

Subadvised by: **MacKayShields**

MainStay Tax Free Bond Fund

Fund Review

MainStay Tax Free Bond Fund posted performance slightly above its benchmark, the Barclays Municipal Bond Index, for the quarter ended June 30, 2010. Sovereign credit concerns and negative news stories questioning the viability and creditworthiness of municipal issuers weighed on all but the safest credits as investors purchased higher-quality, shorter-maturing bonds as a safe haven during the month. The Fund's overweight position in longer-maturing bonds with a call option, as well as investments in A and BBB rated securities, contributed to its outperformance. An underweight position in pre-refunded bonds and bonds maturing in seven years or shorter detracted from the Fund's performance for the quarter.

We continue to have a bias towards revenue bonds and are finding attractive opportunities in the essential service sectors, which includes hospitals and transportation credits. On a state level, California, New Jersey, and Florida are among the top states in the Fund. We have a neutral weight in California, relative to the Index, and are overweight New Jersey and Florida. New Jersey and Florida have balanced their respective budgets and made some difficult decisions to bring their budgets in line. Additionally, there have been some attractive relative trading opportunities in both states.


We continue to believe that the current structure of the portfolio with an emphasis on those higher-yielding, longer-maturing securities will prove prudent in the next few quarters as demand is expected to increase due to limited supply, the expectation of higher tax rates, and a perceived low interest rate environment.

Outlook

The month of June represents the end of the fiscal year for most municipal governments. At the fiscal year-end, state governments in all but two states (California and New York) were able to balance their budgets and eliminate a collective \$89B gap in their 2011 budgets with major expenditure cuts, tax increases and, in some cases, one-time fixes. Budgets were further strained by the loss of federal funding through the American Recovery and Reinvestment Act (ARRA) and the possible non-extension of Federal Medicaid reimbursement. State and local governments' unfunded pension liabilities remain at the forefront of budget negotiations. Many governments continue to pursue and succeed with contribution level, age requirement, and cost-of-living-increase reforms which will begin to lower government obligations in future years' budgets.

The outlook for the municipal market remains balanced between positive technicals and the perception of negative fundamentals. From a technical standpoint, factors impacting supply and demand point to better prices. We expect that Build America Bond (BAB) issuance will continue to reduce tax-exempt issuance leading to a shrinking outstanding supply of tax-exempt bonds. The extension of the BAB program as part of the Tax-Extender Bill has been delayed in Congress after passage in the House. The ultimate status of the BAB program will potentially affect valuation and issuance patterns through the remainder of 2010. On a positive note, the Rockefeller Institute reports that state revenues increased 2.4% in first quarter 2010 from the previous year. The municipal market outlook is also very closely tied to legislative (in)action regarding Federal Medicaid reimbursement, extension of the BAB program, and, on the state level, continued efforts to rein in budget deficits.

Looking forward, we feel that the attractiveness of municipals, on an absolute and relative basis when compared to Treasury bonds, will result in strong performance through the second half of this year. Additionally, large coupon payments, bond calls, and bond maturities in the months of July and August should buoy the market. A significant portion of the money is expected to be deployed



back into municipal bonds amidst a reduced supply of long-term issuance as the BAB program's 35% subsidy has allowed issuers to borrow more cheaply in the taxable market than the tax exempt. We also believe that rising tax rates in 2011 due to the expiration of the 2001 & 2003 Bush tax cuts should result in increased demand as municipals remain one of the last tax shelters available to individual investors.

The opinions expressed are those of MacKay Municipal Managers™ Team of MacKay Shields' John Loffredo and Robert DiMella, managers of MainStay Tax Free Bond Fund, as of the date of this report and are subject to change. This is no guarantee that any forecast made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. MacKay Shields is a federally registered advisor and an affiliate of New York Life Investment Management LLC.

Barclays Capital Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. The index is composed of approximately 60% revenue bonds and 40% state government obligations. For comparison purposes, the index is fully invested, which includes the reinvestment of income. The returns for the index do not include any transaction costs, management fees or other costs.

Build America Bonds (BAB) are taxable municipal bonds that carry special tax credits and federal subsidies for either the bond issuer or the bondholder. BABs

A portion of the Fund's income may be subject to state and local taxes or the alternative income 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.



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

mainstayinvestments.com

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