Calamos' Grant On Getting Equity-Like Returns Without Market Correlation

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Michael Grant, Co-Chief Investment Officer at Calamos Investments, Co-Manager of the Calamos Long/Short Equity & Dynamic Income Trust. Michael says that current market conditions have made it that bonds are no longer a natural working hedge for equities downturns, and the downside risk in terms of capital return can be greater in the bond market than in stocks. He notes that investors are over-exposed to Magnificent Seven and the biggest of the large-cap stocks, noting that the typical client has about 40 percent of their equity assets there and they need to diversify away from those positions to be less market-sensitive. He worries that turning to bonds in an inflationary environment will create portfolio pain, so he's looking to non-correlated assets to ride out the rate cycle, tariff problems and more.

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

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CHUCK JAFFE: Michael Grant, co-manager of the Calamos Long/Short Equity & Dynamic Income Trust is here, we're getting his take on where he's finding income in times that are, well, dynamic, maybe. It's time for The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, which is a unique industry organization representing the full spectrum of the closed-end fund business from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today we are looking at the markets and at generating dynamic income with Michael Grant, who is co-chief investment officer and senior portfolio manager at Calamos Investments, he's their head of long/short strategies and he's co-manager of CPZ, that's the Calamos Long/Short Equity & Dynamic Income Trust. If you want to learn more about Michael, the firm, that closed-end fund or anything they do at Calamos, go to Calamos.com. And to learn more generally about closed-end funds, interval funds, and business-development companies, go to the Active Investment Company Alliance website, AICAlliance.org. Michael Grant, great to have you back on The NAVigator.

MICHAEL GRANT: It's great to be back, Chuck. Thanks very much.

CHUCK JAFFE: CPZ is a really interesting fund, you and I talked about it several years ago and I remember when the fund came out, and let's face it, the conditions in the market and in the bond market several years ago were very different than they are now. This was created to generate income in every market condition, but that was also because we weren't getting any real income and yield out of bonds at that point. Now we have a market that's very different conditions, people are very nervous about the equity side of things and they aren't getting paid for the bond market, so start by giving us an understanding of where you see things at right now and how that informs your decisions on where to pursue income.

MICHAEL GRANT: Thanks very much for having me back, Chuck. So we last spoke in the pre-pandemic era, the setting was the setting where the bond market largely yielded no income, and we launched CPZ as a vehicle to generate income from investors, but to do it without the bond market, we would focus on the equity world. The premise of that related to the mispricing of bonds generally when interest rates were at zero, our concern was that if we ever went back to a more normal interest rate setting, the capital returns from bonds would be disastrous for investors, and in fact, that's exactly what we've seen. The last three, four years, however you measure it, have been some of the worst on record for total return from the bond market ever recorded, so our strategy of generating very competitive income, 8-9% annualized income, has been the right one, and we did that without the capital downside of the fixed-income markets. Now the world today is completely different than the pre-pandemic world primarily because interest rates are now back to normal, you can get a genuine return from bonds, from the bond market, you know, typical risk-free rates are 4-5% over 10 years, if you go into slightly higher risk, you can get 6-7%. Now our product still yields a very healthy 8-9% annual income, and you might ask, well, now that interest rates are back to normal, what's the purpose of a product that delivers a competitive yield from the equity side? And I would say it's this, prior to the pandemic, investors owned the bond market often as a hedge against the equity world. In other words, investors believe rightly that in a deflationary setting, if equities got into trouble, bonds would go up in value, so they were a natural hedge that could help to product client portfolios. Today that hedge no longer works. In fact, I would argue that the downside risk in terms of capital return can be greater in the bond market than the equity market, so let's look to what happened in April of this year. Trump came out with his Liberation Day and there was a shock in the equity world, what was the safe haven? Was it bonds? No, bonds did not go up in value. In fact, this was the first time in 30 years where investors perceived an external shock in the equity world, but it did not lead to higher bond prices. The new safe haven was actually gold, not bonds, and the problem with gold is you don't earn any income. So if you look at CPZ, what you saw was an uncorrelated equity product, uncorrelated to the turmoil in the equity world, that's because we're long and we're short, and yet we were still able to generate a health 8-9% income. So most of your clients will have a fairly healthy equity exposure of some form, today many clients' portfolios are dominated by passive equity exposure, which means they are mirroring the major benchmarks, which means they have boatloads of seven mega cap stocks. The question is, how do they hedge that? The biggest problem today is that investors need a product that can deliver equity-like returns but not correlated to the S&P 500, they already have too much in those big mega caps, and typically when the equity world gets into trouble, bonds might be your safe haven. That was certainly true pre-pandemic in a deflationary era, today that's no longer true because the source of risk for equities today is now inflation, not deflation. In other words, when equities get into trouble, it's just as likely to be because interest rates are going higher or inflation is going higher. So the punchline here is that CPZ, an income-generating vehicle that is hedged for your equity risk, is exactly the kind of safe-haven product that generates income and that has a real role in your client portfolios.

