

Market Review
and Outlook

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We believe that our decades of experience and cautious approach will serve us well as we enter a period in which active management and rigorous research will be particularly important.

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Past performance is no guarantee of future results.

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The Shape of Things to Come

During the third quarter, investors grew increasingly confident that the worst of the global economic crisis may have passed. As the tide of negative economic data ebbed somewhat, the equity, high yield and convertible markets extended their rebounds from a strong second quarter.

These recent months have affirmed the view that we expressed in our January outlook, "The 'Fix is In' – But Will it Last?," in which we stated:

We will get a response from the extraordinary global monetary expansion. Money will make its way into the economy, financial markets and hard assets. ... It seems likely that initially, monetary expansion will cause financial and hard assets to rebound as new money makes its way around the globe.

We also wrote:

We encourage investors to remember that price and value are not the same. We believe that the prices of stocks and non-government bonds do not reflect the true value of these assets. At today's prices, we believe that stock and bond market prices offer attractively valued opportunities to earn above-average returns over the next decade.

And indeed, since then, the equity and non-government bond markets have rebounded considerably and now reflect valuation levels that we believe indicate a prolonged recession, but not a depression. So how will the economy and markets play out over the next few years?

We expect that the forces governing the markets, capital and incentives will be changing along the way, contributing to continued longer-term uncertainty. That said, over the near term, we believe that the markets and economy will likely benefit from a number of factors. The year-over-year comparisons for earnings-per-share (EPS), revenue growth and many economic statistics will be easy comparables to measure up to, because the numbers are no longer falling off a cliff. Likewise, the auto and building industries are no longer showing huge negative impacts on GDP, not because they are rebounding, but because they may have stabilized and therefore are not subtracting from GDP growth measures.

Finally, corporate America was very quick to respond to the recessionary crisis and as a result, inventory levels are nearly depleted, and staffing has been aggressively reduced. This provides strong EPS operating leverage as the inventory cycle is replenished and fiscal stimulus injects capital into some areas of the economy. We believe a lean corporate workforce and inventories will support very good EPS growth and help extend the equity price rally seen over the past six months.

In three months, we will be into next year's comparisons, looking for capital spending to ramp up and for businesses to start hiring and reaching for new growth opportunities. If this does not start to play out, we believe we will likely experience more volatility in the markets and lower valuations.

The Shape of Things to Come: W's or V's or L's or What?

The most common question we are asked is, "What will mark the end of this crisis?" The quick answer is that we believe the crisis will end when assets move from financially weak hands to financially strong hands. It would be nice to see debt reduction continue, but it is not necessary for the short-term recovery. And of course, a pick-up in the demand for credit and a solid recovery in real estate would also be signs that the near-term crisis has ended.

The shape and duration of the economic recovery and expansion will be determined by a combination of forces already present in the global economy and some new ones that will emerge in the future. So, whether the long-term economic recovery will be V-shaped, W-shaped or something else entirely is still cause for conjecture. What we do know from past balance-sheet recessions is that it will take some time for things to feel normal again.

On the upside, merger-and-acquisition activity around the world indicates that assets are moving from financially weak to financially strong hands in a number of industries, including banking. Stronger hands are also acquiring real estate, though at a slower pace than in the banking industry.

Throughout most of our 30-year history, we described ourselves as "short-term cautious and long-term bullish." In our second quarter outlook, however, we noted that we felt the opposite: "short-term bullish and long-term cautious." We believe the current fiscal and monetary approaches have long-term implications that are not positive. The purchase of loans and mortgage debt by the government is not a final or sustainable solution, and not a positive factor until private buyers acquire these securities from the government.

That said, we believe that the global economy will eventually right its course. But we expect that it will take time, trial and error. (For more on the themes that we believe will drive growth through this more difficult period, please see page 6.)

