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

GARY D. BLACK
EVP AND GLOBAL CO-CIO

Recovery Trumps Taper Talk

July 2013

During the second quarter, market participants vacillated between glass-half-full and glass-half-empty frames of mind as they confronted the prospect of a post-QE world. After Chairman Bernanke put forth the possibility of tapering quantitative easing in late 2013 and ending it in 2014, rates on the 10-year Treasury staged a quick ascent from their unprecedented lows. Global equity markets tumbled, stabilized, and now seem to have largely discounted a Fed tapering beginning this fall.

News that QE may go on indefinitely but not forever should come as no surprise. When it comes to rates, what goes down must come up. In recent years, the Fed has put forth clear criteria for unwinding QE—lower unemployment, a by-product of sustained economic recovery. Within this context, a moderate rise in rates shouldn't be seen as bad news. Economic expansion and job growth are both good problems to have.

In this Commentary:

We believe less Fed intervention will prove to be a long-term positive for the economy and markets.

We expect volatile, rotational markets during this mid-cycle phase of the U.S. economic cycle.

China is facing growing pains that could stoke macro uncertainties, but they have weathered ups and downs before.

Historically, equity markets have rallied coming out of sideways-moving markets characterized by rising long-term bond yields (as in 1994).

Equities remain attractive in our view, particularly growth equities. Equity P/Es have typically been highest when long-term interest rates are in the 4-6% range, and the global economy is expanding.

Income-oriented investors should approach government bonds with caution; high-yield debt, convertibles and dividend growth stocks may be more compelling.

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Second Quarter Market Review

During the quarter, speculation about when and how the Federal Reserve would taper its quantitative easing stoked significant volatility in the markets, both upward and downward. When all was said and done, U.S. equity markets posted respectable gains, though they were a far cry from those of the first quarter (Figure 1). Convertible securities participated in a large measure of the equity market's upside.

Treasury bonds performed poorly, as 10-year bond rates increased from 1.6% in early May to 2.6% after Chairman Bernanke's June remarks. Oil fell on concerns about slowing growth in China and other emerging markets (EMs). Gold prices plummeted, hitting a three-year low in response to the prospect of tapering QE and stronger economic growth.

Uneven and Rotational Markets Take Hold

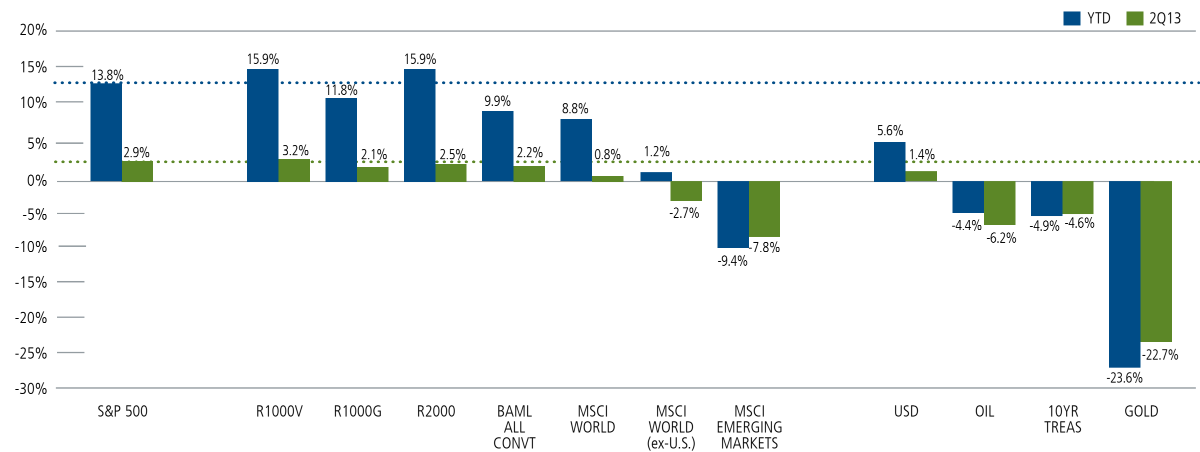
With 15 consecutive quarters of U.S. expansion, we had anticipated growth-oriented attributes would enjoy greater favor among investors. However, distortions caused by low rates globally remained a stronger driving force. Particularly during the start of the quarter, the search for income continued to spill into the equity markets as investors sought fixed-income surrogates in stocks with the highest dividends.

As the quarter progressed, the markets became more cautious and reactionary amid crosscurrents of a stronger U.S. economic recovery, QE3 tapering, and weaker data out of China. Within the S&P 500 Index, the generally more defensive, higher-yielding telecommunications, utilities, and staples sectors led in April; but in May, leadership shifted to the more cyclical areas of the market, including financials, consumer discretionary and industrials.