CHUCK JAFFE: I want to jump in quickly because I've got so many questions because there's a lot in that answer, and I don't want to get sidetracked but obviously part of what you're saying is, here is something that you can use to hedge off some of your stock risk and your risk on the Mag 7 and the S&P, and yet you do have Microsoft and Alphabet in your holdings, at least the last time I looked, so is it more that you're doing it with other things, or it plays that role even though it also has a small weighting? And I will point out, it's not a big weighting, it's a 2%-ish weighting in any of those stocks, but it plays out that way even though you have a small weighting there?

MICHAEL GRANT: So we're an active mandate, and also a mandate that can be hedged, so in the mega caps we like Microsoft, we like Amazon, we like Google, and right now we like Nvidia, but we're short Apple and we've been short Tesla, we have used other index-related instruments to help hedge that mega cap risk. So your typical long-only investor will have an exposure to those mega caps of more than 40% of their US equity exposure, for us that weighting is typically less than 10%, so that gives you the scale of the difference between what we're doing and what the typical client has exposure to in their long-only portfolios.

CHUCK JAFFE: One of the things that I have been watching with this market is what I think is mixed messages. I think the stock market is sending one message and the bond market is sending a different message, and the bond market's message by the way, much darker, but historically when the two sides disagree on the message they're sending, if I had to say who'd I'd expect to win, it's usually the bond market. So as somebody who is trying to provide income, potentially hedge not only the equity market but make it that you have something that is hedging the bond market as well, how do you read those messages and which side do you think is sending the right message now, stocks or bonds?

MICHAEL GRANT: Well, I would disagree with you a bit here, Chuck. To say that they disagree means you have to have an idea of what they're messaging, and I would argue that actually the messaging, and let's talk now since April, the messaging has been aligned, and here's how. When Liberation Day came along, investors perceived a shock, the tariff shock, now most investors read that as a negative shock for the economy. My view was always that tariffs were a reflationary shock, reflationary with a very complicated mix of both inflation and deflation impulses. Now the bond market agreed with my interpretation, the bond market did not drive yields to new lows, it was not signaling economic vulnerability, and this is especially true if you looked at credit spreads, so the market was initially unsettled, the equity market, for two reasons in my view. Number one, the confrontation with China was moving way too fast and it was too broad, investors were expecting a rivalry with China, not with the entire world. The second risk was the question over inflation and interest rates, now when Trump dialed down the escalation, we very quickly saw the market recover. In fact, the recovery was so robust, we really should step back and say, why? What is the market reading, the equity market, that would drive such a fast recovery? And I think the answer is that the Trump agenda today is extremely ambitious, and Donald Trump is operating with democratic constraints, he has a short window of time, three and a half years at best, maybe less depending upon the midterms. In other words, Donald Trump cannot afford any major disruption, and economic disruption means that none of his agenda would get through the front door. I think part of the impressive recovery we've seen in equities is investors understanding that there is a very real put under the economy and under the financial markets here in the United States. Now, how did the bond market read all this? Well, the bond market has pretty much said the same thing, interest rates are drifting higher, not lower, they are understanding that the impulse here is much more reflationary than deflationary, and of course as we've shifted from the tariff dialogue to the fiscal policy dialogue, that's become even more apparent. The establishment is doing everything it can to maintain high levels of nominal economic activity, higher for longer, that is the correct interpretation of both the economic fundamentals, and I think the outcome for both inflation and interest rates.

CHUCK JAFFE: It raises so many more questions, unfortunately we're out of time. Michael this has been great, I hope you will come back, and as we watch things play out, we can follow up with you and see again how you're positioning and repositioning and taking advantage of the situation as it changes. Thanks so much for joining me on The NAVigator.

MICHAEL GRANT: Yeah, it's always great, Chuck, and happy to be back. I'll sit here and wait for my next invitation.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and yeah, I am Chuck Jaffe and I'd love it if you'd check out my hour-long weekday podcast at your favorite podcast app or by going to MoneyLifeShow.com. To check out more information on closed-end funds, interval funds, and business-development companies go to AICAlliance.org, that's the website for the Active Investment Company Alliance. Thanks to my guest Michael Grant, co-chief investment officer and senior portfolio manager at Calamos Investments, head of long-short strategies for the firm and co-manager of the Calamos Long/Short Equity & Dynamic Income Trust, it's a closed-end fund that trades under ticker symbol CPZ. Get more information on Michael, the firm, and the fund at Calamos.com. The NAVigator podcast is new every Friday, make sure you don't miss an episode by subscribing or following along on your favorite podcast app. We'll be back next week with more closed-end fund fun, until then, happy investing, everybody.

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