

Combining the Advantages of Stocks and Bonds in One Investment

Convertible securities offer investors advantages specific to both stocks and bonds—like the former, they have the potential for capital appreciation and like the latter, they offer the potential for interest income and downside risk mitigation.

Considered a hybrid security, convertible bonds encompass characteristics of both bonds and stocks. Although issued as bonds, they can be converted into a specific number of shares of common stock, typically of the issuer's company. This "conversion ratio" is determined at issuance and can be acted upon at any time by the bondholder during the life of the bond.

Fixed-Income Characteristics

Like any other bonds, convertibles represent a loan to the issuing company with no rights of ownership. They are typically issued at a par (face) value of \$1,000. During the life of a bond, interest is paid at a stated rate called the coupon. When the bond matures or is redeemed (also referred to as "called,") by the issuing company, investors are paid back the \$1,000 face value. Unlike traditional bonds, convertible securities offer the added attraction of upside potential due to their equity sensitivity, and thus typically offer lower coupons than equivalent non-convertible bonds.

Equity Characteristics

Because convertibles can be exchanged for a specific number of shares of stock, they tend to gain or lose value along with the underlying stock. When the price of the underlying stock rises, the price of the convertible tends to rise as well. When a stock price falls, however, the convertible bond price typically declines only so far before it begins trading based upon its bond value. While convertibles are thus sensitive to their underlying equity's price movements, as bondholders convertible investors still receive the interest income and the guarantee of principal that bonds offer.

What is Unique About Convertibles?

Because convertibles possess both equity and bond characteristics, it's not surprising that they generally yield less than their issuers' straight bonds, but more than their stocks' dividend. While convertibles are typically priced so that an investor would receive less than the full value of the underlying stock upon conversion, in return the convertible investor earns a higher yield and has greater downside risk mitigation

than an equity shareholder. In essence, the investor is "paid to wait," earning income until the bond matures or until—hopefully—a rising stock price positively affects the convertible bond's value.

Valuing the Convertible

Calculating a convertible's value is complex since it is affected by so many factors, including the performance of the underlying stock, its volatility, interest rates, etc. Changes in the value of a convertible bond as a result of changes in the bond value or the stock value are illustrated by the "Convertible Price Track."

The Convertible Price Track illustrations below and on the next page show the theoretical relationships between a convertible bond's price and the par value of the bond as the underlying stock price rises or falls. Some of the basic principles behind convertible bond valuation include:

- » **Investment Value** is the value of the convertible bond as if it were simply a straight bond without a conversion feature. The value of the bond at maturity is fixed. The bond value stays relatively constant over time and is not affected by changes in the issuer's stock value unless the issuer approaches insolvency.

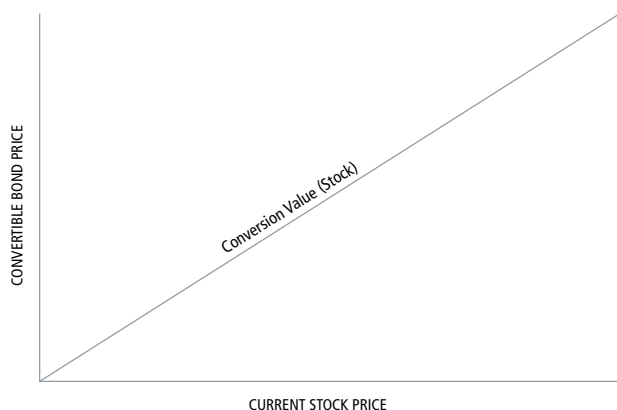
INVESTMENT VALUE



Convertible Bonds

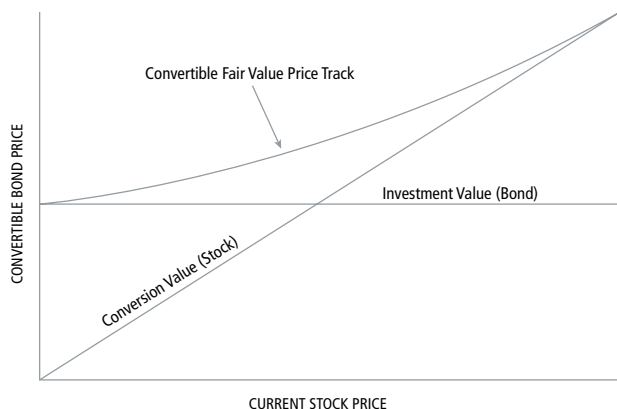
- » **Conversion Value** is the stock's current price times the pre-specified number of shares the convertible bond can be exchanged for. Thus, the conversion value tends to move in tandem with changes in the stock price. (On the graph, conversion value is represented by the diagonal line.)

CONVERSION VALUE



- » **Convertible Price Track** is the line representing the theoretical value of the convertible bond. It tracks the upward changes in the price of the underlying stock, yet is cushioned by the bond floor as the stock price declines. Should equity prices get quite high, the convertible is priced very similarly to its underlying equity. Conversely, when the underlying stocks are far below conversion value, convertibles are said to be “busted” and perform more like straight bonds. Thus, convertibles can provide the greatest advantage to investors when they are in the middle range of the fair value price track, providing a

CONVERTIBLE PRICE TRACK



The figures depicted above are for illustrative purposes only and do not represent the past or future performance of any security or Calamos portfolio.

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

Convertible bonds are not FDIC insured, not bank nor credit union guaranteed, and may lose value.

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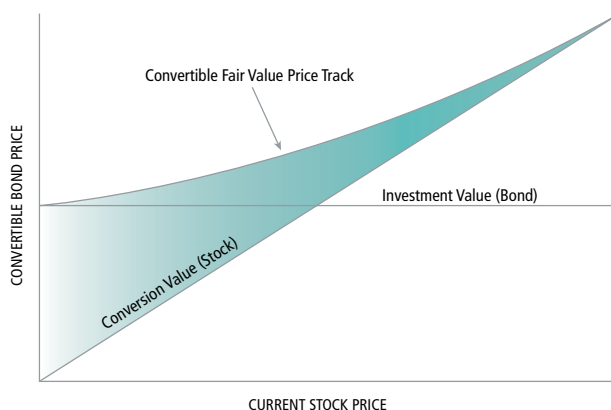
Past performance is no guarantee of future results.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

combination of equity upside potential with bond-like downside risk mitigation.

- » **Conversion Premium** is represented by the shaded area between the equity value and the convertible's fair value price track. This

CONVERSION PREMIUM



“conversion premium” is the premium an investor will pay over a “straight” bond price, representing the value offered by the convertible's option to be converted into common stock.

One of the more attractive attributes of convertibles is that they have historically participated in a greater portion of their underlying stocks' upside performance than their downside. This dynamic creates a risk/reward profile that is compelling to an investor who desires equity participation and potential downside risk mitigation.

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TODAY FOR TOMORROW

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