Perspectives

Portfolio Resiliency in a Volatile World: Shareholder Yield Strategy

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Key takeaways

- A resilient portfolio captures the most stable sources of return to quickly recover from declines
- There are three drivers of profit from stock ownership: dividends, change in earnings and change in P/E multiple
- Dividends and earnings have consistently driven the vast majority of equity market returns
- Portfolios that focus on high dividend paying companies tend to experience less volatility
- The Global Shareholder Yield strategy focuses on companies which return capital to shareholders up front, and as a result has historically experienced less volatility and recovered more quickly from downturns than the broader market[1]

[1] There is no assurance that the fund's investment objectives can be met.

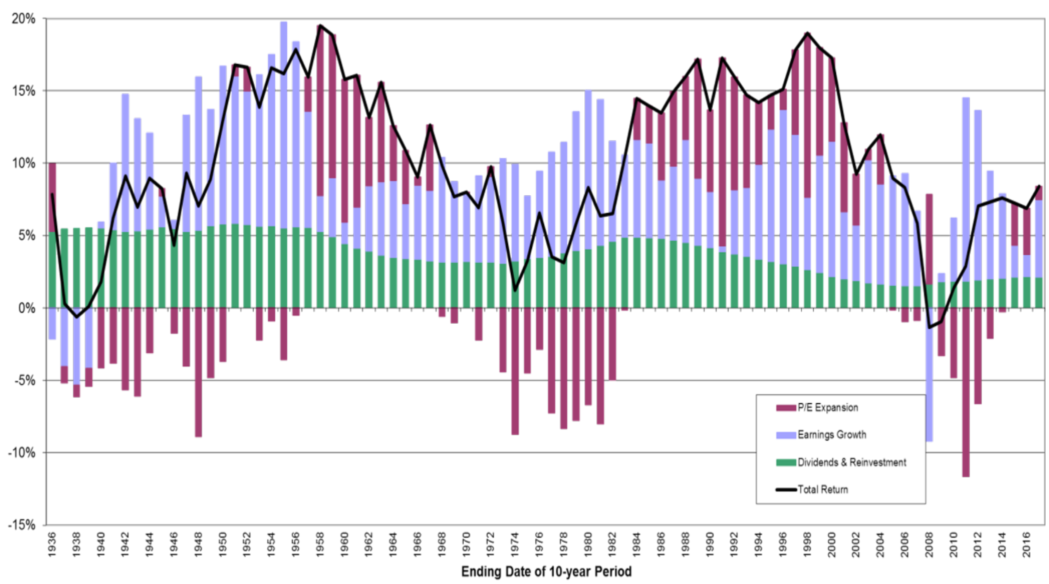
What does "resilient" mean? Applied to physical things, it indicates something's ability to return to its original shape after being stretched, compressed or otherwise altered. When used to describe a person, it means one who is able to recover quickly from a setback. So what does "resilient" mean in the context of an equity portfolio? Beyond recovery and return to normalcy, consider also these synonyms: hardy, tough, strong. Bringing these all together, we define a resilient portfolio as one with a robust investment process focused on capturing the most stable sources of return, and which as a result can recover from declines more quickly than the broader market.

A robust investment process ...

There are essentially two ways to make money through stock ownership: via dividends or price increases. If we consider a stock's price to be its earnings times its price/earnings (P/E) multiple, then we can further break down a change in price as the product of any changes in both earnings and the P/E multiple. More simply put, there are three drivers of profit from stock ownership: dividends, change in earnings and change in P/E multiple.

Figure 1: Components of Equity Returns

Components of Compound Annual Returns for Trailing 10-Year Periods
***S&P 500 Composite 1936–2017** (without combined effects)*



Source: Epoch Investment Partners Inc.; Standard & Poor's; as of 12/31/18.

Note: We use U.S. historical data as a proxy for global markets because similarly detailed data is not available for non-U.S. markets. **Past performance is not indicative of future results.** An investment cannot be made in an index.

Figure 1 shows the contribution of these components to the total return of the S&P 500 Index dating back to the 1930s. Dividends have been a positive contributor in all 82 rolling 10-year periods, and earnings have contributed positively in all but five[2]. It is the change in P/E multiple that has been the most unpredictable in determining when stocks perform particularly well, as they did in the 1980s and 1990s, and when they perform poorly (such as the 1970s).

These swings in valuation multiples are driven by several factors. Interest rates play a role, as does investor sentiment. When investors are optimistic about the future, their expectation of future cash flows – and subsequently their estimation of a company's worth – will be higher. Thus, the price they are willing to pay will be greater relative to today's earnings – i.e., a higher P/E multiple. Conversely, when investors grow pessimistic about the future, expectations for future cash flows, business valuations and P/E ratios will decline.

