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Low-Volatility Equity Funds: Crafting an Asset Allocation Core

By John P. Calamos, Sr.
Chairman, CEO and Co-Chief Investment Officer of Calamos Investments

Worries over potential government defaults in Europe and a sluggish economic recovery in the U.S. have dampened some of the enthusiasm from the market rally of 2009. Advisors are now conditioned to expect that adding stock of any kind to a portfolio may feel like entering a mine field. This is where low-volatility equity strategies discussed in this paper may serve as an addition or replacement for the equity core in a portfolio. For more than 20 years, Calamos has utilized its expertise in growth stocks and convertible securities to actively create portfolios with risk-reward profiles appropriate for investors looking for a potentially smoother ride through uncertain equity markets.

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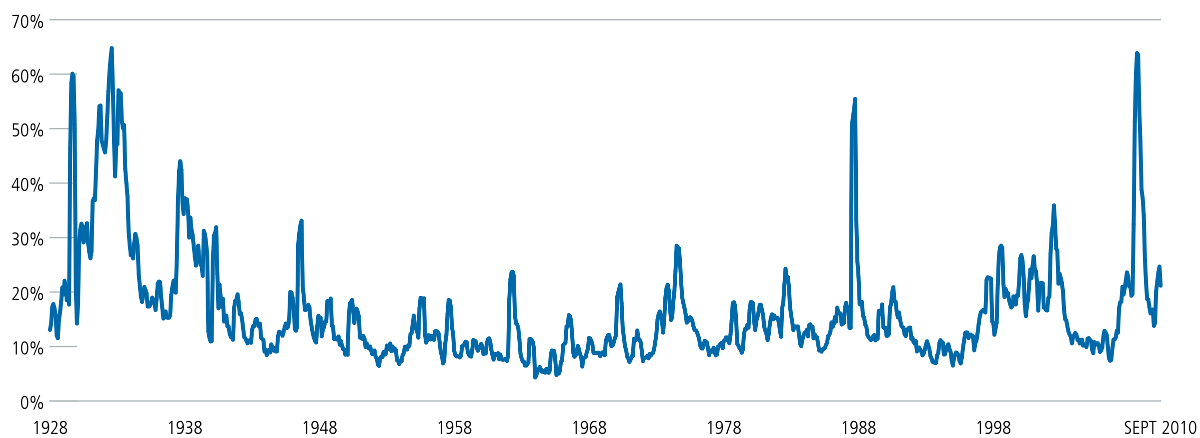
Although markets have rallied briskly from March 2009 lows and the economy is in recovery mode, volatility has once again returned to the markets. Aggressive economic stimulus and coordinated global monetary policy have prevented a catastrophic global economic crisis, but it is likely that these same policies have set the stage for longer-term economic challenges, including inflation.

A steady string of new uncertainties is also playing havoc with investors' confidence. The current series of economic crises in Europe has cast a shadow over more favorable economic indicators and earnings reports and serves as a reminder of how quickly policy risk can impact global markets and increase the risks that investors face. Many fear that these events may act as a catalyst for increasing risks throughout the global economy. The result will likely be a higher level of fear as the debt to GDP ratios in developed market countries approach alarming levels.

We have long discussed the futility of predicting volatility. The recent market events have only served to reinforce this belief. However, despite the current uncertainty and volatility, we believe that there is considerable potential in the global economy. In short, volatility is not a valid reason to stay out of the markets. What matters is not volatility itself, but rather how an investor responds to volatility. Therefore, what we need are asset allocation strategies that address this reality and focus on leveraging the opportunities that arise from continuing volatility. As a result, we believe that

FIGURE 1. STOCK VOLATILITY S&P 500 INDEX, 90-DAY VOLATILITY

APRIL 1928 TO SEPTEMBER 2010



Source: Bloomberg

a properly diversified asset allocation must continue to include a core equity participation. However, in the current environment, this core equity component must have lower risk than a traditional equity allocation.

Over multiple market periods, including the Lost Decade and the 2008-2009 "mini-cycle," Calamos low-volatility equity strategies have outperformed the broad markets.