Figure 1. "Old" Misery Index

Annually 1929–2008, with 1Q and 2Q 2009

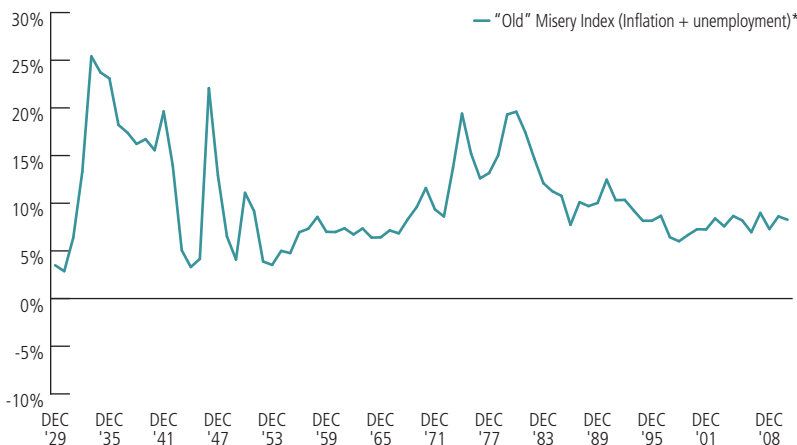
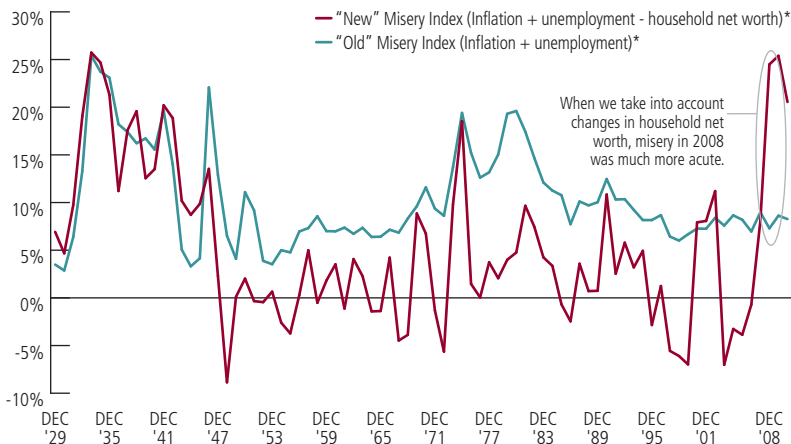


Figure 2. Misery Index: "New" vs. "Old"

Annually 1929–2008, with 1Q and 2Q 2009



Sources: For household net worth data: For 1929-1941 (billions of 1958 dollars), Frederic S. Mishkin, "The Household Balance Sheet and The Great Depression," *Journal of Economic History* 38 (December 1978), p. 920; 1928, 1942-1944 data is estimated; 1945-2008 data from the Federal Reserve. For CPI and unemployment: Bureau of Labor Statistics.

* CPI and household net worth track year-over-year percentage change; unemployment is expressed as a flat rate.

A New Perspective on Misery

Understanding what's going on today should give us a better perspective on future economic possibilities. For perspective on the shock the economy has lately suffered and how it compares to past economic shocks, we looked at the Misery Index (MI). The MI combines inflation, as measured by the Consumer Price Index, and the unemployment rate. Constructed in the 1970s to reflect the impact of economic malaise on households, the MI historically has been a simple and effective tool that combined the unemployment rate and inflation to capture the "misery" that the average consumer faced. The Misery Index suggests that the 1973–1981 period was the roughest period faced by households since the Depression. This seems logical, by all accounts. Interestingly, however, we believe the MI has lost some of its effectiveness. Consider that the levels of the MI at the end of 2008 do not differ substantially from the levels for most of the past 25 years.

Clearly then, this index needed some updating. This current crisis has been extraordinary by many economic measures. Misery is not only inflation and unemployment but also a decrease in net worth. Decreasing net worth can be very miserable and a telling gauge of future savings, spending and willingness to take risk with capital. This episodic shock has been defined by its dramatic negative impact on household net worth as housing, financial assets, pensions, real estate and just about every risk asset have declined significantly.

We tracked down household net worth figures back to 1928 and combined them with the old misery index. The result is what we call the "New Misery Index" (NMI). Figure 2 compares the New Misery Index to the old index and provides a different perspective on how this most recent economic shock stacks up.