FIGURE 1. FED UNKNOWNS, CHINA WOES IMPACT ASSET CLASS PERFORMANCE IN 2013

TOTAL RETURN, YTD AND 2Q 2013

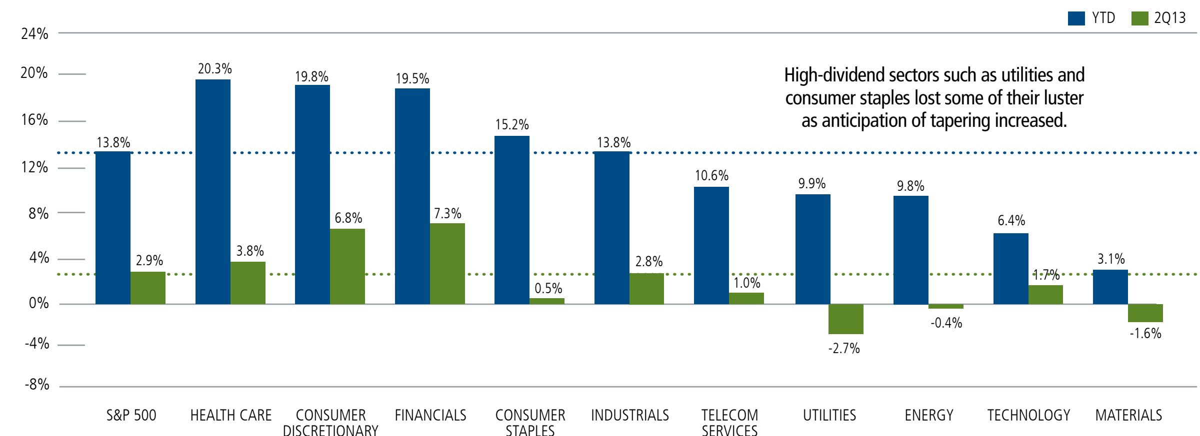
U.S. equities continued to lead, but uncertainty about the Fed's next steps weighed on sentiment. EMs struggled amid crosscurrents of Fed QE tapering, increased QE in Japan and finally, slowing growth in China.



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

FIGURE 2. S&P 500 INDEX SECTOR PERFORMANCE, 2013

TOTAL RETURNS AS OF 6/28/2013



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

For the quarter overall, financials stocks provided the most robust performance (Figure 2), benefiting first from dividend yield characteristics and then from the prospect that rising rates could improve margins on their loan activities.

As Figure 3 shows, correlation among stocks with the S&P 500 Index increased in the immediate wake of Chairman Bernanke's comments. However, there was good news in that correlations moved back down, likely due in large measure to the steps that Fed leaders took to alleviate market anxiety. This gave investors time to re-center on fundamentals; if this continues, we believe it bodes well for Calamos' high-conviction approach to active management.

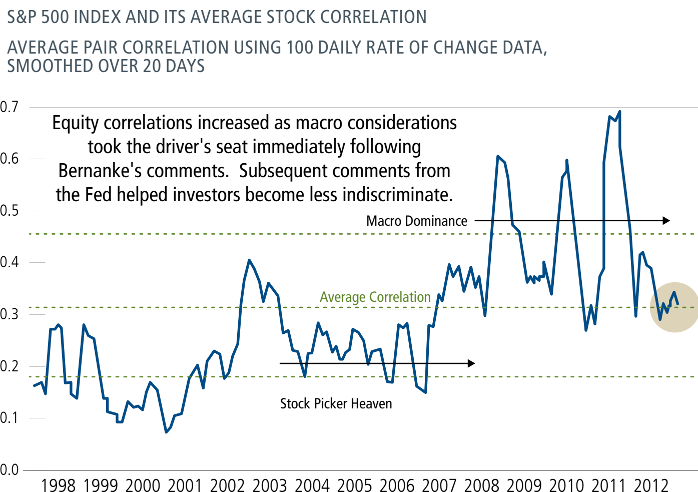
U.S. equity markets may have been choppy, but equity performance outside the U.S. reflected bleaker sentiment on the whole. The MSCI World ex-U.S Index, a benchmark of developed equity markets, lagged as anxiety about Fed policy combined with concerns around still-negative euro zone GDP data, rising unemployment and elections. Japan was able to skirt the developed market malaise, as "Abenomics" buoyed that country's equity market by more than 10% (in local currency), albeit with considerable volatility.

EM equities came under the most intense pressures, with commodity producers facing stiff headwinds as the price of oil stagnated and those of other resources tumbled. The potential impacts of less QE in the U.S. caused headwinds worldwide, but especially in the EMs. China was a source of consternation as downward revisions to GDP growth rekindled fears of a not-so-soft landing. Anxiety mounted as the central bank tightened

FIGURE 3. RETURN TO FUNDAMENTALS IN THE EQUITY MARKET?

S&P 500 INDEX AND ITS AVERAGE STOCK CORRELATION

AVERAGE PAIR CORRELATION USING 100 DAILY RATE OF CHANGE DATA, SMOOTHED OVER 20 DAYS



Past performance is no guarantee of future results.
Source: GK Research, Quarterly Strategy Chart Book, "The Fork in the Road", June 2013

credit access in a bid to deflate a potential credit bubble in shadow banking without derailing economic growth.

While China may have dominated investors' attention, there was enough angst to go around. With high inflation, weak growth and the expectation that rates could climb even further, Brazil's market was particularly vulnerable to anxiety around Fed tapering. Social unrest clouded sentiment even more, as World Cup preparations unleashed a wave of protests around wealth inequities.