We believe that this environment clearly demonstrates the long-term need for a low-volatility equity strategy. Because uncertainty always exists, we believe that there is always a need for such strategies. However, our view is that the need is more pronounced today than in the past, since the markets will likely be more volatile than they were in the recent years leading up to the 2008 crash.

WHAT DO WE MEAN BY LOW VOLATILITY EQUITY?

When we discuss volatility, our focus is on the variation of returns in our low-volatility equity funds versus full equity benchmarks such as the S&P 500 Index and the MSCI World Index. We consider a fund to have lower volatility when its beta versus the equity benchmark is less than one. For example, a beta of 0.70 means a fund's returns are about 30% less volatile than its benchmark.

This paper discusses the Calamos approach to low-volatility equity strategies and how they can be positioned in an investor's asset allocation. We focus on two Calamos low-volatility equity funds and discuss their strong performance and resilience during short and longer-term periods, including the "Lost Decade" (the period from 2000 to 2009 during which equities as an asset class failed to provide positive returns for investors) and the volatile market "mini-cycle" of 2008 and 2009. We believe the funds' historical results, particularly during the most difficult markets, provide strong evidence of the benefits of using low-volatility equity strategies as a core equity allocation.

AN INTRODUCTION TO LOW-VOLATILITY EQUITY STRATEGIES

The objective of low-volatility equity strategies is to outperform the equity market with less risk than a comparative pure-stock portfolio. (In this paper, equity indexes are represented by the S&P 500 Index and the MSCI World Index.) They seek to provide an asymmetrical risk profile by participating in a greater portion of equity upside than downside over a full market cycle.

At Calamos, we have spent more than three decades refining our approach to low-volatility equity strategies. We pioneered risk management strategies using convertibles in the 1970s. This was a particularly challenging time to invest as the markets moved sideways for many years and both fixed-income investments and equities struggled. Nonetheless, we were able to uncover investment opportunity amid this volatility.

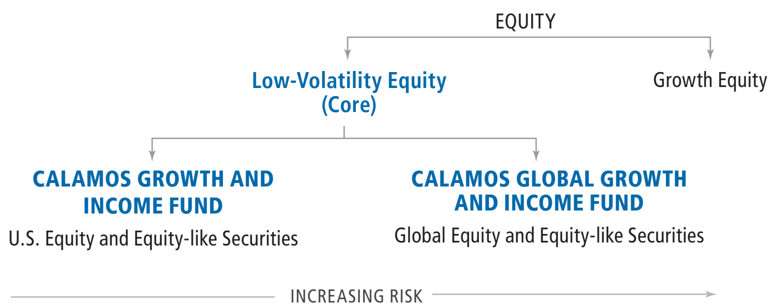
This is not simply an asset allocation between types of securities, i.e., "a balanced strategy," but rather a risk-managed approach designed to maintain an acceptable risk posture throughout the market cycle. The objective is to manage risk so that the strategy remains as a low-volatility position at the core of the asset allocation program throughout the market cycle.

THE CORE OF AN EQUITY ALLOCATION

We believe that the favorable risk/reward profiles of low-volatility equity strategies make them appropriate for use as "core" holdings. Of course, the percentage of low-volatility equity investments in a given allocation varies based on the investor's specific risk profile, but we believe that many investors may wish to consider investing a portion of their equity allocations in such strategies.

Growth of principal is a central consideration in asset allocation for most investors, and it may become even more important if inflationary pressures increase as the global monetary authorities begin to pull back from their aggressive monetary easing. As the policymakers struggle with structurally higher unemployment and slower growth in GDP, they may wait too long to remove the historic amount of monetary stimulus and thus add

FIGURE 2. LOW-VOLATILITY STRATEGIES: THE CORE OF THE EQUITY ALLOCATION



to inflationary concerns. However, growth of principal is not the only key consideration in establishing the core of an asset allocation strategy. As the 2008-2009 downturn showed, a strong, risk-managed foundation is also essential.