The key is determining which companies are most at risk for these changes in valuation multiples. Suppose ABC Inc. is a well-established, relatively stable company generally unaffected by swings in the economy. As a result, earnings are expected to grow at a modest but steady rate over the next few years. ABC has paid a consistent, and even increasing, dividend, even in recessions. Meanwhile, XYZ Ltd., a recently formed company in a relatively new industry, is developing a product with explosive growth potential, but also very real loss potential, if the product fails to meet expectations or the company cannot attract enough new business. Which company's price is more sensitive to changes in sentiment, and hence to changes in valuation multiples? It seems quite likely that XYZ will experience greater fluctuations in its valuation multiple than ABC. Not only is XYZ's outlook much more uncertain, but ABC's reliable annual dividends decrease the likelihood of a future negative change in investor sentiment.

[2] You may note that the contribution from dividends begins to decrease in the early 1990s, which can be attributed to earlier regulatory changes which made share buybacks an attractive and tax-efficient alternative to cash dividends. As companies began to make increasing use of this method for returning cash to shareholders, and because buybacks reduce outstanding share count and drive up earnings per share, some of the previous contribution of dividends shifted to that of earnings. We view dividends and buybacks as equivalent though, constituting two of the three possible "shareholder yield" uses of free cash flow (the third being debt reduction).

In fact, as Figure 1 shows, swings in P/E ratios have virtually netted out over the long term, yielding a less than 1% contribution to the S&P 500's cumulative return over the past 80 years – and while there have been periods where changes in P/E ratios have contributed greatly to positive market performance, they have also proven virtually impossible to predict in the short term. Rather, dividends and earnings have consistently driven the vast majority of equity market returns.

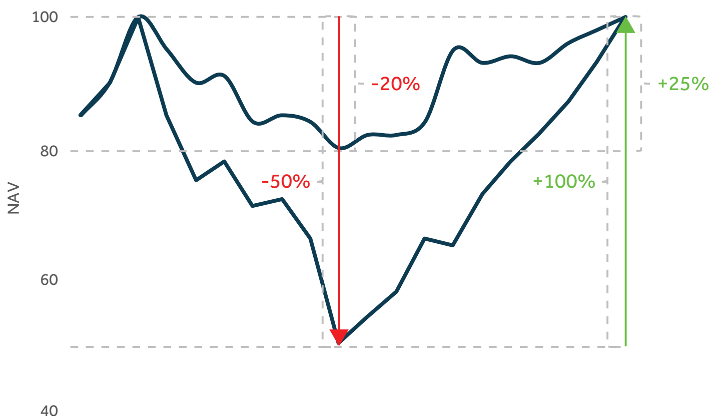
> *The lesson to us is clear: a resilient investment process is one that focuses first and foremost on the most stable driver of return – dividends – and then on what makes those dividends possible and sustainable: steady growth in cash flow.*

… that can recover quickly from a setback

As a result of our focus on high dividend paying companies, the stocks we own tend to experience less volatility than the market; there is less uncertainty around the total return generated by these companies over time, which is reflected in their price movements. Additionally, our portfolio construction process mitigates volatility by diversifying the sources of return, prohibiting any individual stock from contributing a disproportionate share of the portfolio's dividend yield or cash flow growth.

Why is low volatility important? Consider the apocryphal "law of holes" – namely, when you find yourself in a hole, stop digging. It would also stand to reason that since shallower holes are easier to climb out of, if you must be in one then better it be shallow. What does this have to do with investing? Consider the magic of compounding: if a portfolio loses 50% from peak to trough, then it must rise 100% to return to the peak. But if the loss was limited 20%, it would only need to gain 25% of the new total to recoup **(Figure 2)**. Indeed, a shallower hole is easier to climb out of.

Figure 2: The Magic of Compounding



When the broad market falls drastically, it is difficult for even the best manager to generate a positive return. A resilient equity portfolio is one that drops less than the overall market in periods of decline, and can therefore return to positive territory more easily, and likely more quickly, when stocks rise again.