As you can see, the old Misery Index (MI) was less volatile, and indicates that the early 1950s and a brief period in the late

1990s were the best of times. The NMI is almost always lower than the old index (that is, indicative of less misery) because of the astonishing climb in household net worth over the past 60 years. The NMI indicates that times were quite good for most of the post-WWII period, except for 1973–1974 and some brief periods of stress in 1981–1982, 1990 and 2000–2001.

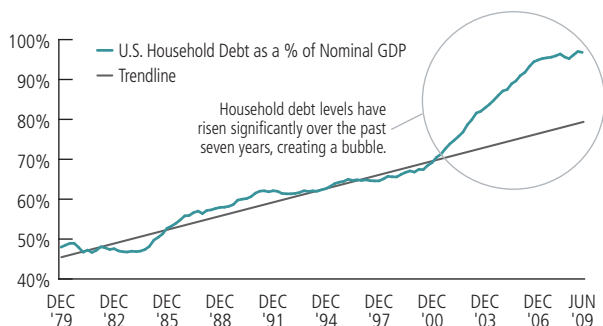
The NMI also indicates that the economic shock of the past year and a half has created a spike in “misery” more acute than during any other period we considered, *including the Great Depression!* That said, it is important to remember that during the Great Depression, both the MI and the NMI remained very high for many years, as policy actions prolonged the malaise. In contrast, when we consider the current environment, we are looking at a period of just one year of acute misery. We believe it unlikely that misery will persist at this high level for as long as it did during the Depression.

Nonetheless, the NMI illustrates the true, punishing impact on the economy and the average household, especially those of Baby Boomers who are nearing or entering retirement age. The time for these individuals to rebuild net worth is short, so the savings rate should remain high for the foreseeable future. Keep in mind this is a volatile index and rebounds can occur quickly. However, while it is possible that the financial asset portion of net worth could rally very strongly, the real estate and housing components are unlikely to rapidly appreciate without the use of leverage in the economy and without market clearing actions that would first result in lower valuations.

The assault on household net worth has recently resulted in a large increase in savings (the savings rate has moved to above 7%), a modest reduction in household debt (a rare event), and of course, a tight rein on spending. Figure 3 indicates that the household debt level has moved significantly above trend since 2001. At a 7% to 8% savings rate, it will take three to four years to move back to trend growth and a decade to get back to the 1990s’ level. Expect continued consumer balance sheet deleveraging and slower consumption for many years to come, unless household net-worth levels rebound significantly.

Figure 3. U.S. Household Debt as a % of Nominal GDP

1Q 1980–2Q 2009



Source: Bloomberg.

Equity Volatility Underscores the Severity of the Market Shock

Equity market volatility is another important gauge of the anxiety and panic market participants feel regarding the future economic path or the risk in the financial markets. As Figure 4 indicates, we have experienced a period of extreme volatility in the equity markets that exceeds the other large shocks of the past 80 years.

What is critical to watch for here is the degree of realized volatility in the future and the duration that high volatility is present in the markets. Economic policies will likely contribute considerably to the market response. Consider that the market experienced a significant degree of volatility from 1929 to 1940, a period characterized by a confused economic picture and policies. Remarkably, the market’s volatility level was higher during the 1930s than it was during WWII even though the future of civilization had to be a question for many during the War.

Demand Side vs. Supply Side—Why it Matters if it’s the Carrot or the Stick

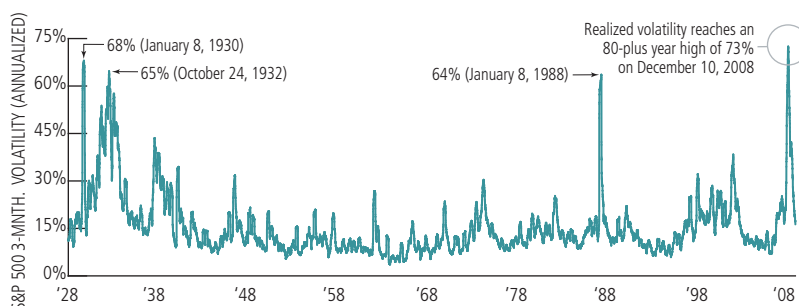
We therefore can establish both anecdotally and statistically that the economy has endured an extraordinary shock. This brings us to the question of how we can build a base for future recovery and a new economic growth phase. The current debate in academic circles and the financial press can be split into two main factions: the demand-side or Keynesian view on one side, and the supply-side or Austrian School of economics view on the other.