A low-volatility equity asset allocation can offer investors time in the market at a comfort level that neither stocks nor bonds alone can provide. Such strategies may be particularly attractive for investors who have a constructive view of the equity markets, but remain concerned about the potential for continued downside volatility. We believe the bottom line is that a low-volatility equity strategy mitigates the need to make the "equity timing decision." As a result, investors can avoid the potential of being "whipsawed"—i.e., buying just before prices fall and selling just before prices rise. Further, short maturity convertibles can act as a put in the event that stock prices decline.

It's our view that low-volatility equity strategies may solve the dilemma of how to simultaneously pursue growth and manage risk. Large-cap equities are the well-established choice for pursuing capital appreciation. The equity characteristics of convertibles can further enhance opportunities for growth, while their fixed-income features can provide downside protection.

RISK MANAGEMENT WITHIN LOW-VOLATILITY EQUITY STRATEGIES

We have always believed that risk control will be the key to wealth creation. We closely consider a strategy's participation in up and down markets in order to keep risk/reward at an acceptable and consistent level, even as equity markets fluctuate.

The primary goal of our risk management is to contain equity risk without giving away equity opportunity. Ours is not a market-timing strategy that cycles in and out of cash. Instead, our low-volatility equity strategies are fully invested portfolios that utilize a range of risk management strategies to maintain a consistent and acceptable risk posture.

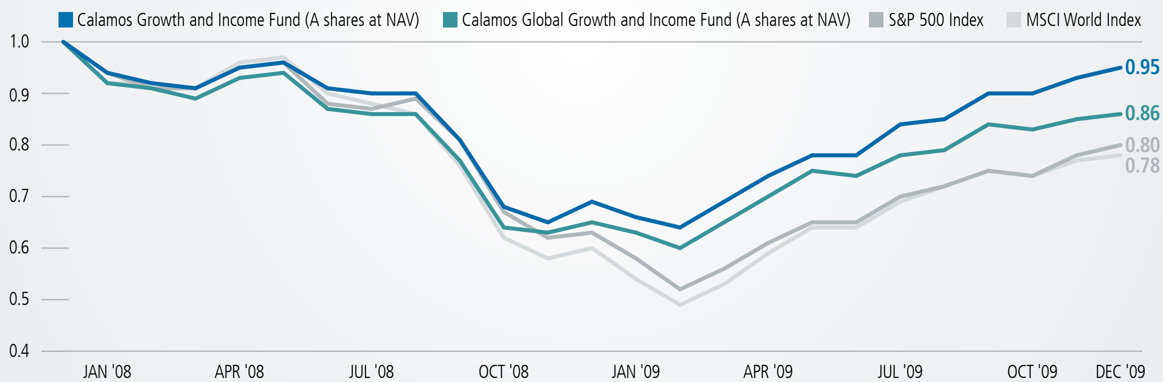
Investing in both equities and convertibles provides us greater flexibility to both manage risk within the portfolio and keep risk at our predetermined level over the course of a market cycle. Because of their fixed-income characteristics (e.g., bond value and coupon income), convertibles can provide a measure of protection against downward equity market volatility.

LOW-VOLATILITY EQUITY 2008 TO 2009

This case study illustrates the performance of two Calamos low-volatility equity funds during the "mini-cycle" of 2008 - 2009. Each strategy proved more resilient when markets plunged in 2008 and early 2009, but were also well positioned to participate in the rally of 2009.

FIGURE 3. UPSIDE PARTICIPATION, DOWNSIDE PROTECTION DURING THE "MINI-CYCLE"

GROWTH OF A UNIT: 1/1/2008 TO 12/31/2009



Sources: Mellon Analytical Solutions LLC and Calamos Advisors LLC.

It is not simply the inclusion of the convertibles that lowers the risk profile, but rather how we utilize the convertibles in conjunction with the equities. Convertibles can be more equity-sensitive or fixed-income-like, and the characteristics of individual convertible securities can change over time. We continually monitor each convertible both independently and within the context of the portfolio as a whole. We are able to use convertibles with varying degrees of equity sensitivity or fixed income characteristics to tailor the risk/reward profile of each position or industry group within a portfolio.