Global Economic Outlook: A Mixed Hand

United States. The U.S. economy may not have a full house, but it does seem to have the best cards at the table. With growing strength in the housing sector, brightening consumer sentiment, contained inflation, and improving manufacturing and industrial sector data, the U.S. economy could very well be in a mid-cycle phase—a period historically characterized by healthy albeit measured economic data and sideways-

moving but generally upward-sloping equity markets. The amount of stimulus in the economy creates uncertainty of course, and we will have a better sense of where we are in the economic cycle once the Fed removes the stimulus backstop.

Rising equity markets, higher home prices, and improving employment are supporting a "wealth effect" that has bolstered discretionary spending. Consumer net worth has strengthened as debt burdens have fallen dramatically. The June jobs report extended the string of good news, with employment and wage growth coming in ahead of consensus expectations, supported by gains in the private sector.

Some have pointed to the rise in mortgage rates as a headwind to the recovery. Rates on 30-year fixed mortgages have jumped from a recent low of 3.4% in early December to 4.6% in early July. This is not welcomed news for those looking to buy or refinance, but from a consumer psychology standpoint, we believe these quite modest increases in mortgage rates (off historic lows, no less) are more than offset by the appreciation in home values, up 12% year over year, according to Case-Shiller. We believe this increase in housing values is more important to the recovery. Banks will likely extend more loans given the greater compensation afforded by a steeper yield curve.

Turning to corporate America, businesses continue to stockpile cash. Although earnings guidance has softened, operating earnings remain high. If recent rallies in the S&P 500 Index are any indication, market participants seem to be holding on to brighter hopes. Earnings have continued to rise, and look set to

FIGURE 4: THE U.S. ECONOMIC RECOVERY CONTINUES

Recessions indicated by shaded areas.

FIGURE 4a. ENCOURAGING TRENDS IN HOUSING

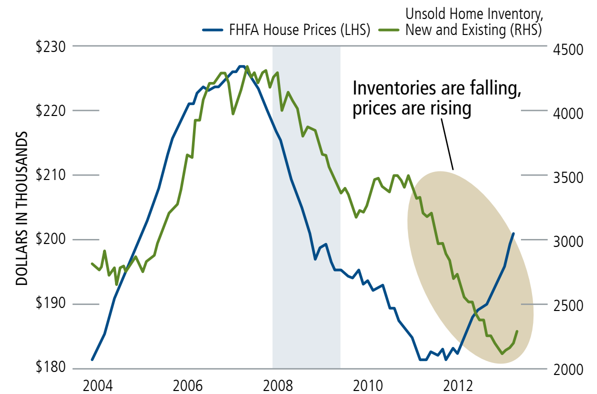


FIGURE 4b. CONSUMER BALANCE SHEET IMPROVEMENTS

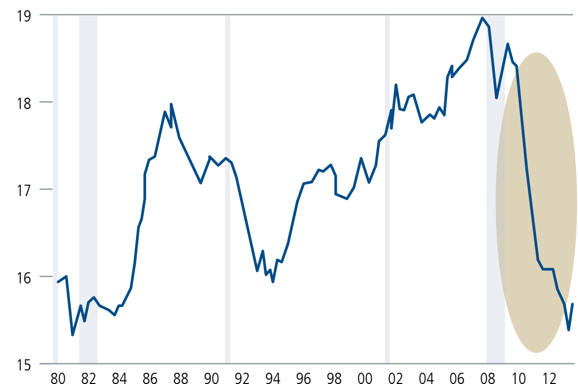
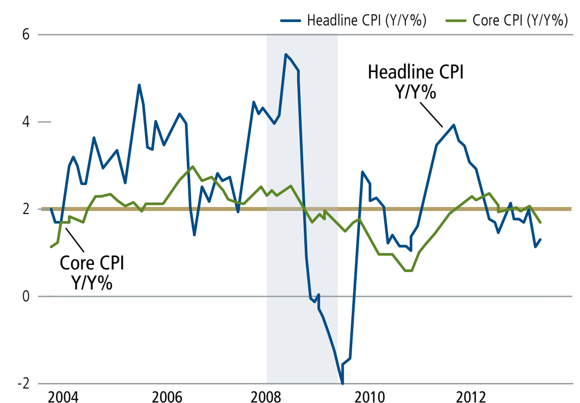


FIGURE 4c. INFLATION IS BELOW 2% TARGET

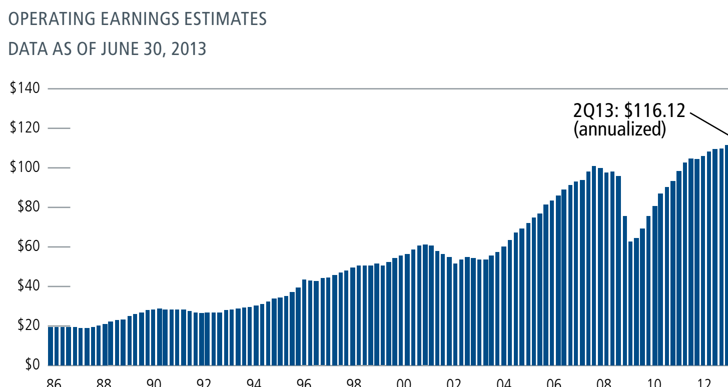


Source: ISI Group

continue to grow at low single-digit rates (Figure 5). As we enter the upcoming second quarter earnings season, revenues will be especially interesting to watch, given the downward earnings revisions and slowing growth out of Asia. The auto sector was able to provide a Cinderella story of sorts as U.S. auto manufacturers announced upside earnings surprises, supported not only by domestic demand but also on their ability to increase exports.

