

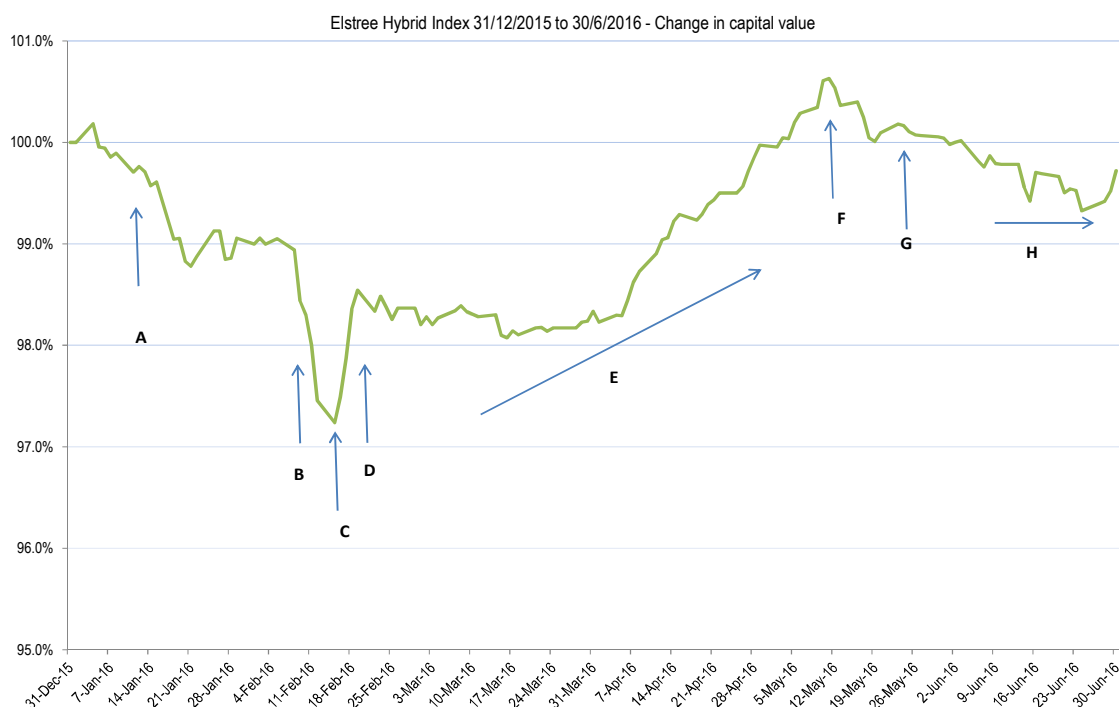
December 2016 Review – Listed Hybrid Sector

Performance

The Elstree Enhanced Income Fund's total investment return for December 2016 was 2.61%. This compares with the Elstree Hybrid Index return of 1.96%. In other markets the All Ordinaries Accumulation Index returned 4.17% while the All Maturities Bond Index returned (0.17%).

That was the year that was

It was an interesting year for the hybrid market. The charts below show the capital movements of the Elstree Hybrid Index (we've taken out the distributions) over the year.



A) Equity market weakens on fears of a Chinese recession. The All Ordinaries falls 8% from Jan 1. AUD falls. Hybrid volumes decline to their lowest levels since April 2012. Hybrid market weakens on general fears and expectation of a new CBA issue.

B) CBA announces results. Market has anticipated new issue to replace PERLS III, but there's no announcement on results date. Presumably CBA thinks conditions will shortly improve.

C) CBA can't wait any longer. Announces issue at low price point for the year which is some delayed justice for screwing the hybrid market in August 2014. Commentator Chris Joye claims PERLS VIII is a "dud deal". We made the issue our largest holding.

