

Australian Enhanced Income Fund - ASX Code "AYF"

February 2020 Investment Update and NAV

February 2020 NAV and Fund performance

The Fund's NAV of a unit at the close of business on 28 February 2020 was **\$5.844** per unit. This compares with the Fund's NAV of a unit at the close of business on 31 January 2020 of \$5.927. The change in NAV over the month of February represents a return of **(1.40%)**. The franking benefit for February was estimated to be **0.02%**. Including the value of franking the Fund returned **(1.38%)** over February 2020.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	(1.40%)	(0.29%)	4.19%	4.61%
UBS(A) Bank Bill Index	0.08%	0.23%	1.30%	1.68%

*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 market returned (1.74%) for the month. This compares with the All Ordinaries Accumulation Index return of (8.08%) and the UBSA Bank Bill Index return of 0.08%. After fees and before the value of franking, the Fund outperformed the broader market this month. Over 3 years the Fund's rolling annual net return, which excludes the benefit of franking but is net of all fees, for the period ending 28 February 2020 was 4.61%.

A word about the way the hybrid market works and fund out performance

The month was dominated by 2 events, one relatively commonplace, the other less so! The NAB announced, the redemption (and roll) of the \$1.34 billion NABPC security and the issue of a new security, NABHG. There was good demand for the new issue, which was priced at the bottom end of the guidance range at 295 over 90 day BBSW. Not surprisingly, the NAB 'upsized' the issue from initial indications of c\$750 million to \$1.95 billion. While some short-term price negativity was expected due to the NAB issue being upsized, pricing was further impacted by the coronavirus induced, equity market drawdown. In-line with our expectations, an equity market 'delta' of around 0.1 ensued, although the delta was a little higher due to the fact that the hybrid market was already reacting negatively to the upsizing of the NAB issue. We anticipate the hybrid market will find a floor soon enough – most likely when risk free term deposit rates fall below 1%.

The observant among you will note that the portfolio's metrics changed materially over the month (refer table overleaf). The portfolio's credit term declined sharply, our weighting to Bank issued Tier 1 securities declined and the cash yield of the underlying portfolio fell (the cash yield referenced in the table overleaf is basis the NAV). These changes were due almost entirely to our increased cash weighting which now stands at just under 25%. We weighted more heavily to cash in anticipation of the NABHG issue being upsized. Our increased cash weighting not only reduced our equity market delta but it also afforded us with significant out performance of +0.36% (including the value of franking) of the Elstree Hybrid Index. Investors will note that we plan to deploy our surplus cash in the coming weeks when we perceive that hybrid securities are cheapest.

With an eye to income generation we read an interesting note last month on dividends on listed equities and thought we would share some of the commentary. In summary, the note compiled by Stephen Hillebrecht of Product Strategy in the US articulated that with the coupon rates on risk free bonds so low investors were 'forced' to seek alternative assets to generate income. The one sub sector of the broader market that was attracting most attention was dividend paying stocks. For the first time in 4 years the dividend yield of the S&P 500 exceeded the 10 years bond rate. While this in itself is a compelling enough reason to focus on this sector of the market Hillebrecht opined that such securities not only provided income today at reasonable prices (read "yield") but they provided an income stream that would grow over time. In an example he sighted a \$10,000 investment in the S&P 500 in 1976. 44 years later that investment would generate an annual income return of 65% or \$6,500 (this ignores the capital growth which on a \$10,000 investment exceeded \$350,000!).

We have our own homegrown example, the recently redeemed Multiplex SITES security, MXUPA. At the GFC's nadir in March 2009 the MXUPA security was trading at a price of \$18.40 per \$100. At the time the security was paying a 'stepped up' coupon of 3.90% over 90 day bbsw (bbsw was priced at 4% around about the same time). This meant that the annual coupon payment approximated to \$7.9 on an initial investment of \$18.40. This represented a staggering income yield of 43% (it also meant that the initial investment of \$18.40 would be 'paid back' by income in just over 2 years reducing the risk materially!). While the yield on the security just prior to redemption on 31 December 2019 was a modest 4.8%, the yield on the initial investment of \$18.40 was still a mouth watering 26% (i.e \$4.8 over \$18.40). The table below details this information.

MXUPA	Market yield March 2009	Market yield December 2019	Yield on initial investment (December 2019)
Price	\$18.40	\$100	\$18.40
Coupon (\$)	\$7.90	\$4.80	\$4.80
Yield (%)	42.93%	4.80%	26.08%

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

	Jan 2020	Feb 2020
Net Asset Value (NAV). "#" denotes "Ex distribution".	\$5.927	\$5.844
Change in NAV month on previous month (mopm)*	0.78%	(1.40%)
Change in NAV including the value of franking (mopm)	0.79%	(1.38%)
Dividend paid 15 January 2020. Next dividend due - 15 April 2020.	n/a	n/a
Percent franked (<i>quarterly estimate @ 30% tax rate</i>).	n/a	n/a
Cash yield per annum (basis NAV and annual cash dividend of \$0.28cpu).	4.72%	4.76%
Grossed up yield (basis NAV) per annum (<i>estimated</i>)	5.57%	5.61%
Investment grade issuer (including cash)	92.3%	92.9%
Fund average term	3.30 years	2.21 years
Major Bank Tier 1 exposure	43.6%	30.5%
Property exposure	0.00%	0.00%

* Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance. # Refer to change of dividend announcement 2 October 2019. 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.