Global Shareholder Yield: A Resilient Equity Strategy

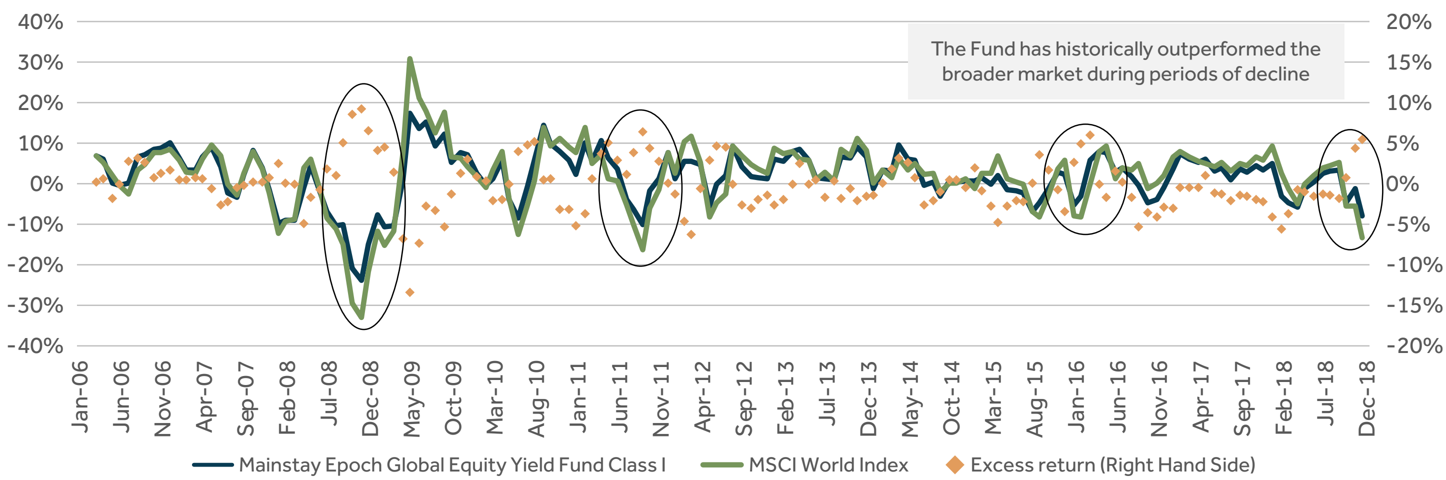
Epoch's Global Shareholder Yield strategy offers a resilient approach to equity investing in uncertain times. Our process focuses on the most stable driver of equity returns: actual payouts to shareholders, either in the form of cash dividends or stock buybacks. To ensure payouts are sustainable, we actively manage the portfolio, seeking to eliminate companies whose current high payouts are likely to be cut.

> *By focusing on companies that return capital to shareholders up front, we construct a portfolio that experiences less extreme swings on both the upside and the downside, and which is able to recover more quickly from market downturns.*

Figure 3 shows the rolling three-month returns for the strategy's Global Equity Yield Fund. During the 47 periods since inception in which the MSCI World Index saw a decline, the Fund outperformed in 38 of them, or 81% of the time, with average outperformance of 3.56%. In periods of considerable market decline, where the Index fell 5% or more, the Fund outperformed 24 out of 25 times (96%) by an average of 4.07%.

Figure 3: Global Equity Yield Fund Performance

MainStay Epoch Global Equity Yield Fund vs. MSCI World Index, rolling 3-month returns since inception



Source: Morningstar, as of 12/31/18.

Past performance is not indicative of future results. An investment cannot be made in an index. I shares are only available for institutional investors.

Average Annual Total Returns

(As of December 31, 2018)

MainStay Epoch Global Equity Yield Fund				
Share Class	**1 year**	**3 years**	**5 years**	**10 years**
Class A (NAV)	-9.43%	4.15%	2.68%	8.48%
Class A (max. 5.5% load)	-14.41%	2.20%	1.53%	7.86%
Class I (no load)	-9.25%	4.38%	2.94%	8.71%

Fund inception: 12/27/2005; Class A inception: 8/2/2006

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-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.

Total annual operating expenses are: Class A: 1.14%, Class I: 0.89%. Net annual operating expenses are: Class A: 1.09%, Class I: 0.84%.

Average annual total returns include the change in share price and reinvestment of dividends and capital gain distributions. Effective after the close of business 11/13/09, Epoch Global Equity Shareholder Yield Fund was reorganized as MainStay Epoch Global Equity Yield Fund. Performance for Class A and I shares reflects the performance of the Class P and Institutional Class shares, respectively, of Epoch Global Equity Shareholder Yield Fund (which was subject to a different fee structure) adjusted to reflect sales charges, but not fees and expenses; absent these adjustments, performance may have been lower. Class I shares are generally available only to corporate and institutional investors.

Before You Invest:

Before considering an investment in the Fund, you should understand that you could lose money.

The principal risk of investing in value stocks is that the price of the security may not approach its anticipated value. Investing in smaller companies involves special risks, including higher volatility and lower liquidity. Investing in mid-cap stocks may carry more risk than investing in stocks of larger, more well-established companies. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks. These risks may be greater for emerging markets.

Dividends fluctuate and are subject to change. There is no guarantee they will continue to be paid. While dividends may cushion returns in down markets, investments are still subject to loss of principal amount invested.

Morgan Stanley Capital International (MSCI) World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed markets. **Standard & Poor's (S&P) 500 Index** is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. It is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

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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