October 2024 Review – Listed Hybrid Sector

Fund and market performance

The Elstree Enhanced Income Fund's investment return net of fees and including the value of franking credits for the month of October 2024 was 0.70%. This compares with the Elstree Hybrid Index return of 0.76%. In other markets the All-Ordinaries Accumulation Index returned (1.33%) while the All Maturities Bond Index returned (1.88%). "()" Denotes negative return outcome

Where do you get it?

We have always been a little coy about detailing where we get our performance from. While not being as transparent as perhaps we could have been over the journey, the reason lay in us not wanting to telegraph specifically how we structure portfolios, in case it was mimicked, which given the finite nature of the investible universe, it was possible to do. However, with APRA's proposal to close down the bank alternative tier one (AT1) hanging over the longevity of the market we thought we would do a deeper dive into our portfolio structure without being security specific. In sum, we divide the broader market (and our funds) up into sub-sectors based on the term to first call of the security, the credit quality of the underlying issuer and the liquidity of the security, the latter being a function of the size of the issue and the turnover. So, for term to first call, we have 3 categories, short, medium and long, and for credit quality, size and turnover, we also have 3 categories, being, major bank, regional bank/insurer and corporate. We also have what we term "non-correlated", which typically comprises securities which are fixed rate (hence we term them "non-correlated"). We also have "cash" or near cash. In total we have 11 categories. We are under/overweight those categories relative to the broader market's weighting based on our view at the time. As an example, the left-hand table below details our portfolio positioning on 1 September 2024 *vis-à-vis* the broader market as represented by the Elstree Hybrid Index (franked series). The table reveals our overweight position in all 3 long-term categories and our underweight position in all 3 short-term categories. You will note we were positioned this way in advance of APRA's proposal coming to light on 10 September which only intensified the demand for long term bank AT1's. The right-hand table represents our positioning 4weeks later on 30 September 2024. The portfolio structure did not change materially over the course of the month, save for the additional deployment of cash.

Weightings by category (%) 1/9/2024	Market	Fund
Short major	14.6	2.5
Medium major	23.3	17.1
Long major	35.2	41.8
Short regional	5.9	6.1
Medium regional	5.7	2.6
Long regional	7	12.7
Short corporate	0.4	1.9
Medium corporate	0.8	0.5
Long corporate	1.1	3.2
Non-correlated	1.5	6.8
Cash	4.5	4.8

Weightings by category (%) 30/9/2024	Market	Fund
Short major	10.3	1.8
Medium major	25.8	18.6
Long major	34.2	41.4
Short regional	5.7	6
Medium regional	5.6	3.1
Long regional	10.1	16.8
Short corporate	0.7	1.8
Medium corporate	0.4	0.5
Long corporate	1	3
Non-correlated	1.5	6
Cash	4.7	1

Elstree Investment Management Limited (ABN: 20 079 036 810)
Level Nine, 100 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au

