Combined March/April 2015

MainStay Marketfield Fund

Fund Overview

Objective

The investment objective of the Fund is capital appreciation.

Strategy & Process

The Fund has a broad investment charter that allows it to utilize equity securities, fixed-income instruments, commodities, futures, and options. Additionally, with respect to 50% of the Fund's net assets, the Fund may engage in short sales of securities to profit from an anticipated decline in the price of the security sold short. The use of short selling could result in increased volatility of returns.

Fund Facts

Fund Statistics

CUSIP:	Class A: 56064B878
	Class I: 56064B852
	Class R2: 56064B845
Inception Date	7/31/07
Benchmark	S&P 500 Index
Net Assets	$6,411 M
Number of Holdings	92

Top Ten Long Holdings (Excluding Cash) (As of 03/31/15)

HSCEI Index April 2015 Futures* China	5.7%
iShares Russell 2000 ETF	5.1%
iShares China Large-Cap ETF	3.5%
iShares MSCI Japan Index ETF	2.4%
Bank of China, Ltd. Class H	2.2%
Merlin Properties Socimi SA (Spain)	2.0%
Kennedy Wilson Europe Real Estate Plc UK	1.9%
iShares MSCI Hong Kong Index ETF	1.9%
Facebook Inc. Class A	1.8%
SPDR S&P Homebuilders ETF	1.6%
TOTAL:	28.1%

Portfolio Allocation (As of 03/31/15)

Equity Long	79%
Equity Short	-12%
Equity Index Futures Long*	6%
Equity Index Futures Short*	-10%

Option delta not reflected.
**Notional Value*

Fund Performance

Quarterly Average Annual Total Returns as of 3/31/15

	Tickers	YTD	One Year	Three Years	Five Years	Inception
Class I (07/31/2007)	MFLDX	-0.18%	-10.84%	2.85%	4.82%	6.60%
Class A (Max. 5.5% load) (10/05/2012)	MFADX	-5.73%	-15.98%	0.70%	3.39%	5.56%
Class A (NAV) (10/05/2012)	MFADX	-0.25%	-11.09%	2.62%	4.57%	6.34%
Class R2 (10/05/2012)	MFRDX	-0.31%	-11.22%	2.47%	4.44%	6.22%
HFRI Macro Discretionary Thematic Index (12/31/2007)	N/A	1.75%	0.35%	0.37%	0.46%	0.53%
S&P 500® Index (07/31/2007)	N/A	0.95%	12.73%	16.11%	14.47%	7.00%

Performance data quoted represents past performance. Past performance is no guarantee of future results. Due to market volatility, current performance may be less or higher than the figures shown. Investment return and principal value will fluctuate, so that upon redemption, shares may be worth more or less than their original cost. Performance figures for Class I shares reflect a contractual fee waiver and/or expense limitation agreement in effect through 2/28/16, 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. For performance information current to the most recent month-end, visit our web site at mainstayinvestments.com.

Total Annual Fund Operating Expenses are: Class A: 2.93%, Class I: 2.66%, and Class R2: 3.05%. Expenses include *Dividend Expense on Securities Sold Short and Broker Fees and Charges on Short Sales* for each share class, without which, the total net expenses are as follows: Class A: 1.84%, Class I: 1.58%, and Class R2: 1.95%.

Average annual total returns include the change in share price and reinvestment of capital gains and distributions. Effective 10/5/12, Marketfield Fund became MainStay Marketfield Fund. At that time, the Fund's existing no-load shares became Class I shares. Performance for Class I shares reflects the historical performance of the then-existing shares of Marketfield Fund (which were subject to a different fee structure) for periods prior to 10/5/12. Performance for Class A shares includes the historical performance of Class I shares, adjusted to reflect the differences in fees and expenses. Class I shares are generally available only to corporate and institutional investors. Class R shares are available only through corporate-sponsored retirement programs.

Equity allocations may include fixed-income exposure.

Top Five Sectors–Net

Financials	18.7%
Consumer Discretionary	12.8%
Industrials	8.6%
Information Technology	7.3%
Materials	6.1%

Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security. Current and future portfolio holdings are subject to risk. There can be no guarantee that investment objectives will be met.