The demand side of the camp believes that the government can fill the gap caused by faltering consumer spending. That is, recessions and depressions can be cushioned or avoided if the government steps up spending when the consumer is not willing.

In contrast to the Keynesian focus on demand and consumption, supply-side theory focuses on profits, innovation, incentives and investment. Supply-side theory holds that an environment that incentivizes and encourages innovation and the production of goods and services leads to falling prices and rising output. Price declines raise demand further, spurring

Figure 4. S&P 500 Index, 3-Month Realized Volatility

March 30, 1928–June 30, 2009



Source: Goldman Sachs.

additional production and more price declines. Some of the best supply-side examples include Ford Motor in the 1920s, when it made automobiles accessible to the middle class, and Wal-Mart over the past 30 years.

Virtually the entire technology sector has operated according to the supply-side model over the past few decades, with innovation and supply driving prices lower and demand higher. Think Apple and Google who create demand for their products, which in turn generates profits and allows for future innovation and R&D, which in turn leads to more price drops which fuel additional demand.

The mantra of supply-side economics is that *“corporate profits, not consumption, are the cause of economic growth.”* Supply-side growth fares best in an entrepreneurial economy that rewards risk taking, with small government and without overly punishing taxes, regulations, wage controls and trade restrictions. Unfortunately, our elite political class has almost no direct business experience and many “lifetime” politicians’ loath profits, assuming them to be the result of exploitation and greed (although their own greed for power is somehow altruistic). In fact, profits allow for the reinvestment or expansion of a business or a return of capital to the risk takers and best allocators of resources.

Demand-side purists believe that the government saved capitalism during the Depression with a command-and-control economy operated out of Washington. The supply-side purists point to the length of the Depression as being the result of higher taxes, wage and price controls, and increased government regulation. Supply-side purists also point to demand-side model’s inability to explain the 1970s high inflation and high unemployment, which occurred despite high government spending.

Much evidence supports our belief that an economic recovery based on government direction is less sustainable than one built on economic and market forces. Market forces provide a

platform for growth that is based on the preferences and needs of consumers. An economic recovery based on government direction is often biased, favoring special interest groups and old capital and businesses, while lacking the support of consumer preferences and other proper economic forces.

We have left the speculating to others, and are instead focusing on strong businesses with lower leverage, high returns on capital and cash flows that should help them survive even a prolonged economic crisis.

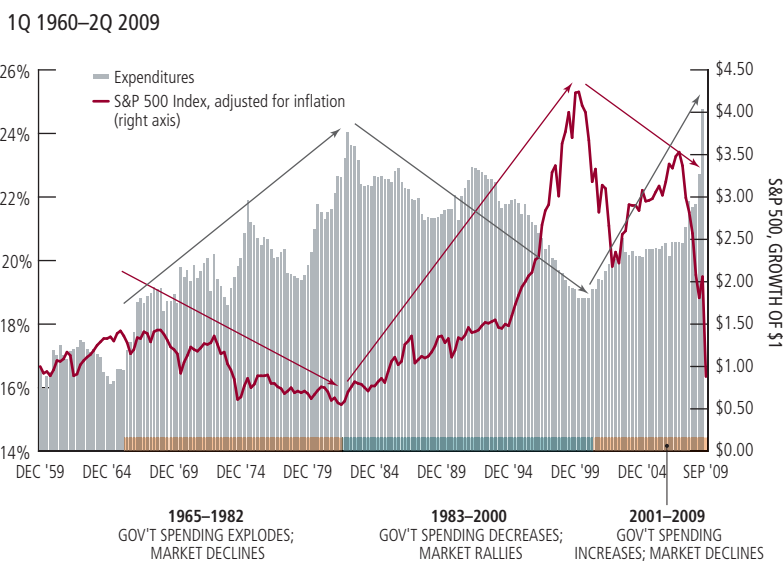
Under the demand-side model, government determines how you should spend your money, or government spends it for you. Government may favor a certain window type, drink, automobile or contractor—the list goes on. These preferences are based not on economics, but on politics and what the government feels is right for everyone. These days, the demand-side solution is the only answer the political leadership seems willing to accept—of course, we got ourselves into this mess and the politicians are here to save us from our free choices and dumb decisions! Meanwhile, the entire supply-side economic program is under attack or off the radar.

