Top 5 Municipal Market Insights for 2018

INSIGHTS SERIES Q1 2018
From MacKay Municipal Managers™

A YEAR OF RETURN AND RISK

We believe that tax reform and the implementation of new regulatory policies will present investment opportunities for municipal investors who are well-positioned, but will also present risks for those investors who fail to adjust to the new investment environment. The traditional approach of being a passive, intermediate maturity focused investor seeking income only is no longer suitable. We believe that tax reform will result in a structural shift in the municipal market. Historical patterns of issuance will change as will the instruments issued. Some investors will shift away from municipal bonds, while others will take on more prominent roles. Overall demand will likely increase. Concerns over limitations on earning tax-exempt income have been put to rest for likely the next several years. Likewise, we expect retirees, a growing demographic within the population, to continue to increase their exposure to fixed income and, more likely, municipal bonds. Investor demand for liquidity and better price transparency will favor rated bonds and diminish the value of non-rateds. Anticipating all of these changes, we believe an active, relative value approach based on fundamental research will prove to be the prudent approach going forward.

1 Taxable Municipal Issuance Accelerates

We expect taxable municipal issuance could double to ~ $60B annually. We believe that low rates, tight credit spreads and demand for yield should keep taxable municipal yields low. Issuers will likely refinance their higher cost tax-exempt debt with taxable municipal bonds, overcoming the elimination of tax-exempt financed advanced refundings by the 2017 tax reform act. The increased volume of taxable municipal bonds should broaden the investor base, increase liquidity, and provide attractive yield opportunities. Individual investors in high tax states where the top marginal rate is quickly reached may also find in-state taxable municipal bonds, still exempt at the state level, to be attractive.

2 High Yield Municipal Bonds' Outperformance Continues

We anticipate that favorable technical and improving fundamental conditions will result in tighter high yield municipal credit spreads and outperformance relative to investment grade municipal bonds. Tax reform will likely reduce tax-exempt issuance by 30%, while individual investor and mutual fund manager demand remains strong. We believe ongoing economic expansion and increasing tax revenues, especially excise taxes, should improve coverage ratios for dedicated tax bonds. Stronger credit fundamentals should result in tighter spreads as investor comfort with high yield increases. However, 2018 implementation of the SEC's rules governing liquidity risk for mutual funds and exchange-traded funds will likely result in the underperformance of non-rated municipal debt as the rule favors frequently traded bonds with published ratings and proven price transparency.

3 Intermediate Municipal Bonds Underperform

Low yields, interest rate sensitivity, correlation to Treasury yields, and curve flattening will, in our opinion, result in underperformance of higher quality intermediate municipal bonds. We anticipate that higher short-term yields and diminished demand from banks and property and casualty insurance companies will lead to a flatter curve. We believe that investors who reposition away from the high grade portion of the intermediate yield curve to invest in longer, more credit sensitive municipal bonds will experience a higher level of income. This is due to the higher yield on longer maturity bonds, a better return profile due to credit spread tightening and improved liquidity from owning bonds in a more favored portion of the market.

4 Tax-Exempt Municipal/Treasury Ratios Hit 20-Year Lows

We expect that Municipal/Treasury yield ratios will decline due to supply/demand technicals and improving fundamental conditions. As a result, we anticipate that tax-exempt municipal bonds will outperform Treasury bonds and other high-quality taxable bonds. We look to the 2017 tax law changes to increase demand for income exempt at both the federal and state levels and reduce tax-exempt supply. In high tax states, the relative outperformance of tax-exempt bonds will be particularly impactful.

5 Tax-Exempt Market Liquidity Declines

We believe that liquidity will decline and volatility will rise. Lower corporate tax rates will reduce the profitability of trading tax-exempt debt for broker-dealers, leading to a reduction in trading capital committed to the municipal market. As a result, they will likely redeploy capital into the taxable markets to generate trading profits. For capital still committed to the municipal market, we expect broker-dealers to prefer rated, liquid names as the capital cost of positioning non-rated paper will be prohibitive. As a result, non-rated bonds will trade primarily on an agency basis, where the broker will only transact with the seller and buyer simultaneously. We believe this will further reduce their liquidity and, most likely, value.

Definitions

Active management is the use of a human element, such as a single manager, co-managers, or a team of managers, to actively manage a fund's portfolio. Active management strategies typically have higher fees than passive management.

Advanced refunding enables an issuer to "refinance" and obtain the benefit of lower interest rates when their outstanding bonds that offer higher interest rates have not reached their callable date.

Before you invest

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. High-yield securities (commonly referred to as "junk bonds") are generally considered speculative because they present a greater risk of loss than higher-quality debt securities and may 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.

Credit ratings: Standard & Poor's rates borrowers on a scale from AAA to D. AAA through BBB represent investment grade, while BB through D represent non-investment grade.