MainStay Investments® — New York Life

Marketfield Asset Management

Combined March/April 2015

MainStay Marketfield Fund

Fund Overview

Objective

The investment objective of the Fund is capital appreciation.

Strategy & Process

The Fund has a broad investment charter that allows it to utilize equity securities, fixed-income instruments, commodities, futures, and options. Additionally, with respect to 50% of the Fund's net assets, the Fund may engage in short sales of securities to profit from an anticipated decline in the price of the security sold short. The use of short selling could result in increased volatility of returns.

Fund Facts

Fund Statistics

CUSIP:	Class A: 56064B878
	Class I: 56064B852
	Class R2: 56064B845
Inception Date	7/31/07
Benchmark	S&P 500 Index
Net Assets	$5,924 M
Number of Holdings	95

Top Ten Long Holdings (Excluding Cash) (As of 04/30/15)

HSCEI Index May 2015 Futures* (China)	7.2%
iShares China Large-Cap ETF	4.4%
iShares Russell 2000 ETF	3.2%
Bank of China, Ltd. Class H	2.8%
iShares MSCI Japan Index ETF	2.6%
Merlin Properties Socimi SA (Spain)	2.2%
iShares MSCI Hong Kong Index ETF	2.2%
Kennedy Wilson Europe Real Estate Plc UK.	2.2%
China Life Insurance Co Ltd. Class H	1.7%
Bank of Ireland	1.6%
TOTAL:	30.1%

Portfolio Allocation (As of 04/30/15)

Equity Long	81%
Equity Short	-11%
Equity Index Futures Long*	7%
Equity Index Futures Short*	-10%

Option delta not reflected.
**Notional Value*

Fund Performance

Monthly Average Annual Total Returns as of 04/30/15

	Tickers	YTD	One Year	Three Years	Five Years	Inception
Class I (07/31/2007)	MFLDX	1.85%	-7.13%	3.15%	4.46%	6.80%
Class A (Max. 5.5% load) (10/05/2012)	MFADX	-3.86%	-12.47%	0.99%	3.03%	5.77%
Class A (NAV) (10/05/2012)	MFADX	1.73%	-7.38%	2.91%	4.20%	6.54%
Class R2 (10/05/2012)	MFRDX	1.74%	-7.45%	2.79%	4.09%	6.43%
S&P 500® Index (07/31/2007)	N/A	1.92%	12.98%	16.73%	14.33%	7.05%

Quarterly Average Annual Total Returns as of 3/31/15

	Tickers	YTD	One Year	Three Years	Five Years	Inception
Class I (07/31/2007)	MFLDX	-0.18%	-10.84%	2.85%	4.82%	6.60%
Class A (Max. 5.5% load) (10/05/2012)	MFADX	-5.73%	-15.98%	0.70%	3.39%	5.56%
Class A (NAV) (10/05/2012)	MFADX	-0.25%	-11.09%	2.62%	4.57%	6.34%
Class R2 (10/05/2012)	MFRDX	-0.31%	-11.22%	2.47%	4.44%	6.22%
HFRI Macro Discretionary Thematic Index (12/31/2007)	N/A	1.75%	0.35%	0.37%	0.46%	0.53%
S&P 500® Index (07/31/2007)	N/A	0.95%	12.73%	16.11%	14.47%	7.00%

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Equity allocations may include fixed-income exposure.

Top Five Sectors—Net

Financials	21.5%
Consumer Discretionary	13.1%
Industrials	7.7%
Information Technology	6.7%
Materials	6.3%

Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security. Current and future portfolio holdings are subject to risk. There can be no guarantee that investment objectives will be met.

