March 2026 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 March 2026 was (0.18%). Over the 12months to 31 March it was 5.35%. This compares with the Elstree Hybrid Index return of (0.01%). In other markets the All-Ordinaries Accumulation Index returned (7.3%) while the All-Maturities Bond Index returned (1.42%).

"()" Denotes negative return outcome

The risk markets are all over the place as investors and central bankers alike try to make sense of what is going on in Iran. It looks, if the money markets are correct in their collective thinking, as though the RBA could raise rates by as much as 0.65% by the years' end

We know the RBA raised the official cash rate again this month to 4.10% from 3.85% previously. The money markets are expecting at least two (2) possibly three (3) more 0.25% increases before the calendar year end with the December 2026 futures contract now predicting that the terminal cash rate will be as high as 4.75% in December (it is currently around 4.10%). We know that the war in Iran is responsible for higher oil prices. The flow through of higher oil and petrol prices needs no explanation as it simply means higher inflationary pressures (and expectations) and should the RBA be true to its mandate of maintaining price stability along with full employment it will dutifully continue to raise interest rates. While the RBA is a renowned inflation hawk (meaning, it is always on the look-out for the emergence of price pressures) it will recognise that price pressures emerging from a spike in oil prices will be temporary and of course it (the RBA) will keep an eye on the impact higher oil prices have on employment and economic growth. This means, that the RBA will, to the extent that it can, "look through" (means ignore) oil induced price pressures. Of course, we can pontificate all we like about what the RBA will and will not do, but the key is just how long oil prices remain elevated and that is commensurate with the duration of the war in Iran. Clearly, the shorter the duration the better. At this point we don't know the answer to how long the war will last so there is great deal of uncertainty in risk markets. So as to highlight the uncertainty US FOMC member Austan Goolsbee said he could imagine both a scenario where rates were raised and cut depending on how the war in Iran played out. That's having an "each way" bet in anyone's language and only serves to highlight the uncertainty in the minds of (even) the FOMC. Because of heightened inflationary fears bond markets, the traditional safe-haven asset, have been hit with the Australian 10year bond rate trading above 5% for much of the second half of March. While 10year US treasury bonds were slightly better-behaved trading at 4.40% around the same time they have not been immune – bear in mind 10year US treasury bond yields were as low as 4.0% around the time the war began – the magnitude of the 40basis point mark to market capital loss wiping out almost a whole year's income. What was that about investing in safe-haven assets?

Pricing of Australian bank issued AT1 securities has been remarkably stable

By contrast, Australian bank issued AT1's have behaved in an exemplary fashion since the outbreak of the war in Iran – pricing has been stable. Of course, the likelihood of additional interest rate increases by the RBA translating to higher periodic cash-flows generated from the coupons of AT1 securities would be a driving force behind the stability of pricing in an uncertain "risk off" scenario. As we have highlighted ad infinitum, 7% – 7.5% annual coupon rates are looking very likely over the next 2 - 3years or so. A most attractive feature particularly as the market transitions gradually toward 2032. If you think of it logically, why would you want to divest from a market that is reducing in size where annual coupon payments are likely to remain elevated (on average above 7%) for most of the market's duration of c5.5years. The answer is you wouldn't!

