New York Life
MainStay Investments®

December 2013

Top Five Municipal Market Insights for 2014

MacKay Shields
MacKay Municipal Managers™

The Year of After-Tax Returns

1. Municipal market supply and demand technical features provide relative price support in 2014

New issuance supply is expected to continue to decline toward all-time lows as municipalities increasingly find more favorable direct loan terms from banks. We anticipate that supply will not be able to fully replace the volume of bonds maturing and being called in 2014. As a result, the amount of bonds outstanding in the municipal market will recede for the third consecutive year. Additionally, we believe demand will rise throughout the year as: 1) baby boomers have officially begun transitioning toward retirement and are increasingly looking for tax-exempt income, 2) investors realize that higher tax rates on both earned and unearned income are increasing their tax burden, and 3) investors determine that the taxable-equivalent yields on municipal bonds exceed historical equity returns while still maintaining a very low default rate.

In summary, we believe there will be:

- Lower issuance
- Net negative supply
- Demand increase
  - Increased taxes hitting taxpayers in April still not priced into the market
  - Increased insurance company demand for attractive yielding investments

2. Local general obligation bonds outperform

Harrisburg and Detroit brought heightened focus on the state of local government finance. However, we believe the real news is that the credit profile of local governments throughout the United States will improve as property valuations rise, local sales and income taxes increase, and major reform of public employee pension plans accelerates. In addition, we expect that after resolving their own financial challenges, state governments will be able to budget larger state aid support to local governments. The market better understands the statutory issues that create differences in general obligation bonds from state to state. The one major credit that we believe may regress financially and, therefore, may be at risk for spread widening is New York City.

3. The municipal market refocuses on monoline insurance in secondary trading

As trading volatility of specific distressed credits, such as Puerto Rico, increases, we expect the market will reassess the value of bond insurance. As a result, we expect that municipal bonds wrapped by insurance will start to trade in much narrower spreads. A recovery in insured bond trading levels will be further supported as many insurance companies continue to improve their balance sheets. For example, successful litigation over representations and warranties associated with mortgage loans is being settled to the favor of the insurers, and the insurers' capital position is in a better position than dire projections predicted.

4. Lower investment-grade and high-yield municipal credits outperform

If interest rates move higher, we believe both lower rated investment-grade and high-yield municipal bonds will outperform high-quality intermediate bonds. We expect that in such an environment, the rebounding fundamentals of lower-rated paper will outpace the negative impact of higher rates. By contrast, we believe high-grade intermediate bonds should underperform as their price performance is negatively correlated to the overall direction of interest rates. In addition, their lower yields are quickly overshadowed by their price depreciation. When compared to their historic averages, lower investment-grade quality bonds, as well as high-yield municipal spreads, are currently at very attractive levels versus both tax-exempt and taxable alternatives.

5. Broker/dealer reduction in capital commitment to municipal bonds will continue to reduce market liquidity

The capital commitment started 2013 at over $50 billion and will end the year down over 50%, which is a 10-year low.[1] We believe even with the recent positive position on municipal bonds and the Volcker Rule, municipal capital commitment will remain very low due to many bank regulations and internal bank risk profiles. This low capital commitment will keep spreads between retail and institutional trades very wide to historical numbers. In addition, this will keep volatility at the higher end of the spectrum. These two conditions in combination can be exploited by active managers whom we believe will have a clear advantage in generating excess return when compared to passive managers, such as those that employ a buy and hold strategy or exchange traded funds (ETFs).[2]

1. Source: Federal Reserve, 2013.
2. Fees associated with active managers are greater than those charged by passive managers.

Before you invest

All mutual funds are subject to market risk and will fluctuate in value.

A portion of a municipal fund's income may be subject to state and local taxes or the alternative minimum tax. Funds that invest in bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. High-yield securities (sometimes called "junk bonds") are sometimes considered speculative because they present a greater risk of loss than higher-quality debt securities, may be less liquid, and can also be subject to greater price volatility. High-yield municipal bonds may be subject to increased liquidity risk as compared to other high-yield debt securities.

Municipal securities risks include the ability of the issuer to repay the obligation, the relative lack of information about certain issuers, and the possibility of future tax and legislative changes which could affect the market for and value of municipal securities. Such uncertainties could cause increased volatility in the municipal securities market and could negatively impact the Fund's net asset value and/or the distributions paid by the Fund. Securities purchased by the Fund that are liquid at the time of purchase may subsequently become illiquid due to events relating to the issuer of the securities, market events, economic conditions, or investor perceptions.

Bond ratings are evaluations of a bond issuer's financial strength, or its ability to pay a bond's principal and interest as agreed upon. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'C' ("junk"), which is the lowest grade.

Volcker Rule: Named after former Federal Reserve Chairman Paul Volcker, the Volcker Rule separates investment banking, private equity, and proprietary trading (hedge fund) sections of financial institutions from their consumer lending arms.

Past performance is no guarantee of future results.

Please call 800-MAINSTAY (624-6782) for a prospectus or summary prospectus. Investors are asked to consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus or summary prospectus contains this and other information about the investment company. Please read the prospectus or summary prospectus carefully before investing.

