

## November 2011 Performance Review – Listed Hybrid Sector

### Sector Performance

#### Performance

The Elstree Enhanced Income Fund's Net Asset Value (NAV) decreased over the month of November from a price of \$0.7479 per unit to \$0.7349 per unit representing a return of -1.74%. This compares with the All Ordinaries Accumulation Index and the UBS All Maturities Bond Index returns of -3.43% and +1.73% respectively. The Fund's performance this month was negatively influenced by the poor performance of handful of discounted securities the Fund owns. The Fund's over the year net return (after fees and before adjusting for franking credits) decreased to 1.20% from 4.25% previously. The Fund's over the year gross return decreased from 5.83% to 2.76%.

### Events

Two more securities were announced with Origin and AFIC issuing listed debt. Both were denigrated by a number of commentators as 'too expensive' or 'too risky', but we think both have a place in a diversified portfolio.

### What happens when banks don't lend to each other

One of the hallmarks of financial crises is that banks stop lending to each other. Unless this process is stopped, a systemic crisis ensues which invariably ends in something really nasty. There's a lot of asinine garbage in the press about how central banks pumping liquidity into the system doesn't solve the problem, but merely exacerbates it. They are technically correct, but substantially wrong. If we go back to 2008, it was only the actions of the world's central banks which prevented a depression (and ensured we only got a recession). The chart below is a bit crowded but it shows what happened from March 08 to 2009. The OIS - LIBOR spread is the indicator of how much banks are lending to each other (low is good) while the US Bank index and the US Federal Reserve Balance sheet, (both indexed to 100 at March 09) are on the LHS.



*Liquidity is the real catalyst for equity markets*

What the chart shows is that banks slowed lending to each other before 2008 and interbank lending ceased in mid to late 2008. After the TARP capital injections into the US banks, interbank lending improved markedly. Bank share prices fell for another 3-6 months. The catalyst for the bottom seems to be the Federal Reserve's decision to start buying assets and reduce the risk that banks would be forced into further write downs and capital injections. Bank prices climbed off the bottom. The OIS - LIBOR spread continued to narrow over the rest of the year to reach normal levels where it remains today – in Europe it is a different story.

*So what? Europe is reliving 2008 that's what*

We have recently seen the European equivalent of the OIS - LIBOR spread increase to early 2008 levels which is dangerous and, if unsolved, will lead to a 2008 type event. The cause is clearly the political uncertainty and no-one knows whether Italy will restructure or whether the Euro will survive. We heard last week that banks had pulled limits on French banks and there was a rumour on 30 November that a "large European bank" was close to failure. Clearly the joint action of 8 central banks to provide liquidity aimed to short circuit the potential train crash. While it was an important move, we think that it's not the final solution. That will be when the ECB starts pumping liquidity into the system. The great news about Wednesday action is that it's the first indication that authorities realise they have a problem, but one that is solvable if they have the will to do something about it. On Wednesday they did something about it.

*One swallow doesn't make a summer*

In September's aggregate credit growth put in a 'pass' performance but in October it reverted to more recent form with a dismal 0.2% MOM increase for a 3.5% annual growth rate. Business credit growth is flat, housing credit growth is falling and given the prognosis for flat or negative house prices, may fall further. Most fascinating is "other personal" credit growth which includes credit cards and margin loans. This is now negative on an annual basis. There was a large fall in this category in 2009 when margin loans were called, but apart from that, the only time it has been negative since 1977 was in the early 90's recession. This is a sign that the domestic economy will go nowhere in the next 12 months.

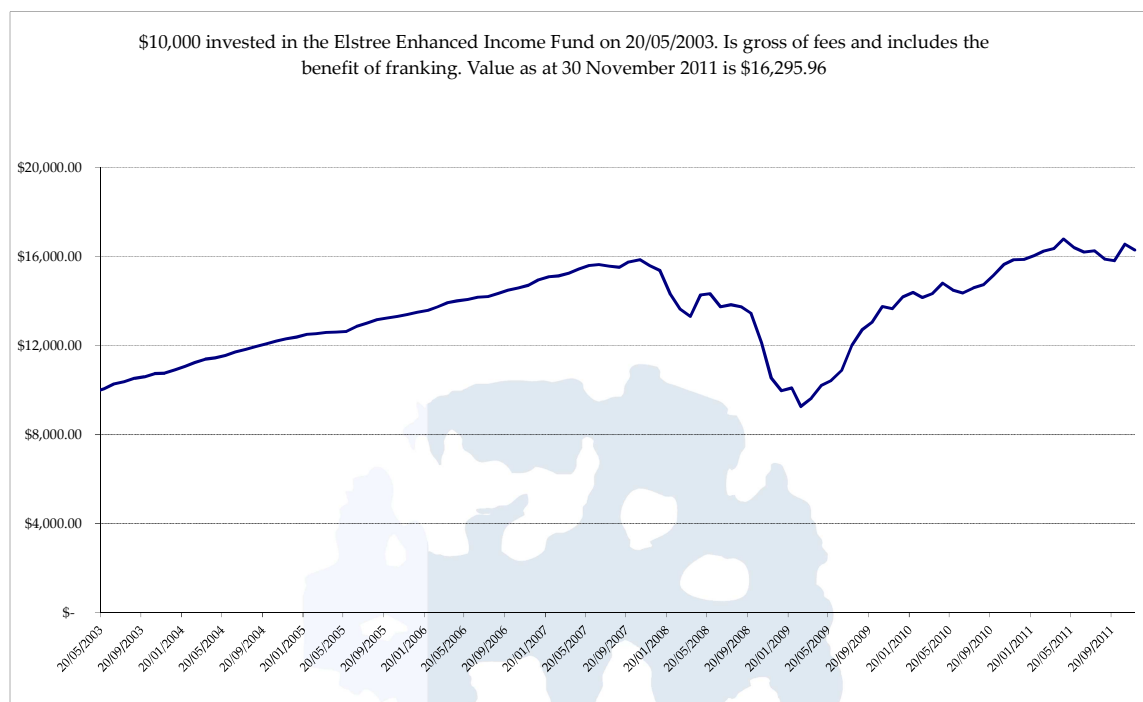
Performance Table	1 month	3 months	12 months	Since Inception % Per Annum
Elstree Enhanced Income Fund	-1.74%*	2.15%	1.20%	5.89%#
UBS Warburg Bank Bill Index	0.39%	1.20%	5.02%	5.55%

\*Returns are net of fees and do not include the benefit of franking credits.

# Return is gross of fees and includes the benefit of franking.

Past performance is not necessarily a guide to future performance

## Value of \$10,000 Invested on 20/05/2003



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