PORTFOLIO MANAGER COMMENTARY | Q1 2020

BNY Mellon Tax Sensitive Total Return Bond Fund

CLASS A DSDAX  CLASS C DSDCX  CLASS I SDITX

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

BNY Mellon Tax Sensitive Total Return Bond Fund underperformed its benchmark, the Bloomberg Barclays 3-, 5-, 7-, 10-Year Municipal Bond Index, during the first quarter of 2020.

Asset allocation and security selection drove the underperformance. An overweight to revenue bonds, as well as an underweight to general obligation bonds, detracted from relative returns for the quarter. Security selection among New York City bonds and retirement community bonds also weighed on performance.

Slightly offsetting this was stronger returns from yield curve/duration positioning. A slight overweight duration position drove stronger results as rates rallied during the quarter.

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

The global fiscal and monetary responses to the COVID-19 pandemic along with the volatility experienced within the financial markets, including municipal bonds, have been unprecedented. With a steep pandemic-led economic contraction expected for the remainder of the year, many state and local governments will face revenue shortfalls, amid diminished consumer spending and business activity. Federal support will be a key mitigating factor and source of stabilization with the passing for the $2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, bringing direct aid and stimulus programs, along with the Federal Reserve programs to purchase certain municipal bonds from states and large cities.

Technical factors will remain a challenge with a primary issuance calendar that is building and tepid mutual fund outflow trends, which could fuel further selling pressure. Overall, we remain cautious on valuations and credit expectations in the near term while keeping a close eye on the expected duration and depth of the pandemic and the fiscal response from municipal issuers and the impact from federal support.

With municipal fund flows a key demand driver for the market, we expect any continuation of sustained outflows to negatively impact market liquidity and pricing. The relative attractiveness of municipal bond yields to Treasuries as well as high grade corporate securities will likely entice greater buying interest from crossover corporate buyers such as banks and insurance companies. Direct buying from retail investors is likely to remain muted as investors observe ongoing negative headlines regarding the virus and its impact on municipal issuers.

From a supply perspective, we see the primary new issue calendar building and expect activity to pick up amid further market stabilization and with municipalities needing to fund pent-up infrastructure projects and other cash flow needs. A potential surge in supply, if coupled with a period of weak or tepid demand, could add pressure to liquidity and valuations. However, we expect the establishment of the Federal Municipal Liquidity Facility to purchase up to $500 billion of notes from states and large local governments to help mitigate supply pressures.

From a municipal credit quality perspective, the potential economic and fundamental credit implications from COVID-19 are a deep concern among all stakeholders. The potential for rating agencies to downgrade is
heightened as some of the largest municipal issuers and state governors make public appeals for additional federal aid with the growing revenue shortfalls they are experiencing. A mitigating force will be the CARES Act grants of $150 billion to state and local governments to reimburse the costs of dealing with COVID-19, which will likely be sufficient to cover needed expenses during the crisis. The CARES Act also includes benefits to several municipal sectors including healthcare, airports, transit and education that will limit credit quality deterioration due to COVID-19. Because of the uncertainty associated with the duration and severity of the coronavirus outbreak and the magnitude and impact of federal assistance, we prefer essential service revenues sectors (electric, water/sewer, gas, waste disposal), which should fare well in this environment. AA rated and higher state/local governments with diversified revenues streams and strong pension systems should also prove relatively resilient.

Strategy positioning in the near term will emphasize sector diversification across both revenue and general obligation issues. A bias to economically defensive sectors such as water/sewer and public power represent key holdings. Stable issuers within hospital and airport sectors drive the yield profile. The strategy liquidity allocation remains adequate to capture potential attractive buying opportunities with a likely up-in-quality bias amid the economically challenging environment. We target strategy duration postures to approximate benchmark levels looking to mitigate risk during a potentially volatile interest rate environment. The flat municipal curve slope limits the incremental yield advantage from duration extension. We will look to reinvest cash among cheaper maturity portions of the curve and keep total portfolio duration within our targeted range.

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.

The performance data quoted represent past performance, which is no guarantee of future results. Share price and investment return fluctuate, and an investor’s shares may be worth more or less than original cost upon redemption. Current performance may be lower or higher than the performance quoted. Go to im.bnymellon.com for the fund’s most recent month-end returns. Not all classes of shares may be available to all investors or through all broker-dealer platforms.

Risks

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. Municipal income may be subject to state and local taxes. Some income may be subject to the federal alternative minimum tax for certain investors. Capital gains, if any, are taxable. Mortgage securities: Ginnie Maes and other securities backed by the full faith and credit of the United States government are guaranteed only as to the timely payment of interest and principal when held to maturity. The market prices for such securities are not guaranteed and will fluctuate. Privately issued mortgage-related securities also are subject to credit risks associated with the underlying mortgage properties. These securities may be more volatile and less liquid than more traditional government-backed debt securities. High yield bonds involve increased credit and liquidity risk than higher-rated bonds and are considered speculative in terms of the issuer’s ability to pay interest and repay principal on a timely basis. 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.

Asset allocation and diversification cannot ensure a profit or protect against loss in declining markets.
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.

The Bloomberg Barclays 3-, 5-, 7-, 10-Year Municipal Bond Index is composed of an equal-weighted composite of the 3-Year, 5-Year, 7-Year and 10-Year Bloomberg Barclays Municipal Bond Indices. It reflects investments of dividends and, where applicable, capital gain distributions. Investors cannot invest directly in any index.

Views expressed are those of the advisor stated 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.

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