

Australian Enhanced Income Fund - ASX Code "AYF"

March 2018 Investment Update and NAV

March 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on March 29, 2018 was \$5.965 per unit. After the cash payment of \$0.0875 per unit to unit holders registered at the close of business on 29 March the ex-distribution NAV of a unit was \$5.877. This compares with the NAV of a unit at the close of business on 28 February 2018 of \$6.048. The change in NAV over the month of March represents a return of **(1.37%)**. The franking benefit for March 2018 was estimated to be **0.31%**.

| Performance | 1 month | 3 months | 12 months | 5 Year p.a. |
|----------------------------------|---------|----------|-----------|-------------|
| Australian Enhanced Income Fund* | (1.37%) | (1.79%) | 3.51% | 4.53% |
| UBS(A) Bank Bill Index | 0.14% | 0.43% | 1.74% | 2.28% |

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

Relative performance

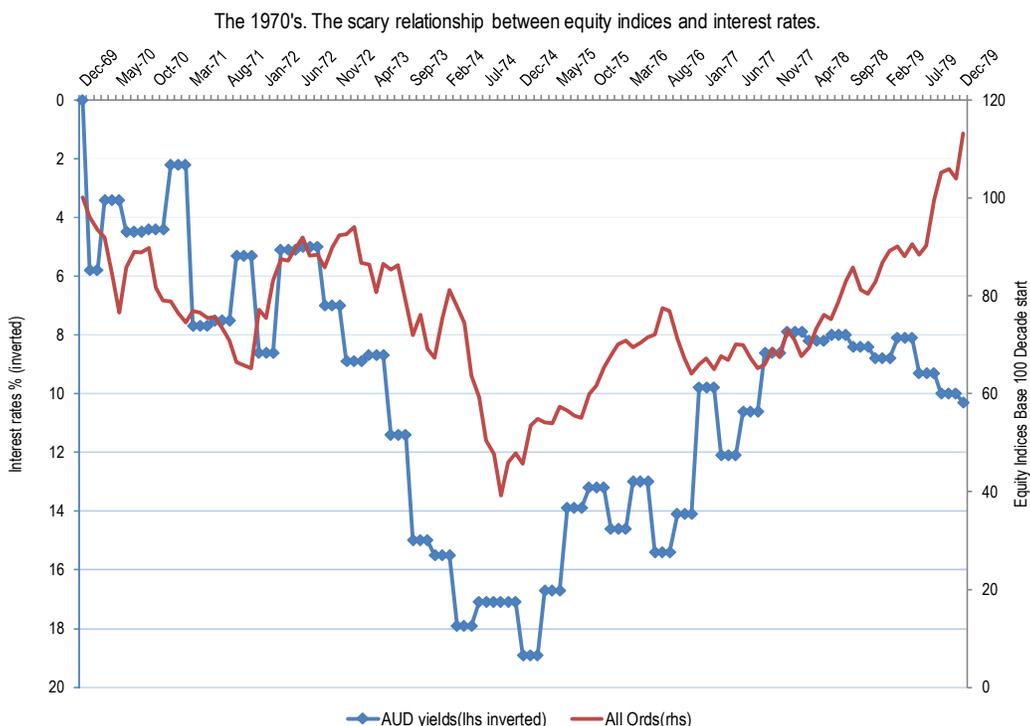
Including the value of franking the ASX listed hybrid sector returned (0.91%) for the month. This compares with the All Ordinaries Accumulation Index return of (3.55%) and the UBSA Bank Bill Index return of 0.14%.

After fees but before the value of franking, the Fund underperformed the broader market 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 March 2018 was 3.51%.

The scary relationship between interest rates and listed equities

The absolute level of interest rates is a major determinant of asset valuations particularly long duration assets such as infrastructure and equities. While we concede that there are other drivers of valuations including of course earnings growth, the mathematics of rising interest and bond rates are inevitably brutal on the present values applied to infrastructure and equity investments. It's reasonably safe to assume that interest rates have bottomed. We're not sure exactly how quickly they will back up and to what level, suffice to say they are still so far below any mean, median or economically justifiable level that there is a reasonable way to go yet. Despite the excellent returns applied to long duration assets over the past 10 years they are about to face strong headwinds.

The chart below shows what happened in the 1970's. Obviously, things aren't quite the same, but it's a spectacularly scary chart. We've shown the path of interest rates and the All Ordinaries Index since the decade beginning (the All Ordinaries Index is based at 100 while the interest rates axis is inverted) and guess what? They move in the same direction at the same time.



Hybrids are largely floating rate instruments and immunised from most of the effects of higher interest rates and inflation. Higher interest rates have a mixed, but positive, effect on credit. Defaults loss rate will increase in some sectors, but they will be confined to sub investment grade. Overall, higher inflation devalues debt and decreases the probability of default as, in nominal terms, company revenues increase while debt levels remain static.

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

| | February 2018 | March 2018 |
|--|---------------|------------|
| Net Asset Value (NAV) * Ex-distribution. | \$6.048 | \$5.877* |
| Change in NAV month on previous month (mopm)* | (0.71%) | (1.37%) |
| Total investment return includes the value of franking (mopm) | (0.66%) | (1.06%) |
| Dividend (declared March 2018 and payable 16 April 2018) | n/a | \$0.0875 |
| Percent franked (quarterly estimate @ 30% tax rate) | n/a | 50.23% |
| Ex-distribution cash yield per annum (basis NAV) | 5.79% | 5.94% |
| Ex-distribution grossed up yield basis NAV per annum (estimated) | 6.61% | 6.79% |
| Investment grade issuer (including cash) | 93% | 93% |
| Fund average term | 4.3 years | 3.7 years |
| Major Bank Tier 1 exposure | 57% | 52% |
| Property exposure | 1.5% | 2.0% |

* 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.