Why does this economic debate and political bantering matter so much? For one, the demand-side stimulus has a fiscal limit; once it is reached or removed, growth stops because it is not based on economic opportunity. Whether we have a demand-side or supply-side approach also matters because the economy appears to have both supply-side and demand-side characteristics or sectors. Growth industries are most often on the supply side, while mature or supply constrained industries—such as energy or commodities—are demand driven. So, understanding the impact of the supply-side model or demand-side models can have a very real economic impact on an investor’s financial well being.

The supply-side and demand-side models can also be thought of as the carrot (supply-side) or the stick (demand-side) approaches to economic stimulus. The carrot approach favors innovators by encouraging lower taxation, lower regulation and open trade. The stick approach favors higher government spending through higher taxation, higher debt, more regulation (another form of tax) and trade tariffs to protect the well-entrenched and our old economy jobs.

One approach has a clear pro-growth bias with the carrot as the prize, while the other is about control and command with “equal” sharing. However, we believe that over the long term, the redistribution of wealth ultimately hurts the economy and society as a whole. Lasting economic growth is not about

Figure 5. Federal Government Expenditures as a % of GDP



Source: Federal Government Expenditure Data provided by Bureau of Economic Analysis; S&P 500 data from Bloomberg

splitting up a fixed pie equally. History has shown that the best way to grow standards of living for all is to grow the pie quickly, allowing everyone to benefit in proportion to their contribution, while taking care of the less fortunate in society. When taking risks with capital is rewarded proportionately, we believe the result is job creation and rising living standards for all. Standards of living for the middle class are significantly higher today than 30 years ago because of economic growth—not because of government growth and redistribution.

Let's look at how a growing or shrinking government influences the real wealth of a society and economic progress. Figure 5 shows federal government expenditures as a percentage of GDP. The P/E ratio and the real return on equity demonstrate the economic impact of a growing government and of a shrinking government. Forget the political party in power and look at the actual spending and government's role. Big government takes from one citizen and gives to another; and unfortunately, it does so in an inefficient manner. When government spending is a smaller piece of the economy, there is more wealth creation and job creation for all citizens.

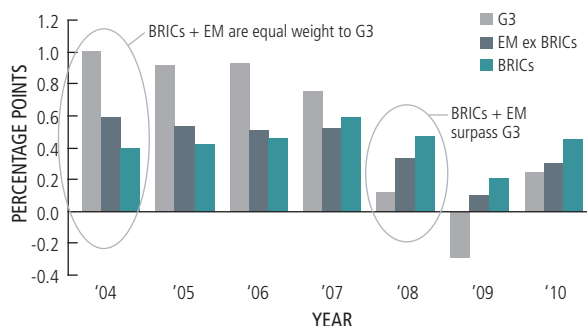
Opportunity in the Next Phase of Global Growth

Unfortunately, governments generally move slowly and stifle growth and innovation, so the degree of top-down command economy we get will influence the speed of progress. Growing out of our debt problem is much more favorable than inflating ourselves out, or being trapped in a prolonged debt deflation akin to what Japan has experienced for the past 20 years.

What gives us lasting optimism is that around the world, many creative businesspeople, scientists, educators, entrepreneurs and dreamers are working to shape the future and our economic path. New products and industries will emerge and create a different environment for all of us. Below, we explore two exciting opportunities and changes occurring in the world today—trends that we believe will shape the next secular bull market.

