

## INVESTMENT UPDATE

September 2022

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

### Returns

Elstree Hybrid Fund (“EHF1”) produced a return of 1.19% in September, below the broader market’s return of 1.33%. Since the fund was first listed on 31 March 2021, it has returned a cumulative return of 6.3% (after fees, including franking) which is above the benchmark return of 5.8%.

We’ve now had 3 months of large returns. The Elstree Hybrid Index quarterly return of 3.7% is the 7<sup>th</sup> largest quarter over the last decade. Despite equity market volatility, traded spread margins contracted again resulting in higher hybrid security prices. We believe the increase in prices is a consequence of continued demand due to the high income levels, low Term Deposit (TD) rates and expectations of limited amounts of new hybrid primary market supply (i.e IPO’s).

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

### Performance figures

Performance as of 30 September 2022	1 MONTH	3 MONTHS	1 YEAR (p.a)	3 YEARS (p.a)
ELSTREE HYBRID FUND NAV + FRANKING (EHF1) *	1.2%	3.9%	3.5%	n/a
Distribution (cpu) (% franked)	3.4c (93%)	4.6c (76%)	15.6c (66%)	n/a
ELSTREE HYBRID INDEX (P.A.) **	1.3%	3.7%	3.3%	3.8%
BANK BILLS	0.15%	0.4%	0.5%	0.4%

\* Elstree Hybrid Fund (EHF1) Investment Performance is net of all fees and includes 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
NABPH	0.13%	RHCPA	0.11%
WBCPJ	0.12%	NABPF	0.10%
CBAPJ	0.11%	AYUPA	(0.05%)

### Income Funds: not a great year

If you are an investor, most of your investments would have done badly this year. Even most income type investments have generated historically poor performances, although in hindsight some of the structural risks were ignored. The very useful **Yield Report** ([www.yieldreport.com.au](http://www.yieldreport.com.au)) publishes a

weekly report of income ETFs. Even we didn't realise how poorly some ETFs performed, but we think there are some useful lessons to be learned. The extract from the **Yield Report** below covers most of the ETFs and EHF1 is highlighted. It looks like returns don't include the value of franking which makes the hybrid funds even better.

NAME	SYMBOL	CLOSE PRICE	WEEK CHANGE	*1M RETURNS(%)	*1Y RETURNS (%)	RUNNING YIELD (%)	FUND SIZE (\$m)
BetaShares Australian High Interest Cash ETF	AAA	50.10	-0.07	0.17	0.56	0.73	1887
BetaShares Australian Government Bond ETF	AGVT	41.55	0.29	-4.03	-16.88	2.14	363
BetaShares Australian Major Bank Hybrids Index ETF	BHYB	9.90	-0.04	0.67	0.28	2.73	194
iShares Core Cash ETF	BILL	100.31	-0.06	0.17	0.37	0.37	350
SPDR S&P/ASX Australian Bond Fund ETF	BOND	23.69	0.16	-2.90	-13.01	0.93	39
Betashares Legg Mason Australian Bond Fund	BNDS	23.24	0.15	-2.60	-12.25	1.47	219
Betashares Australian Investment Grade Corporate Bond ETF	CRED	21.61	0.12	-2.64	-16.84	3.64	434
Daintree Hybrid Opportunities ETF	DHOF	9.23	-0.13	0.26	n/a	1.95	18
<b>Elstree Hybrid Fund</b>	<b>EHF1</b>	<b>5.10</b>	<b>0.01</b>	<b>1.74</b>	<b>0.80</b>	<b>3.06</b>	<b>22</b>
elinvest Core Income Fund	ECOR	47.20	-0.13	0.16	-3.11	4.01	19
VanEck Vectors Australian Floating Rate ETF	FLOT	24.77	-0.03	0.17	-1.21	1.17	402
Betashares Sustainability Leaders Diversified Bond Hedged ETF	GBND	20.46	-0.01	-3.98	-14.39	2.31	180
BetaShares Global Government Bond 20+ Year ETF Currency Hedged	GGOV	15.73	-0.36	-3.88	-23.44	1.65	10
SPDR S&P/ASX Australian Government Bond Fund ETF	GOVT	23.32	0.22	-3.21	-13.83	1.33	28
BetaShares Active Australian Hybrids Fund ETF	HBRD	10.12	-0.02	0.68	0.52	2.76	1897
iShares Core Composite Bond ETF	IAF	98.73	0.39	-2.55	-11.69	1.59	1716
iShares Treasury ETF	IGB	96.51	0.42	-2.75	-12.24	0.62	367
iShares Global High Yield Bond ETF	IHHY	86.09	-0.39	-3.47	-11.28	3.85	87
iShares Core Global Corporate Bond ETF	IHCB	88.50	-0.49	-3.63	-14.33	2.23	301
iShares J.P. Morgan USD Emerging Markets Bond ETF	IHEB	69.79	0.67	-2.72	-22.40	6.35	36
iShares Government Inflation ETF	ILB	116.30	2.62	-2.67	-10.94	0.85	529
iShares Enhanced Cash ETF	ISEC	100.45	-0.12	0.18	0.34	0.43	264
Betashares Australian Composite Bond ETF	OZBD	43.56	0.25	-2.93	n/a	2.02	155
VanEck Vectors Australian Corporate Bond Plus ETF	PLUS	15.90	-0.01	-1.94	-12.62	2.77	226
BetaShares Australian Bank Senior Floating Rate Bond ETF	QPON	25.62	-0.04	0.54	-0.50	1.29	571
Russell Australian Select Corporate Bond ETF	RCB	19.17	0.16	-0.52	-5.74	0.55	263
Russell Australian Government Bond ETF	RGB	18.52	0.15	-3.57	-0.94	2.09	80
Russell Australian Semi-Government Bond ETF	RSM	18.70	0.15	-1.98	-0.73	0.13	46
VanEck Vectors Australian Subordinated Debt ETF	SUBD	24.62	0.01	0.89	-1.16	2.29	292
Vanguard Australian Corporate Fixed Interest ETF	VACF	47.70	0.30	-1.33	-9.16	1.13	577
Vanguard Australian Fixed Interest Index ETF	VAF	44.14	0.25	-2.55	-11.63	1.57	1455
Vanguard Global Aggregate Fixed Interest Index Hedged ETF	VBND	40.63	-0.04	-3.15	-12.15	1.54	474
Vanguard International Credit Securities Index ETF	VCF	36.87	-0.04	-3.15	-13.66	2.41	170
Vanguard Ethically Conscious Global Aggregate Bond Index Hedged ETF	VEFI	41.53	-0.17	-3.16	-11.91	1.28	56
Vanguard Australian Government Bond Index ETF	VGB	45.23	0.29	-2.78	-12.29	0.50	717
Vanguard International Fixed Interest Index ETF	VIF	38.07	0.00	-2.88	-10.69	1.67	615
ActiveX Ardea Real Outcome Bond Fund ETF	XARO	23.74	-0.31	0.62	-1.36	7.42	863

