

# PORTFOLIO COMMENTARY

THIRD  
QUARTER  
2009



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## Calvert Small Cap Value Fund

The Calvert Small Cap Value Fund (Class A shares at NAV) returned 14.31% for the quarter ended September 30, 2009. The Fund underperformed its benchmark, the Russell 2000 Value Index, which returned 22.70%.

### Market Environment

For the third quarter ended September 30, 2009, both the S&P 500 and the Dow Jones Industrial Average finished the quarter ahead, gaining more than 15%. The Russell 2000 Index had similar results, gaining 19%. Despite this, U.S. markets struggled throughout the last week of the quarter as a flurry of mixed economic data continued to come in, leading investors to fear a double dip. Merger and Acquisition activity is picking up, which is a positive sign that the economy continues to recover. Economic data also suggested a recovery in the housing market, as home prices for the 20 largest U.S. cities rose 1.6%. On the other hand, consumer confidence

for the month of September drove markets lower, coming in at 53.1, against the backdrop of a weak labor market. Despite the lack of confidence, consumer spending rose 1.3% in August—lifted primarily by auto sales sparked by the Car Allowance Rebate System program (Cash for Clunkers).

Perhaps the largest upset that ended September, and the third quarter, came from the latest round of jobless data. The unemployment rate (9.8% for September) continues to increase towards 10% as non-farm payrolls fell 263,000 in September, much worse than many economists expected. Initial weekly jobless claims also rose to 551,000, while continuing claims

### HISTORICAL FUND PERFORMANCE

Average Annual Total Returns as of 9/30/2009. Inception Date 10/1/2004.

CALVERT SMALL CAP VALUE FUND	QTR	YTD	1YR	3YRS	5YRS	10YRS	SINCE INCEPTION
A Shares at NAV	14.31%	17.74%	-9.48%	-6.30%	-1.16%	N/A	-1.16%
A Shares Max load of 4.75%	8.85	12.13	-13.78	-7.82	-2.12	N/A	-2.12
Russell 2000 Value Index	22.70	16.36	-12.61	-6.65	1.78	N/A	1.36

Source: Calvert Performance Analytics

Gross expense ratio: 1.88%. Net expense ratio: 1.69%. Performance data quoted already reflects deduction of fund operating expenses. Net expense ratio reflects contractual fee waiver and/or expense reimbursement through January 31, 2010.

The performance data quoted represents past performance, which does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance data quoted. An index reflects no deduction for fees or expenses. An investor cannot invest directly in an index. Visit [www.calvert.com](http://www.calvert.com) to obtain performance data current to the most recent month-end.



fell by 70,000 to 6.09 million as of the end of September. At the same time, 104,000 workers rolled into the extended unemployment benefits program which stands at 9.8 million workers as of the end of September. On a positive note, the final GDP report for the second quarter of 2009 did show a slight net upward revision as the economy shrank at an annual rate of 0.7%—the best performance in more than a year. However, reported real GDP has declined for four consecutive quarters through the second quarter of 2009.

In reviewing our market outlook from prior quarters of the year, and looking at the most recent quarter that just passed, we find that the economy has performed much better than anticipated. We previously stated that there is likely more pain to be felt in the U.S. financial sector and that we did not expect the recovery to come until late 2009 or early 2010. While the unemployment rate remains high, there have been some signs of a much faster recovery.

## **Portfolio Review**

### **Negative Contributors**

Fund holdings in the industrials, consumer discretionary, and financials sectors adversely impacted performance for the quarter. Specific stocks include The Brinks Co., Interface Inc., and Tesco Corporation. The Brink's Company, a leading provider of security services, has seen its share price decline on headwinds as a result of ongoing difficult conditions in Europe, Middle East and Africa (EMEA), a slowdown in the movement of gold and other precious metals (affecting the higher margin Global Services segment), and the adverse impact from the potential risk of the Venezuelan government deciding to devalue its currency. While we remain comfortable with the long-term intrinsic value of Brinks, we are monitoring the stock closely and have reduced the Fund's position somewhat to manage the near-term risk and reward potential relative to other opportunities.

Interface Inc., which engages in the design, production, and sale of modular carpet for commercial, institutional, and residential customers, has seen its share price decline on an overall weakness in the home furnishing sector over the past year due to the economic recession. While the U.S. carpet tile market is showing signs of sequential stabilization, Europe remains weak and Asia is just beginning to rebound. The impact of recently increased carpet prices by competitors adds further uncertainty as Interface does not believe that the market will support price increases. We believe that as the economy emerges from the downturn, Interface should be a beneficiary in the long term. Tesco Corporation, which engages in the design, manufacture, and service delivery of technology-based solutions for the upstream energy industry worldwide, has seen its share price decline on poor second quarter results based upon lower-than-expected activity and downward pricing pressure, which is not expected to subside anytime soon. Relatively depressed margins are likely to continue hurting Tesco with the company needing a return in utilization to see any sort of pricing power. As a result of these deteriorating business conditions, we decided to exit the Fund's position shortly after the end of the quarter.

