

Subadvised by: **MacKayShields**

### MainStay High Yield Opportunities Fund

The big story of the second quarter of course was the European debt crisis, which developed seemingly overnight in April when it became apparent that the nation of Greece was virtually insolvent. The impact of this crisis on global financial markets was severe. Although U.S. high yield was able to hold on to gains in April, May saw a serious setback, with the broader market down over 3%. Indeed, the 554 basis point spread at which the market closed on April 20<sup>th</sup> turned out to be the tightest of the period. Even with a modest rally in June, spreads still ended the quarter at over 700 basis points, taking the market back to spread levels last seen in late 2009. While investors rather quickly concluded that Germany, France, and the European Central Bank would not permit the European Union or the Euro to unravel, and would follow in the footsteps of the U.S. Federal Reserve to take whatever steps were necessary to prevent an overall financial collapse, the longer-term impact on global growth and confidence was less certain. As these uncertainties settled over the market in May and June, the sustainability of the recovery was called more frequently into question, and fears of a "double dip" recession seemed to dominate the market and investor confidence. In this environment, risk assets suffered; CCC and lower rated bonds trailed the broader market substantially in May and June, most notably with a 5.7% loss in May. While there was some positive economic news during the quarter, including decent GDP growth in the first quarter, generally speaking the data was insufficiently positive to inspire a genuine renewal of confidence. The market was particularly disappointed in U.S. employment reports in May and June, with the implications of fiscal austerity measures in Europe, and with the prospect of slower growth in China. The on-going oil spill in the Gulf of Mexico, while expected to have only a modest economic impact, also contributed to negative market sentiment.

With the loss in May, the high-yield market finally broke its remarkable 14-month run of positive returns, and market tone and technicals deteriorated. Retail mutual fund flows turned negative in May, wiping out the inflows from earlier in the year, while high yield new issuance, which had been robust through April, slowed to a trickle as the second quarter ended. The best-performing sectors for the period were health care, consumer cyclicals, and automotive. The laggards for the period were banking, technology, and insurance.

The Fund's performance was mixed for the period, but generally slightly trailed benchmark returns. This was primarily the result of our beta<sup>1</sup> being slightly above the benchmark, and an above market weight in financials. The most significant positive contributors to performance were Continental, Harsco, United Rentals, Icahn, and Novelis. The most significant laggards were Colt Defense, Hornbeck Offshore Services, Helix, Teekay, and Geokinetics.

We continue to be comfortable with our positioning and there have been no material adjustments in terms of beta or sector allocations in the past quarter. During the period, we initiated a capital structure arbitrage<sup>2</sup> in the securities of Anadarko Petroleum. As would be expected, when the new issue market slowed, so did our participation in the primary market.

We intend to maintain our current positioning. Apart from the break up of the Euro, none of the threats to world economic growth that have been promoted seem to be high probability events. In summary, we believe low interest rates will cause a sluggish recovery,

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<sup>1</sup> Beta is a measure of historical volatility relative to an appropriate index (benchmark) based on its investment objective. A beta greater than 1.00 indicates volatility greater than the benchmark's.

<sup>2</sup> Capital structure arbitrage is a strategy aimed to exploit the pricing inefficiency that exists in the capital structure of the same firm. For example, one could go long the high yield bond and short the stock of a company to hedge the equity risk component of the high yield bond.

just as it did in 2002, and that high yield will be an attractive investment option. Currently, we do not see any significant credit bubbles and on balance, we are more concerned that growth accelerates than it collapses.

### About Risk

Short sales involve costs and risk. If a security sold short increases in price, the Fund may have to cover its short position at a higher price than the short sale price, resulting in a loss. Because the Fund's loss on a short sale arises from increases in the value of the security sold short, such loss is theoretically unlimited. When borrowing a security for delivery to a buyer, the Fund also may be required to pay a premium and other transaction costs, which would increase the cost of the security sold short. By investing the proceeds received from selling securities short, the Fund is employing a form of leverage, which creates special risks. The use of leverage may increase the Fund's exposure to long equity positions and make any change in the Fund's NAV greater than it would be without the use of leverage. This could result in increased volatility of returns. The Fund may experience a portfolio turnover rate of over 100% and may generate short-term capital gains which are taxable. High-yield securities ("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. Funds that invest in bonds are subject to interest-rate risk and can lose principal value when interest rates rise.

Foreign securities may be subject to greater risks than U.S. investments, including currency fluctuations, less liquid trading markets, greater price volatility, political and economic instability, less publicly available information, and changes in tax or currency laws or monetary policy. These risks are likely to be greater for emerging markets than for developed markets. 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.

*MainStay High Yield Opportunities Fund top 10 holdings as of June 30, 2010: GMAC, Inc., 8.00%, due 11/1/31 (1.9% of Fund), Motors Liquidation Co., 8.38%, due 7/15/33 (1.6%), Sprint Nextel Corp., 8.38%, due 8/15/17 (1.6%), Freescale Semiconductor, Inc., 9.25%, due 4/15/18 (1.5%), Linn Energy LLC/Linn Energy Finance Corp., 8.63%, due 4/15/20 (1.5%), HCA, Inc., 6.50%, due 2/15/16 (1.4%), Anadarko Finance Co., 7.50%, due 5/1/31 (1.3%), Energy Future Holdings Corp., 12.00%, due 11/1/17 (1.2%), Hertz Holdings Netherlands BV, 8.50%, due 7/31/15 (1.1%), and Delta Air Lines, Inc., 12.25%, due 3/15/15 (1.1%).*



Please contact your investment professional for a free 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 and summary prospectus contains this and other information about the investment company. Please read the prospectus or summary prospectus carefully before investing.

[mainstayinvestments.com](http://mainstayinvestments.com)

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