New York Life MainStay Investments®

The case for increasing equity allocations

It's all too easy to find reasons to hold off investing in stocks. These may include uncertainties regarding the direction of the economy, natural disasters, political issues, and fears that the market could be headed for a downturn. In reality, there's never an "all clear" signal that it's a good time to invest in stocks. In fact, the stock market is often a forward-looking indicator. In other words, by the time it's obvious that the environment for investing in stocks is positive, much of the market's ascent may have already occurred.

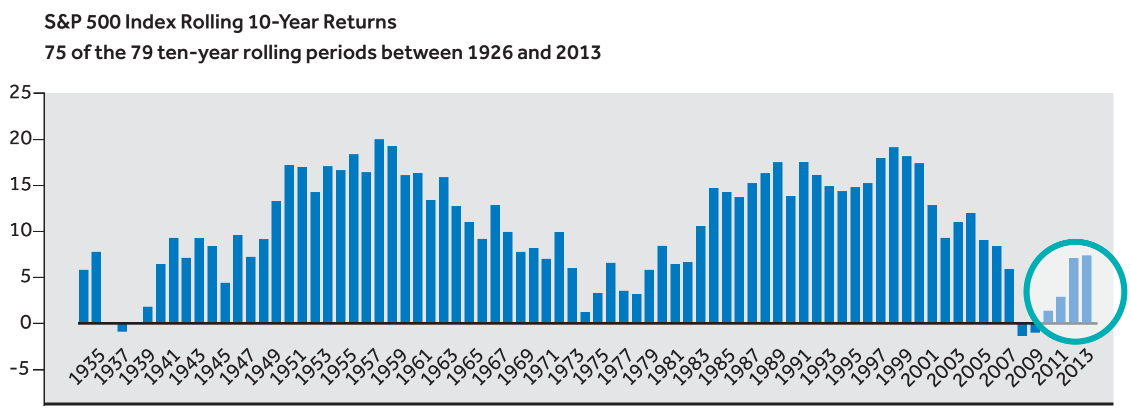
Since its trough in March 2009, the equity market has experienced periods of growth, along with periods of sporadic volatility. With this in mind, we have identified five key factors that point to the stock market remaining attractive. As such, long-term investors may want to consider "tilting" a larger portion of their overall investment portfolio toward stocks.

All investing involves risk. There is no guarantee that any investment objective will be met. The principal risk of investing in stocks is volatility, or significant price changes in relatively rapid succession. Stocks are generally considered to be more volatile than bonds or cash. Bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, the bond issuer's failure to repay (default); and call risk, the possibility that a callable bond will be redeemed before maturity.

#1: A strengthening economy

The financial markets are cyclical, therefore, the performance of the stock and bond markets are often driven by the economic cycle. When the economy is stumbling, bonds often perform well, as the Federal Reserve Board often takes actions such as lowering interest rates to stimulate growth. Since bond prices and interest rates move in opposite directions, the bond market generally rises when interest rates decline. But, historically, when the economy gains traction, as currently appears to be the case, stocks have done well.