Figure 6. Consumption Trends: BRICs and Emerging Markets vs. G3

Real Contribution to World Consumption



Source: Goldman Sachs Global Economics, Commodities and Strategy Research, in BRICs Monthly, Issue No: 09/07, August 6, 2009. Calculated from consumer expenditure for India, US, Japan, Euroland, and EM ex BRICs. Brazil and Russia use private consumption and China uses household consumption. Annual averages 2004-08, Goldman Sachs' forecasts 2009-10.

Emerging markets are becoming consumption-driven economies. The developed nations face large debt problems, unfunded government liabilities, aging demographics and now, a balance sheet and net-worth imbalance. Past growth engines—such as U.S. consumer demand, credit expansion and an unchecked government spending spree—will be difficult to sustain. Meanwhile, in many emerging markets, consumer demand is ramping up at the same time developed nations' demand for imports is falling.

Figure 6 shows that the BRIC economies (Brazil, Russia, India and China) and emerging markets are a significant and growing factor in global consumption. Changes in world consumption patterns are now favoring the BRICs and emerging economies. In 2004, the combined contribution of BRIC countries and emerging economies to world consumption was equal to that of the G3 countries (the United States, Euroland, and Japan). Since 2008, the BRICs and emerging markets have surpassed the G3 to a *very large* extent.

The United States can replace lost domestic consumption growth with increased global consumption of our products and services. This growth opportunity would be threatened, however, if we turned inward. For example, trade barriers would ultimately do more harm than good to our producers, as we should expect other nations to follow our lead. We need to make sure that we can keep production costs low enough to compete in a global marketplace, while not placing undue burdens on businesses with higher taxes, regulations and legal abuses.

Monetary regime. We believe a new monetary regime will unfold in the near future, resulting in changes to the flow and cost of global capital, and to dislocations in financial markets and currencies. Over the last year, we have favored non-dollar exposure as a means to offset the pressure we face as a large debtor nation. We continue to hope and watch for a global monetary direction that will enhance the stability of currencies and reduce the possibility of global imbalances.

We expect that developed markets will continue to feel pressure to devalue currencies in an effort to export more products and replace growth lost due to slowing internal consumption. It seems likely that *a shift in global wealth will occur and be in favor of the developing nations*. In the current monetary regime, the U.S. is a global borrower and China is the saving nation. We expect the future monetary regime to turn this relationship on its head. The U.S. is moving toward the limit of its global capacity to run deficits, while China is fast becoming a global consumer.

Gap Theory and Future Inflation

One of the biggest points of contention in our longer-term outlook is our concern about inflation. As we have discussed in previous commentaries, global governments have turned the cash spigots on full blast. Ultimately, this monetary expansion will need to be reined in, with deflationary pressures giving way to inflation.

The counter-argument against rising inflation is that both the United States and the world have a large amount of

excess capacity, and we are producing well below our ability (gap theory). Until this output gap is filled, we will not have inflation. Although gap theory failed to account for the inflation of the 1970s, its proponents maintain this can be explained by measurement errors as to the actual output potential in the economy.

Our argument for inflation (and skepticism about the utility of gap theory) is based on three premises:

- 1) It's not just the actions taken so far in this crisis that will be inflationary, but also the actions that we believe will happen in the future. The Fed may be too slow to act, due to concerns about persistently high unemployment and keeping banks alive with a steep yield curve.
- 2) The fiscal response looks like it will continue to be, "spend and borrow, and if the economy slows, then spend and borrow more." Ultimately, the debt build-up will need to be addressed. The most politically acceptable way to do so will be with some inflation to reduce the real debt burden and dollar devaluation globally.
- 3) The level of output potential in this economy is going to be difficult to measure. Companies are restructuring for lower output levels and have already made some significant reductions, while bankruptcy rates and business closures will continue to climb. In the end, measuring the output gap will be messy at best.

Good Deflation and Bad Deflation

Of course, we cannot predict exactly when inflationary pressures will come to the forefront. We have already had a large degree of deflation, but not all deflation is cause for equal anxiety. We believe the government and Fed should not be concerned about deflation in consumer prices, but should be quite attentive to deflation in assets. A reduction in the price of consumer goods allows people to purchase more products—

and to us, this is not a bad thing. Companies will have to adjust to lower prices, just as the technology sector has each year for many years. In a globally competitive marketplace, we should expect deflation in products we purchase. (That is, declining expenses should be viewed as the normal course.) We will all benefit from this if businesses remain creative, competitive and focused on ongoing productivity improvements.

