

# PORTFOLIO COMMENTARY

SECOND  
QUARTER  
2010



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## Calvert Short Duration Income Fund

Calvert Short Duration Income Fund (Class A shares at NAV) returned 0.75% for the quarter ended June 30, 2010, underperforming its benchmark, the Barclays Capital 1-5 Year U.S. Credit Index (the "Index"), which returned 1.29% for the quarter. The Fund's short duration<sup>1</sup> relative to the benchmark accounted for the bulk of its relative underperformance in the quarter.

### Market Review

During the second quarter of 2010, fears about sovereign credit risk, which started with Greece, spread significantly to include countries such as Spain and Italy. Starting in late April, these worries about contagion from the European debt crisis sparked a sell-off in riskier assets, such as corporate bonds, and a flight to quality. This triggered a jump in bond-market volatility, which reached a peak on May 6, the day of the "flash crash" in the stock market.

The Federal Reserve (Fed) kept the target for its benchmark federal funds rate near zero percent throughout the quarter as a way to help stimulate economic growth following the severe recession that started in late 2007. Economic data released during the quarter continued to show mixed signs about the strength of the recovery, raising some concerns about the risk of a "double-dip" recession.

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### HISTORICAL FUND PERFORMANCE

Average Annual Total Returns as of 6/30/10. Inception Date 1/31/2002.

| CALVERT SHORT DURATION<br>INCOME FUND         | QTR   | YTD   | 1YR   | 3YRS  | 5YRS  | 10YRS | SINCE<br>INCEPTION |
|-----------------------------------------------|-------|-------|-------|-------|-------|-------|--------------------|
| A Shares at NAV                               | 0.75% | 1.91% | 6.67% | 5.28% | 5.06% | N/A   | 5.97%              |
| A Shares Max load of 2.75%                    | -1.99 | -0.88 | 3.75  | 4.30  | 4.47  | N/A   | 5.62               |
| Barclays Capital 1-5 Yr.<br>U.S. Credit Index | 1.29  | 3.20  | 9.11  | 6.43  | 5.25  | N/A   | 5.15               |

Source: Calvert Performance Analytics

Gross expense ratio: 1.19%. Net expense ratio: 1.08%. Performance data quoted already reflects deduction of fund operating expenses. Net expense ratio reflects contractual fee waiver and/or expense reimbursement through January 31, 2011.

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. Indexes reflect no deductions 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.



While the economy as measured by gross domestic product (GDP) grew at a 2.7% annual rate in the first quarter of 2010, that pace was slower than historical economic growth rates after deep recessions. Also, the unemployment rate remained at 9.5% as of June, indicating that the economy is not creating many new jobs.

Despite their relatively low yields, Treasuries benefited from the flight to quality later in the second quarter. For example, the yield on the 10-year Treasury note dropped quickly from 3.83% to 2.93% over the course of the quarter. The three-month Treasury bill finished the quarter yielding 0.18%. The Treasury yield curve flattened somewhat, although it is still quite steep by historical standards. The yield difference between two-year and ten-year Treasuries, for example, dropped from 281 basis points<sup>2</sup> at the beginning of April to 233 basis points at the end of the quarter.

The other side of the flight to quality in the quarter was an increase in credit spreads<sup>3</sup> as investors generally sold off assets with any type of credit risk, including corporate bonds. For the quarter, the average credit spread on bonds in the Barclays Capital U.S. Credit Index of investment-grade bonds rose from 136 basis points to 179 basis points. The widening of credit spreads was even more pronounced for high-yield bonds during the quarter.

## Portfolio Highlights

The Fund underperformed the Index primarily as a result of its short duration relative to the Index during a quarter when interest rates dropped amid the flight to the safety of Treasuries. At the beginning of the second quarter, the Fund's duration was 1.01 years while the duration of the Index was 2.83 years. We continue to hedge the Fund's interest-rate duration through the use of various Treasury futures. In addition, it's a good idea to keep in mind that duration only measures interest-rate risk. We have been keeping the spread duration, which is a measure of credit risk, of the Fund about the same as that of the Index.

