WHY IT MAY BE TIME TO CONSIDER A CORE PLUS BOND FUND

NOT FDIC-INSURED | NO BANK GUARANTEE | MAY LOSE VALUE
After a 35-year bull run, bonds are coming under pressure as President Trump’s fiscal reforms and tighter Federal Reserve policy begin to bite. Nearly all Treasurys – aside from the short end – are in the red for the year, while investment grade corporate bonds are suffering one of their worst spells since the financial crisis (at late September).

That has meant that flexibility and diversification have become key, said Citywire AA-rated Gautam Khanna, portfolio manager of the BNY Mellon Insight Core Plus Fund.

‘If you think about the current cycle that we’re in,’ he said, ‘it’s 109 months old. Although we’re not calling an end any time soon, investors need to understand the changes that are occurring. Interest rates have been so low that people have reached for yield in all sorts of exotic places. With rates rising, not having a diversified ballast – essentially a hedge against markets – and an experienced manager is going to hurt.’

The best of both worlds

But now is not quite the time to go defensive, according to Khanna, particularly with the US economy accelerating at its fastest clip since early 2014 and with inflation running hot. ‘Yields may look slightly more attractive, but both Treasuries and investment grade corporates have suffered this year as rates moved higher,’ he explained. ‘That has really hurt many Core bond funds.’

Instead, it’s important to take a step back and remind oneself of the case for owning fixed income to begin with, he pointed out. ‘There are really two reasons. One is predictable income, and the other is for potential diversification benefits and a hedge against market risk.’

Unlike more rigid Core bond funds, which invest almost solely in Treasuries, investment grade bonds and mortgage-backed securities, ‘a core plus fund may provide both of these key objectives,’ he added. ‘There are times when you want to emphasize income at the expense of ballast when the economy is very strong, such as now, and there are times when you want to play defense and reduce your income. An actively managed Core Plus fund can do both very nicely.’

Generally speaking, Core Plus funds help to deliver higher income by investing in sub-sectors such as high yield and emerging market bonds, as well as international developed market bonds. They can also utilize derivatives to add returns and manage risks – such as hedging interest rate risk.

Casting a wider net

Given the pervading concerns about duration risk, investors are also giving non-Core markets greater consideration. Lower-rated investment grade credit, high yield, floating rate and securitized loans, and even Treasury inflation-protected securities are in vogue, as investors flee high grade credit.

‘With the economy doing well, these securities can provide a yield pick-up to a core or Barclays Aggregate index investor,’ Khanna continued. ‘As rates rise and certain sectors come under pressure, you want a manager that has the flexibility and mandate to make nimble asset allocation decisions. Investors can’t invest like they could several years ago.’
TOTAL RETURNS AND RANKINGS
Data to September 30, 2018

<table>
<thead>
<tr>
<th>Share class/inception date</th>
<th>Quarter</th>
<th>YTD</th>
<th>1YR</th>
<th>3YR</th>
<th>5YR</th>
<th>Inception</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class I (inception Q2/02/18)</td>
<td>0.54%</td>
<td>-1.23%</td>
<td>-0.53%</td>
<td>2.74%</td>
<td>3.28%</td>
<td>3.42%</td>
</tr>
<tr>
<td>Class A (4.5% max. load) (inception Q2/02/18)</td>
<td>-4.05%</td>
<td>-5.89%</td>
<td>-5.21%</td>
<td>1.10%</td>
<td>2.29%</td>
<td>2.79%</td>
</tr>
<tr>
<td>Morningstar Intermediate-Term Bond category percentile rank (Class Y)</td>
<td>–</td>
<td>–</td>
<td>22</td>
<td>11</td>
<td>6</td>
<td>–</td>
</tr>
<tr>
<td>Morningstar category rank/ Number of funds in category</td>
<td>–</td>
<td>–</td>
<td>203/1,039</td>
<td>88/902</td>
<td>42/796</td>
<td>–</td>
</tr>
<tr>
<td>Bloomberg Barclays US Aggregate Bond index</td>
<td>0.02%</td>
<td>-1.60%</td>
<td>-1.22%</td>
<td>1.31%</td>
<td>2.16%</td>
<td>–</td>
</tr>
</tbody>
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The performance data quoted represents 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. For funds with less than 1 year’s history, year-to-date and 3-month performance are not annualized. Go to dreyfus.com for the fund’s most recent month-end returns. The net expense ratio(s) reflect a contractual expense reduction agreement through 08/31/2019. Total Expense Ratios: Class A 2.05%, Class I 1.98%. Net Expense Ratios: Class A 0.70%, Class I 0.45%.