FIGURE 5. EARNINGS HAVE MAINTAINED AN UPWARD COURSE

OPERATING EARNINGS ESTIMATES
DATA AS OF JUNE 30, 2013



Past performance is no guarantee of future results.

Source: JP Morgan, Guide to the Markets, 3Q 2013, using data from Standard & Poor's, IBES, FactSet, JP Morgan Asset Management. Earnings estimates are for calendar years and taken at quarter end dates throughout the year.

Less Fed Intervention: A Long-Term Positive

Will an end to QE upend the U.S. economic recovery? We believe less Fed intervention should ultimately benefit the U.S. economy and stock markets. A healthy economy is driven by free market activity, not the Federal Reserve. As discussed in our April 2013 commentary, "Up, Up and Away?", aggressive intervention has produced results that are uneven at best. The velocity of money, a measure of how fast money is moving through the economy, has fallen despite the unprecedented efforts the Fed has undertaken to boost the monetary base.

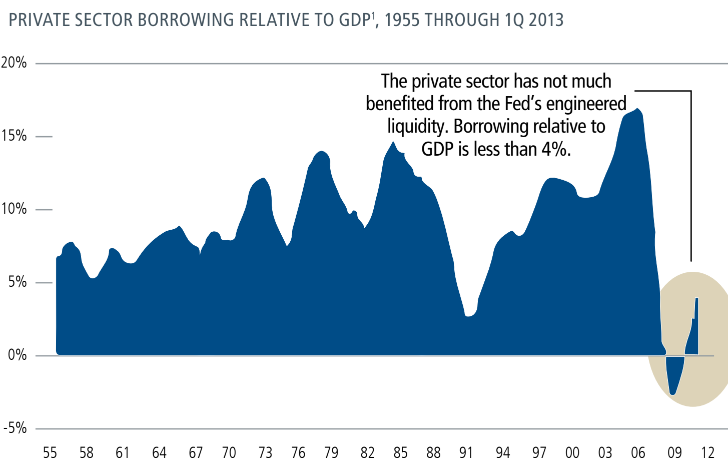
For small businesses in particular, QE has fallen far short of its billing. Small businesses have historically been the engine for job creation (and economic growth), but abnormally low rates have given banks little incentive to lend to most consumers and small businesses.

Moreover, as shown in Figure 6, private sector borrowing as a percent of GDP has fallen sharply over recent years, influenced in large measure by banks' reluctance to lend and a lack of confidence in future business prospects, post-2008. An unintended result of this could be reduced vulnerability to rising rates, due to the fact that there is less credit in the private sector.

Of course, a too rapid rise in rates would present big problems for the U.S. economy, problems which would likely spill across the global economy in short order. The good news is that the Fed is keenly aware of the complex tasks at hand. It also has considerable latitude (the silver lining of its unprecedented easing), and seems committed to not painting itself into a corner.

FIGURE 6. MONEY, MONEY EVERYWHERE, BUT NOT A DROP TO BORROW

PRIVATE SECTOR BORROWING RELATIVE TO GDP[1], 1955 THROUGH 1Q 2013



Source: Federal Reserve Board, Empirical Research Partners Analysis
[1]Annualized quarterly data, smoothed on a trailing two-year basis

Moderate Rates and Higher P/Es: Historically, Hand in Hand

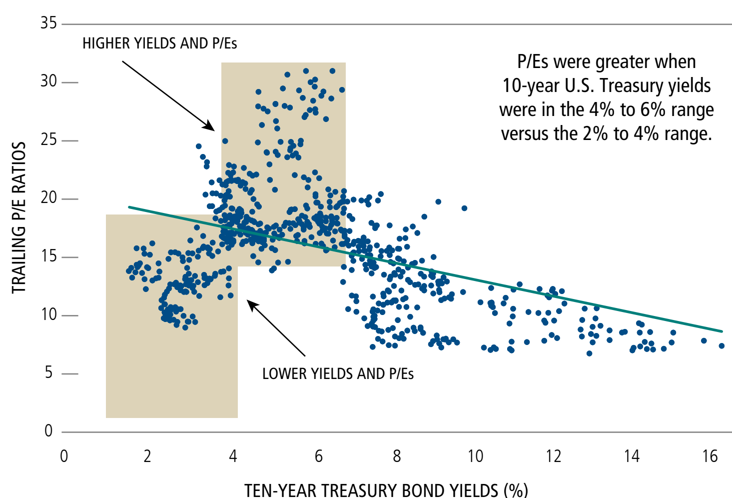
We believe less Fed intervention should benefit the stock market as well as the U.S. economy. Historically, price-to-earnings ratios have been higher during periods of modestly higher rates (yields of 4% to 6% for the 10-year Treasury) compared with periods when rates were in the 2% to 4% range (Figure 7), as investors gain more confidence about future economic growth.

Global Wildcards

We remain constructive about the U.S. economy and increasingly optimistic on Japan, but have more modest expectations for the global economy as a whole. Robust growth in 2013 is unlikely given the headwinds of a languishing euro zone and economic slowdown in the emerging markets.