### **Positive Contributors**

Fund holdings in the financials, industrials, information technology, and consumer staples sectors were some of the key contributors for the quarter. With respect to specific stocks, the Fund benefited from strong contributions by Phillips Van Heusen Co., Plexus Corp., Littelfuse Inc., and Treehouse Foods Inc. Phillips Van Heusen Co., a leading supplier of branded apparel stores and licensed merchandise, has seen its share price increase on an improved outlook for a challenging retail environment over the past year, particularly with depressed consumer spending trends following the height of the credit crises in the fourth quarter of 2008.

Despite the challenging retail environment, Phillips Van Heusen is starting to see an improved outlook for its moderate brands and improving traffic trends, which should benefit its stock price in the long term once there is a full economic recovery. Plexus Corporation, which provides design, prototype, test, and manufacturing services to the electronics industry, has seen its share price increase on strong bookings and low inventory despite soft end markets. Booking levels are expected to remain strong and Plexus is well positioned to benefit from potential incremental growth from its new mechatronics operations into 2010. Littelfuse, the world's foremost designer, manufacturer and marketer of fuses and other circuitry protection devices for the electronics and automotive industries, has seen its share price appreciate on better than expected quarterly results and on the strength of both its automotive and electronic business segments, which make up 85% of overall sales. Littelfuse continues to win new business, and the continued shift towards hybrid/electric vehicles should also increase demand for related circuit protection products. Treehouse Foods, Inc., a leader in private label pickles, condensed soups, salad dressings and other spreads, has seen its share price appreciate on strong sales volume in all four of its private label categories. We remain positive on Treehouse, which continues to execute well in a challenging economic environment.

## **Outlook**

The U.S. economy is at an inflection point. All of the policy actions and improvements in financial markets have set the stage for an economic recovery and a return to growth. Real GDP for the third calendar quarter of 2009 appears to be growing at about a 3% annual rate, following a decline of 0.7% (revised) in the second quarter. However, there are still some near term challenges, particularly for labor markets and the commercial real estate market. After a long period of high unemployment, consumers will need

to feel more confident about the job market before increasing discretionary spending again. Consumer confidence was little changed in August as reports indicated industries such as housing and manufacturing are stabilizing and the economy is on a path to recovery.

The Federal Reserve is holding short-term interest rates at the lowest levels in history—0% to 0.25%—even though the economy is showing signs of a recovery. On August 25, President Obama announced that he will reappoint Chairman Bernanke to another four-year term. Chairman Bernanke has succeeded in persuading most fellow economists and the market that continued low rates pose no immediate risk of inflation and are, in fact, essential to keeping the U.S. economy from suffering a double-dip, W-shaped recession.

However, there are key questions that remain unanswered: When will payrolls start growing again? How strong will job growth be? And when will the jobless rate begin to come down? Job growth in the current upturn will face a special set of headwinds, as lingering credit constraints and debt-burdened consumers limit growth. Businesses

continue to remain focused on cutting costs and maintaining high productivity. Therefore, businesses are likely to remain hesitant to hire as long as overall demand remains subdued, and that is almost certain to be the case in the near term.

Despite evidence that the worst is behind us, we believe that a sustained economic recovery will not occur until 2010, to be preceded by a market recovery as is already being demonstrated. In our view, the cyclical impact of the macroeconomic stimulus will overwhelm longer-term, secular concerns about massive budget deficits and inflation for the foreseeable future. As a result, investor cash on the sidelines will be put to work as other choices besides equities generally reflect anemic return opportunities. While the recovery underway may yield below average growth from a historical perspective, we believe that this type of environment will tend to favor quality companies in the coming months along with select cyclicals. As such, it is time to ensure that the Fund is positioned to participate in the ongoing recovery, which we believe is in the early stages when viewed from a historic perspective.

In this environment, we are closely reviewing the equity markets for other suitable opportunities as well as the Fund's holdings' exposure to risk and the prospects for recovery in the months to come. At the same time, we are encouraged, taking a longer-term view, as stock valuations in some areas remain attractive despite the run-up we saw during the second and third quarters of 2009. We believe that a focus on high quality business franchises as well as recovery plays should provide attractive opportunities amongst the rubble for long-term investors. In general, the companies in the Fund possess strong business and attractive cash flow characteristics, and in our opinion, are likely to weather and, in some cases, benefit from the impact of the recovering economy and volatile markets better than most. We are closely looking at new potential investment opportunities with similar characteristics given the uncertain market environment. ■

This commentary represents the opinions of its author as of 9/30/09, and may change based on market and other conditions. The author's opinions are not intended to forecast future events, guarantee future results or serve as investment advice.

As of September 30, 2009, Calvert Small Cap Value Fund's holdings included The Brinks Co. (2.44% of the portfolio), Interface Inc. (1.34%), Tesco Corporation (1.21%), Phillips Van Heusen Co. (3.72%), Plexus Corp. (3.28%), Littelfuse Inc. (3.33%), and Treehouse Foods Inc. (2.78%). Calvert may or may not still invest in, and is not recommending any action on, companies listed. For the most recently available information on individual holdings in each Calvert sustainable and responsible equity fund, visit [www.calvert.com](http://www.calvert.com). Current and future portfolio holdings are subject to market risk.

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