Management Team

Michael C. Aronstein
President, CIO, and Portfolio Manager

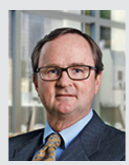
Michael C. Aronstein is President, Chief Investment Officer, and Portfolio Manager of Marketfield Asset Management LLC. He was one of the founding partners of Marketfield, which was created in 2007. In 2004, Mr. Aronstein joined Oscar Gruss & Son Incorporated, where he held the position of Chief Investment Strategist. Prior to joining Oscar Gruss, Mr. Aronstein was Chief Investment Strategist at Preservation Group, a provider of independent macroeconomic and strategic advice to professional investors. Mr. Aronstein began his investment career in 1979 at Merrill Lynch, serving positions as Senior Market Analyst, Senior Investment Strategist, and Manager of Global Investment Strategy. Mr. Aronstein spent six years as President of Comstock Partners, a diversified investment advisor, and left to found West Course Capital, a discretionary commodity management firm. Mr. Aronstein graduated from Yale College with a Bachelor of Arts degree in 1974. His views on macroeconomic and strategic issues are regularly sought by and disseminated through the financial print and visual media. Mr. Aronstein manages $5,924 million in MainStay Marketfield Fund, $431 million in MainStay VP Marketfield Portfolio, and $262 million in Marketfield Fund Dublin; total assets under management are $6,617 million.

David C. Johnson, Jr.
Principal, Director of Research

Mr. Johnson joined Marketfield Asset Management LLC as Director of Research in April 2011. Mr. Johnson is a graduate of the University of North Carolina at Chapel Hill. He received his MBA in 1984 from Darden School of Business, University of Virginia. Prior to joining Marketfield, Mr. Johnson was an Investment Analyst, Portfolio Manager, and Head of Business Development at Wilkinson O'Grady & Co., Inc. He spent the first 10 years of his career in the fixed-income department of Salomon Brothers, where he managed one of its primary sales groups. Mr. Johnson was President of Preservation Group, where he worked closely with Mr. Aronstein.

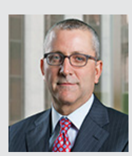
Michael Shaoul
Chairman and CEO

Michael Shaoul is Chairman and CEO of Marketfield Asset Management LLC. Mr. Shaoul is one of the founding partners of Marketfield, which was created in 2007. In his role at Marketfield, he helps formulate the top-down insights that inform the firm's investment decisions and authors a daily commentary that communicates these ideas with clients. He is a frequent contributor to the financial media, which values his views on economic cycles and investment markets. In 1996, Mr. Shaoul joined Oscar Gruss & Son Incorporated. He became its CEO in 2001 and held this position until 2014. He is Treasurer of American Friends of Tel Aviv University and a member of the Board of North American Friends of Manchester University. He was awarded a PhD in Accounting and Finance from the University of Manchester (UK) in 1993.



Myles D. Gillespie
Principal, Senior Trader

Myles D. Gillespie joined Marketfield Asset Management LLC in 2007. Myles is a graduate of The Hotchkiss School and holds a Bachelor of Arts degree from Franklin and Marshall College (Class of 1983). From 1983 to 1986, he worked as a Stock Index Futures Trader with Henderson Brothers and in 1986, became a NYSE Specialist at Quick & Reilly. He was appointed Executive Vice President of JCC Specialist Corp., the successor firm to Quick & Reilly, in 1989. In 1999, he became President of Fleet Specialist, Inc., the successor firm to JCC Specialist Corp., retiring from this position in 2004. During his time at the NYSE, Myles served as a NYSE Floor Official (1993-1999) and NYSE Floor Governor (2001-2004).



Andrew Lyss
Principal, Senior Trader

Mr. Lyss joined Marketfield Asset Management LLC in 2012. He was previously Executive Vice President at Oscar Gruss, which he re-joined in 1997. Mr. Lyss previously worked for Oscar Gruss from 1993 to 1995. Mr. Lyss specializes in special situations, including merger arbitrage, spinoffs, bankruptcy, and post-bankruptcy valuations. Prior to re-joining Oscar Gruss in 1997, Mr. Lyss was employed by Arnhold & S. Bleichroeder from 1995 to 1997 in institutional sales and by Prudential Securities from 1983 to 1989 in varied positions. Mr. Lyss received a BS/BA from the University of Denver in 1982.