FIGURE 7. HIGHER P/Es HAVE HISTORICALLY BEEN ASSOCIATED WITH MORE NORMAL TREASURY YIELDS

S&P 500 TRAILING P/E RATIOS AND 10-YEAR TREASURY BOND YIELDS
1952 THROUGH MAY 2013



Past performance is no guarantee of future results.
Source: Federal Reserve Board, Empirical Research Partners Analysis

Euro zone. Despite lackluster GDP and high unemployment, it may be a relatively quiet summer in the EU as political leaders bide their time in the run-up to German federal elections. Chancellor Angela Merkel's softening stance on austerity creates a disincentive for many countries to rock the boat. Even so, unease among the haves and have-nots hasn't faded, as austerity protests in Portugal and the resignation of two government ministers have recently attested. However, the EU has shown that it will go to great lengths to stay together, and both the Bank of England and European Central Bank have indicated that they expect to continue their supportive policy by keeping rates low.

Japan. It will take time to determine if the Abenomics experiment will prove a lasting success. As we have seen in the U.S., massive stimulus may look good in theory, but drinking from a hose is difficult. The initial signs are encouraging, however. A weakening yen and gains in private consumption and net trade contributed to first quarter GDP growth of 4.1%. Employment and wages are rising faster than inflation, which could help support consumer activity. Japan is the fourth largest economy in the world, so a sustained wealth effect could be a welcomed bright spot countering the less robust prospects of the EU consumer. Improving business sentiment among manufacturers and non-manufacturers is another hopeful sign, and it may portend a reversal in still-sluggish capital spending.

China. China's growth is strong in absolute and relative terms, and we expect GDP growth to be in the 7% to 8% range over the next few years. However, declining growth levels and signs of a credit crunch in China are

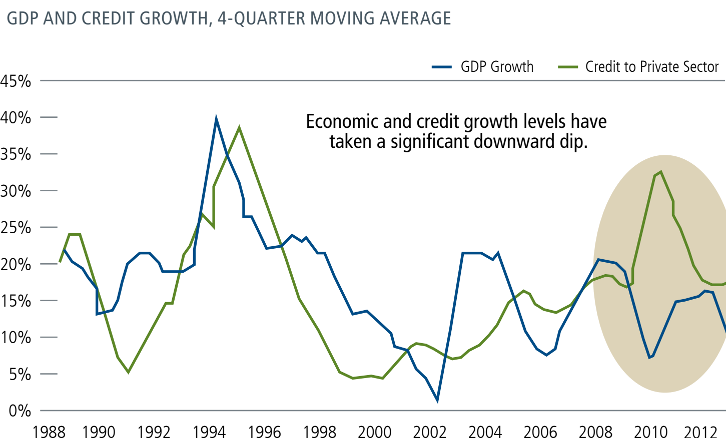
causes for legitimate concern, particularly as the reliance on shadow banking credit is (as-yet) unknown (Figure 8). PMI manufacturing data continues to hover close to contraction levels, hindered by sluggish demand from the U.S. and euro zone (Figure 9), while ghost cities and income inequalities testify to the unevenness of Chinese economic development. However, the wealth gains and economic progress achieved by a growing middle class have created a more diversified economy, albeit one in transition. This greater level of diversification may help weather some of the nearer-term pressures.

China has clearly entered a period of uncomfortable growing pains as it seeks to manage long-term economic expansion. This deceleration is not positive for China or the global economy, near term. We expect China will loom large in market sentiment: Investors often do not keep secular trends (expansion of the middle class) top of mind, nor do they like change (a move to a tightening policy).

Even so, we have been here before with China—many times over recent years, in fact. China will probably weather this storm, as it has before, but the current anxiety should serve as (yet another) reminder that China and the EMs can't carry the global economy alone for the long term. The developed markets must pull their weight, with an emphasis on balancing their economies and further debt reductions. Figure 10 illustrates that a disproportionate share of many countries' exports have gone to China; a number of euro zone countries have made themselves especially dependent on the Chinese market.

FIGURE 8. SLOWDOWN IN CHINA

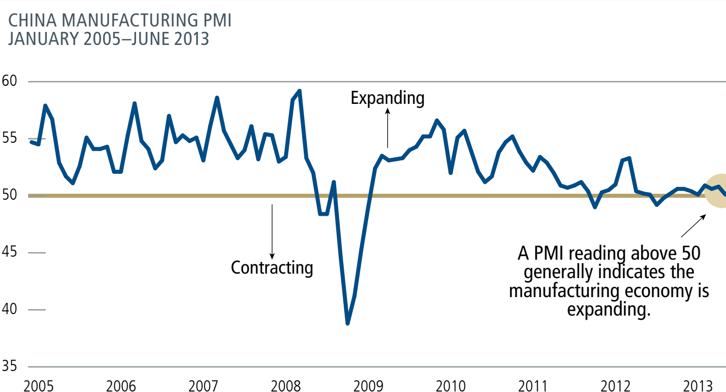
GDP AND CREDIT GROWTH, 4-QUARTER MOVING AVERAGE



Source: Goldman Sachs Equity Research, Fortnightly Thoughts, June 13, 2013, using data from BIS and Datastream.

