

Australian Enhanced Income Fund

June 2010 Investment Update and NAV

Trading details

The Australian Enhanced Income Fund ("Fund") traded at a discount to the most recently published NAV of a unit over the month of June. The volume weighted average price (VWAP) for June 2010 was \$6.26.

June 2010 NAV

The Fund's NAV at the close of business on June 30, 2010 was **\$6.566** per unit. This compares with the NAV of a unit at the close of business on May 31, 2010 of \$6.639. The change in NAV over the month of June 2010 represents a return of **-1.10%**. After the payment to unit holders registered at the close of business on June 30 of the 12.5 cent per unit cash distribution the Fund's ex distribution NAV of a unit was **\$6.441**. The franking benefit for the month of June was estimated to be **0.04%**.

| | June 2010 |
|---------------------------------|-----------|
| Australian Enhanced Income Fund | -1.10%* |
| UBS Warburg Bank Bill Index | +0.40% |

*Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance.

Events of June

- The ASX listed hybrid sector returned +0.65% for the month. This compares with the All Ordinaries Accumulation Index return of -2.60%,
- The breakdown in the correlation between the equity and listed credit market continues to bode well for the sector as a risk reduction tool at the portfolio level.

Fund performance

The Fund's NAV was weaker this month due to the under performance of a number of the non bank hybrid securities the Fund owns. Securities that underperformed over the month included PXUPA (-7.87%), SEVPC (-2.71%) and the unlisted AXA note (-2.05%) while GNSPA (+12.25%) and NFNG (+2.61%) made positive contributions. The Fund's net return for the year ended June 30, 2010 was a respectable +27.5%.

Year in review

The ASX listed hybrid sector staged a strong recovery over the year returning +17.3%. While return volatility was above long term average levels, it is pleasingly on a declining trend. Security issuance was muted with 5 new issues while issue redemptions numbered 3 in total. Individual company event risk continued to remain high with Babcock & Brown Infrastructure (formally BBI), Gunns (GNSPA) and Elders (ELDPA) contributing most to the volatility. On a positive note Paperlinx (PXUPA) announced recently it would resume coupon payments from June 30 this year with some prospect of making one of two previously missed coupon payments.

July 14, 2010

Default rates are declining but security prices are lagging

Fitch Ratings released an interesting report noting that High Yield default rates are running at an annual rate of around 1%. In other words virtually nothing is defaulting. This compares with last year's default rate of around 13% and a cycle average of 4% - 5%. We expect actual default rates to trend below average levels over the next few years. While the evidence is convincing that default rates decline in the period immediately following a recession, the most interesting and intriguing aspect is the lag in security prices. Credit markets globally have weakened since mid April and are priced well below the level implied by the actual default rate experience reported by Fitch. The implication being that credit markets are factoring in something significantly more sinister than they should be.

May credit growth data

Recent RBA data revealed that credit growth was anaemically positive for the month of May. While we have probably seen the bottom of the credit cycle, 4% annualised growth is still below nominal GDP growth and certainly well below the 11.6% of the last decade. Composition however, remains skewed towards housing, with credit advanced to business not growing on an annual basis. More encouragingly, monetary aggregates are heading upwards indicating that the threat of a credit induced recession has most likely passed.

Issued capital and NAV as at close of business 30 June 2010

| | 30 June 2010 | Previous month | Monthly change | Change over Quarter |
|--------------------------------|--------------|----------------|----------------|---------------------|
| Total number of ordinary units | 3,405,998 | 3,410,998 | -5,000 | -2,546 |
| Net Asset Value (NAV) | \$6.441* | \$6.639 | -1.10% | -0.44% |

* Ex Distribution. Excludes franking benefit. Past performance is not necessarily a guide to future performance.

Performance History

| | Feb 2010 | March 2010 | April 2010 | May 2010 | June 2010 |
|---------------------------------------|----------|------------|------------|----------|-----------|
| Change in NAV | -1.66% | +1.20% | +2.93% | -2.20% | -1.10% |
| Change in UBS Bank Bill Index | +0.37% | +0.33% | +0.35% | +0.38% | +0.40% |
| Comparison to Bank Bill Index | -2.03% | +0.87% | +2.58% | -2.58% | -1.50% |
| Franking benefit (<i>estimated</i>) | +0.01% | +0.18% | +0.06% | +0.12% | +0.04% |
| Total Return including franking | -1.65% | +1.38% | +2.99% | -2.08% | -1.06% |

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