In contrast, we believe that the Fed (and everyone else) should be concerned about deflation in assets and net worth. We have already seen the far-reaching consequences of the devastating deflation in investments, homes, real estate and business values.

Portfolio Positioning

Over the past six months, we were advantageously positioned with overweights in strong-performing areas, including technology, infrastructure industry plays, early cyclical and commodity companies. We are excited about the United States' opportunity to grow its export industries; and we have sought to position the portfolios to favor cyclical and technology firms that we believe will benefit from the growing role of emerging-market consumers and a weak U.S. dollar.

We remained underweight in financials; this was a drag on performance during the quarter, but the banks and leasing companies have some major balance-sheet issues that we are not comfortable stepping into. Also, we expect that bank regulations, FDIC insurance costs and lower leverage will result in lower future ROEs and ROAs. (For more on our sector positioning, please see the table on the facing page.)

Growth stocks perform best in periods of increased capital spending, when valuation spreads are widening, when the yield curve is flattening, when high volatility stocks are being rewarded and when margin pressures start to increase. We are not yet in the sweet spot of the economic cycle for growth stocks to significantly outperform. We remain overweight cyclical stocks because generally they perform

Long-term Investment Themes

Our portfolio positioning continues to be heavily influenced by our long-standing investment themes. We believe this thematic approach is particularly advantageous during more challenging and slower-growth periods. We continue to favor companies that we believe are positioned to benefit from these trends:

1. The world is starved for entertainment and information, in many formats and at many price points
2. People want access to everything, anywhere, anytime.
3. The world is flat—the marketplace is global, as is competition
4. Demographic shifts, including Boomer spending and savings
5. U.S. and global infrastructure rebuild
6. Global savings and investment shifts
7. The new monetary regime—increased spending in developing markets, increased saving in developed markets
8. Energy and environmental fears—and the need for green solutions (driven by business and consumer economics)
9. The global war on terror, as a catalyst for increased spending in defense and related industries
10. Democracy and freedom are marching on globally, bringing progress and higher living standards to more of the world
11. Consumers gaining better product information and knowledge—knowledge is free and capital is scarce
12. Sciences—nanotechnology, biotechnology and genetics revolutions

best when global trade is expanding, as we expect it will. Cyclical should further benefit as long as the dollar remains under pressure. Cyclical have performed well during the early stage of this economic recovery, as is to be expected. However, because much of the global fiscal stimulus is focused on infrastructure building, we expect industrials, commodities and technology sectors to be favored beyond the early recovery stage.

Navigating the risk/reward trade-off. We continued to be highly mindful of risk. While we may have left some money on the table during the rebound of the past six months by avoiding the most speculative companies, we think prudence and preservation of capital will prevail. In fact, we expect that our investment approach will miss out on some opportunities because in volatile and upward moving markets, high-risk securities may experience a significant upward bounce.

Since the financial market low in March, the top-performing factors for equities and corporate debt included the following: high betas, small capitalizations, low stock prices and CCC rated credits. Securities in each of these areas topped the market returns by a significant amount. Because most high-beta, small-cap stocks priced under \$5 per share represent the most questionable and unsustainable businesses during a recession, investments in this group are actually speculation in most cases. Also, these high-risk assets are typically among the most illiquid holdings. Because we don't think the economy is out of the woods, we do not believe that a shift into high-risk, speculative companies without adequate liquidity would serve our clients during this very complex economic downturn. We have left the speculating to others, and are instead focusing on strong businesses with lower leverage, high returns on capital and cash flows that should help them survive even a prolonged economic crisis.

Similarly, we have avoided the lowest tiers of the credit quality spectrum. Consider that CCC rated credits have a cumulative historical default rate of 69.1% from 1970 to 2006, according to Moody's Investor Services. Given that this is the worst economic environment since the Depression, we don't see a compelling risk-reward proposition in trying to time investments in highly speculative credits that lack liquidity.

