MainStay MacKay High Yield Municipal Bond Fund Class I MMHIX

Analysis

Courts risk in familiar and unfamiliar places.
By Alaina Bompiedi 9/12/2018

MainStay High Yield Municipal Bond is backed by a tenured team whose opportunistic credit-picking has helped the fund achieve chart-topping returns since its 2010 inception. But above-average expenses and a relatively small and less-experienced analyst bench hold the fund's Morningstar Analyst Rating to Bronze.

Most of the members of this muni team have worked together since their days at Merrill Lynch Investment Management in the 1990s. Co-CIOs John Loffredo and Bob DiMella are supported by four additional portfolio managers including Mike Petty, who dedicates his time to overseeing this fund and the group's high-yield investments more broadly. Their investment process starts with a broad thematic view, developed at the outset of each calendar year. That view guides the portfolio's sector biases and the team's fundamental bottom-up research. Valuation-driven, opportunistic trading ultimately dictates what goes into the portfolio and when.

Lately, that approach has led the team to find value in longer maturities and cheaply priced insured Puerto Rico and tobacco bonds. Such positions expose the fund to spread-widening in those credit-sensitive sectors, but the team has managed the fund's risks prudently. For example, it does not use leverage outright in the fund (instead preferring the occasional small position in leveraged closed-end funds) and treads lightly in less-liquid nonrated bonds. Still, the fund has shown a tendency to hold more long-maturity and lower-quality bonds than its typical peer, which can cause it to lag during sell-offs. Indeed, a bias toward longer-dated and lower-quality fare cost the fund more than 11% in 2013's taper tantrum from May through August.

The fund's since-inception performance has been outstanding. From April 2010 through August 2018, its trailing annualized return (7.8%) beat 95% of peers in the high-yield muni Morningstar Category and was the best on a volatility-adjusted basis (as measured by the Sharpe ratio). Still, the team's bold, contrarian bets aren't risk-free, and the fund has yet to experience a significant muni sell-off.

Process Pillar: Positive

This team blends thematic, macro, and bottom-up analysis to identify the best relative values it can find in the muni market. The team's broad market view, published every January, informs the fund's sector, state, and yield-curve positioning. Credit analysts vet each bond with bottom-up fundamental research, paying sharp attention to valuations. While not one to shy away from longer-maturity bonds and more-distressed municipalities like Chicago and Puerto Rico, the fund has thus far avoided major cataclysms by staying light in credit risk while keeping its duration within 10% of a 40/60 blend of the Bloomberg Barclays Municipal and High Yield Municipal indexes. Bold yet thoughtful risk-taking garners a Positive Process Pillar rating.

The fund invests at least 65% of its net assets in the mid- to lower echelons of the credit spectrum. Since 2013, the fund's allocation to bonds rated BBB and below and nonrated bonds has ranged from 65% to 80%, and stood at 78% in mid-2018 (right at the category average). Yet within that stake, the fund held more BBBs and CCCs and fewer nonrated issues (13% versus its typical peer's 24%). The team typically treads lightly in nonrated bonds, which tend to be less frequently traded and therefore less liquid.

Over the past few years, one of the team's more pronounced top-down views has been its emphasis on insured bonds across its muni fund lineup. Finding insurance-wrapped bonds to be frequently undervalued, the team has adapted that theme for this fund's high-yield focus. The fund holds a relatively heavy exposure to insured Puerto Rico bonds (about 6%), but that stake includes lower-quality insurers that the managers wouldn't hold in funds with a higher-quality mandate. As of June 2018, most of the fund's Puerto Rico stake was wrapped by insurance. The remaining slice that was not insured (about 2%) included bonds issued by the

Morningstar's Take

Morningstar Analyst Rating: Bronze

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Neutral
Price	Negative

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

Gold Silver Bronze Neutral Negative

Fund Performance

	Total Return %	+/- Category
YTD	3.24	2.44
2017	8.87	1.50
2016	1.53	0.63
2015	5.86	1.78
2014	17.80	3.94

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Children's Trust Tobacco Settlement and the Puerto Rico Aqueduct and Sewer Authority, both of which have continued to pay interest on their bonds.

Hospitals were the fund's single largest sector allocation at about 18% as of June 2018. That was just a hair smaller than the category average exposure of 20%. The team's concern about credit weakness in Medicaid expansion states led it to avoid certain states (Kentucky, for example) within this sector. The team also began to modestly taper its tobacco position to 13% from a high of 14.5% in 2016, but that stake was still higher than category average of 8%. Notably, the fund held 3.8% in bonds issued by California's Golden State Tobacco Securitization Authority, its largest concentration in a single issuer.

Performance Pillar: Positive

Since the fund's 2010 inception through August 2018, its returns outpaced just over 90% of peers in the high-yield muni category. It also outran the Bloomberg Barclays High Yield Municipal Index by 107 basis points with merely 30 fewer basis points of volatility over that same period. On a volatility-adjusted basis (as measured by Sharpe ratio), the fund's since-inception results are best-in-category, earning the fund a Performance Pillar rating of Positive.

Modest overweightings to lower-quality bonds increase the fund's vulnerability to credit spread widening. While that positioning can help when spreads tighten in favorable climates for credit risk, it can hurt when investors turn pessimistic. The fund hasn't yet faced an extended credit sell-off, though it has weathered two doses of interest-rate-driven volatility, first from May through August 2013 and again from August through December 2016. In both periods, funds with longer maturities and lower-quality holdings were at a disadvantage. During both periods, the fund suffered steeper losses than the category norm, down 11% in 2013's sell-off and 5.5% at the tail end of 2016. Overall, investors should be aware that the fund courts more volatility than most high-yield muni funds, and its style has yet to be tested through a period of sustained market stress.

