November 14, 2019

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

October 2019 NAV and Fund performance

The Fund's NAV of a unit at the close of business on October 31, 2019 was $**5.921** per unit. This compares with the Fund's ex-distribution NAV of a unit at the close of business on 30 September 2019 of $5.936. The change in NAV over the month of October represents a return of **(0.25%).** The franking benefit for October was estimated to be **0.02%.** Including the value of franking the Fund returned **(0.23%)** over October 2019.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	(0.25%)	(0.10%)	5.59%	5.79%
UBS(A) Bank Bill Index	0.08%	0.25%	1.65%	1.77%

*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 (0.15%) for the month. This compares with the All Ordinaries Accumulation Index return of (0.37%) and the UBSA Bank Bill Index return of 0.08%. After fees but before the value of franking, the Fund underperformed 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 31 October 2019 was 6.23% p.a.

Where to from here with short term benchmark interest rates?

The Reserve Bank of Australia (RBA) has, among its objectives, been mandated to maintain full employment and ensure price stability over the cycle. It would appear, if we are reading the tea leaves correctly, that there is scope for the benchmark overnight cash rate as determined by the RBA to go go lower. The unemployment rate in Australia is currently higher than the so called non-accelerating inflation rate of unemployment or NAIRU as estimated by the RBA. In laymen 'speak' the NAIRU is the benchmark unemployment rate for assessing the degree of spare capacity and inflationary pressures that exist (or don't exist) in the labour market. While estimates of what the current NAIRU rate actually is, vary, the RBA has hinted that it approximates to 4.5%. This means, with Australia's unemployment rate at '5.2%' there is scope for the RBA, in order to meet its objective of full employment, to reduce the cash rate or ease monetary conditions still further.

While nominal interest levels have not been lower, in real, inflation adjusted terms, they are not as low as they might appear. Research from the National Australia Bank recently pointed to the fact that real cash rates were not "extreme relative to history". In a note to investors the NAB said that while the real cash rate was below what it was in previous downturns it was well above recent (is there such a thing?) recessions in Australia. This means that monetary policy is not as "loose" as you might think, which simply increases the probability, in the absence of price pressures, that the RBA will reduce the cash rate again in its pursuit of full employment. Figure 1 overleaf summarises the NAB's findings.

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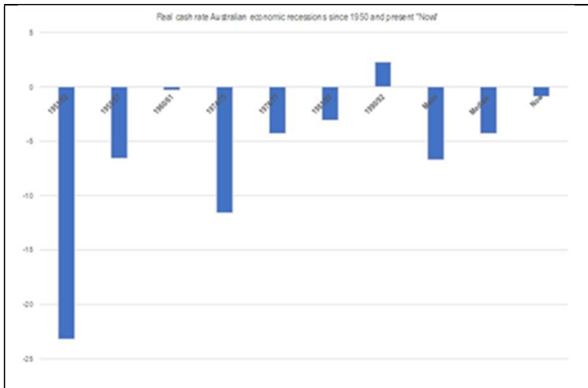	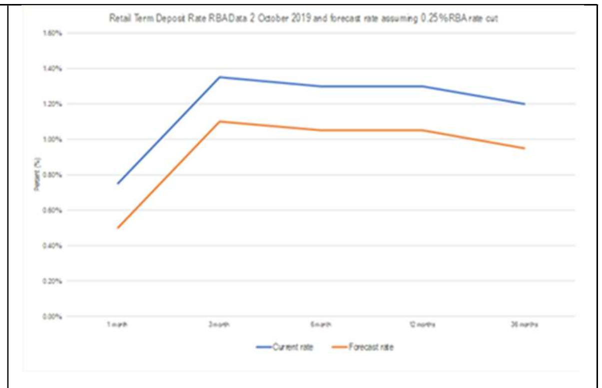
Figure 1. Source: NAB Markets Monthly	**Figure 2**. Source: RBA and Elstree (Forecast)

With benchmark short term interest rates likely to decline further (Figure 2) investors in hybrid securities, because of the yield differential, are well placed to be a direct beneficiary. As an investor in a major bank issued hybrid of a 4 year term you can expect to return (including the value of franking) over the security's life, almost 4 times what you can earn from a term deposit. While there are risks associated with investing in hybrids the most significant risk, that of default, is becoming increasingly more remote as the majority issuers, the banks, have complied with more stringent capital adequacy and funding requirements of the regulator. While there is some probability of equity conversion, it too is remote, being enforceable by the regulator in the case of a capital breach or a worst case scenario, so called, 'non-viability'. While it is indeed possible to buy one or two securities and gain 'market exposure' as an investor you are better off in a 'risk' sense to have a more diverse exposure through a managed fund. Not only do our portfolios typically contain around 35 securities (so there is a diversification benefit) across a range of sectors and sub sectors, including banking, insurance, building and construction and infrastructure but we, as professional managers of credit assets, are well versed on the risks including default and equity conversion.

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

	Sept 2019	Oct 2019
Net Asset Value (NAV) # Ex-distribution of $0.08 cpu).	#$5.936	$5.921
Change in NAV month on previous month (mopm)*	(0.07%)	(0.25%)
Total investment return includes the value of franking (mopm)	0.17%	(0.23%)
Dividend paid 15 October 2019	$0.008 cpu	n/a
Percent franked (*quarterly estimate @ 30% tax rate*).	51.27%	n/a
Cash yield per annum (basis NAV). Dividend change announced 5 October.	4.72%	4.73%
Grossed up yield (basis NAV) per annum (*estimated*)	5.55%	5.57%
Investment grade issuer (including cash)	89.7%	89.8%
Fund average term	3.38 years	3.58 years
Major Bank Tier 1 exposure	50.1%	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 5 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.

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