

INVESTMENT UPDATE

June 2022

Welcome to the latest Elstree Hybrid Fund (Cboe code “EHF1”) Newsletter.

Returns

Elstree Hybrid Fund (“EHF1”) produced a return of (1.27%)* in June being the equal of the broader market’s return of (1.27%)*. Since the fund was first listed on March 31, 2021, it has returned 2.3% p.a. (after fees, including franking) which is above the benchmark return of 2.0% p.a.

**()” denotes negative return outcome

We witnessed the second consecutive negative return month, which is quite uncommon. Prior to the onset of Covid19, we have to go back to the GFC to find lower 2 monthly or quarterly return outcomes. The drivers in June were 3 new issues and continued equity market volatility with the All Ordinaries falling c10% in June.

Returns of the Fund, the Elstree Hybrid Index (Franks Series) and Bank Bill/Term Deposit returns are summarised in the performance table below.

Performance figures as of 30 June 2022:

Performance as of 30 June 2022	1 MONTH	3 MONTHS	1 YEAR (p.a)	3 YEARS (p.a)
ELSTREE HYBRID FUND NAV + FRANKING (EHF1) *	-1.27%	-2.21%	0.12%	n/a
Distribution (cpu) (% franked)	1.6c (95%)	2.8c	14.2c	n/a
ELSTREE HYBRID INDEX (P.A.) **	-1.27%	-2.04%	0.32%	3.1%
BANK BILLS	0.0%	0.1%	0.1%	0.3%

* Elstree Hybrid Fund (EHF1) Investment Performance is return after all fees and after the value of franking credits.

** Elstree Hybrid Index includes the value of franking credits.

Top Holdings & contributors to returns:

Security	Return contribution	Security	Return contribution
CWNHB	0.09%	QUBHA	0.01%
OBLHA	0.02%	MQGPC	0.01%
NABPF	0.01%	NABPH	(0.18%)

The last quarter saw most securities producing negative total return outcomes with income of c1% being offset by capital losses. The capital losses can be approximated by multiplying the change in margin by the duration (term) of the security. In general, longer dated securities produced the largest capital losses due to the longer duration. As always there were exceptions (and we note that over 90%

of the Elstree Hybrid Index performed much better than the bond market, which produced a -3.8% return for the quarter). Some notable performers in June were the Crown Note, CWNHB (+4.5%), WBCPK (-4.5%), BOQPE (-1.2%), IAGPD (0.2%) and LFSPA (-6.0%). We note that Fund returns were largely in line with the Elstree Hybrid Index. There were few securities which either added or subtracted from performance in a material manner.

Market Commentary

BBSW watch

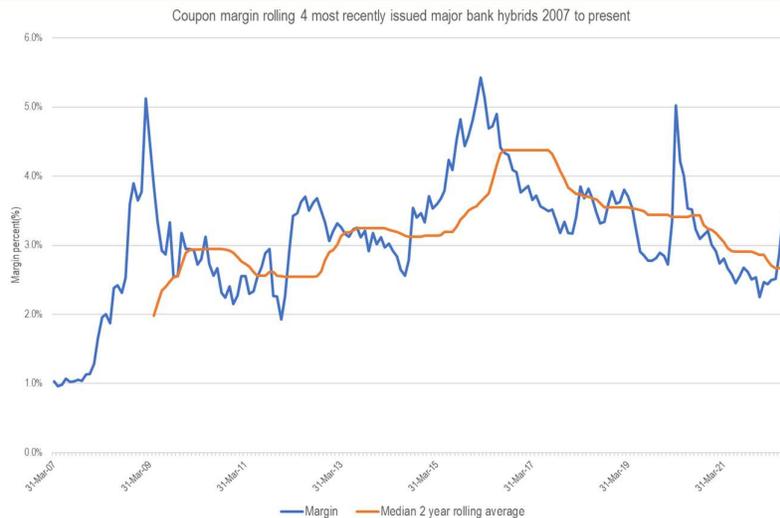
90dayBBSW is important to hybrid investors. Distributions are the sum of 90dayBBSW + the security margin, so a rising 90dayBBSW rate means higher distributions (typically, with a 3month lag). The table below shows the progression of 90dayBBSW over recent months and the market's projection of the level and timing of ultimate 90dayBBSW rate.