Stocks Have Generated Positive Returns 95% of the Time

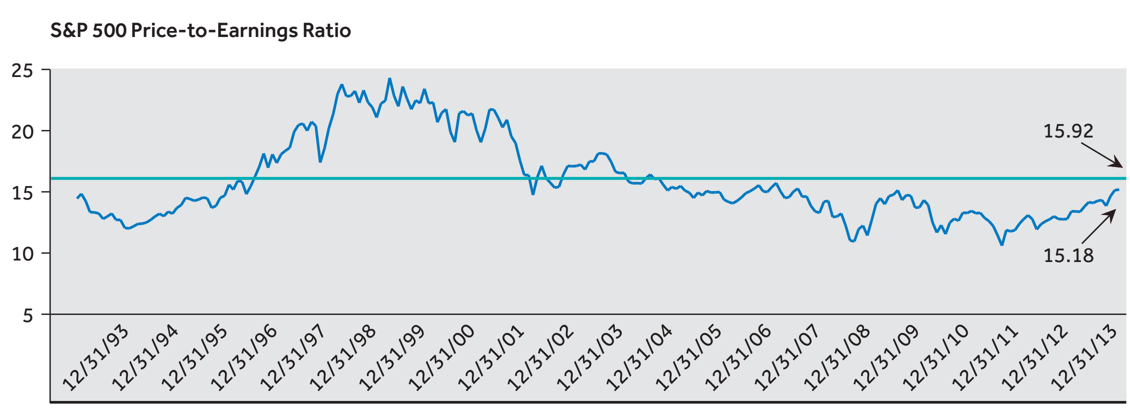


Past performance is no guarantee of future results. The S&P 500 Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. It is not possible to invest in an index.

#2: Stocks remain attractively valued

Stock market valuations are often measured by the multiple of earnings an investor must pay to buy a share of stock. This is also known as the price-to-earnings, or P/E, ratio. The lower the P/E, the less expensive the stock is considered to be, relative to the earnings the company is generating. Stocks of companies in the S&P 500 Index currently trade at nearly 15.2 times the earnings they are expected to generate over the next 12 months. That's lower than the almost 16.0 times earnings the market has averaged over the past 20 years. In addition, given the strengthening economy and the low interest rate environment, stocks appear to be attractively valued when compared with the bond market.

Stock Market Valuations Are Below Historical Averages



Source: Ned Davis Research, Inc., 12/31/13.

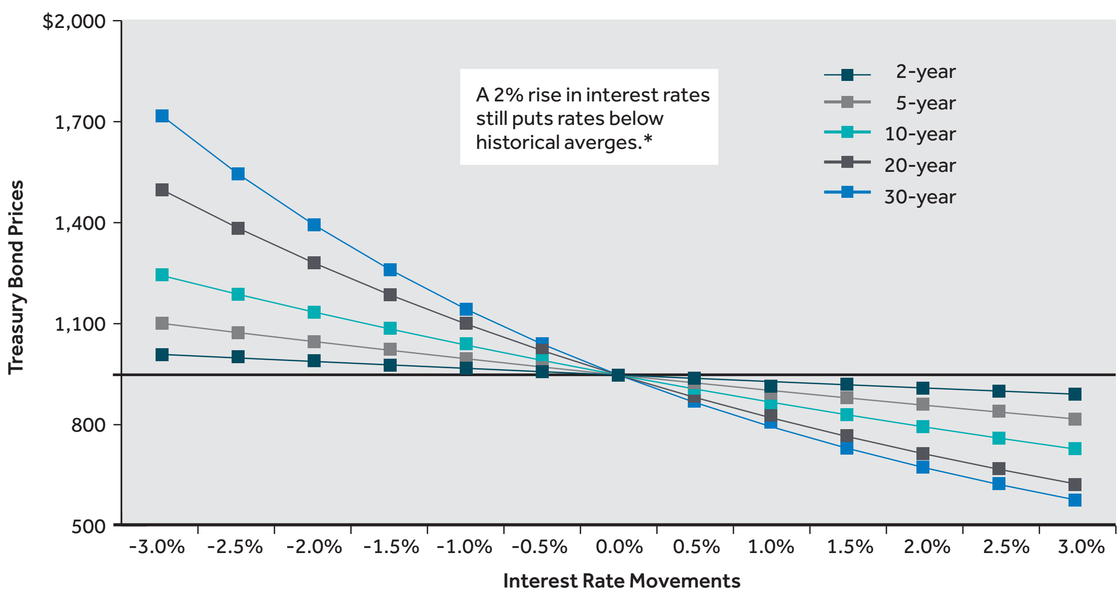
#3: Interest rates are historically low

In recent years, investors have flocked to the bond market. In fact, bond allocations are still above historic average levels, in terms of percent of financial assets they represent.[1] This isn't surprising, and high-quality bonds have been an excellent investment over the past 30 years, but that was the result of an enduring decline in interest rates over that period. Given today's exceptionally low yield on the 10-year Treasury bond of approximately 3%, that phenomenon simply cannot repeat itself over the next 30 years.