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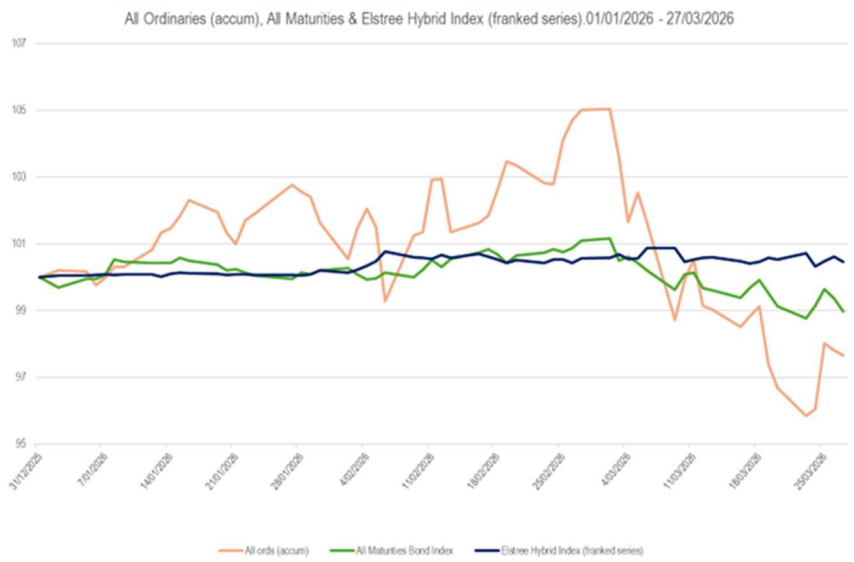
Despite the volatility of risk assets including bonds and equities, underpinned by higher floating benchmark reference rates, the bank issued AT1 market has behaved in an exemplary fashion

The interesting thing about an inflation shock such as this one is the behaviour of risk assets. Bonds, the traditional safe haven asset are clearly not exempt because the inflationary impact. And, of course, equity markets are also not immune because inflation impacts the discount rate applied to the future cash flows as well as reducing the purchasing power of consumers. So, bond yields go up, bond prices go down and the prices (or present value) of equities fall as well. By and large this is not a good outlook. Traditionally, an event shock such as the GFC or covid plays into the hands of bond investors and bond yields fall and prices rise, affording investors some protection against declining (listed) equity valuations and real property. While Australian bank issued AT1 securities are not risk free they have behaved since the war with Iran began as though they are. The market's pricing structure being underpinned by higher floating benchmark interest rates, liquidity and the extenuating circumstances including, declining probability of non-viability risk and materially reduced supply, surrounding, the market's regulatory enforced closure. The chart below highlights just how well the hybrid market has done over the March Quarter in comparison to bonds and listed equities. While we get that it is "cherry picking" (and that can be misleading) the outcome is an excellent one, nonetheless. In the chart we compare the performance of the ASX All Ordinaries Accumulation Index (orange line), the All-Maturities bond index (green line) and the Elstree Hybrid Index (franked series) blue line. We have based the data to 100 at 1 January 2026. The last data point is 27 March 2026.



Because the September quarter coupon payments (and fund distributions) will likely contain up to 0.75% of

The author was conversing with an investor recently when the conversation turned to the premium pricing applied to AT1 securities. It's hard to get one's head around premium pricing for a fixed income security let alone a deeply subordinated floating rate note such as a hybrid. The average weighted price of the AT1 market at large is around $102.50 (per $100) which means that over the average life (term) of the market which we estimate to be approximately 2.6years, a capital loss of $2.50 (the difference between the current price and $100 or PAR) will amortise at a rate of around 1% per annum. This represents the difference (or premium) between the yield (after amortisation of the capital loss) you actually receive on your investment and the cash flow which is a function of the fixed coupon margin which is fixed at the point of issuance and where 90day BBSW sets in the period prior to the coupon payment being made/received (i.e quarterly coupon rates set (say) in