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July 2014

2014 Municipal Bond Market Insights: Mid-Year Update

Insights from: MacKay Shields — MacKay Municipal Managers™

MacKay Municipal Managers™ employs a relative-value investment approach across all of their municipal strategies, with a focus on total return. The team seeks to capitalize on opportunities created by the mispricing of securities and will move along the credit curve based on where they find the best relative value. An emphasis is placed on risk management, and they currently do not employ leverage, which can increase volatility. The team's active research-driven process and keen emphasis on risk control may benefit investors seeking attractive tax-free income.

Top Five Municipal Market Insights for 2014: The Year of After-Tax Returns

Theme	Rationale	Portfolio in Action	Mid-Year Status
1. Falling supply and rising demand provide strong technical support	Issuance is likely to fall in 2014 as austerity continues and direct loan terms from banks to municipalities become more favorable. Net negative supply will cause the market to shrink. Demand will rise as increased taxes hit individuals and insurance companies seek attractive yields.	We are looking for securities that we believe are going to outperform, regardless of what interest rates do. Supply in the 20+ year maturities has fallen the most, and the yield curve remains steep, so we are overweight longer issues.	**On Target:** With issuance even lower than expected, the market has revised its expectations of supply and market shrinkage. Surging institutional and retail demand has helped boost returns. The broad muni market returned 6% in the year to June 30. [1]
2. Local General Obligation (GO) bonds outperform	Local governments' credit profiles will improve amid higher property values, rising local taxes and accelerating reform of public employee pension plans. State government budgets will allow more support for local GO bond holders.	We have maintained an overweight position and continue to capitalize on exposure to local GO bonds.	**On Target:** Strengthening local government credit profiles and more support from state governments have supported local GO bonds, with local GOs returning 5.6%, versus 5.1% for state GOs. Special tax and lease back bonds returned 6.1% and 6.4%.[2]
3. Monoline-insured bonds make a comeback	The Detroit and Puerto Rico defaults will cause retail investors to focus more on insured paper. And insurers' balance sheets are strengthening, helped by successful litigation associated with mortgage loans.	We've had a significant overweight in monoline-insured paper this year, and retain our exposure.	**On Target:** We've seen more court victories and some high-profile credit rating upgrades for the monolines, and wrapped bond values have risen significantly.
4. Lower investment-grade and high-yield issuers outperform	If interest rates move higher, lower-rated (more credit-sensitive) munis will outperform higher-rated (more rate-sensitive) paper. Spreads on lower-rated munis ended 2013 at attractive levels, leaving plenty of room for capital appreciation.	We have a large overweight in credit-sensitive securities, continuing to capitalize on the still-attractive valuation of the market through deep credit analysis and a relative-value approach.	**On Target:** Credit-sensitive sectors outperformed significantly. By mid-year, BBB-rated munis were up 9.8%, and high-yield munis were up 7.5%.[3]
5. Market liquidity continues to diminish as broker/dealers reduce their capital commitment	Bank participation in the municipal market will remain low due to tighter regulation and internal bank risk profiles. This will keep spreads between retail and institutional trades wide by historical standards and keep volatility at the higher end of the spectrum.	This environment carries risks, but it gives active managers an edge over passive strategies, such as ETFs. It's important to be nimble. Our portfolios have liquidity of 3%-8% on any given day, and we avoid using leverage, as this can backfire at times of volatility.	**On Target:** Commitment of capital from banks to munis has dwindled from more than $50 billion in 2012 to just $9 billion by June 2014. Smaller managers, being more nimble than large ones, have a competitive edge in these conditions.

Past performance is no guarantee of future results, which will vary. It is not possible to invest directly in an index.

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[1] Source: Barclays, as of 6/30/14. The broad muni market is represented by the Barclays Municipal Bond Index, an unmanaged index that includes approximately 15,000 municipal bonds, rated Baa or better by Moody's, with a maturity of at least two years. Bonds subject to the Alternative Minimum Tax or with floating or zero coupons are excluded.

[2] Source: Barclays, as of 6/30/14. Local GOs is represented by the Barclays Municipal Local GO Index, a subset of the local general obligation bonds in the Barclays Municipal Bond Index. State GOs is represented by the Barclays Municipal State GO Index, a subset of the state general obligation bonds in the Barclays Municipal Bond Index. Special tax and lease back bonds' returns represent bonds with these qualities within the Barclays Municipal Bond Index.

[3] Source: Barclays, as of 6/30/14. BBB-rated munis represented by the Barclays Municipal BBB Index, a subset of BBB-rated bonds in the Barclays Municipal Bond Index. High-yield munis represented by the Barclays Municipal High Yield Index, a subset of BB- or below-rated bonds in the Barclays Municipal Bond Index.

Before you invest

Mutual funds are subject to market risk and will fluctuate in value.

A portion of the Fund's income may be subject to state and local taxes or the Alternative Minimum Tax. The Fund may invest in derivatives, which may increase the volatility of the Fund's net asset value and may result in a loss to the Fund. Funds that invest in bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner. The Fund may experience a portfolio turnover rate of over 100% and may generate short-term capital gains which are taxable.

Treasurys are backed by the full faith and security of the U.S. Government as to the timely payment of principal and interest when held to maturity.

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