We do not make overall asset allocation calls between equity and convertibles. Instead, our investment team seeks to identify the best equity risk/reward opportunities for a company or a sector. The overall portfolio composition is a result of our guiding macro-economic outlook and rigorous bottom-up research.

Process in Action

At certain points, the downside protection of the convertible security can be used to tailor a strategy's risk/reward posture in certain industries or sectors. If a particular sector is more volatile, we may favor convertibles in that sector more heavily. From 2005 through 2008, we utilized primarily convertibles in the energy sector. We did not believe that oil prices would rise indefinitely, but we also recognized that it was impossible to predict price moves with certainty.

Therefore, we sought a more risk-conscious way of diversifying into these sectors. By choosing convertibles, we were able to participate in upward moves while still maintaining our desired risk/reward profile. As equity valuations became more attractive after the market sell-off in 2008, we rotated most of our energy exposure to common stock and increased the sector weighting.

A NOTE ON ACTIVELY MANAGED VS. PASSIVELY MANAGED CORE ALLOCATIONS

In all market environments, we believe that asset allocations are best built around a core of actively managed strategies. However, our bias toward active management is particularly strong today, given the quantity and magnitude of uncertainties in the global economy. Passively managed strategies cannot respond to the rapidly evolving landscape.

OVERVIEW OF CALAMOS LOW-VOLATILITY EQUITY PORTFOLIOS

Our low-volatility equity strategies seek to provide upside participation in equity markets with less exposure to downside than a pure-equity fund by investing in equities and equity-sensitive securities (convertible bonds and convertible preferred stocks).

This paper discusses the following Calamos low-volatility equity strategies to demonstrate the effectiveness of low-volatility equity strategies:

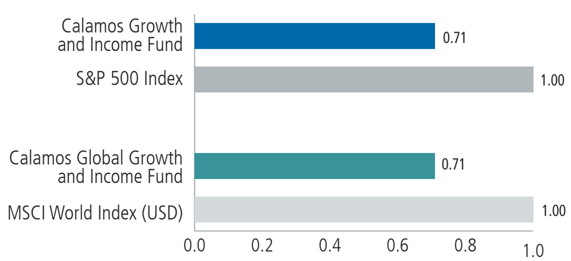
Calamos Growth and Income Fund, launched in 1988, focuses primarily on businesses domiciled in the United States. The investment team seeks to identify companies with sustainable growth prospects, healthy balance sheets, low debt and global focus (globally diversified revenue sources and multinational presence and business strategies). We favor companies positioned to benefit from long-term secular trends, such as the global drive for corporate productivity, demographic shifts in developed and emerging markets and the desire to stay connected to information, entertainment and each other.

Calamos Global Growth and Income Fund, launched in 1996, offers low-volatility equity within a global framework. The investment team favors countries that embrace economic freedoms, such as free trade, transparency in accounting and a business-friendly environment. We believe economic freedoms sow the seeds of progress and prosperity, and create the most compelling backdrop for wealth creation. Generally, this has led us to favor developed markets with selective investment in more established emerging markets.

FIGURE 4. SINCE INCEPTION BETA

AS OF SEPTEMBER 30, 2010

Each fund has demonstrated notably less risk than the broad equity markets.



Source: Mellon Analytical Solutions LLC, Calamos Advisors LLC and State Street Corp. Beta is a measure of stock market correlation or risk. Fund data based on A shares at NAV.

HISTORIC RESULTS MAKE THE CASE FOR A CORE EQUITY ALLOCATION

We have always maintained that a portfolio's core equity allocation should maintain a consistent risk/reward profile. This lends a degree of stability to the investor's portfolio and also drives upside potential.

The historical performance of the two subject Calamos low-volatility equity strategies, particularly during difficult markets, vividly illustrates the benefits of using low-volatility equity strategies within the equity core.