	Actual 90dayBBSW	Highest expected 90dayBBSW rate	Date of highest 90dayBBSW rate
28 February 2022	0.1%	2.6%	June 2024
31 March 2022	0.2%	3.5%	June 2023
30 April 2022	0.7%	3.5%	June 2024
31 May 2022	1.2%	3.7%	June 2023
30 June 2022	1.8%	4.0%	June 2023
12 July 2022	2.0%	3.7%	June 2023

Earlier this year, markets were way more pessimistic than economists regarding cash/BBSW rates. While very few economists were predicting cash rates of over 2%, the money markets were talking cash rates of >2.5% as early as March this year. Since then, economists have revised their estimates upwards, but still markets continue to expect higher cash rates than the economists. Expectations chop around a bit. Since the end of June and the time of writing, 90dayBBSW expectations fell by c0.3%. But if you believe that the market has any credibility (and they have been more accurate than economists/commentators/RBA), we are looking at BBSW rates of 2.75% - 3.0% by the end of the calendar year

Are margins good value yet?

The hybrid market and the Fund have generated mark to market capital losses over the past 6 months and this has been a function of traded spread margins widening. The chart below shows spread margins since 2007: we've used the margins on a rolling basis of the 4 most recently issued major bank hybrids. We've also included the rolling 2 year median (orange line).



We think there are some interesting points about the chart.

- The current margin of c3.4% is just above the post GFC median margin of 3.2%.
- If you have a > 2 year time horizon (and we think that's appropriate for hybrid investors), current margins have provided the foundation for high income levels and capital gains for most of the last decade. The only exception is in the 2015/2016 period, when buying at current spread margins would have produced capital losses for around 12 months with capital gains being generated thereafter (i.e if you bought in May 2015, when margins were around current levels, the total return would have been c2% for the 12 months to end May 2016, but c12% for the 12 months after that as margins reverted to more normal levels).
- We think that markets and hybrids are less risky investments than they were in 2015/2016 when there were high yield defaults, concerns about deflation, a pending recession in China and oil prices falling to \$27 barrel (compare that to current prices!). In addition, the Big 4 banks are much better capitalised now, having gone through a decade long recapitalisation process.

Overall we think there is good value emerging. Income returns from hybrids are soon going to be in excess of 6% annual rate, which is not too far away from long term equity market returns, close to decade long returns of hybrids and in excess of inflation. In addition, we don't see any of the supply issues that have affected returns over the past few months. CBA is the last of the big 4 banks that will issue a hybrid this year to replace the bumper sized c\$3b CBAPD which is due for redemption in December. We expect the CBA will issue a smaller size hybrid and may not accept new money bids.

If we see more equity market weakness, we will see stable or slightly lower hybrid returns, but this will only delay the return of higher returns.

Clarification. We wish to clarify a point made in the May 2022 Investment Update and Market Commentary in relation to the coupon interest payable on hybrid securities. Hybrid coupons are reset

on the first business day of the coupon interest period in which they are paid and are payable in arrears.

News & Media

Elstree Hybrid Fund (EHF1) has been mentioned in the following articles throughout the last six months, many of which are educational in nature.



- [How Hybrids fit into 2021 Income Portfolios](#) – Campbell Dawson | Elstree Hybrid Fund
- [The Hitchhiker’s Guide to Hybrids \(Part 1\)](#) – Bella Kidman | Livewire Markets
- [This is the secret to a diversified portfolio \(Part 2\)](#) – Bella Kidman | Livewire Markets
- [The forgotten asset class presenting exciting opportunities](#) – Bella Kidman | Livewire Markets



- <https://www.firstlinks.com.au/hey-boomer-first-home-buyers-fuss>
- <https://www.firstlinks.com.au/bank-hybrids-equity-market-weakness>
- <https://www.firstlinks.com.au/ddo-change-hybrids-bank-treasurers-nightmare>
- [Fascinating Hybrid Journey Last Year](#) – Campbell Dawson | Elstree Hybrid Fund



- [New Hybrid ETF on Chi-X](#) – Staff Reporter | Financial Standard



- [Support for Elstree Hybrid Fund](#) – Staff Reporter | Money Management



- [Hybrids remain attractive alternative for income generation](#) – Evergreen Ratings

More about Elstree Hybrid Fund (EHF1)

Elstree Hybrid Fund (Chi-X: EHF1) is an Exchange Traded Product or ETP. The fund is designed to allow retail investors to access the same successful and long-term investment strategy as our actively managed unlisted wholesale fund, the Elstree Enhanced Income Fund.

The Elstree Hybrid Fund is an ideal investment for investors seeking a cash or bank term deposit alternative investment that displays an acceptable and appropriate risk adjusted return outcome.

The Elstree Hybrid Fund has 'on market' liquidity provided by a market maker (Nine Mile). The iNAV which is estimate of the live NAV, is updated every 20 seconds.

Additional details can be found on the [Elstree Hybrid Fund website](#) or email [Norman Derham](#) or [Michelle Morgan](#) for further information.

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