FIGURE 9. SLUGGISH MANUFACTURING DATA FROM CHINA

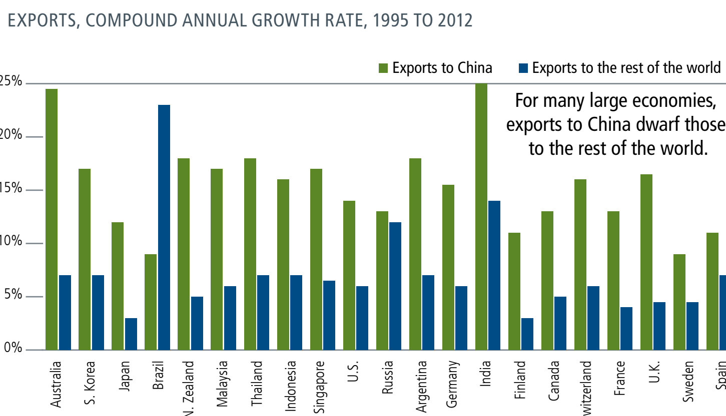
CHINA MANUFACTURING PMI
JANUARY 2005–JUNE 2013



Source: Bloomberg.

FIGURE 10. GLOBAL OVERRELIANCE ON CHINA

EXPORTS, COMPOUND ANNUAL GROWTH RATE, 1995 TO 2012



Source: Goldman Sachs Equity Research, Fortnightly Thoughts, June 13, 2013, using data from BIS and Datastream, using data from UNComtrade

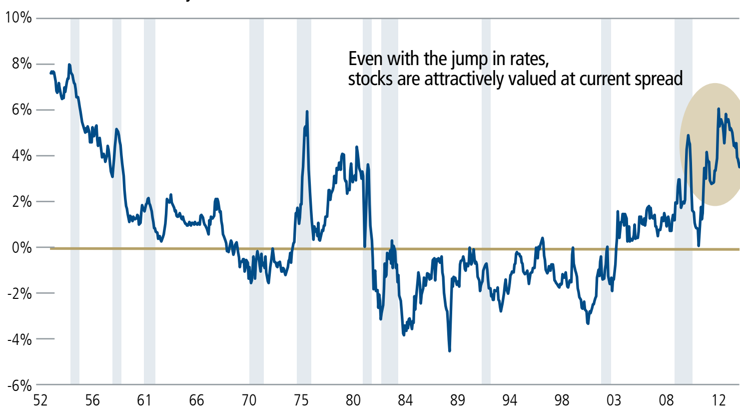
Choppy Markets Call for Active Management

We believe that active, high-conviction strategies may be especially advantageous in the rotational, volatile markets we expect in the near term. Accordingly, we are actively managing sector exposures in conjunction with our fundamental, bottom-up research. With second quarter earnings season coming up against the backdrop of QE tapering, it is our hope that fundamentals will matter more.

FIGURE 11. STOCKS STILL LOOK GOOD

S&P 500 INDEX[1] TRAILING EARNINGS YIELD, LESS THE 10-YEAR BOND YIELD
1952 THROUGH MID-JULY 2013

Recessions indicated by shaded areas.



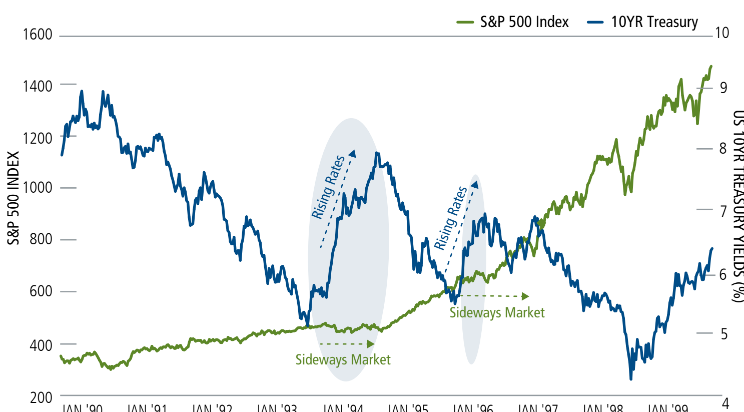
Past performance is no guarantee of future results.

Source: Robert Shiller, National Bureau of Economic Research, Federal Reserve Board, Standard and Poor's, Corporate Reports, Empirical Research Partners Analysis.

[1]Capitalization-weighted data.

FIGURE 12. RISING RATES, SIDEWAYS MARKETS AS ECONOMY REBOUNDS

S&P 500 INDEX VS. U.S. 10-YR TREASURY YIELD, 1990-1999



Source: Bloomberg.

Equities are Reasonably Valued

Although pockets of the equity market are overvalued and despite jumps in stock prices, we believe many equities are attractive by a variety of measures. Despite increases in long-term bond yields, equities still remain near their cheapest levels relative to bonds over the past 60 years (Figure 11).

1994 Redux?

As we noted, we believe that the U.S. economy could be in a mid-cycle phase. In the mid-cycle, markets are often quite volatile, as we have seen of late. However, saw-toothed markets have historically set the stage for upswings. In 1994 and 1996, it may have been hard for investors to maintain optimism. The equity market was moving sideways as rates rose. However, this saw-toothed pattern gave way to an strong advance as economic recovery continued (Figure 12).

