November 2025 Review – Listed Hybrid Sector

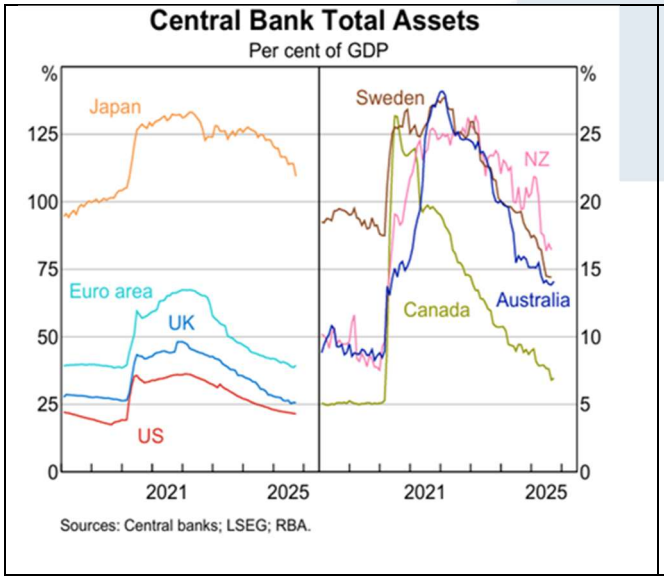
Fund and market performance

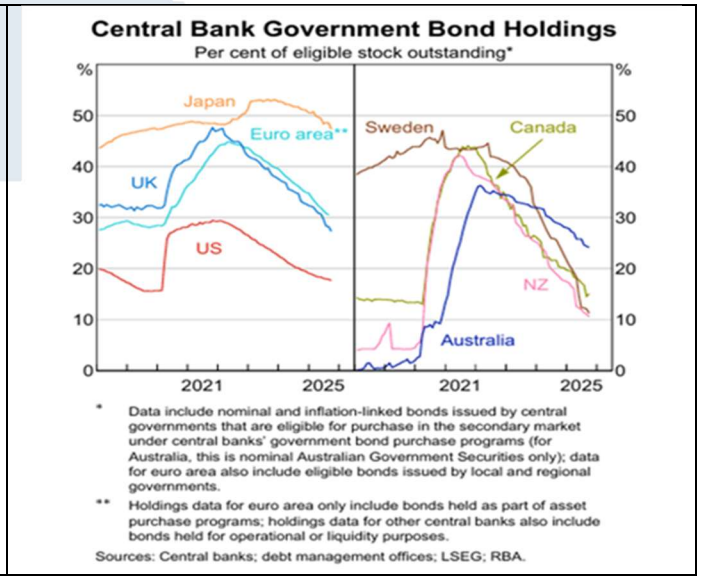
The Elstree Enhanced Income Fund's investment return net of fees and including the value of franking credits for the month of November 2025 was (0.21%). This compares with the Elstree Hybrid Index return of (0.01%). In other markets the All-Ordinaries Accumulation Index returned (2.51%) while the All Maturities Bond Index returned (0.88%).

"()" Denotes negative return outcome

While central bank interest rate policy is the headline act, what goes on behind the scenes with monetary conditions and balance sheet management is equally as important

We've touched on this before, but it bears repeating. The central banks drive the bus, as speculators, investors and commentators alike we are mere passengers on the bus. Of course, we can choose to get on and off the bus when we like but ultimately, whether we like it or not, we are beholden to central bank policy. And as we have discussed previously it is not just interest rate policy that we should be focusing on. Sure, interest rate policy is the "headline act" but what goes on behind the scenes with central bank balance sheet management is equally as important. It was somewhat with surprise then that the author learned after the most recent FOMC meeting held on 31 October that while the Federal Reserve had reduced, as expected, the headline Fed Fund's rate by 0.25% to 3.75% - 4.00% the FOMC decided, from 1 December to abandon quantitative tightening (QT). QT is the process whereby a central bank (in this case the US Federal Reserve) sells assets it owns such as bonds or mortgage-backed securities to qualifying banks and intermediaries to drain liquidity from the financial system. The Federal Reserve has been steadily unwinding its balance sheet since the end of the Covid Period. While it did slow the rate of QT earlier this year it was a surprise (or was it?) that it has decided to cease QT altogether. The Fed's balance sheet is large legacy of first (and still) the GFC and more recently Covid. The charts below are extracted from the RBA's chart pack of 5 November. The LHC details central bank assets as a percentage of GDP while the RHC details the percentage of bond holding held by central banks as a percentage of bonds outstanding. While still substantial as a percentage of both GDP and bonds outstanding, the Federal Reserve's holdings have been steadily declining since the immediate Covid period. Keen observers will note that as a % of bonds outstanding the RBA holds more bonds on its balance sheet than the Fed!





