

Australian Enhanced Income Fund

October 2011 Investment Update and NAV

October 2011 NAV

The Fund's NAV at the close of business on October 31, 2011 was **\$6.514** per unit. This compares with the ex distribution NAV of a unit at the close of business on September 30, 2011 of **\$6.267**. The change in NAV over the month of October 2011 represents a return of +3.94%. The franking benefit was estimated to be 0.06%.

Trading details

The Fund traded at a discount to the most recently published NAV of a unit over the month of October. The volume weighted average price (VWAP) for October 2011 was **\$6.16**.

	October 2011
Australian Enhanced Income Fund	+3.94%
UBS Warburg Bank Bill Index	+0.42%

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

Events of October

- The ASX listed hybrid sector returned 2.31% for the month. This compares with the All Ordinaries Accumulation Index return of +7.17%,
- Woolworths announced the issue of a 5 year note. Demand was strong with the offer being 5 times oversubscribed.

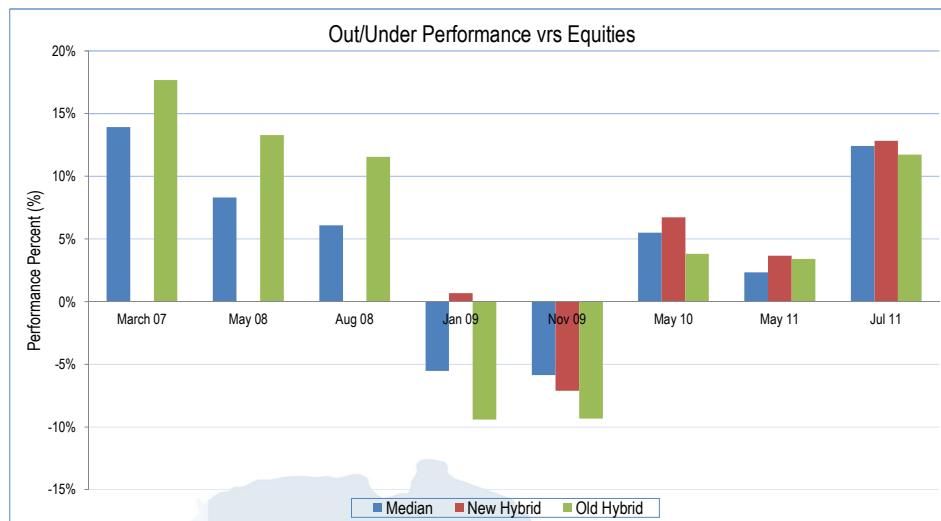
Fund and security performance

The Fund out performed the broader market this month on the performance of a small number of discounted securities that the Fund owns. Positive return contributions came from GNSPA (+100.6%), GMPPA (10.68%) and NFNG (+8.97%) while PXUPA (-2%) detracted from performance. The Fund's net return (excluding franking) for the year ended October 31, 2011 was 2.64% from 1.78% previously.

Is a changing investment base behind the declining return volatility and reduced equity market correlations?

We wrote in last month's review that we were buoyed by the breakdown in the return correlation between the All Ordinaries Index and the Elstree Hybrid Index. The reasons for the breakdown we suggested were many, including the attractive income yield and the balance sheet strength of the underlying hybrid issuers. While there can be no denying the influence these factors have had on the correlation between ordinary equity and hybrid security returns we now think a change in the composition of the investor base is beginning to exert an influence. There can be little doubt that the irrational behaviour and forced selling of hybrid securities by investors during the GFC reeked of speculation and excessive leverage – two things synonymous with the GFC. We suggest that speculation and leverage is now less prevalent than it once was and sight the superior risk return profile of securities issued post GFC compared to the risk return profile of securities issued pre GFC as a means of quantifying the outcome.

Relative out/under performance



Another intriguing aspect of the market is the performance of investment grade hybrids relative to equities during periods of market stress. The chart above denotes the out/under performance of investment grade listed credit relative to equities in 8 periods of market stress we identified since March 2007. While there is no logical reason why investment grade credit should underperform equities during a period of stress there were 2 episodes in 2009. We think this reflects capitulation where investors sell regardless of long term value – this was particularly true in early 2009 when the markets were in disarray. The other thing to note from the chart is the clear outperformance of securities issued post GFC with securities issued pre GFC. A continuation of this bodes well for the long term risk return profile of the sector.

Issued capital and NAV as at close of business 31 October 2011

	31 October 2011	Previous month	Monthly change	Change over Quarter
Total number of ordinary units	3,083,331	3,079,337	+3,994	-123,444
Net Asset Value (NAV)	\$6.514	\$6.267*	+3.94%	+0.44%

* Ex Distribution. Returns exclude the franking benefit. Past performance is not necessarily a guide to future performance.

Performance History

	June 2011	July 2011	Aug 2011	Sept 2011	Oct 2011
Change in NAV	-1.36%	+0.17%	-2.90%	-0.48%	+3.94%
Change in UBS Bank Bill Index	+0.41%	+0.39%	+0.45%	+0.39%	+0.42%
Comparison to Bank Bill Index	-1.77%	-0.22%	-3.35%	-0.89%	+3.52%
Franking benefit (estimated)	+0.10%	0.00%	+0.03%	+0.12%	+0.06%
Total Return including franking	-1.26%	+0.17%	-2.87%	-0.36%	+4.00%

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.