Before You Invest

The Fund regularly makes short sales of securities, which involve the risk that losses may exceed the original amount invested. The Fund may also use options and futures contracts, which have the risks of unlimited losses of the underlying holdings due to unanticipated market movements and failure to correctly predict the direction of securities prices, interest rates, and currency exchange rates. However, a mutual fund investor's risk is limited to the amount invested in a fund. Investments in absolute return strategies are not intended to outperform stocks and bonds during strong market rallies. The Fund invests in smaller companies, which involve additional risks, such as limited liquidity and greater volatility.

The Fund invests in foreign securities, which involve greater volatility, and political, economic, and currency risks, and differences in accounting methods. These risks are greater for investments in emerging markets. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investment by the Fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. Investments in asset-backed and mortgage-backed securities involve additional risks, such as credit risk, prepayment risk, possible illiquidity and default, and increased susceptibility to adverse economic developments. The Fund involves the risk that the macroeconomic trends identified by portfolio management will not come to fruition and their advantageous duration may not last as long as portfolio management forecasts. The Fund may invest in derivatives, which often involve leverage, may increase the volatility of the Fund's NAV, and may result in a loss to the Fund.

MainStay Marketfield Fund is subadvised by Marketfield Asset Management LLC and distributed by NYLIFE Distributors LLC, 169 Lackawanna Avenue, Parsippany, NJ 07054, a wholly owned subsidiary of New York Life Insurance Company. NYLIFE Distributors LLC is a Member FINRA/SIPC.

MainStay Investments® is a registered service mark and name under which New York Life Investment Management LLC does business. MainStay Investments, an indirect subsidiary of New York Life Insurance Company, New York, NY 10010, provides investment advisory products and services.

Neither New York Life Investment Management LLC, its representatives, nor its affiliates provide tax, legal, or accounting advice. Please consult your own advisors on these matters.

Notional value is the total value of a leveraged position's assets.

The S&P 500® Index is a trademark of the McGraw-Hill Companies, Inc. The S&P 500® Index is widely regarded as the standard index for measuring large-cap U.S. stock market performance. The securities holdings and volatility of the Fund differ significantly from the stocks that make up the S&P 500 Index.

The HFRI Macro Discretionary Thematic Index is a broad-based hedge fund index, consisting of strategies that are primarily reliant on the evaluation of market data, relationships, and influences, as interpreted by an individual or group of individuals who make decisions on portfolio positions. These strategies employ an investment process most heavily influenced by top-down analysis of macroeconomic variables.

An investment cannot be made directly into an index.

Obtain the Prospectus

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.

Commentary

A Message from Our Chairman

The Fund performed as we would have hoped during March and April, generating reasonable absolute and relative returns over this 60-day period. Central to the quality of performance was the exposure to Asia in both China and Japan. Regarding the former, we have argued since the late summer that Chinese equities were an interesting destination for capital and chose to express this with an exposure to Hong Kong listed equities (a decision driven by greater liquidity, tighter regulation, and a more institutional marketplace). It would have been easy to reverse course as concerns grew in the media and financial community, but we felt most of the negative arguments contained flaws and were generally made by individuals who remained bullish about China long after it ceased to make sense in early 2010.

We have certainly been surprised at the speed with which some of the gains were generated in April, but not by the size of the aggregate move itself, given how low valuations and investor exposure were last summer. Our view is that we are still quite early in the current investment opportunity and if our assumptions prove correct, our stay in China and its closely associated markets should prove to be about as long as other themes over the history of our Fund.

Regarding Japan, this country has been part of the portfolio for a little more than two years. Again, it required patience to maintain a position for much of 2014, given the distortion of economic data around the sales tax and sudden depreciation of the Yen which eliminated equity gains for an unhedged investor. However, we remained satisfied with the progress of overall social and economic reform in Japan and chose to keep this portion of our portfolio in place. Thus far, 2015 has generally been a much more pleasant ride with solid equity market gains and a stable Yen, and there are finally signs that this is being recognized by global investors.