The proof is in the return outcome and out performance of the benchmark

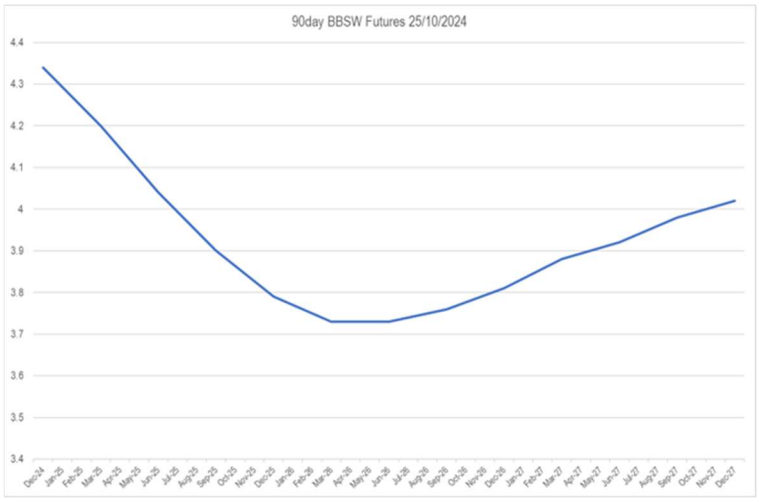
While this is all well and good the proof, as they say, is in the eating! Over the month of September 2024 the broader market as represented by the Elstree Hybrid Index returned 1.54%. This includes the value of franking credits. Over the same period the Elstree Enhanced Income Fund returned, net of fees and including the value of franking 2.09%. This represented an outperformance of 0.55%. The out-performance, which is not always of this magnitude of course, serves nonetheless to highlight the role active portfolio management periodically plays in the value proposition. It's obvious that the portfolios' positioning added value otherwise it would not have outperformed the broader market. The table below details the returns from each category over the month. It is clear to see that all 3 long term to call categories (highlighted in green), where the portfolio was overweight outperformed all 3 short term categories (highlighted in orange) where the portfolio was under weight. Positioning the portfolio in this way added material value over the period.

Return by category (%) month end 30/9/2024	Return %
Short major	0.37
Medium major	1.36
Long major	2.09
Short regional	0.89
Medium regional	1.05
Long regional	2.23
Short corporate	0.51
Medium corporate	0
Long corporate	1.59

90day BBSW futures continue to point to "higher for longer" which is positive for investors in floating rate instruments

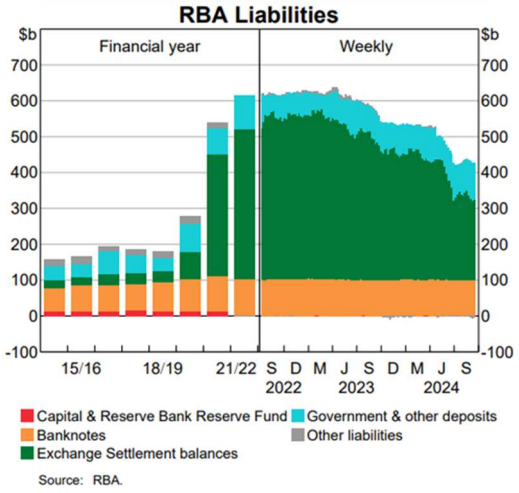
Being an investor in securities that pay a fixed coupon margin above a cash rate proxy such as 90day BBSW we are always interested in the market's predictions of the cash rate as determined by the RBA. While the market's expectations are prone to swings directly commensurate with economic data releases, we note, that the markets are now predicting only two (2) 25 basis point interest rate cuts over the next 18months after which time interest rates are predicted to rise again. The chart below is taken from Trading View on 25October. It is of 90day BBSW futures. The first data point or contract is the December 2024 contract and the last, December 2027. This is without doubt good news for investors in floating rate instruments including hybrids. Should the money market be right in its collective thinking then annual cash flows of hybrid capital instruments (including the value of franking), will not fall below 6.75% over the next 3years. We acknowledge that APRA's proposal to close the hybrid market down by 2032 and the global search for yield which has reached a crescendo, have combined to drive security prices to a premium across the curve, with the consequence that the yield to maturity (YTM) including franking, is less at c6.25% than the annual cash flow.

Elstree Investment Management Limited (ABN: 20 079 036 810)
Level Nine, 100 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au



