December 13, 2019

Australian Enhanced Income Fund - ASX Code "AYF" November 2019 Investment Update and NAV

November 2019 NAV and Fund performance

The Fund's NAV of a unit at the close of business on November 29, 2019 was $**5.931** per unit. This compares with the Fund's NAV of a unit at the close of business on 31 October 2019 of $5.921. The change in NAV over the month of November represents a return of **0.17%.** The franking benefit for November was estimated to be **0.03%.** Including the value of franking the Fund returned **0.20%** over November 2019.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	0.17%	(0.15%)	6.22%	5.64%
UBS(A) Bank Bill Index	0.08%	0.25%	1.58%	1.75%

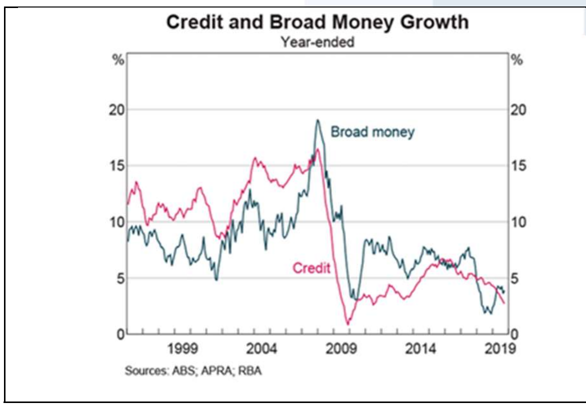
*Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance.

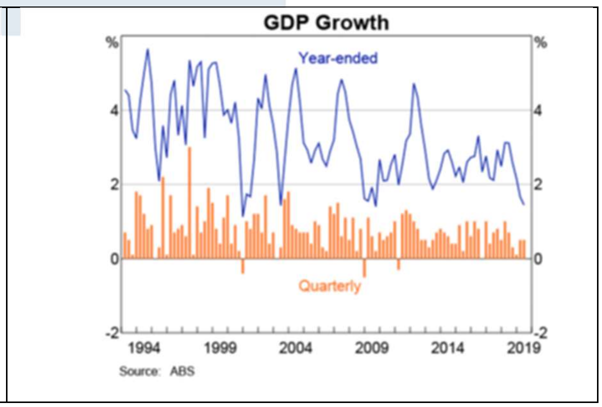
Relative performance

Including the value of franking the ASX listed hybrid market returned 0.21% for the month. This compares with the All Ordinaries Accumulation Index return of 3.07% and the UBSA Bank Bill Index return of 0.08%. After fees but before the value of franking, the Fund performed in line with 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 30 November 2019 was 5.64% p.a.

The relationship between credit growth and economic growth

As investors in hybrid capital instruments, which are contingent upon bank balance sheet growth, credit growth has always been of interest to us. It has also been of interest to us because it is a widely held proxy for economic growth. In commentaries past, we used to reference its' release. It's interesting that we haven't referenced it because it accords closely with our sanguine view of hybrid security issuance. The fact is that credit growth (red line in the left hand chart below) is now growing at a pace last experienced in the immediate post GFC period in early 2009. It is probably, of course, no coincidence that economic growth too is slowing (right hand chart - blue line YoY).





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A slowing rate of credit growth goes 'hand in glove' with bank balance sheet growth and is one of the reasons why there has been a benign period of hybrid security issuance by the majority issuers, the banks. This accords with the banks' targeting outstanding hybrid security issuance at approximately 2% of their risk weighted assets (RWA). In the short term it is hard to see bank balance sheets expanding materially, which is one of the reasons we are confident about the supply of new hybrids and as a consequence, the current pricing of hybrid securities. The lack of bank balance sheet growth is a story in itself. Is it that the demand for credit is slowing, is it the proliferation of non-bank, non-regulated lenders, or is it something deeper, perhaps (even?) the over regulation of the banks more broadly and what that means for credit creation?

With interest rates at record low levels and likely to remain low for an extended period, which, everything being equal, should engender confidence in borrowers, it would be hard to argue that the demand for credit would be slowing. We understand the affordability argument with respect to housing, but house prices have fallen, so too have borrowing costs and there are a plethora of 'one off' packages available to first home buyers and deposit constrained buyers. Non-capital constrained lenders such as the industry super funds, which are not included in official credit growth figures, have increased their share of the lending market and are without doubt a factor.

We understand APRA's desire for the banks to be "unquestionably strong" but could the combination of more stringent capital, liquidity and term funding requirements be contributing factors behind sluggish credit growth which is contributing to sluggish economic growth? We think there could be a link which is evidenced by the tighter lending standards applied by the banks (tried getting a loan lately?). The irony is that while making the banks safer entities by imposing restrictions on them it is giving rise to a new cohort of lenders that are not capital constrained and not highly regulated. The lending landscape is changing and that is a little concerning to us. We suspect, in time, there may be a 'softening' of bank regulation to counter the rapid growth in the new cohort of non capital constrained lenders. Now, however, is not that time.

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

	Oct 2019	Nov 2019
Net Asset Value (NAV).	$5.921	$5.931
Change in NAV month on previous month (mopm)*	(0.25%)	0.17%
Total investment return includes the value of franking (mopm)	(0.23%)	0.20%
Dividend paid 15 October 2019	n/a	n/a
Percent franked (*quarterly estimate @ 30% tax rate*).	n/a	n/a
Cash yield per annum (basis NAV). Dividend change announced 2 October.	4.73%	4.70%
Grossed up yield (basis NAV) per annum (*estimated*)	5.57%	5.56%
Investment grade issuer (including cash)	89.8%	90.0%
Fund average term	3.58 years	3.60 years
Major Bank Tier 1 exposure	47.9%	47.9%
Property exposure	1.70%	1.70%

* 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