single name and intraday volatility, however, did provide slight opportunities to gamma trade.

Interest Rate Environment. Narrowing high yield credit spreads helped convertible arbitrage during the period. JPMorgan reported that spreads narrowed from 441 basis points to 415 basis points. The Federal Reserve also announced plans to begin reducing its balance sheet. The Fed's September comments also included a constructive near-term outlook on the U.S. economy and plans to begin quantitative tightening. The U.S. Treasury yield curve flattened slightly during the quarter. Two-year yields closed at 1.48% up from 1.38%, and ten-year yields closed at 2.33%, up from 2.30%. Additionally, high yield credit spreads narrowed 26 basis points to 415 basis points over Treasuries, according to JPMorgan. The overnight interest carry (interest net of stock borrowing costs) was roughly 83 basis points.

Calamos Market Neutral Income Strategy

CONVERTIBLE ARBITRAGE



COVERED CALL WRITING

SOURCES OF RISK/RETURN
MANAGEMENT

Convertible arbitrage is an investment strategy that generally involves a long position on a convertible security and a short position on the issuing company's common stock. A long position is the buying and holding of a security and a short position is the selling of a security that the seller does not own. Eventually, the seller must purchase the same security (hopefully at a lower price) and return it to the owner.

Covered call writing is an options strategy whereby an investor holds a long position in an asset and writes (sells) call options on that same asset in an attempt to generate increased income from the asset. The strategy also allows for the purchase of put options on individual securities and indexes to protect principal against downside moves in the equity market.

Convertible Valuations. Convertible valuations did not change by a meaningful amount during the quarter. The average convertible in the BofA Merrill Lynch All U.S. Convertible Index (VXA0) traded at a 1.54% discount, which was a slight improvement from the 1.58% discount at the beginning of the quarter as reported by BAML.

Outlook

While a lower-volatility environment has been persistent, we are positioned well should volatility enter the market from a variety of sources. Geopolitical factors ranging from tensions with North Korea to Washington paralysis to a secessionist movement in Spain all have the potential to disrupt markets. As we expect volatility in the equity and credit markets to be inevitable, we remain enthusiastic about the Market Neutral Income Strategy. The strategy derives benefits from "volatility in volatility," whether from the rebalancing opportunities higher volatility provides to convertible arbitrage or the potential to receive higher call premiums in the covered call allocation.

After a prolonged period of historically low interest rates, the Fed has been raising short-term rates and has announced plans for quantitative tightening. While accommodative monetary policies and purchase programs of other global central banks may prevent soaring U.S. interest rates, the interest rate environment is likely to be volatile amid speculation over the direction and magnitude of rate movements. Within the portfolio allocation, we see opportunities for investors in the Market Neutral Income Strategy. When used within the fixed income allocation, the Market Neutral Income Strategy has historically provided bond-like returns with bond-like risk without having bond-like interest rate sensitivity. Additionally, as the portfolio has lower correlations to other asset classes, portfolios should benefit as the strategy can provide stability in a market environment that turns increasingly volatile.

Calamos Market Neutral Income Strategy

Past performance does not guarantee or indicate future results. Current performance may be lower or higher than the performance quoted. Portfolios are managed according to their respective strategies which may differ significantly in terms of security holdings, industry weightings, and asset allocation from those of the benchmark(s). Portfolio performance, characteristics and volatility may differ from the benchmark(s) shown.

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The information portrayed is for the Calamos Market Neutral Income Composite. Representative holdings and portfolio characteristics are specific only to the portfolio shown at that point in time. Other portfolios will vary in composition, characteristics, and will experience different investment results. The representative portfolio shown has been selected by the advisor based on account characteristics that the advisor feels accurately represents the investment strategy as a whole.

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It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

Performance returns presented reflect, unless otherwise noted, the Calamos Market Neutral Income Composite, which seeks to generate consistent income and capital appreciation through complementary underlying strategies of convertible arbitrage and covered call writing. The composite includes all fully discretionary, fee-paying accounts, including those no longer with the firm. The Composite inception date is January 1, 1991.

Alpha is the extra return of a portfolio due to non-market factors. **Beta** is a historic measure of a portfolio's relative volatility, which is one of the measures of risk; a beta of 0.5 reflects half the market's volatility as represented by the strategy's primary benchmark, while a beta of 2 reflects twice the volatility. The **Bloomberg Barclays U.S. Government/Credit Index** comprises long-term government and investment-grade corporate debt securities and is generally considered representative of the performance of the broad U.S. bond market. Unlike convertible bonds, U.S. Treasury bills are backed by the full faith and credit of the U.S. government and offer a guarantee as to the timely repayment of principal and interest. The **BofA Merrill Lynch All U.S. Convertibles Index (VXA0)** measures the return of all U.S. convertibles. The **CBOE Volatility Index or VIX** (based on its CBOE ticker symbol) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. The **Citigroup 30-Day T-Bill Index** is generally considered representative of the performance of short-term money market instruments. The **Credit Suisse Fear Barometer** essentially tracks the willingness of investors to pay up for downside protection with collar trades on the S&P 500 Index. **Delta** is the ratio of change in price of an option to the change in price of the underlying asset. The **S&P 500 Index** consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index (stock price times number of shares outstanding), with each stock's weight in the index proportionate to its market value. **Sharpe ratio** is a measure of the excess return per unit of risk taken by an investment strategy. **Skew** describes asymmetry from the normal distribution in a set of statistical data. **Standard deviation** is a statistical measure of the historical volatility of a mutual fund or portfolio.

Unmanaged index returns assume reinvestment of any and all distributions and do not reflect any fees, expenses or sales charges. Investors cannot invest directly in an index.

Fees include the investment advisory fee charged by Calamos Advisors LLC. Returns greater than 12 months are annualized. All returns are net of commission and other similar fees charged on securities transactions and include reinvestment of net realized gains and interest. Chart Data Sources: Calamos Advisors LLC.

Average annual total return measures net investment income and capital gain or loss from portfolio investments as an annualized average assuming reinvestment of dividends and capital gains distributions.

Calamos Advisors LLC is a federally registered investment advisor. Form ADV Part 2A, which provides background information about the firm and its business practices, is available upon written request to:

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