In fact, if history is to be believed, then the exact opposite is more likely. If we look back to the prior 30-year window, roughly 1952-1982, when interest rates rose from 2% (ominously similar to today's levels) to the mid-teens, long Treasury bonds generated a negative real return over the ensuing decades.[2] We've been conditioned to think of Treasury securities as a source of risk-free return, but it may be more fitting to view them as a source of return-free risk moving forward, especially if interest rates rise. High-quality bonds expose investors to interest rate risk, as their prices generally fall when interest rates rise. As shown below, the more interest rates rise, the greater the potential loss. Given the likelihood that interest rates will eventually rise, prospects for investors in high-grade bonds may not be that promising.

As an increasing number of investors come to that realization, there is a chance that the flows out of equities into fixed income observed over the past several years will reverse direction, helping to drive equity prices higher.

Figure 1: Bond Prices and Interest Rates



Source: Department of Treasury, using proprietary calculations of bond duration and price in relation to interest rate movements.

* Ned Davis Research as of 12/31/13. Current rate is ~0.07, they would still be below the 20- and 30-year historical averages of 3.07% and 4.35%, respectively. Diversification does not guarantee a profit or assure against loss in a declining market.

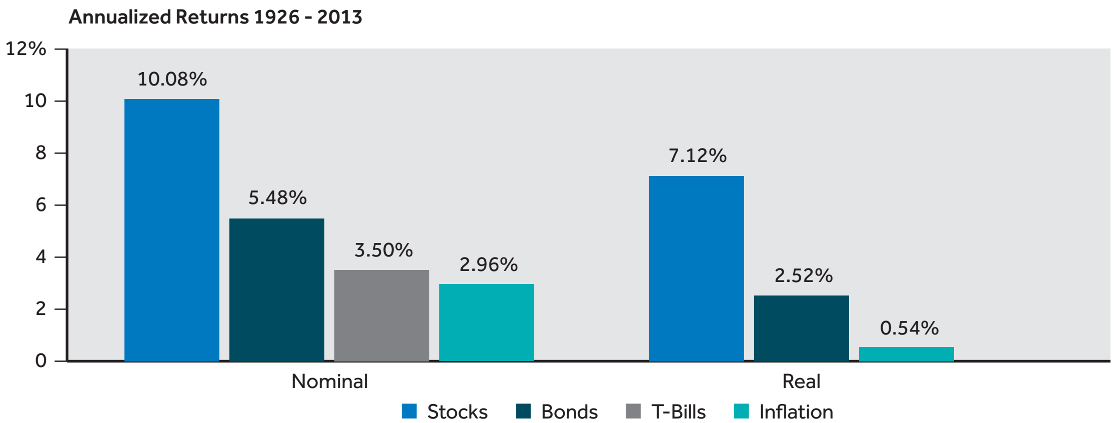
When held to maturity, Treasury securities are backed by the full faith and credit of the United States government as to timely payment of principal and interest.

1. Source: Ned Davis Research, Inc., 12/31/13.
2. Source: Ibbotson, as of 12/31/13. Return per year from investing $100 in a Treasury bond and holding it for 30 years, while reinvesting all coupon payments in new bonds. Past performance is no guarantee of future results.

#4: Seeking to preserve and grow wealth

In prior generations, planning for a retirement that lasted 10 years may have been sufficient. But given today's life expectancy, individuals could spend 20 or 30 years out of the workforce. The longer the retirement, the greater the risk of outliving one's savings. Historically, the stock market's return has far surpassed that of the bond market, and has provided a cushion against rising prices. The chart below illustrates nominal and real returns for stocks, bonds, and T-bills going back to 1926. Nominal returns are the rate of return on an investment without adjusting for inflation. Real returns factor in inflation.