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cash rate increases it makes sense to consider making an investment or adding to an existing investment in AT1 securities	March won't be received until June). This is where consideration of the timing of entry or exit of an investment in AT1 securities, or indeed one of funds is important. We know, for example, that the coupon rates set in early March contained one 0.25% RBA rate rise (and there was speculation at the time that the RBA would likely increase rates again, which it did, subsequent to the rate set in March, so 90BBSW was likely priced at the "premium" to the official cash rate). This means that the June coupon payment (or distribution payment in the case of the Elstree Enhanced Income Fund) will contain, and be reflective of, one 0.25% RBA cash rate increase (plus a small premium). The September payment (and/or distribution) however, will contain at least two 0.25% increases and should the RBA raise rates at its May meeting ahead of the June rate reset (which the money market predict it will) as many as three (3) 0.25% increases. This means, in simple terms, investors could receive as much as 0.75% more in the coupon/distribution payment due September 2026 than they did in March 2026, remembering, of course, that rate set for the March coupon and distribution payments were determined in early December 2025 before the RBA raised rates.
In summary	In summary, for investors seeking a high level of franked income the period between now and September 30 would be a good time to consider investing in AT1 securities or indeed, in one of our funds. Equally, over that period, an income seeking investor would be ill advised to sell an AT1 security or drawdown an investment in one of our funds. While we understand that an investment in an AT1 security (and the market more broadly) is not devoid of mark to market risk, non-viability risk (the ultimate AT1 risk) is reducing by the day. The stability (refer chart above) of the AT1 market's pricing structure during the most recent bout of heightened listed equity and bond market volatility is a pointer to the future between now and 2032. We understand the AT1 market is by no means risk free but it displayed, because of the extenuating circumstances surrounding the market's pending closure and the prospect of higher benchmark reference rates over which the coupons are priced, all the hallmarks of a more senior asset rather than a deeply subordinated one that sits just above equity in the capital structure. We suggest investors (and would be investors) continue to enjoy the ride, highlighted by stable pricing, low volatility, high levels of franked income and liquidity.

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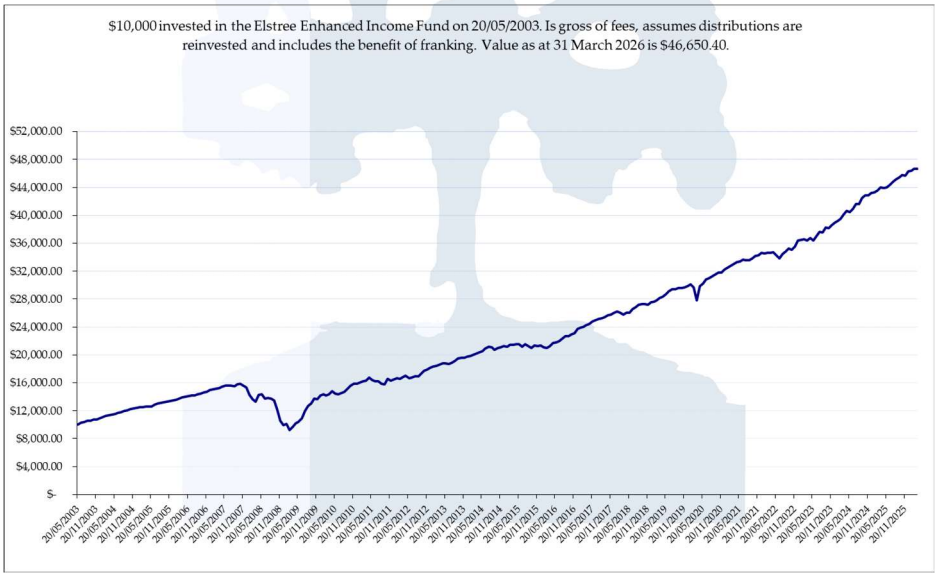
Elstree Enhanced Income Fund portfolio metrics as at (close of business) 31 March 2026

Performance Table	1 month	3 months	1 year	3years p.a.	5years p.a.
Elstree Enhanced Income Fund *	(0.18%)	0.46%	5.35%	7.98%	6.47%
Elstree Enhanced income Fund (Basis NAV)	(0.47%)	0.12%	3.81%	6.27%	5.05%
Betashares Hybrid Fund HBRD (Basis NAV)#	0.04%	0.77%	4.65%	5.83%	4.29%
UBS Australia Bank Bill Index	0.32%	0.91%	3.80%	4.15%	2.89%

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	5.00%
Credit term duration (average years)	3.42
Default cost (per annum)	0.07%
Investment grade issuer (% holding)	87.8%
Bank tier 1 exposure (% holding)	61.2%
Value at Risk (VaR)	3.09%

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



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