The BNY Mellon Insight Core Plus Fund (“the fund”) commenced operations after the assets of a predecessor mutual fund reorganized into the fund on February 2, 2018. Performance for Class Y is the performance from the predecessor fund. The total return performance figures for Class A and I shares of the fund represent the performance of the successor fund’s Class Y shares for periods prior to 2/2/18, the inception date for Class A and I shares, and the performance of Class A and I shares, from that inception date. Performance reflects the applicable class’s distribution/servicing fees since the inception date. Investors should consider, when deciding whether to purchase a particular class of shares, the investment amount, class restrictions, anticipated holding period and other relevant factors.

‘With rates rising, not having a diversified ballast and an experienced manager is going to hurt’

That added flexibility and freedom has certainly aided Core Plus managers, with the Citywire Core Plus sector outperforming its more traditional rivals on a one-, three- and five-year basis.

Putting it together

So how do Khanna and his team go about investing? And where are they finding the best opportunities right now? Unlike other Core managers who rely on a certain specialty, Khanna said his team takes a broad-based approach as its starting point and targets specific securities depending on the macro conditions.

‘I think many of the traditional Core managers tend to have a particular area of specialization,’ he said. ‘It could be credit all the time, or mortgage-backed securities all the time. What we’re looking to do is to have an active strategy that looks at what’s available at any point in time. We combine that with our top-down macro view in an effort to achieve the best outcomes.’

The BNY Mellon Insight Core Plus Fund can access high yield, emerging markets, asset-backed securities, as well as deeply subordinated bonds — when the timing makes sense, of course. Being able to invest in these more esoteric and underresearched areas has certainly helped to boost overall performance and source alpha relative to the fund’s peers. ‘These are all areas that are highly complex,’ Khanna said. ‘There are risks with all of them, as well as bigger rewards if you get it right generally. That’s why we’ve skewed the investment team heavily into these areas which are more inefficient and complex, but which have a better risk/reward profile if you do the research.’

Overall, the fund has a relatively large overweight to corporate bonds, both high yield and investment grade, as well as asset-backed and commercial mortgage-backed securities. It also has an effective duration of just 5.8 years. And while there is a temptation to reach for higher yields and potentially richer spoils, Khanna noted that his team follows a stringent risk management process that helps to limit the potential for drawdowns.

‘We have a really strong risk management culture,’ he said. ‘We’ve developed a proprietary model referred to as “Units of Risk.” The idea behind the model is that it enables various teams to communicate at the same level so we all understand the various risks being taken. It also helps portfolio managers eliminate any biases we have and ensures that we are getting adequately rewarded for risk that we’re taking.’

That diligent framework and Khanna’s experience and strong convictions have certainly paid off so far. The fund is a top-quartile performer over one, three and five years, including an annualized return of 3.24% (Class A at NAV) over five years.

‘We’ve been doing this for a long time, so we know to trust our instincts,’ Khanna said. ‘We don’t get bullied by the market or get shaken out of positions the moment they turn against us. If you’ve done your homework and have a high degree of conviction around your investment thesis, then you don’t pay attention to that noise. It’s all about sticking to a tried and tested process.’

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

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All investments involve risk including loss of principal. Certain investments involve greater or unique risks that should be considered along with the objectives, fees, and expenses before investing. 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. 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. 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. Currencies can decline in value relative to a local currency, or, in the case of hedged positions, the local currency will decline relative to the currency being hedged. These risks may increase fund volatility.

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