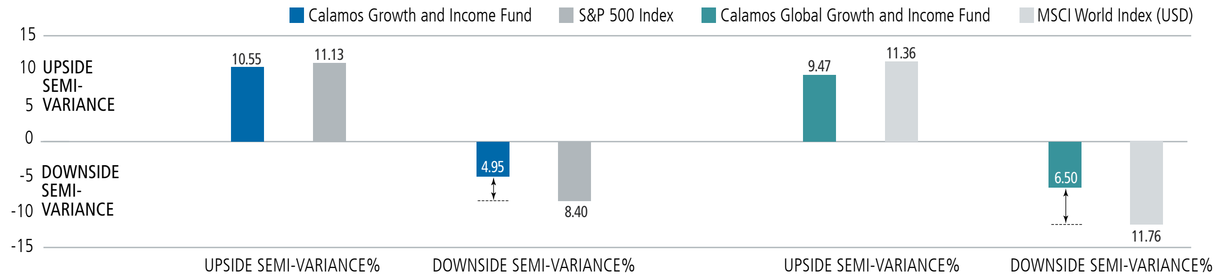
Beta is widely accepted as a particularly useful measure of risk. Figure 4 shows that each funds's beta since inception has been approximately 0.7, indicating 30% less risk than the broad stock market, as measured by the S&P 500 Index for our domestic strategy and by the MSCI World Index for our global strategy.

Another risk metric, upside/downside semi-variance, is particularly valuable for understanding the type of volatility experienced by the portfolio and the index. Risk is generally thought of in negative terms, but not all risk is undesirable. If the risk is asymmetric, with more expected upside volatility than downside, then the probability of a positive return outcome is increased. The upside/downside variance illustrated in Figure 5 looks at risk in this context and is, therefore, more consistent with the management approach that we utilize in connection with the low-volatility strategies.

FIGURE 5. UPSIDE AND DOWNSIDE SEMI-VARIANCE SINCE INCEPTION

AS OF SEPTEMBER 30, 2010

Upside semi-variances are similar for each fund and its comparable index, while the downside semi-variances diverge, with downside semi-variance much lower for the funds.

