

Australian Enhanced Income Fund - ASX Code "AYF"

May 2020 Investment Update and NAV

May 2020 NAV and Fund performance

The Fund's NAV of a unit at the close of business on 29 May 2020 was **\$5.841** per unit. This compares with the Fund's NAV of a unit at the close of business on 30 April 2020 of \$5.778. The change in NAV over the month of May represents a return of **1.09%**. The franking benefit was estimated to be **0.02%**. Including the value of franking the Fund returned **1.11%** over May 2020.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	1.09%	1.24%	3.02%	4.11%
UBS(A) Bank Bill Index	0.09%	0.16%	0.97%	1.58%

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

Relative performance

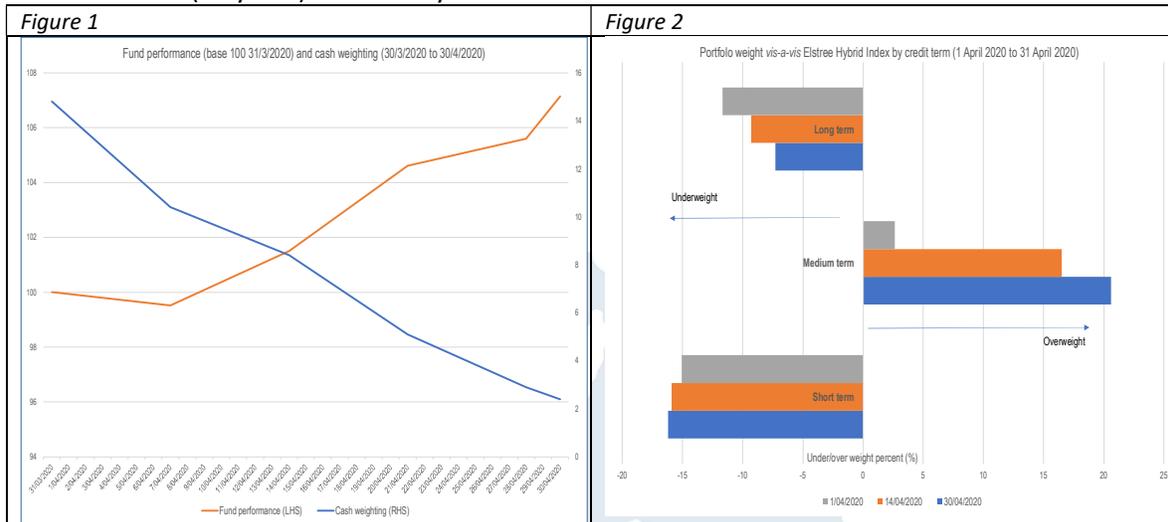
Including the value of franking the ASX listed hybrid market returned 1.11% for the month. This compares with the All Ordinaries Accumulation Index return of 5.04% and the UBSA Bank Bill Index return of 0.09%. After fees and before the value of franking, the Fund performed in-line with the broader market this month returning 1.09%.

Whether as a manager of money you perform well, or you perform less well, investors are always interested to understand how you did what you did. We thought, without fanfare, we would articulate how we were able to achieve a material out-performance of the broader market in April.

While we understand that markets are markets and they will do whatever they do irrespective of the extent of our quantitative analysis and qualitative thought processes the events of both March and April were extraordinary. The market in April was stronger for a variety of reasons including the fact it was heavily sold down in March, due readers will recall, to the panic and indiscriminate selling of securities by investors on or around 23 March. And because the 'trading window' is, extremely narrow sellers swamped buyers with the result that prices fell sharply and randomly exceeding, as a collective, on March 23 the 5.98% decline in the broader equity market. While we were of the opinion in March that the hybrid market displayed all the classic symptoms of being 'oversold' and was ripe for retracement we were yet to be convinced.

As if on cue in early April, the US Federal Reserve provided the spark for a repricing of risk assets when it announced that it would begin to buy, in addition to investment grade quality debt and ETF's, a broader range of debt including sub investment grade debt. This was the signal for us to continue to deploy our surplus cash which, at the beginning of April stood, as a percentage of Fund assets, at 15% (it was above 20% on March 27). The broader market, also buoyed by the Fed's announcement, rallied strongly. While we said in our review that the Fund's performance over April was a function of a number of things including, a strong underlying market and the Fund's relatively small size it was really our strategic individual security and sector selection combined with a material

change in the cash weighting that drove the performance both in absolute and relative terms. *Figure 1* below shows the performance of the Fund vis-à-vis the cash weighting while *Figure 2*, highlights our sector bias, which became more pronounced as the month progressed, to securities that we classify as, ‘medium term to maturity securities’ (i.e securities with a term of 2 – 5 years). You will note we were significantly under-weight over the course of the month both long term (>5 years) and short term (<2 years) to maturity securities.



Despite the market recovering materially in April we think it still presents as better than ‘fair value’. It represents value by almost any long term historic, absolute or comparative measure. While we recognise there are risks, for example the level of default activity on issuer balance sheets remains highly uncertain, history points to ongoing margin compression (prices rising) precipitated by buying at market spread margins, at or around current levels (i.e 4.00% - 4.50% over bbsw).

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

	April 2020	May 2020
Net Asset Value (NAV). ** denotes “Ex distribution”.	\$5.778	\$5.841
Change in NAV month on previous month (mopm)*	7.02%	1.09%
Change in NAV including the value of franking (mopm)	7.03%	1.11%
Dividend payable 15 May 2020*. Next dividend due - 15 July 2020.	n/a	n/a
Percent franked (quarterly estimate @ 30% tax rate).	n/a	n/a
Cash yield per annum (basis NAV and annual cash dividend of \$0.22cpu).#	3.81%	3.76%
Grossed up yield (basis NAV) per annum (estimated)	4.67%	4.62%
Investment grade issuer (including cash)	94.1%	93.2%
Fund average term	2.95 years	3.19 years
Major Bank Tier 1 exposure	53.0%	55.6%

* Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance. # Refer to change of dividend announcement 6 May 2020. 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.