\*Closing price as at end of week. Returns in AUD before fees

For those of you who have invested in EHF1, congratulations (and thank you). Often, it's not easy investing in smaller managers, but EHF1 has outperformed every other ETF in the survey, and some by material amounts. Being large or having a well known brand is not a guarantee of success.

We think there are other important lessons. They are;

- **Diversify you risks:**

- The major risk of a hybrid fund is that the issuers won't be sufficiently viable in 4 or 5 years to refinance the hybrid. As we noted previously, WBC has paid a dividend on its ordinary shares every year for the past 205 years, so we think that viability risk is very much a fat tail risk. Liquidity risk and spread margin risk have not been major.
- Most of the other funds in the income sector have either duration or default risk. Duration risk has been underestimated until now (because yields only ever go down, right?) and we haven't seen a default cycle for the last decade, so that is looking like another underestimated risk. Default risk tends to be all or nothing: either not much is defaulting, or you get a recession, and everything is defaulting (typical high yield default rates in recessions is c8% - 10%). For example: a global High Yield fund has default risk and also duration risk. A sub investment grade Loan Fund also has medium/high default risk over a cycle, no duration risk but because the underlying assets are not traded, it has material liquidity risk. You may not get your money back until the loans mature.

A diversified income portfolio should contain investments with a variety of risks. Hybrids are important for 2 reasons; they have fewer types of risk than other income funds and it's a differentiated risk, so you gain a correlation benefit (as per this year).

- **Don't sell low risk assets.**

We are an active manager who is always conscious of value and whether we should be increasing or decreasing portfolio risk. We've also been around markets a long time, but we are still learning. One lesson that has taken a long time to sink in is not to sell low risk hybrids if we think they are overvalued. It's partly because they tend to improve really quickly when markets bottom (and you miss out), and partly because the healthy margins mean they need to get really cheap really fast. On the other hand, we are pretty good at working out when low risk hybrids are cheap and ok at analysing whether high risk hybrids are cheap or expensive; we'll stick to those factors.

We think this applies to overall investment strategy as well. Hybrids are one of the lower risk segments of investment markets and there is very little utility in reducing exposure to the sector if you think "market" valuations are expensive. If you do want to do that, it makes more sense to adjust exposures via one of the more riskier asset classes.

## BBSW watch

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

	<b>Actual 90day BBSW</b>	<b>Highest expected 90day BBSW rate</b>	<b>Date of highest 90day BBSW rate</b>
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
31 July 2022	2.1%	3.4%	June 2023
10 August 2022	2.3%	3.7%	June 2023
31 August 2022	2.5%	4.0%	June 2023
14 September 2022	2.7%	4.0%	June 2023
30 September 2022	3.1%	4.5%	December 2023
10 October 2022	2.8%	4.2%	March 2024

The cash rate increase of 0.25% on October 4 was less than the market anticipated, so actual BBSW (which is the market's expectation of average cash rates for the quarter) fell marginally.

More interestingly, the ultimate peak is now higher and further out than any time this year: markets expect c4% cash rates until the end of 2024.

The increase in BBSW is feeding through to hybrid and Fund distributions. The EHF1 September distribution was the highest in the Fund's short history and will increase again in the December quarter.

## A real bear market

One of the writer's favorite internet-ty type things is Fat Bear week, (<https://explore.org/fat-bear-week> and <https://explore.org/livecams/brown-bears>) where you can watch web cams of Brown Bears somewhere in the back of Alaska catching salmon at a waterfall to fatten up for hibernation. You can then vote for the fattest. The devilishly handsome favorite, 747 (named after the jet), weighs in at a healthy 630+kg. One of the candidates apparently ate 42 salmon in one feeding session, which if he was in in Sydney and went to a Hemmes restaurant, would cost him around \$6000 (+ tip).

## 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.



- <https://www.livewiremarkets.com/wires/is-the-asx-home-to-the-longest-dividend-paying-company-in-the-world>
- [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

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### 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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