Exchange settlement account balances at the RBA continue to tell a tale

As we articulated in the previous review the interest rate differential between the annual cash flows from hybrid investments and term deposit investments looks like it is going to widen underpinning hybrid security pricing still further. We note that the RBA's Average All Terms Advertised TD Rate has fallen to 3.40%. The reason is simply that the banks are not incentivised to "pay up" for TD funding. We know this because risk averse households and businesses deposited record amounts of monies with the banks during the pandemic. These monies present now on the RBA's balance sheet as Exchange Settlement Account (ESA) balances. This balance effectively represents monies not lent by the banks to the broader economy. We know the banks are constrained in their lending by capital requirements and a desire to earn an economic return on invested capital. As we wrote previously the constraints imposed on the banks explains both the rise of private credit and the decline in advertised TD rates as published by the RBA as the banks, try to protect market share by lending more aggressively while simultaneously protecting their net interest margins by reducing TD rates. The chart below is extracted from the RBA's Chart Pack of September 2024. It details the liabilities of the RBA's balance sheet with ESA balances (green) representing far and away the biggest liability. While ESA balances have declined from a high of around A$473billion in February 2023 to A$232billion today a big proportion of that reduction (c$190b) can be attributed to the run-off of the RBA's pandemic induced funding relief package called the Term Funding Facility. We note that over the last 30years the median ESA balance was just under A$4billion!



Elstree Investment Management Limited (ABN: 20 079 036 810)
Level Nine, 100 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au

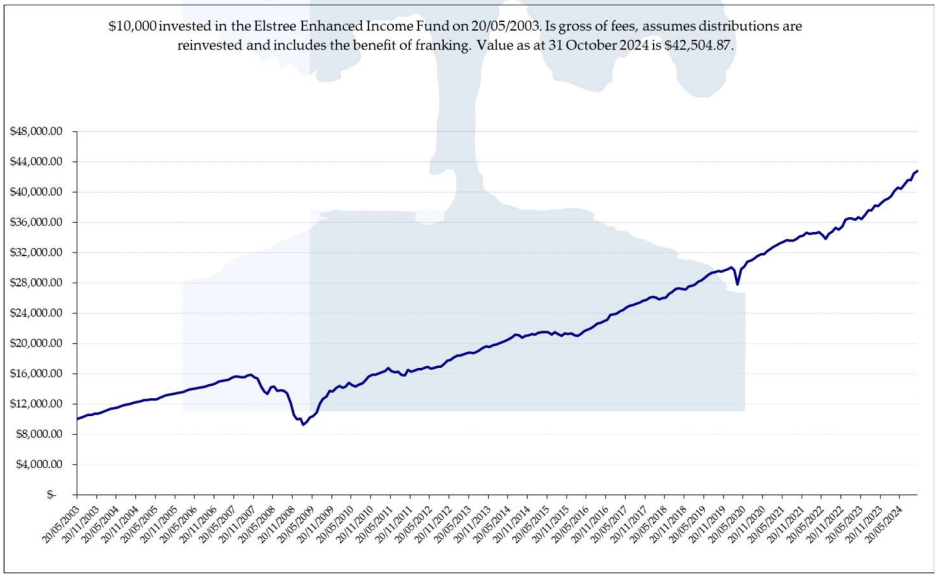
Elstree Enhanced Income Fund portfolio metrics as at (close of business) 31 October 2024

Performance Table	1 month	3 months	1 year	3years p.a.	5years p.a.
Elstree Enhanced Income Fund *	0.70%	2.79%	11.41%	7.14%	7.04%
Elstree Enhanced income Fund (Basis NAV)	0.67%	2.40%	9.61%	5.69%	5.85%
Betashares Hybrid Fund HBRD (Basis NAV)#	0.79%	1.87%	7.71%	4.31%	3.90%
UBS Australia Bank Bill Index	0.37%	1.12%	4.45%	2.94%	1.87%

Past performance is not necessarily a guide to future performance. *Is the "NAV" Plus franking.**"()"** denotes negative return outcome. # Source: Betashares. Betashares return is net of fees and does not include the value of franking credits.

Yield to Maturity (includes franking)	6.20%
Cash yield to maturity (excludes franking)	5.10%
Credit term duration (average years)	3.92
Default cost (per annum)	0.09%
Investment grade issuer (% holding)	93.5%
Bank tier 1 exposure (% holding)	62.5%
Value at Risk (VaR)	3.20%

Value of $10,000 Invested on 20/05/2003



Elstree Investment Management Limited (ABN: 20 079 036 810)
Level Nine, 100 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au