The rest of the portfolio behaved acceptably. Exposure to U.S. housing was helpful in the first 3 months of the year, but was quite detrimental in April. Nevertheless, the balance of data suggests that the second leg of a U.S. housing cycle has commenced this springtime with the major risk being margin pressures in states with tight labor markets. European property exposure has delivered steadier returns as investors start to appreciate the relative values available, compared to U.S. equivalents. With most global markets, range-bound index hedges were not a meaningful contributor to performance overall, but did serve to dampen the volatility of returns.

May 4, 2015

Michael Shaoul
Chairman and CEO

Portfolio Manager's Report

The half-decade following the 2008-2009 panic and crisis featured widespread asset price inflation, uneven economic recovery, record fixed-income issuance and absorption, and the re-emergence of the U.S. as a preferred destination of global investment flows. These processes were supported by expansive monetary initiatives from the Federal Reserve.

The two most prominent aspects of monetary policy during this period were the suppression of short-term rates and the nearly limitless purchases of longer-term instruments. Each influenced the other, with the final result being the most favorable bond market conditions and highest bond prices in modern history.

As the domestic economy began to normalize and, in certain portions, accelerate, the torch of monetary expansion was passed to Europe and important emerging economies, most notably China.

As our regular readers are aware, we have been concerned that the consequences of present day global monetary experiments are apt to be a continuing source of risk to investors in a variety of asset classes and geographies.

The initial results, which are largely visible in the form of asset price inflation, have been mostly benign or beneficial from the perspective of investors, with the clear exception of those who by statute or longstanding practice are reliant on savings and money market returns.

Commentary (continued)

The political ramifications of asset inflation have been more unsettling, as the wealth accruing to owners, managers, and intermediaries in rapidly inflating assets has been spectacular. This contrasts with the moribund pace of wealth creation taking place in more prosaic aspects of the economy, which are not only outside the scope of current inflationary processes, but are also increasingly beset by regulatory burdens. A host of potentially destructive, populist movements have gained momentum in response.

Every era of experimental policy is in need of some widely accepted, theoretical justification. The present one is no different.

Underlying the relentless intervention of monetary authorities into capital and money markets is their stated need to fend off deflation. That task, so necessary in 2008-2009 and again in Europe in 2011, is, at present, somewhere between superfluous and dangerous.

Deflation, in its virulent form, involves liquidation of distressed collateral assets that underpin institutional liabilities commonly utilized as money. In different circles, the instruments serving this purpose have been described as fiduciary media or means of purchase. They are all media of exchange, which allow the psychological desire for economic goods or services to be expressed as actual demand. The maintenance of a reasonably stable stock of money and its close substitutes is widely acknowledged as a prerequisite for a properly functioning economy.

It should be fairly obvious that an abrupt destruction of a meaningful portion of monetary resources in a system will quickly translate into evaporating demand and impairment of business and personal incomes. The process undermines cash flows needed to service debt, and a vicious cycle of liquidation and contraction proceeds.

This holds true in contemporary systems of fiat currency, credit, and quasi-monetary instruments as well as in barter-based systems, where the sudden destruction or loss of a large stock of the commodity that was used as money, whether metals, jewels, seashells, spices, or grains, would rapidly destroy demand, and thus, the function of the entire system.

Steering clear of a true monetary deflation is certainly a primary task of any central monetary authority. This was demonstrated clearly and tragically in the early 1930s, where the banking system was up to its neck in stock market credit and was effectively wiped out in the aftermath of the 1929-1931 collapse.

Failing banks took their deposits with them to the graveyard, and money supply fell by 30%. The Federal Reserve, having not even reached drinking age, was obsessed with a host of secondary issues and overlooked the primary risks to the system.

This all became clear only in hindsight. It is fortunate, that among those enthralled by the forensics of that awful sequence of events and errors, was Professor Bernanke.

When the contemporary banking and capital markets' system, up to its neck in housing-related credit, began buckling under the weight of collateral deflation, the instrumental deflation arose in money markets, rather than traditional (now FDIC insured) deposits. The threat was exactly the same as in 1931, and was recognized by then Chairman Bernanke.