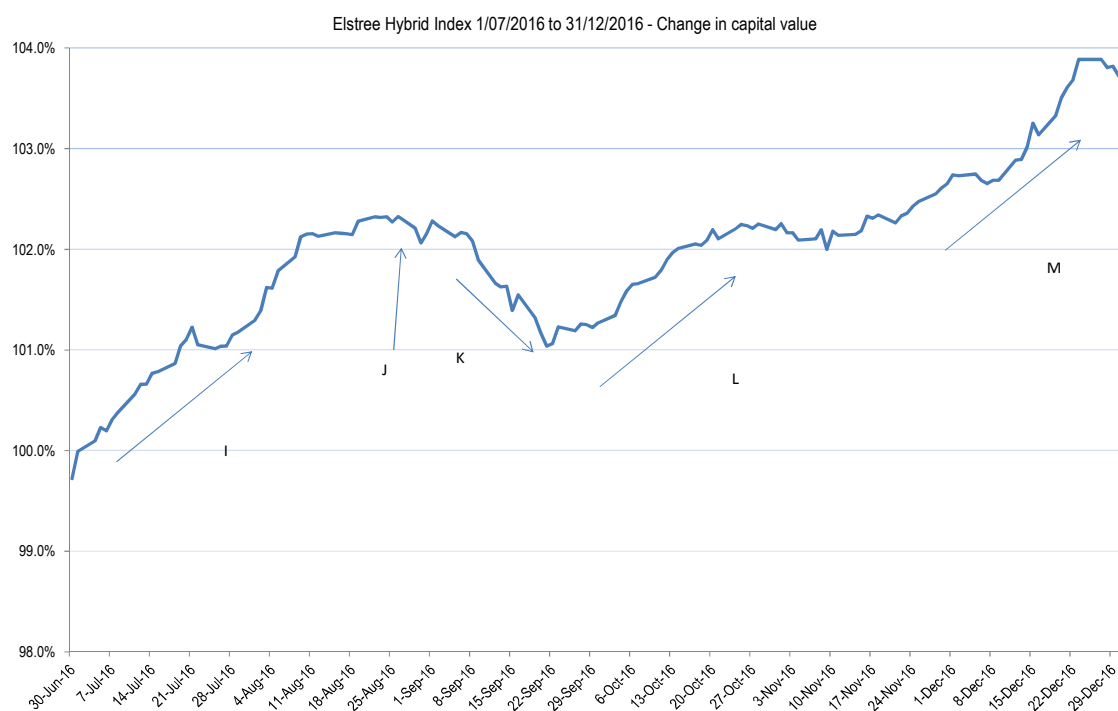
D) PERLS VIII book build closes on 24/2 with \$910m allocated, but CBA finds an institutional investor(s) in the aftermarket and issues an additional \$540m. Margin of 5.2% is highest new issue margin ever resulting in yields in excess of 7.0%. Equity markets recover 5% from their mid-February nadir and are only 5% down on 2015 CY end.

E) Hybrids rally on realisation that now there is institutional demand and supply outlook is much diminished with equity markets lending a supportive tone.

F) WBC and NAB announce issues within the space of 2 weeks. The issue margins of c4.9% are around 0.35% lower than the CBA PERLS VIII. Both allocate c\$300m to institutional investors.

G) ANZ announces that it has attained a ruling from the ATO to allow it to issue unfranked capital issues to offshore investors. The USD \$1b issue is priced for success with bids totalling \$18b! Pricing is comparable with domestic pricing, but term of 10 years compared with domestic issues of 5-7 years is attractive to banks. Banks now have feasible alternative to issuing AT1 to domestic investors.

H) Brexit. Who remembers that now? Hybrid markets mark time while equities weaken.



I) World decides Brexit is not the end of the world. Hybrids perform better than equities on healthy demand and pending supply shortage.

J) ANZ announces a new issue to replace ANZPA which has a December 2016 reset. Due to reduction of Asian business and May 2016 offshore issue, the ANZ doesn't require much additional capital and new issue is limited to \$1.2b of \$2b maturing ANZPA issue. We are scaled back 80% on our bids. Margins decrease further to 4.7%. Welcome to the future.

K) September is all about European problems. Deutsche Bank insolvency rumours peaked and the DBK share price fell to EUR 10.55 (Dec 31 17.11). Some weakness flows through to hybrids.

L) Bond yields bottomed in July at 1.8% and increased 0.5% by October. World is in a "risk on" phase which helps hybrid capital values.

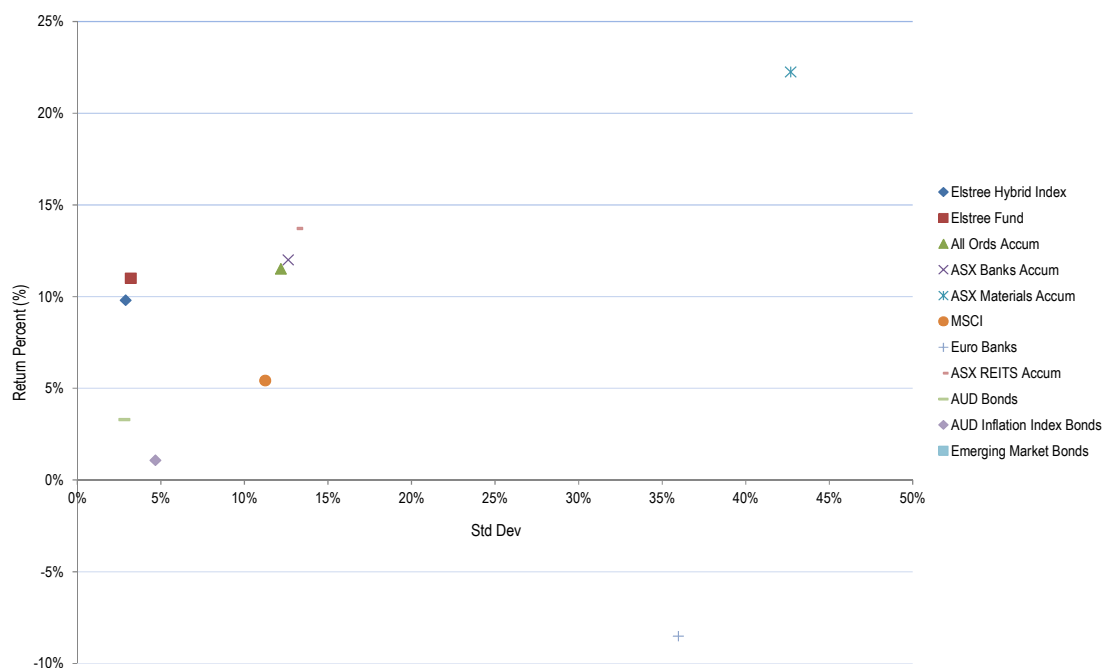
M) Trump flat line period followed by year end euphoria.