ABOUT MACKAY SHIELDS

MacKay Shields specializes in taxable and municipal fixed income credit and less efficient segments of global equity markets where proprietary research and unique portfolio construction techniques can generate attractive client oriented outcomes. As of November 30, 2017, MacKay Shields had approximately $113 billion* in assets under management.

MACKAY SHIELDS

For more information about MainStay Funds®, 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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* Information related to assets under management reflects the addition of Cornerstone Capital Management Holdings LLC's investment teams that joined MacKay Shields on January 1, 2018.

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2018 Municipal Bond Market Insights: "A Year of Return and Risk" Mid-Year Update

July 2018

MACKAY SHIELDS
A NEW YORK LIFE INVESTMENTS COMPANY

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 in the mutual funds they manage, 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 2018 – "A Year of Return and Risk"

Theme		Rationale	Portfolio in Action	Mid-Year Status
1	**Taxable Municipal Issuance Accelerates**	We expect taxable municipal issuance could double to ~$60B annually. We believe that low rates, tight credit spreads and demand for yield should keep taxable municipal yields low. Issuers will likely refinance their higher cost tax-exempt debt with taxable municipal bonds, overcoming the elimination of tax-exempt financed advanced refundings by the 2017 tax reform act. The increased volume of taxable municipal bonds should broaden the investor base, increase liquidity, and provide attractive yield opportunities. Individual investors in high tax states where the top marginal rate is quickly reached may also find in-state taxable municipal bonds, still exempt at the state level, to be attractive.	While our mutual funds do not have direct impact in terms of material exposure to taxable municipal bonds, increased taxable municipal issuance leads to decreased tax-exempt municipal bond supply therefore contributing to positive technicals broadly. In select investment mandates where taxable municipal bonds are part of the investment guidelines, MacKay Municipal Managers seeks relative value opportunities in this segment of the market.	**Pending:** We believe issuers will likely refinance their higher cost tax-exempt debt with taxable municipal bonds since advance refundings in the tax-exempt market are no longer an option. While taxable municipal bond issuance is not currently on track to double in 2018, the market has observed an increase, if annualized, of ~20%.[1] We believe this will accelerate over time, particularly as the market observes more clarity in Washington DC related to infrastructure spending.
2	**High Yield Municipal Bonds' Outperformance Continues**	We anticipate that favorable technical and improving fundamental conditions will result in tighter high yield municipal credit spreads and outperformance relative to investment grade municipal bonds. Tax reform will likely reduce tax-exempt issuance by 30%, while individual investor and mutual fund manager demand remains strong. We believe ongoing economic expansion and increasing tax revenues, especially excise taxes, should improve coverage ratios for dedicated tax bonds. Stronger credit fundamentals should result in tighter spreads as investor comfort with high yield increases. However, 2018 implementation of the SEC's rules governing liquidity risk for mutual funds and exchange trades funds will likely result in the underperformance of non-rated municipal debt as the rule favors frequently traded bonds with published ratings and proven price transparency.	MacKay Municipal Managers increased exposure to credit within the investment grade portfolios that we manage to capitalize on attractive spreads and yield potential. Based on our view that high yield municipals would outperform in 2018, MacKay Municipal Managers recommended an overweight of 70% to investment grade and 30% to high yield municipals as a starting point for the average moderate investor. This represented a constructive view on high yield municipals since an 80% investment grade/20% high yield allocation indicates the team's neutral position. In July, 2018, the team updated the recommended allocation to 75% investment grade/25% high yield municipals maintaining a constructive, albeit tempered, view of high yield municipals.	**On Target:** Through June 30, 2018, year-to-date performance for the Bloomberg Barclays High Yield Municipal Bond Index was 3.66%, outperforming the Bloomberg Barclays Municipal Bond Index by 391 basis points, which returned -0.25% for the same period.[2]

NEW YORK LIFE INVESTMENTS

Top Five Municipal Market Insights for 2018 – "A Year of Return and Risk"