After the process was made clear by the collapse of Lehman Brothers and the vortex that threatened every related institution, the Federal Reserve began direct, unlimited support of all money markets and capital market financing channels.

Absent that, another great depression was in the cards.

Once the Federal Reserve committed to attenuate the monetary consequences of the deflation in real estate collateral values, conditions for recovery in other asset prices were set. This prompted our aggressive risk seeking in 2009.

Commentary (continued)

By cutting the transmission wire between deflating housing collateral and the bulk of monetary instruments based on that collateral, the Federal Reserve did not save housing from its awful supply and demand fundamentals, but did prevent property deflation from becoming pandemic.

It is our sense that the glimpse into a deflationary abyss in 2008 and 2009 induced a nearly obsessive, post-traumatic aversion to anything remotely suggestive of price declines in any aspect of economic life. The phobia seems to extend to perfectly normal fluctuations in market prices. Any falling prices, regardless of origin or consequence, are taken as harbingers of systemic, deflationary threat. Rising inflation is an explicit policy goal put forth by the Federal Reserve Board, the European Central Bank (ECB), and the Bank of Japan.

This strikes us as theoretically misguided and counterproductive in light of actual, present conditions. A monetary Tower of Babel is rising, with ever-higher inflationary statistics marking its path to heaven.

This creates some interesting policy dynamics.

We have seen reports in the past weeks suggesting that state attorneys general are opening investigations into the pricing of pharmaceuticals, going so far as to expect detailed accounting from companies about the actual profitability of each individual drug. Aside from this being impossible in practice, someone needs to tell these ambitious crusaders that their attempts to put downward pressure on drug prices are undermining the work of the Federal Reserve and all other developed world central bankers as they labor to raise CPI (Consumer Price Index) indices.

In similar fashion, City Councils in New York and San Francisco are pulling out every administrative trick in the book to halt, and even reverse, the pattern of rising rents. Given that rents, both actual and implied, are the largest single contributor to reported inflation, attempts to suppress them by edict will not only have the traditional effect of diminishing supply and thereby guaranteeing even tighter markets, but could, if successful in the short run, contribute to an unwelcome impediment to higher inflation.

The spectacle of various official policies acting at cross purposes is nothing new in our system and certainly not in Europe, where longstanding animosities toward commerce surface simultaneously with lamentations about the lack of employment opportunity in the private sector.

The striking feature of the present dissonance in policy objectives is the prominence of central banks on the world stage. Their prognostic utterances are received with ever less critical scrutiny.

We wrote in our most recent annual letter that we would like to see one prominent central banker specify the items within their consumer price index that they intend to make more expensive. Rising wages at the low and middle levels would clearly be welcome in nearly all government circles, but the dynamics of labor markets are sufficiently complex and fragmented to all, but rule out monetary policy as an effective determinant.

We understand the imperative among central bankers to avoid a systemic, monetary deflation, but question their ability to assess the present risks of that outcome. Their attempts to influence the general level of consumer prices are not only misguided, but also potentially destabilizing.

Price declines, brought about by the local supply and demand dynamics of a particular market, are only threatening to the extent that the goods in that market have been widely adopted as collateral within credit and banking systems. If that has been the case, the deflation of the favored form of collateral will quickly infect the financial system and produce, de facto, a contraction in the means of purchase that rapidly eliminates demand across large swathes of the system.

This dynamic is unquestionably dangerous and worthy of great concern.

Trouble arises when normal price fluctuations in a wide variety of goods are mistaken for the deflation of collateral items that would undermine the monetary basis of an entire economy.

Commentary (continued)

The trouble with the analysis needed to make such a determination is the absence of hard and fast rules that can be plugged into quantitative models of the type that all central bankers rely upon for forecasts and risk assessment.

The deflation of single-family home prices from 2006 onward was clearly a threat to the financial system at large. The recent collapse in oil prices, brought on by supply and demand imbalances in energy markets, poses no such threat, unless we are talking about a national economy that is petroleum-based. There, the problem could easily become systemic, but the local central bank will likely be constrained by foreign exchange markets, where extraordinary monetary expansion will be met by rapid depreciation in the exchange rate. This process will, if undertaken, replace deflation with inflation. Local debts are more easily paid with an increasingly worthless currency. Real wealth destruction proceeds unabated. Venezuela is a good, energy-related case in point.