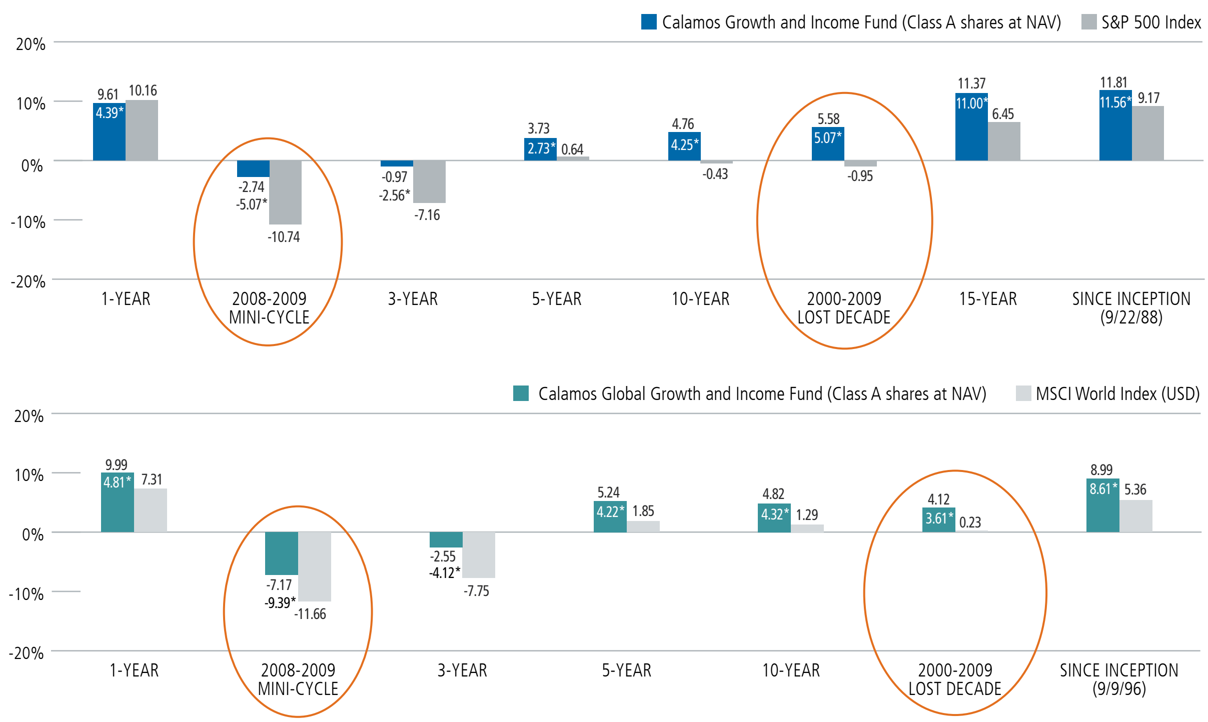


Source: Mellon Analytical Solutions LLC, Calamos Advisors LLC and State Street Corp.

Past performance is no guarantee of future results. Upside and Downside Semi-Variance: Semi-variance breaks down deviation from the mean into two more meaningful parts, the upside and downside. Upside semi-variance shows how much of the investments' overall volatility is the result of upward price movements and downside semi-variance similarly represents downside movements. Fund statistics are based on Class A shares at NAV.

FIGURE 6. OUTPERFORMANCE OVER SHORT AND LONG TIME PERIODS

AVERAGE ANNUAL RETURNS (%) AS OF SEPTEMBER 30, 2010, UNLESS OTHERWISE NOTED



*A shares load adjusted

Sources: Mellon Analytical Solutions LLC, Calamos Advisors LLC and State Street Corp.

Performance data quoted represents past performance, which is no guarantee of future results. Current performance may be lower or higher than the performance quoted. *The principal value and investment return of an investment will fluctuate so that your shares, when redeemed, may be worth more or less than their original cost. You can obtain performance data current to the most recent month end by visiting www.calamos.com. Calendar year returns measure net investment income and capital gain or loss from portfolio investments for each period specified. Average annual total return measures net investment income and capital gain or loss from portfolio investments as an annualized average. All performance shown assumes reinvestment of dividends and capital gains distributions. Class A shares load-adjusted returns are adjusted for the maximum front-end sales load of 4.75%. The Funds also offer Class B and C shares, the performance of which may vary. Performance shown reflects an expense reimbursement that improved results. As of the prospectus dated 3/1/10, the gross expense ratio for Calamos Growth and Income Fund Class A shares is 1.13%; Class B and C shares is 1.88%; Class I shares is 0.87%. For Calamos Global Growth and Income Fund, the gross expense ratios are 1.45% for Class A shares, 2.20% for Class B and C shares, and 1.19% for Class I shares. The MSCI World Index return since inception start date is 8/31/96.*

In addition to this more attractive volatility profile, Figure 6 shows that both strategies outperformed the broad markets over short- and long-term periods. As the broad U.S. and global markets struggled during the infamous "Lost Decade," each of our featured strategies earned positive returns. When this information is combined with the case study on page 6 (Figure 3), which demonstrated that the two strategies also proved considerably more resilient during the turbulent market "mini-cycle" of 2008 and 2009, it is easy to see the value of combining downside protection and upside participation within a single portfolio.

CONCLUSION

As we look to 2010 and beyond, we believe equity market volatility will continue. At the same time, however, we believe that the equity markets continue to be the best place for long-term investors. Some investors might view this as an uncomfortable, unwinnable contradiction, but we do not. We believe core allocations to low-volatility equity strategies provide a risk-managed means to pursue market opportunity in the face of continued volatility.

A consistent risk profile over a full market cycle is especially important for a core equity allocation. Given the volatility inherent in the equity market, this consistent risk profile may be difficult to achieve through a pure-equity allocation. Because our low-volatility equity strategies invest in equity and equity-sensitive securities, we utilize a broader range of risk management strategies than possible in a pure-equity portfolio. As a result, we have better opportunities to pursue equity upside with less risk.

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Over multiple market periods, including the Lost Decade and the 2008-2009 "mini-cycle," the Calamos Growth and Income Fund and the Calamos Global Growth and Income Fund have outperformed the broad markets with less downside volatility. While the past cannot guarantee the future, we believe the results of our low-volatility equity strategies provide a compelling starting point for revisiting established asset allocations.

