

January 12, 2018



Australian Enhanced Income Fund - ASX Code "AYF" **December 2017 Investment Update and NAV**

December 2017 NAV and Fund performance

The Fund's NAV of a unit at the close of business on December 29, 2017 was \$**6.161** per unit. This compares with the NAV of a unit at the close of business on 30 November of \$6.107. After the payment of the \$0.0875 cash distribution due to unit holders registered on 29 December 2017 the Fund's ex-distribution NAV of a unit was \$6.0735. The change in NAV over the month of December represents a return of **0.88%**. The franking benefit for December 2017 was estimated to be **0.22%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	0.88%	1.79%	6.93%	5.38%
UBS(A) Bank Bill Index	0.14%	0.42%	1.75%	2.34%

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

Relative performance

Including the value of franking credits the ASX listed hybrid sector returned 0.97% for the month. This compares with the All Ordinaries Accumulation Index return of 2.03% and the UBSA Bank Bill Index return of 0.14%.

After fees but before the value of franking, the Fund underperformed the broader market marginally this month. The Fund's rolling annual net return, which excludes the benefit of franking but is net of all fees, for the 12 month period ending 29 December was 6.93%.

The year that was

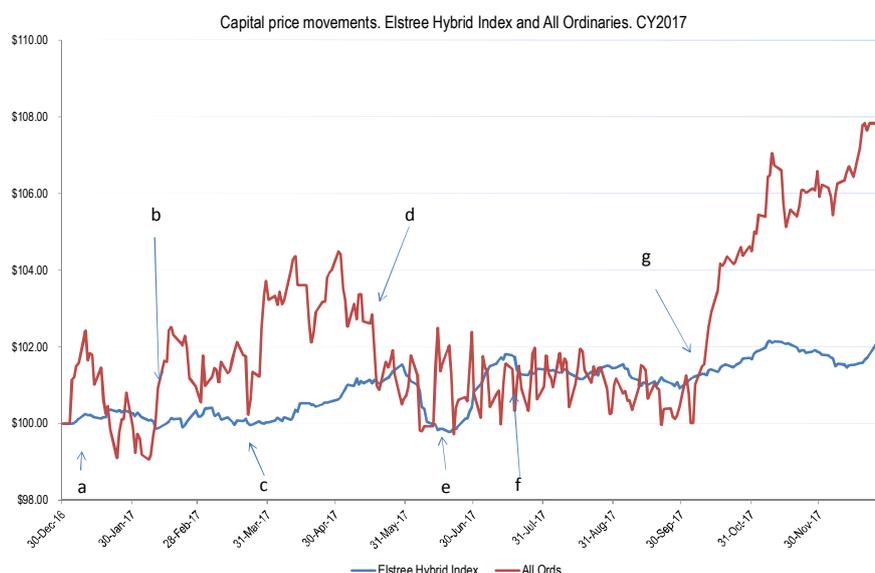
The chart overleaf details the capital price movements of the Elstree Hybrid Index and the All Ordinaries over 2017. The chart clearly shows the correlation of the return outcomes of the 2 markets. In 2017 the return outcomes were correlated in small movements (because sentiment is important), uncorrelated in large movements (because they are driven by different fundamentals) and highly correlated in catastrophes but we haven't had one of those for 10 years. We have highlighted with letters a number of significant events to occur over the year. They are;

- a) Bloomberg headline that Deutsche Bank and Unicredit CoCo coupons at risk. Reflects some panic about hybrids/CoCo's.
- b) Strong reporting season for Australian Equities. Leads to strong month for equities.
- c) Deutsche Bank hybrid reach \$100 after bottoming at \$75 in 2016 and \$85 at end of 2016. In hindsight this is the end of the European banking crisis. Deutsche Bank is not going broke, ending every journo's and hedge fund tenacious and lazy short of the past 4 years.
- d) Australian banks sink on news that the government will impose a levy on their borrowings. It also indicates that the banks are on the nose, so investors take a big stick to bank share

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- prices. Hybrids largely unaffected, indicating that the bank share price fall is largely PE compression rather than a fundamental indicator of bank solvency.
- e) Banco Popular, a zombie-ish Spanish bank, is put to death by the regulators with hybrid capital instrument holders receiving zero. A short sell off follows but very little long term effect on bank capital markets at a global or Australian level.
 - f) CBA issues a 30 year issue in US markets at 3.9%. Very cheap borrowing but also a very low margin (historically) over bond. An important indication of the lack of investment market concern about banks (or the world in general).
 - g) Equity markets take off. Small effect on hybrid market prices.



Fund ready reckoner. Fund metrics and portfolio characteristics at a glance

	November 2017	December 2017
Net Asset Value (NAV) * Ex-distribution.	\$6.107	\$6.0735*
Change in NAV month on previous month (mopm)*	0.36%	0.88%
Total investment return includes the value of franking (mopm)	0.43%	1.10%
Dividend (declared December 2017 and payable 15 January 2018)	n/a	\$0.0875
Percent franked (quarterly estimate @ 30% tax rate)	n/a	43.08%
Ex-distribution cash yield per annum (basis NAV)	5.73%	5.76%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.55%	6.59%
Investment grade issuer (including cash)	91%	92%
Fund average term	4.1 years	4.3 years
Major Bank Tier 1 exposure	49%	57%
Property exposure	6%	1.5%

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

For additional information please contact **Norman Derham** at Elstree Investment Management Limited on (03) 8689 1348 or by email info@eiml.com.au While the information in this report has been prepared with reasonable care Elstree Investment Management Limited accepts no responsibility for any errors, omissions or misstatements however caused. This is general securities information only and is not intended to be a securities recommendation. This information does not account for your individual objectives, needs or financial situation.