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Faced with a confluence of factors the US Federal Reserve determined from December 1 to cease quantitative tightening (QT)

By ceasing QT what is the US Federal Reserve telegraphing to the markets? The conspiracist's could easily conclude that Fed is concerned that there are stresses and disequilibrium's beginning to appear in the US (and global) financial system and as such the Fed is readying itself for a shock of some description such as a sharp devaluation of overinflated risk markets, or something perhaps more sinister. Indeed, on October 31 - the very day the Fed reduced the Fund's rate and decided to cease QT - coincided with a post covid record daily repurchase facility provided by the Fed whereby it advanced USD50.3billion to the market (a repurchase agreement or repos is a facility whereby a bank provides collateral, such as bond, to the central bank (or other entity) in return for cash). We can talk about the permutations and combinations of ceasing QT ad-infinitum however, the real reason may be less sinister and far simpler. We know that the US was held to ransom recently by the debt ceiling and with that now finally resolved the US Treasury can get on with the business of issuing government bonds again. The situation faced by the Treasury was, if the Fed hadn't decided to cease QT, the Treasury would be issuing large quantities of bonds into a market potentially already saturated by bond selling driven by the Fed's QT program. So, the Fed pauses QT allowing the Treasury to issue relatively seamlessly. We know too that the US housing and construction market is beholden to the level of long bond yields in particular the US 30year treasury bond over which fixed rate mortgages are priced. So, it makes absolute economic sense for the Fed to back away from QT. Central banks, including the Fed, are widely known for their yield curve management and by stepping away from QT the Fed is exerting some control over the term structure of interest rates in the US. The quid pro quo is that the front end of the yield curve may suffer as a reduction in QT will likely mean that the Fed is less accommodating than it might ordinary be with interest rate policy resulting is less fed fund rate cuts in the future.

And what of the RBA?

And so, what of Australia and the RBA? While the RBA still holds around 25% of government bonds outstanding there is some plausibility in the explanation for why that is so. We know that the banks have chosen not to hold bonds but rather they have chosen to hold cash reserves on deposit at the RBA instead (we can speculate ad-infinitum as to the reason, but interest rate risk may be as good an explanation as any, notwithstanding interest rate risk can be hedged but there is a cost in doing so). Bank deposits at the RBA are held in individual bank exchange settlement accounts (ESA). And we know too ESA balances count toward high quality liquid assets (HQLA) just as government bonds do for liquidity ratio purposes (banks are required to hold a percentage of their assets as liquid assets that can be readily converted to cash). By buying bonds from a participating bank as part of its open market operations (OMO) the RBA increases reserves by crediting the participating banks ESA account with the proceeds (so ESA balances go up and reserves increase by the corresponding amount). Similarly, but conversely, when the RBA sells a bond to a participating bank it debits the participating bank's ESA by the bond payment amount (so ESA balances go down and reserves are reduced). If you look at the RBA's balance sheet as represented by the charts below extracted from the RBA's chart pack of October 2025 you will notice that ESA balances (dark green shaded area in right hand chart) approximate very closely with the $value of bonds held by the RBA (left hand chart grey area). By purchasing (and selling) government bonds of differing tenors in the open market in this way, the RBA is intentionally influencing the term structure of interest rates.

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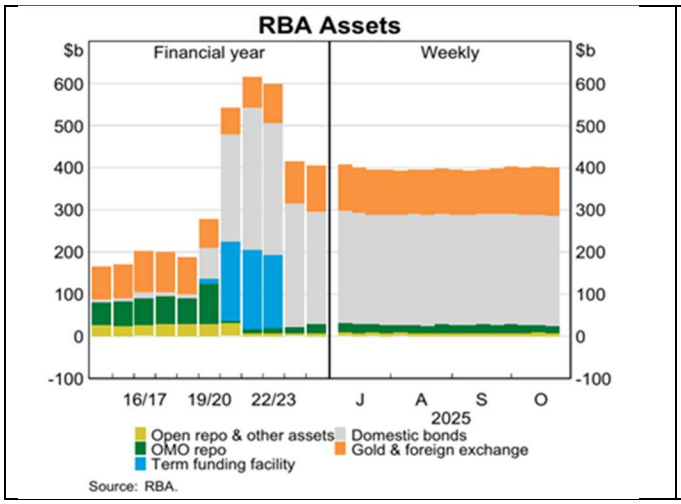

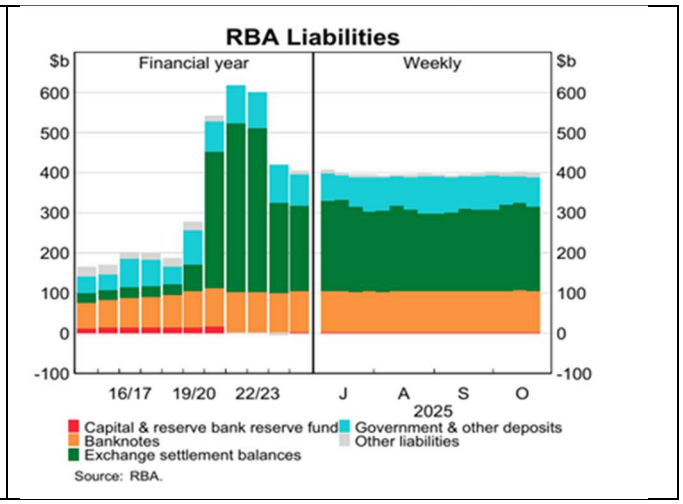

The RBA will continue to unwind its balance sheet and reduce its bond holdings as the supply of reserves continues to exceed "ample levels"