For additional information about low-volatility equity funds, please visit us at **www.calamos.com/lve**. You can also contact us at 800.582.6959, and we will be glad to provide the resources that best address your specific needs.

ABOUT THE AUTHOR

John P. Calamos, Sr. is chairman, chief executive officer and co-chief investment officer of the firm he founded in 1977, which he took public as Calamos Asset Management in 2004 (Nasdaq: CLMS). A recognized authority on convertible securities, he has pioneered investment strategies and techniques to help manage risk for major institutional and individual investors for more than 30 years.

Mr. Calamos received his undergraduate degree in Economics and M.B.A. in Finance from the Illinois Institute of Technology. He joined the United States Air Force after graduation, served as a combat pilot during the Vietnam War, and ultimately earned the rank of Major. While in the Air Force, Mr. Calamos became intrigued by the risk management aspects of convertible bonds. By applying option price theory to the valuation of convertibles, he was able to demonstrate the benefit of convertibles as part of an of investment strategy.

He has shared his expertise in two books, *Convertible Securities: The Latest Instruments, Portfolio Strategies, and Valuation Analysis* (McGraw-Hill, 1998) and *Investing in Convertible Securities: Your Complete Guide to the Risks and Rewards* (Longman Financial Services Publishing, 1988). He has also authored numerous articles in various financial journals and is a frequent guest on nationally syndicated financial networks, including *CNBC*, *Bloomberg TV* and *Fox Business Channel*.

ABOUT CALAMOS INVESTMENTS

Calamos Investments is a diversified investment management firm offering defensive equity, growth equity, convertible, enhanced fixed income and alternative investment strategies. With roots dating back to 1977, the firm applies a risk-managed approach to capital appreciation and income generation. Calamos serves institutions and individuals with a variety of separately managed accounts and a family of open-end and closed-end funds. The firm has $30.2 billion in assets under management as of August 31, 2010.

The Calamos investment process focuses on gaining a comprehensive understanding of a company and its relative attractiveness of the securities within its capital structure. This rigorous approach has allowed the investment team to readily expand the application of its discipline across strategies. Today, Calamos offers a broad range of strategies that have compellingly demonstrated their ability to capture market upside while limiting downside through full market cycles.

Throughout its history, the Calamos investment team has benefitted from a very high level of stability, at both the chief investment officer and senior analyst levels. The team includes more than 50 investment professionals,* working together as an integrated group across all of our strategies. Each portfolio benefits from the collaborative insights and collective knowledge that the team has amassed over decades.

*As of June 30, 2010

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.

In addition to market risk, there are certain other risks associated with an investment in a convertible bond, such as default risk, the risk that the company issuing debt securities will be unable to repay principal and interest, and interest rate risk, the risk that the security may decrease in value if interest rates increase.

Important Fund Information

The Global Growth and Income Fund may invest up to 100% of its assets and the Growth and Income Fund may invest up to 25% of its assets in foreign securities and in an array of security types and market-cap sizes, each of which has a unique risk profile. As a result of political or economic instability in foreign countries, there can be special risks associated with investing in foreign securities. These include fluctuations in currency exchange rates, increased price volatility, and difficulty obtaining information.

Both funds may invest in mid-size and small companies which present greater risk and higher volatility than investments in larger, more established companies, and in lower-rated securities, which may present greater risk than investments in higher-rated securities. This is because there is a greater likelihood that the company issuing the lower-rated securities may default on income and principal payments. In addition to market risk, there are certain other risks associated with an investment in a convertible bond, such as default risk, the risk that the company issuing debt securities will be unable to repay principal and interest, and interest rate risk, the risk that the security may decrease in value if interest rates increase.

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. The "500" is one of the most widely used benchmarks of U.S. equity performance.

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 the Asia/Pacific region. The index is calculated without dividends, with net or with gross dividends reinvested, in both U.S. dollars and local currencies.

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.

Before investing, carefully consider the fund's investment objectives, risks, charges and expenses. Contact 800.582.6959 for a prospectus containing this and other information. Read it carefully.

CALAMOS®

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

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