Describe the performance of the fund relative to its benchmark during the last three months.

The BNY Mellon High Yield Fund (Class I shares) outperformed its benchmark, the Merrill Lynch Constrained High Yield Index (the “Index”), during the first quarter of 2020.

Sector allocation was a positive contributor to relative performance, notably the Fund’s underweight to those sectors particularly exposed to the COVID-19 crisis, such as energy & leisure. The Fund’s positioning in select fallen angels also contributed to relative performance during the period. Conversely, selection within Broadcasting and Paper/Packaging detracted from relative performance, while the Fund’s allocation to CLOs also detracted.

Risk assets came under severe pressure in the first quarter of the year, as the COVID-19 outbreak quickly morphed into an economic crisis that elicited unprecedented measures from policymakers. US high yield bonds endured a historic selloff, sharply underperformed the broader fixed income market, as defined by the Bloomberg US Aggregate Index, returning -13.13%. High yield spreads, which had rallied in the back half of 2019 and started the year near post-crisis lows, experienced one of the most pronounced periods of widening on record, breaching the 1000 basis point (bp) level in late March before partially recovering late in the month due in part to extraordinary monetary and fiscal stimulus. Still, spreads finished the quarter well above post-crisis and long-term median levels.

Primary new issuance totaled $72.6B for the period, with the majority of the issuance coming in January and February. A large portion of this issuance was refinancing related alongside the fall in U.S. Treasury yields. Primary market activity stalled throughout most of March as the the COVID-19 pandemic turned into a global economic crisis. With yields soaring to a decade high, only five bonds priced for $4.2bn during the month, four of which occurred on the first three business days of the month. The High Yield market saw a net outflow in the first quarter of $16.7B. In March, high yield mutual funds saw outflows totaling -$13.0bn, the second largest monthly outflow on record, only a notch below the record outflow of -$13.6bn experienced in June 2013.

Returns were sharply negative across the quality spectrum in the first quarter with higher quality outperforming. For the period, BBs returned -10.23% while Bs and CCCs returned -14.09 and -22.43%, respectively. As of quarter end, the spread of the Merrill Lynch Constrained High Yield Index stood at 877bp, 517bp wider to year end 2019 levels (360bp). Despite the sharp rally toward the end of March (post March 23), we continued to see bifurcation among credit tiers, with BBs continuing to sharply outperform the lower-rated segment.

From a sector standpoint, those exposed to the COVID-19 crisis were the largest underperformers (energy, gaming/leisure, transportation) while the more defensive sectors held in better (healthcare, telecom, technology and media).

How is the fund currently positioned and what is your current strategy?

We believe that volatility levels will remain elevated in the near term and believe the Fund remains well-suited to capitalize on potential inefficiencies. We have been adding to more defensive credits and high conviction names, those we believe will withstand continued volatility as the crisis continues. Notably, we are highly focused on fallen
angels, as they tend to outperform once they enter the high yield universe. This conviction has been bolstered by the recent Fed corporate support program, which we believe will provide further support for fallen angels. We are underweight those sectors exposed to the COVID-19 crisis, such as travel/leisure, and we are continuing to add to more defensive segments of the market.

While there is investor concern surrounding the health of the leveraged credit market, and high yield in particular, we believe that this market environment is much healthier that of past cycles. Unlike 2008, which was driven by a liquidity squeeze and too much leverage in the system, we are experiencing a demand shock, driven by a health crisis and a cessation of normal day activities. We think underlying fundamentals for the high yield space are in much better shape than they were in 2007/2008 as well. The high yield market has enjoyed strong earnings, improving balance sheets, and a vast improvement of overall quality for the index since the financial crisis of 2008-2009. That said, we acknowledge that current market dynamics will likely put pressure on credit fundamentals.

While underlying fundamentals remain healthy, in our view, the depth and duration of this crisis is unclear and we do not have the visibility on when there will be normalization. The focus is on the growth rate in the number of infections, mortality rate, and our healthcare system’s ability to absorb the afflicted. Further, at current spread levels, the implied default rate is between 9-10% (7% excluding energy). The duration of this crisis will largely dictate the number of defaults in both directions. At the same time, there has been some extraordinary monetary and fiscal stimulus measures that we believe may help alleviate some of the economic pressures, both on a corporate and consumer level.

Investors should consider the investment objectives, risks, charges and expenses of a mutual fund carefully before investing. To obtain a prospectus, or a summary prospectus, if available, that contains this and other information about a fund, investors should contact their financial advisor or visit im.bnymellon.com. Investors should be advised to read the prospectus carefully before investing. Not all classes of shares may be available to all investors or through all broker-dealer platforms.

Bonds are subject to interest-rate, credit, liquidity, call and market risks, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. High yield bonds are subject to increased credit risk and are considered speculative in terms of the issuer’s perceived ability to continue making interest payments on a timely basis and to repay principal upon maturity. Investing in foreign denominated and/or domiciled securities involves special risks, including changes in currency exchange rates, political, economic, and social instability, limited company information, differing auditing and legal standards, and less market liquidity. These risks generally are greater with emerging market countries.

Recent market risks include pandemic risks related to COVID-19. The effects of COVID-19 have contributed to increased volatility in global markets and will likely affect certain countries, companies, industries and market sectors more dramatically than others. To the extent the fund may overweight its investments in certain countries, companies, industries or market sectors, such positions will increase the fund’s exposure to risk of loss from adverse developments affecting those countries, companies, industries or sectors.

Bond ratings reflect the rating entity’s evaluation of the issuer’s ability to pay interest and repay principal on the bond on a timely basis. Bonds rated BBB/Baa or higher are considered investment grade, while bonds rated BB/Ba or lower are considered speculative as to the timely payment of interest and principal.

Views expressed are those of the author(s) and do not reflect views of other managers or the firm overall. Views are current as of the date of this publication and subject to change.
The ICE BofA Merrill Lynch U.S. High Yield Master II Constrained Index contains all securities in the ICE BofA Merrill Lynch U.S. High Yield Index but caps issuer exposure at 2%. Index constituents are capitalization-weighted, based on their current amount outstanding, provided the total allocation to an individual issuer does not exceed 2%. Issuers that exceed the limit are reduced to 2% and the face value of each of their bonds is adjusted on a pro-rata basis. Similarly, the face values of bonds of all other issuers that fall below the 2% cap are increased on a pro-rata basis. In the event there are fewer than 50 issuers in the index, each is equally weighted and the face values of their respective bonds are increased or decreased on a pro-rata basis. Investors cannot invest directly in any index.

A fallen angel is a bond that was initially given an investment-grade rating but has since been reduced to junk bond status. The downgrade is caused by a deterioration in the financial condition of the issuer. Basis points, otherwise known as bps or "bips," are a unit of measure used in finance to describe the percentage change in the value of financial instruments or the rate change in an index or other benchmark. One basis point is equivalent to 0.01% (1/100th of a percent) or 0.0001 in decimal form.

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