Sector Outlook and Positioning

In our last commentary, we included a summary of our sector positioning. We've updated it below:

Sector	Positioning*	Key Considerations
Financials	Underweight	Banks will be under pressure to pay for the FDIC's huge insurance liability, while new regulations, lower ROEs and ROAs continue to make the banking sector too dicey to participate in. Asset managers and insurance look reasonable from valuation- and business-model perspectives.
Technology	Significant Overweight	Capital spending as a percentage of GDP is at a 40-year low, and we expect that this trend will reverse. Technology companies are positioned well for a rebound in the capital spending cycle and are very used to competing in a deflationary environment. Productivity enhancement and cost controls should help technology spending. We see consumers remaining willing to purchase certain "special" products such as cell phones, laptops and flat-screens. We have found software companies offering stable revenue streams, strong balance sheets with lots of cash, and products that offer solutions for cost reduction and productivity. The sector will benefit from global infrastructure stimulus spending. Stock valuations are attractive and the risk/reward is compelling. The sector may be re-establishing its leadership position in the equity market for the first time since last decade's collapse.
Consumer Staples	Neutral (increased from underweight)	Due to the sector's lagging in the market rebound, better relative valuation opportunities have emerged There is presently a narrow risk/reward band, but as emerging economies improve, we may consider moving to overweight exposure. We favor low-cost producers with global reach. High-end consumer items are still under pressure but stock values reflect an opportunity for high returns.
Industrials	Neutral (decreased from overweight)	Valuations previously implied a very weak economic cycle for the next decade, but valuations are now pricing in a more normal cycle; we have reduced our overweight to a neutral weight. Global infrastructure stimulus spending will benefit many companies in this sector, so we expect that overall growth should be above the average global growth rate.
Materials	Overweight	Muted recovery implied in stock valuations. Further U.S. dollar devaluation and global stimulus spending should help boost commodity prices. The small capitalization of this sector and volatility of commodity prices will again make it prone to large price swings.
Energy	Overweight	U.S. dollar devaluation should help support energy prices. Mid-East turmoil adds to the attractiveness of this sector as it can hedge unforeseen energy price spikes. Stock valuations appear reasonable but government intervention will make this a difficult sector to value.
Consumer Discretionary	Underweight	Stocks offer significant discrepancies in values and opportunities. Consumers are more cost conscious and value conscious. The U.S. appears to have excess retail capacity. Overall potential minefield with some gems buried within.
Health Care	Neutral	This sector may be undergoing some significant changes with the government taking on a more activist approach, and becoming a major player and insurer. It is important to follow government actions and adjust accordingly.

* Sector overweights and underweights are general indications for the broad sectors. Each portfolio may hold different overweights or underweights due to characteristics particular to individual asset classes utilized.

Conclusion

We believe the global economy is at a crossroads. The next forces of economic growth will be different than those of the past. As we have discussed throughout this and other recent commentaries, the solutions to many of the economy's current problems have yet to be achieved. Yet, risk and uncertainty are always present forces in the global economy. As investment managers, our job is to identify opportunity and growth while understanding the financial risks of the changing world economy.

We are not in an environment in which a "rising tide will lift all boats." However, we believe that there are still many waves of opportunity, including exciting new drivers of long-term growth. Even as the worst of the recent crisis appears to be behind us, we are prepared for continued global economic challenges and slower growth. We believe that our decades of experience and cautious approach will serve us well as we enter a period in which active management and rigorous research will be particularly important.

S&P 500 Index-Is generally considered representative of the U.S. stock market. Unmanaged index returns assume reinvestment of any and all distributions and, unlike fund returns, do not reflect fees, expenses or sales charges. Investors cannot invest directly in an index.

Example company names mentioned in the "demand side vs. supply side" text have been chosen solely on the basis of name recognition and to illustrate these macroeconomic concepts. Use of these names does not constitute a recommendation to buy or sell any security or product.

The information in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in any account's portfolio at the time you receive this report. The securities discussed do not represent any account's entire portfolio and in the aggregate may represent only a small percentage of any account's portfolio holdings. 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 we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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