Stocks Have Helped Preserve Purchasing Power



Source: Morningstar, 12/31/13. Stocks are represented by the S&P 500 Index, a capitalization-weighted index of 500 stocks. Bonds are represented by the Barclays U.S. Aggregate Bond Index, a market capitalization-weighted index representing investment grade bonds being traded in the United States. T-Bills are represented by the Merrill Lynch 3-Month T-Bill Index, an unmanaged index that measures returns of three-month Treasury Bills. Past performance is no guarantee of future results. It is not possible to invest directly in an index.

#5: Innovation leads to investor opportunity

We are in the midst of an information revolution that began with the creation of the microchip and continues to radically change the economic landscape. Improvements in business processes and innovative technologies are enabling companies to offer higher-quality products and services at lower costs and greater profit. Output has expanded even as the workforce has gotten smaller—proving companies are doing more with less. The pace of change is only gathering steam with game-changing developments on the horizon in automation, artificial intelligence, biotechnology, communications, transportation, etc.

Productive capacity is exploding and will be met by the equally rapid growth of demand, as literally billions of people in the developing world enter the modern, industrialized world.

There is only one asset class that can capture productivity gains—and that's equities. It is stockholders, owners of the "means of production," and owners of the businesses that create more goods for more consumers, who therefore will benefit most from changing technologies and the growing global economy.

Strategies for investing in stocks

Given the market's gyrations in recent years, it's no wonder that some people are wary of the stock market. While stock prices experience periods of volatility, for generations equities have helped investors achieve their financial goals. In addition, there are a number of reasons why it may now be an appropriate time to add to one's allocation to stocks. Before doing so, it is helpful to follow some basic principles:

Develop a plan. It's critical to have specific financial goals and a well-established strategy that seeks to achieve those goals.

Keep a long-term perspective. Stay focused on your long-term financial goals and avoid making emotion-driven changes to your portfolio during periods of short-term market volatility. Avoid making emotional moves due to media noise and market pundits.

Dividends count. Data shows that dividend paying companies, and those companies that can grow their dividends, have outperformed in most economic environments compared with non-dividend-paying companies.

A company's willingness and ability to pay steady dividends over time denotes a positive image of the firm's financial well-being, while sending a clear message to shareholders about its future prospects and management's commitment to increasing shareholder value. While dividends may cushion returns in down markets, investments are still subject to loss of principal amount invested. There is no guarantee they will continue to be paid.

Dollar-cost averaging. An effective way to maintain your investment focus is a strategy known as "dollar-cost averaging"—investing a set amount each month, regardless of what happens in the market. The advantage is that you buy more shares when the market is down and fewer shares when the market is up–ultimately lowering the cost basis of your overall investment. While no investment strategy can guarantee profits or protect against loss, dollar-cost averaging may help you provide insulation against changes in market price due to volatility. Investors should consider their ability to continue purchases through periods of low price levels.

Don't chase yesterday's winners. Avoid the temptation of following the herd and investing in today's best-performing stocks or sectors, as it tends to result in "buying high and selling low."

Use market volatility to your advantage. No one likes to see the market decline. But when it does, it may present an opportunity to invest in fundamentally strong companies whose stock price is essentially "on sale."

Carefully select investment managers. Invest with high-quality equity managers who focus on risk management and seek to invest in companies that have strong balance sheets.

Work with a trusted financial professional. Maintaining your investment focus, especially in light of the financial markets in recent years, isn't easy. While there are ways to keep your resolve, it's sometimes easier said than done. That's why many people rely on the support and guidance of a financial professional. While the use of a financial professional cannot guarantee investment success, a financial professional can develop a personalized investment strategy that can be proactively adjusted as needed. Finally, he or she can help you to keep focused on the reason why you're investing in the first place—to achieve long-term financial goals.

Clearly, there are some very compelling reasons why equities are attractive for the long–term investor, especially compared with high-quality, fixed-income investments. Fortunately, there are more ways than ever for individual investors to get equity market exposure, including mutual funds, variable annuities, and even variable life insurance policies. A financial professional can help determine what type of equity product is right for you, as well as provide guidance on how to pursue a well thought out, well-balanced, and well-diversified financial strategy that includes a mix of equities, fixed income, and guaranteed income for those close to or in retirement.

Please 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.

For more information

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