Another factor that contributed to the Fund's relative underperformance during the quarter was its holdings of high-yield corporate bonds. At the beginning of April, 9.42% of the Fund's net assets were in high-yield bonds. The Index does not include high-yield bonds. For the quarter, the BofA Merrill Lynch High Yield Master II Index returned -0.07%.

In terms of positive contributors to performance for the quarter, we were able to add incremental return by actively trading Treasuries and Treasury futures contracts. In addition, we positioned the Fund's Treasury holdings to benefit from a narrowing in the spread between two- and

ten-year Treasury yields, which took place to some extent over the course of the quarter. Since the yield curve is still quite steep relative to historical averages, we plan to maintain that positioning.

Particularly after the sell-off in assets with credit risk during the second quarter, we believe that selected corporate bonds offer good value, although rigorous analysis of individual issuers is more important than ever. We have been looking for opportunities to add to positions in specific corporates on price weakness as well as to actively trade around volatility in the corporate bond market. Also, we believe that some high-yield bonds, particularly those with relatively high credit ratings within the high-yield category, offer opportunities for price appreciation in addition to the income from their high coupon payments.

## Outlook

We expect the fragile economic recovery to continue with GDP growth that will likely be slower than the pace of past recoveries. Central banks around the world are continuing to maintain extremely accommodative monetary policies, which has generally kept interest rates very low by historical standards. Despite the flight to quality in the second quarter, these low rates have convinced some investors to take on more risk than they did during the financial crisis of 2008 and early 2009. This motivates us to be even more conservative in trying to limit both the Fund's credit risk and interest-rate risk as much as possible.

Treasury yields are also quite low by historical standards, and the further drop in Treasury rates during the second quarter makes it more likely that they will eventually rise to closer to historical norms. Given our outlook for rising interest rates, we plan to continue to keep the Fund's duration shorter than that of the Index. While we may gradually lengthen the Fund's duration as interest rates climb, we anticipate maintaining an overall duration strategy that is conservative and helps to offset interest-rate risk as much as possible. The Treasury Department continues to issue record amounts of new debt, and eventually the added supply may push yields higher.

We anticipate that the market's concerns about the credit quality of European sovereign debt will keep volatility levels relatively high in the financial markets in general. We will continue to actively trade Treasuries and Treasury futures, in particular, to try to take advantage of the volatility and generate incremental return. ■

1. Duration measures a portfolio's sensitivity to changes in interest rates. Generally, the longer the duration, the greater the change in value in response to a given change in interest rates.
2. A basis point is 0.01 percentage points.
3. Credit spreads measure the difference in yield between a corporate bond and a Treasury security with a comparable maturity.

This commentary represents the opinions of its author as of 6/30/10, 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.

Investment in mutual funds involves risk, including possible loss of principal invested. The Fund is subject to issuer default risk and interest rate risk, the risk that changes in interest rates will adversely affect the value of an investor's securities. When interest rates rise, the value of fixed-income securities will generally fall. The value of a futures contract tends to move in tandem with the value of the underlying instrument, can be highly volatile, and the potential loss from futures can exceed the Fund's initial investment in such contracts. The Fund is non-diversified and may be more volatile than a diversified fund. There is also a risk that the Fund's portfolio management practices might not work to achieve their desired result.

High-yield bonds involve a greater risk of default and price volatility than U.S. Government and other high-quality bonds. High-yield/high-risk bonds can experience sudden and sharp price swings, which will affect net asset value.

*For more information on any Calvert fund, please contact your financial advisor, call Calvert at **800.368.2748** or visit [www.calvert.com](http://www.calvert.com) for a free summary prospectus and/or prospectus. An institutional investor should call Calvert at **800.327.2109**. An investor should consider the investment objectives, risks, charges, and expenses of an investment carefully before investing. The summary prospectus and prospectus contain this and other information. Read them carefully before you invest or send money.*

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