Core collateral forms vary markedly across borders. Each central bank is forced to assess the nature of the critical assets and processes supporting their particular financial infrastructure. They must identify and pay close attention to the underlying fundamentals in their primary collateral asset if destabilizing monetary volatility is to be avoided. The idea that central banks cannot foresee destructive excesses is nonsense. More accurate is the observation that the tools they employ to accomplish this are largely ineffective, but persist nonetheless.

At the verge of systemic, deflationary crisis in 2010, the ECB did not realize that their entire financial system was structured around the creditworthiness of member states and their sovereign bonds. As global credit strains weighed on the European Union (EU), bloated and inefficient peripheral economies saw access to credit dry up.

Between the second quarter of 2010, when Greek ten-year yields briefly touched 12%, and the full-blown crisis of the following summer, the ECB contracted its balance sheet by more than 200 billion Euros. During the last quarter of that interval, the main refinancing rate rose from 1% to 1.50%. Adios Greece.

We point this out to illustrate how central banks tend to miss identifying the systemic lynchpins among the thousands of variables that they process. This is particularly true in diversified, modern economies. It is a lot easier for the Saudi monetary authorities to appreciate the importance of the oil price than for the Federal Reserve of 1931 to understand that railroad credit and the level of gold reserves were less important to the financial system than margin lending.

As the threat of crisis awakens more central bankers to the necessity of providing support to their critical collateral forms, we have moved portfolio exposures toward regions where recognition and repair were in the early stages. To the extent that this monetary support is reinforced by real structural, economic reform, we are more enthusiastic. Monetary intervention can avert disaster, but sound, long-term policy support is necessary for wealth creation that extends beyond asset inflation.

This is the basis of our positioning in Asia, particularly in China and Japan. Leaders in the former recognize that property prices and their near relation—local government finances—are the critical vulnerabilities in the financial system and have taken steps to allow an orderly restructuring of both.

Financial infrastructure is being directed toward more open, capital market funding and away from credit based on political connections with state-sponsored banks.

Endemic corruption, which is an inevitable outcome of state-run economies, is being addressed through law enforcement and through a gradual relinquishment of economic and business outcomes to the verdicts of market preference rather than political favor. In this respect, China's leadership compares quite favorably with executive branches in the U.S. and much of Europe.

Commentary (continued)

China's reforms and monetary supports contrast with markets that were priced for insolvency. During most of 2014, it was easy to find financial equities in China in which the dividend yield and the PE (Price-Earnings) ratio were equivalent around the mid-single digit mark. With any possibility that failure could be avoided, these valuations struck us as the most compelling in the world.

Reforms in Japan, backed by the world's most consistently expansive policy, are more cultural than political. Most important is a trend among corporate managers towards acceptance of the idea that public companies are rightfully bound to act in the interests of their outside shareholders. The combination of better governance and management practice with product offerings that are already at the top echelons of quality is a powerful, long-term support for expanding valuations.

The expansion of extreme monetary stimulus from its beginnings in the U.S. to a greater share of the global economy will likely continue until the consequences begin to outweigh the presumed benefits. Staving off monetary deflation, as the Federal Reserve did in 2008, is a clear benefit. Arresting deflation in a core collateral asset, as the Chinese are doing with property, is another.

Consequences, when they arise, will take the form of inflationary price dislocations in real goods and services or foreign exchange markets. Thus far, asset inflations and currency volatility have done little to undermine the expansionary reflex among central bankers.

The more dangerous consequences will be those that undermine faith in the benevolent role of central banks. This faith lies at the core of an increasingly interdependent, global financial system. It is manifest in extraordinarily inflated prices for most income-producing assets, including many where the buyer pays for the privilege of lending. It will be here, and not in the declining cost of airfares, cell phones, corn, or copper, that the next dangerous deflation will arise.

April 28, 2015

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