You will note that the RBA's balance sheet has been steadily declining as you would rightfully expect it to do in the aftermath of covid. Its balance sheet currently stands at around AUD375 billion having reached a covid induced high of cAUD650 billion in March 2022. While much of the decline can be attributed to the run-off in 2024 of the term funding facility or TFF, much can (also) be attributed to bond maturities, remembering, of course that the RBA purchased, on market, large amounts of government bonds with a 3year tenor during the immediate covid period. The RBA's monetary policy statement of November 2025 provides an insight into its current thinking about bank reserves when it commented that "in Australia, demand for funding at the RBA's open market operations and activity in private repo markets suggest that the supply of reserves still exceeds ample levels". This means, in layman terms that monetary conditions are accommodating (i.e there is no stress in the funding markets). This will allow it (the RBA) to continue to slowly unwind its balance sheet by reducing its bond holdings as bonds either mature (with the proceeds not being reinvested) or are sold directly to participating banks as the RBA determines from time to time. This contrasts with the US Federal Reserve where at its 31 October meeting it deemed that monetary conditions had tightened sufficiently, underpinning its decision to not only reduce the Fed funds rate by 0.25% but cease QT as well. Despite the RBA reducing its bond holdings materially, its balance sheet remains gorged (its about twice what it was pre covid) and monetary conditions, by its own admission, are accommodating ("reserves exceed ample levels"). Not surprisingly, the money markets are in total agreement. The money markets are pricing in a terminal cash rate of 3.6% (where it stands currently) whereafter it is expected to rise by a material 90bps or 0.90% to 4.5% by the September quarter of 2029. In a shock to indebted households the money market are now predicting a 0.25% or 25bps rise as early as the June quarter 2026. As investors in instruments that pay a fixed coupon margin over a floating benchmark reference rate linked to the cash rate we are buoyed by this expectation.

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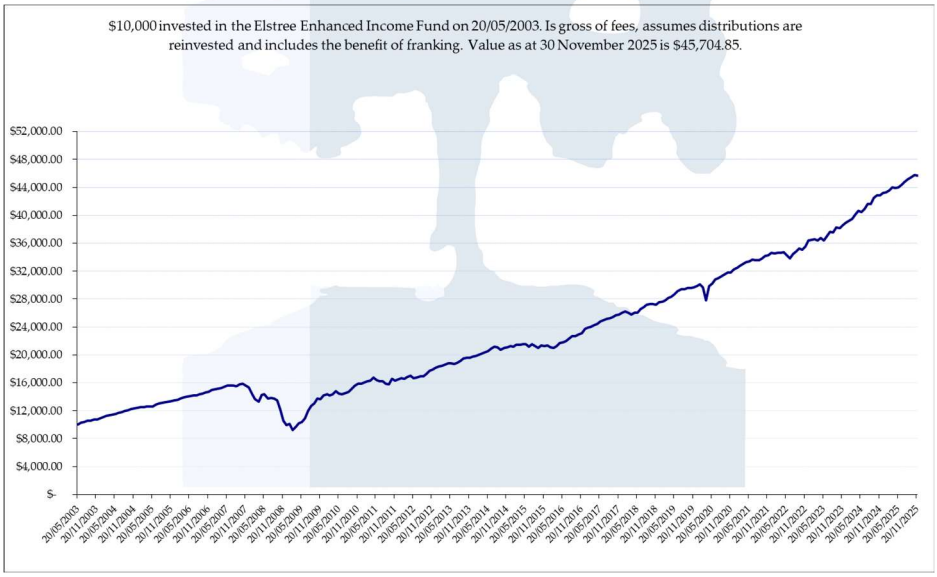
Elstree Enhanced Income Fund portfolio metrics as at (close of business) 28 November 2025

Performance Table	1 month	3 months	1 year	3years p.a.	5years p.a.
Elstree Enhanced Income Fund *	(0.21%)	0.93%	6.02%	8.11%	6.86%
Elstree Enhanced income Fund (Basis NAV)	(0.24%)	0.55%	4.36%	6.40%	5.50%
Betashares Hybrid Fund HBRD (Basis NAV)#	0.10%	1.10%	4.89%	5.70%	4.46%
UBS Australia Bank Bill Index	0.30%	0.89%	4.04%	4.09%	2.64%

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)	5.70%
Cash yield to maturity	4.50%
Credit term duration (average years)	3.67
Default cost (per annum)	0.07%
Investment grade issuer (% holding)	90.1%
Bank tier 1 exposure (% holding)	62.3%
Value at Risk (VaR)	3.09%

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



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