Growth Equities: The Overlooked Opportunity

A reduction in Fed intervention could benefit growth equities in particular. Over recent quarters, QE has contributed to significant dislocations in the equity markets. As yields on long-term bonds have fallen, investors have turned to the highest-dividend-paying equities instead. The valuations of some utilities and staples stocks soared to levels we believe are unsustainable, while growth-oriented companies with better earnings projections have enjoyed less favor.

As Figure 13 shows, the forward P/E for the S&P 500 Index is well below its long-term average, and the technology sector is even more significantly undervalued. In contrast, the forward P/Es for staples,

utilities and telecommunications are much closer to their longer-term averages.

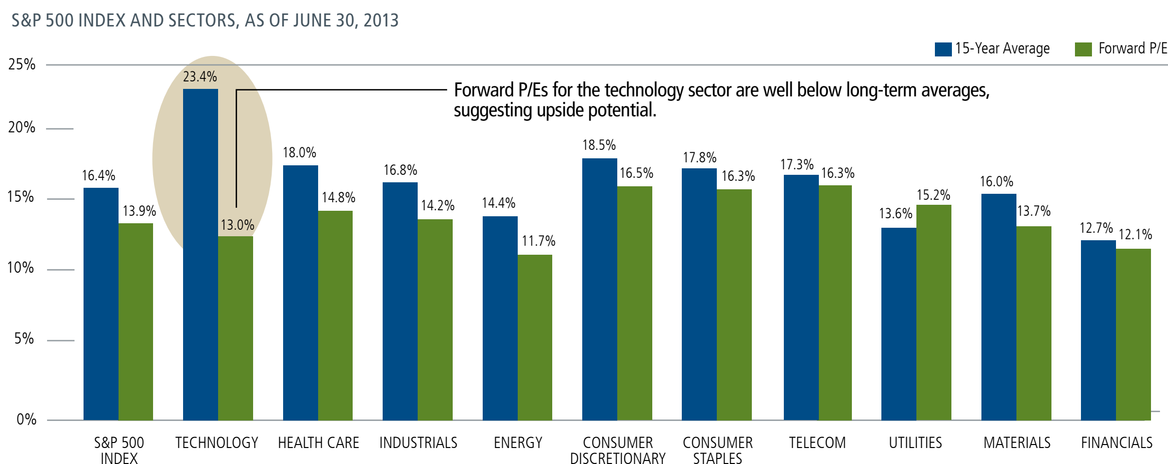
We believe that growth equities remain highly compelling on a number of measures. For one, on a free-cash-flow yield basis versus 10-year Treasurys, large-cap growth stocks are near their highest levels during the past 60 years. Second, on a P/E valuation basis, growth equities are well below average levels versus the S&P 500 Index.

A move by the Fed to taper or remove its QE could help spur a shift to growth stocks. Historically, technology and materials have performed well during periods of rising rates, while consumer staples and utilities have faced headwinds (Figure 14).

Our economic outlook further supports our constructive outlook for growth equities. Although this recovery hasn't been as dramatic as some may have hoped, it has been relatively steady and sustained over three

FIGURE 13. ATTRACTIVE P/Es IN EQUITIES, ESPECIALLY GROWTH SECTORS

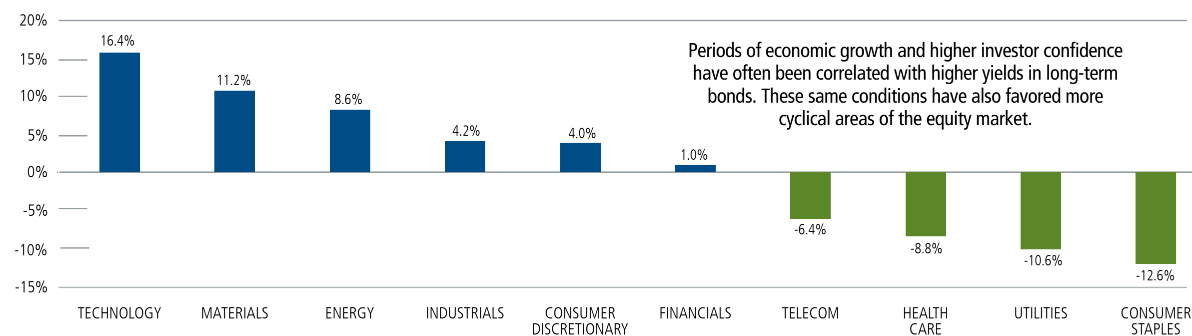
S&P 500 INDEX AND SECTORS, AS OF JUNE 30, 2013



Past performance is no guarantee of future results.
Source: JP Morgan, Guide to the Markets, 3Q 2013, as of June 30, 2013. Forward P/E Ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in teh next 12 months (NTM), and is provided by FactSet Market Aggregator.

FIGURE 14. DURING PERIODS OF RISING RATES, CYCLICAL SECTORS OUTPERFORMED DEFENSIVE ONES

SECTOR PERFORMANCE (S&P 500 INDEX) WHEN 10-YR TREASURY YIELDS ROSE
ANNUALIZED TOTAL RETURNS, 1990–2013



Past performance is no guarantee of future results.
Source: Wells Capital Management Economic and Market Perspective, "Confidence Runs Through the Stock Market," May 17, 2013 . Total return for all periods since 1990 for all weeks when the 10-Year Treasury bond yield rose.

years. As investors come to terms with this good news, we would expect that they would become increasingly inclined to favor companies with stronger longer-term growth prospects. As we move into the mid-cycle, we favor technology, industrials, financials and consumer discretionary.