People Pillar: Positive

Managers Bob DiMella and John Loffredo have worked together for more than two decades. They joined Merrill Lynch Investment Management's municipal bond team in 1993 and remained with the firm through BlackRock's acquisition of it in 2006 until they started their own firm (Mariner Municipal Managers) in 2007. In 2009, MainStay brought the team over to run its muni-bond platform at MacKay Shields. The team's other four portfolio managers--Mike Petty, David Dowden, Scott Sprauer, and Frances Lewis (named as a manager in 2017)--all made the transition from MLIM to MacKay Shields. The managers' experience and long working relationship earn this fund a Positive People Pillar rating.

Loffredo is the lead manager in charge of portfolio construction; the other four managers have specific credit specializations, and Lewis continues to run the five-person analyst team, whose experience ranges from one to six years. The analysts provide credit research but can also initiate buy and sell calls. Trader John Lawlor and risk analyst Joanna Ng round out the team. Research and trading are collaborative efforts, and all contribute to the group's annual market outlook.

This team manages four additional municipal strategies for MainStay--Tax Free Bond MTBAX, California Tax Free Opportunities MCOIX, New York Tax Free Opportunities MNOAX, and Short Term Municipal MSTIX.

Parent Pillar: Neutral

MainStay is the retail investment brand of New York Life Investment Management, itself the asset-management arm of insurance company New York Life. MainStay's expansive mutual fund lineup is managed by NYLIM's investment professionals and subsidiaries, including fixed-income specialist MacKay Shields, global equity shop Candriam, Australian equity group Ausbil, and more recently, U.S. exchange-traded fund specialist IndexIQ. NYLIM also uses subadvisors, such as Epoch and Winslow, the latter of which runs MainStay's largest offering, MainStay Large Cap Growth. NYLIM has grown mostly through acquisitions and distribution partnerships.

NYLIM's boutiques tout that the parent allows them to operate with autonomy. In 2017, MacKay Shields Municipal Managers--one of the stronger boutiques under the NYLIM umbrella--was able to open a second office in Los Angeles to serve its growing base of California clients.

Yet, NYLIM's track record as a parent has some blemishes. The firm acquired long-short equity manager Marketfield in 2012, whose flagship fund, MainStay Marketfield, swelled to over $20 billion in assets by 2014, partly because of a strong sales push from MainStay. Asset bloat impeded performance, and the firms ended their relationship in early 2016. And while NYLIM grants its boutiques some independence, it merged Cornerstone into MacKay Shields in 2018. Overall, MainStay earns a Neutral Parent rating.

Price Pillar: Negative

Close to two thirds of the fund's assets are held in the I share class; its 0.62% prospectus net expense ratio, excluding interest expense and other investment-related costs, is about average for institutional share classes in the high-yield muni category. A fourth of the fund's assets are held in the A share class; its 0.87% expense ratio is above the average of its distribution group. The remainder of the fund's assets can be found in the C share class, whose 1.65% fee is higher than most level-load high-yield muni funds. On the whole, most of the fund's assets have fees that are higher than their distribution averages, resulting in a Price Pillar rating of Negative.

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MainStay MacKay High Yield Municipal Bond Fund - Class A and Class I shares
Standardized Performance (Period ended 9/30/18)

Symbol (Inception)		**1 Year**	**3 Years**	**5 Years**	**Since Inception**
Class A MMHAX (3/31/10)	*(NAV)*	4.71%	5.79%	7.32%	7.42%
Class A MMHAX (3/31/10)	*(max. 4.5% load)*	0.00	4.18	6.34	6.84
Class I MMHIX (3/31/10)	*(no load)*	4.97	6.03	7.59	7.67

Total annual operating expenses are: Class A: 0.88% and Class I: 0.63%. Net annual operating expenses are: Class A: 0.87% and Class I: 0.62%.

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 2/28/18, without which total returns may have been lower. This agreement shall renew 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 mainstayinvestments.com for the most recent month end performance. Average annual total returns shown include the change in share price and reinvestment of dividends and capital gain distributions. Class I shares are generally available only to corporate and institutional investors.

The Bloomberg Barclays Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. An investment cannot be made directly into an index. Past performance is no guarantee of future results.

Credit Ratings: S&P rates borrowers on a scale from AAA to D. AAA through BBB represent investment grade, while BB through D represent non-investment grade.

Duration, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates.

Taper tantrum refers to the 2013 surge in U.S. Treasury yields, due to the Federal Reserve's use of tapering to gradually reduce the amount of money it was putting into the economy.

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Morningstar Analyst Rating Spectrum: *Gold:* Best-of-breed fund that distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. *Silver:* Fund with notable advantages across several, but perhaps not all, of the five pillars—strengths that give the analysts a high level of conviction. *Bronze:* Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating. *Neutral:* Fund that isn't likely to deliver standout returns but also isn't likely to significantly underperform, according to the analysts. *Negative:* Fund that has at least one flaw likely to significantly hamper future performance and that is considered by analysts an inferior offering to its peers.

Before you invest

Before considering an investment in the Fund, you should understand that you could lose money. A portion of the Fund's income may be subject to state and local taxes or the alternative minimum tax. Investing in below investment grade securities may carry a greater risk of nonpayment of interest or principal than higher-rated bonds. The Fund may invest in derivatives, which may increase the volatility of the Fund's NAV 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.

For more information about MainStay Funds®, call 800 -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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