Theme		Rationale	Portfolio in Action	Mid-Year Status
3	**Intermediate Municipal Bonds Underperform**	Low yields, interest rate sensitivity, correlation to Treasury yields, and curve flattening will, in our opinion, result in underperformance of higher quality intermediate municipal bonds. We anticipate that higher short-term yields and diminished demand from banks and property and casualty insurance companies will lead to a flatter curve. We believe that investors who reposition away from the high grade portion of the intermediate yield curve to invest in longer, more credit sensitive municipal bonds will experience a higher level of income. This is due to the higher yield on longer maturity bonds, a better return profile due to credit spread tightening and improved liquidity from owning bonds in a more favored portion of the market.	For some time, MacKay Municipal Managers has largely avoided the intermediate, high-grade segment of the market within maturity ranges of 3 to 8 years. Instead, the team has actively managed an overweight position within longer, more credit sensitive municipal bonds as we seek a more compelling return profile for clients. That said, in cases where the yield curve flattens and credit spreads tighten, the team may gravitate down the curve and increase credit quality if we are no longer being compensated for this positioning.	**On Target:** On a year-to-date basis through 6/29/2018, the intermediate segment of the municipal market has underperformed an actively managed investment grade portfolio taking a barbelled approach with a focus on credit-oriented bonds. For example, and on a year-to-date basis through 6/29/2018, the MainStay MacKay Tax Free Bond Fund (MTBIX), has returned 0.73%[3] while the Bloomberg Barclays 5-10 Year Index has returned -0.36% during the same period.[4] The Fund's benchmark, the Bloomberg Barclays Municipal Bond Index, has returned -0.25%.[5]
4	**Tax-Exempt Municipal/ Treasury Ratios Hit 20-Year Lows**	We expect that Municipal/Treasury yield ratios will decline due to supply/demand technicals and improving fundamental conditions. As a result, we anticipate that tax-exempt municipal bonds will outperform Treasury bonds and other high-quality taxable bonds. We look to the 2017 tax law changes to increase demand for income exempt at both the federal and state levels and reduce tax-exempt supply. In high tax states, the relative outperformance of tax-exempt bonds will be particularly impactful.	Within MacKay Municipal Managers' investment process, the team seeks exposure on segments of the yield curve where the most compelling value is observed. This includes an assessment of municipal/ Treasury ratios across the yield curve. With this in mind, the team has largely avoided the intermediate segment of the curve, while taking a "barbelled' approach combining longer dated with maturities with primarily 1 to 3 year maturity bonds. This positioning could change periodically since it is driven by where we believe we can capture value at the time.	**Pending:** In early 2018, projections of low supply and high demand materialized, although rising rates caused 10 and 30-Year Municipal/Treasury yield ratios to rise as of 6/29/2018. At the same time, 5-Year ratios have declined thus far in 2018. MacKay Municipal Managers believes a decline in Municipal/Treasury yield ratios will accelerate in the second half of 2018. Yield Ratios – 5, 10, and 30 Year • As of 1/1/2018: 76%, 82%, and 93% respectively[6] • As of 6/29/2018: 73% , 86%, and 98% respectively[6]
5	**Tax-Exempt Market Liquidity Declines**	We believe that liquidity will decline and volatility will rise. Lower corporate tax rates will reduce the profitability of trading tax-exempt debt for broker-dealers, leading to a reduction in trading capital committed to the municipal market. As a result, they will likely redeploy capital into the taxable markets to generate trading profits. For capital still committed to the municipal market, we expect broker-dealers to prefer rated, liquid names as the capital cost of positioning non-rated paper will be prohibitive. As a result, non-rated bonds will trade primarily on an agency basis, where the broker will only transact with the seller and buyer simultaneously. We believe this will further reduce their liquidity and, most likely, value.	In a municipal market where bank and broker dealer committed capital and liquidity has declined since 2008, MacKay Municipal Managers believes liquidity management is an integral part of a prudent investment process. When managing "daily access" mutual funds, the team seeks to maintain liquidity on a "local level", by maintaining some cash, avoiding leverage, and carrying modest levels of non-rated bonds relative to many peers managing high yield municipal portfolios. This positions the team well to effectively navigate and potentially capitalize, particularly during steeper municipal market sell-offs and recoveries.	**On Target:** In light of lower corporate tax rates, banks and property and casualty insurance companies scaled back municipal purchases and were also net sellers in the first half of the year. As referenced in Insight 3, the intermediate maturity segment of the municipal market has underperformed due to this lack of buying from a consistent liquidity provider. Large broker dealers remain active in the secondary market, however, this activity has been heavily tied to recent underwritings while smaller regional broker dealer's activity in the secondary market has dropped significantly, also detracting from market liquidity.

1. J.P. Morgan

2. Bloomberg Barclays Municipal Bond Index and Bloomberg Barclays High Yield Municipal Bond Index, as of June, 2018

3. Morningstar – Performance As of 6/29/2018. **Returns represent past performance which is no guarantee of future results. Current performance may be lower or higher. Investment return and principal value will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Performance reflects a contractual fee waiver and/or expense limitation agreement in effect through 2/28/19, without which total returns may have been lower. This agreement renews automatically for one-year terms unless written notice is provided prior to the start of the next term or upon approval of the Board. Visit nylinvestments.com/funds for the most recent month-end performance. For standardized Fund performance, click the hyperlinked Fund name.**

4. Bloomberg Barclays Municipal 5-10 Year Index

5. Bloomberg Barclays Municipal Bond Index

6. MMD: Thomson Reuters as of January 1, 2018 and June 29, 2018

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

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