> "The good news is that we are in a global market that provides opportunities around the world. The bad news is that we are in a global market, so whatever happens anywhere, be it U.S., China or Europe, affects us all."

Perspectives on Convertible Securities

We also maintain a constructive outlook on convertible securities. Because of their combination of fixed-income and equity characteristics, convertibles have often done well during volatile, but upward-moving equity markets.

A good number of convertibles have been retired this year and more are likely to follow. However, new issuance has been encouraging. So far, in 2013, we have seen $40 billion in global convertible issuance, including $18 billion in the second quarter. For the quarter, 33 U.S.-based companies brought securities to market, representing $10 billion. Widening spreads and economic growth bode well for a continuation of this issuance activity.

Finding Income in a Rising Rate Environment

Meanwhile, to income-oriented investors, we say, "caveat emptor." As the end of QE nears, long-term government bonds and investment-grade corporate debt should be approached with care. High yield securities look far more compelling to us in a period of economic recovery, given their reduced interest rate sensitivity and greater equity sensitivity. Over recent years, many issuers have taken advantage of low rates to decrease their borrowing costs and push debt maturities outward. Defaults remain very low relative to long-term measures. We have seen a slight uptick in defaults over recent months. This does not mean the proverbial bloom is off the rose, but serves as a caution that credit analysis will be important in this sort of market.

Income-oriented investors may also wish to consider certain types of alternative strategies* that utilize less interest rate-sensitive investments, and which have demonstrated lower correlations with traditional fixed-income asset types. Additionally, while many of the highest-dividend-paying stocks strike us as overvalued, there may be select opportunities among dividend growth stocks. Companies that can grow dividend income over time may be better able to offset the effects of inflation that can take a toll on many types of income-oriented securities.

*The strategies that alternative portfolios employ to achieve less-interest-rate-sensitive income streams do entail added risks, and alternatives may not be suitable for all investors.

Conclusion

Despite the rise in U.S. long-term interest rates, our global outlook remains one of cautious optimism. Many signs point to the U.S. being in a mid-cycle phase: recovery looks sustainable at this point, given the housing recovery and its contribution to the consumer wealth effect. U.S. consumer confidence and purchasing manager surveys both continue to be strong.

We are prepared for continued choppiness in the equity markets; these up-and-down, rotational markets are characteristic of mid-cycle phases. But even so, the markets seem to be refocusing on fundamentals, and this is a tailwind for our active, high-conviction approach. History has shown that markets have discounted moderate increases in long-term interest rates, with stocks moving generally higher as strong economic activity rules the day. Valuations of U.S. equities are still compelling, despite the rise in rates.

We expect shifting and rotational markets to continue throughout 2013—perhaps longer. But even within a sideways market, we feel that the sector rotations will likely benefit the undervalued growth areas of the market, more so than the equities that have been favored primarily for their dividends. Our fundamental research is leading us to a range of opportunities, including those in technology, consumer discretionary and financials.

The good news is that we are in a global market that provides opportunities around the world. The bad news is that we are in a global market, so whatever happens anywhere, be it U.S., China or Europe, affects us all.

Our concerns about the euro zone persist, but austerity rhetoric has softened and accommodative monetary policy remains unchanged. We continue to watch the emerging markets carefully, particularly how China navigates its slowdown and the ramifications to the global economy as a whole. Even so, with still-strong growth, we expect that China and the EMs can continue to contribute favorably to the global economy.

The **S&P 500 Index** is considered generally representative of the U.S. equity market. The **MSCI World Index** is considered generally representative of the market for developed market equities. The **MSCI World ex-U.S. Index** is a market capitalization weighted index composed of companies representative of the market structure of developed market countries in North America (excluding the U.S.), 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. The Russell 1000 Growth Index is considered generally representative of the U.S. large-cap growth stock market. The **Russell 1000 Value Index** is considered generally representative of the U.S. large-cap value stock market. The **Russell 2000 Index** is considered generally representative of the U.S. small-cap stock market. The **BofA Merrill Lynch VXA0 Index** is considered generally representative of the U.S. convertible market.

This material is distributed for informational purposes only. The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the information mentioned, and while not guaranteed as to the accuracy or completeness, has been obtained from sources we believe to be reliable.

Outside the U.S., this presentation is directed only at professional/sophisticated investors and it is for their exclusive use and information. This document should not be shown to or given to retail investors.

Investments in overseas markets pose special risks, including currency fluctuation and political risks, and greater volatility than typically associated with U.S. investments. These risks are generally intensified for investments in emerging markets.

The price of equity securities may rise or fall because of changes in the broad market or changes in a company's financial condition, sometimes rapidly or unpredictably. These price movements may result from factors affecting individual companies, sectors or industries.

Fixed income securities are subject to interest rate risk. If rates increase, the value of fixed income investments generally declines.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. Investors may not make direct investments into any index.

CALAMOS®

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

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

© 2013 Calamos Investments LLC. All Rights Reserved.
Calamos® and Calamos Investments® are registered trademarks of Calamos Investments LLC.

OUTLKCOM 15613 0613Q C