Asset class returns

The chart below shows returns and volatility (std dev) for the year ending 31 December 2016. It was a great year for hybrids. The market, as denoted by the Elstree Hybrid Index, returned 9.91% with volatility of 3%. The return outcome was attributable to small positive changes in the capital value of securities and healthy income levels. On a gross basis (before fees but including the value of franking)

the Elstree Enhanced Income Fund outperformed the index over the year returning 11.27% with marginally higher volatility. Outside of materials, it's tough to find an asset class that did exceptionally well. At the same time, there were few disasters with European banks being the only laggard.

Various asset class returns and risk (Std Dev) CY 2016



Final word

While it has been an excellent year for hybrids and our fund(s) it is worth reflecting on the performance over an extended timeframe (say 3 years). On a gross basis over 3 years the Elstree Enhanced Income Fund returned 6.26% per annum. This compares with the All Ordinaries Accumulation Index return of 6.76% p.a. over the same period. On an absolute return basis the return outcomes of the Fund and the All Ordinaries Accumulation Index are similar. The major difference of course is that the returns of the Fund are achieved with a lot less volatility.

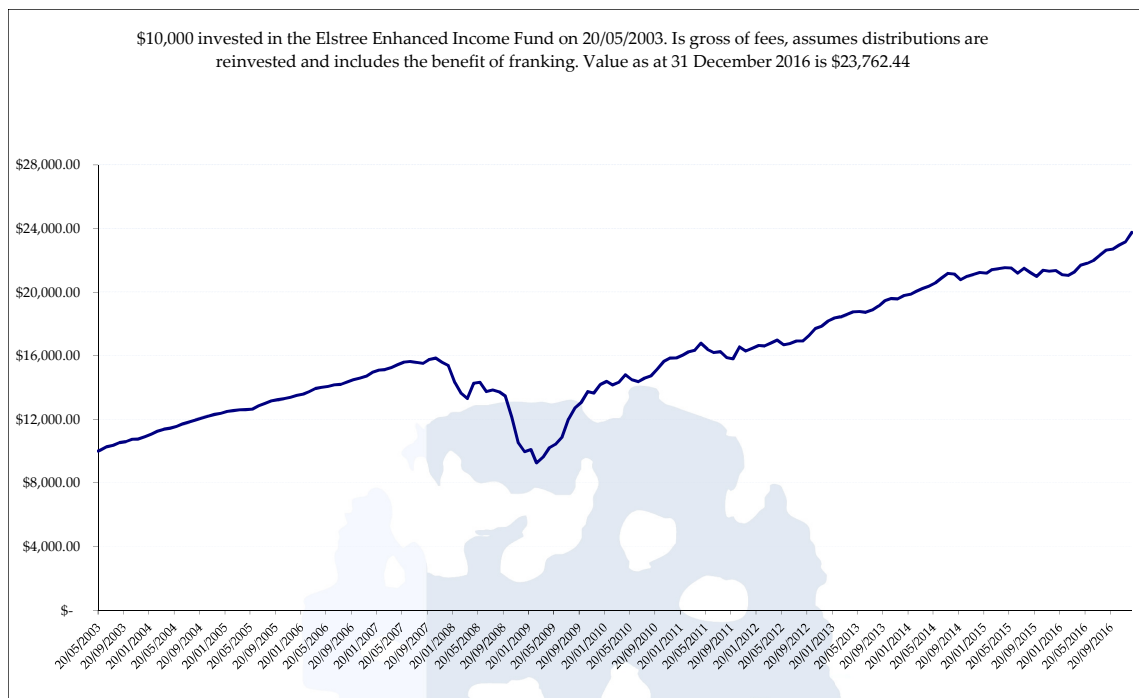
Fund characteristics as at 31 December 2016

Yield to Maturity	5.2%
Cash yield to maturity + franking (income yield)	5.2%
Investment grade issuer	91%
Fund average term (years)	4.1
Bank Tier 1 exposure	46%
Property exposure	6%

Performance Table	1 month*	3 months	12 months	3 years (p.a.)	5 Years p.a.
Elstree Enhanced Income Fund	2.61%	4.68%	11.27%	6.26%	7.63%
UBS Australia Bank Bill Index	0.15%	0.44%	2.07%	2.36%	2.79%

*Returns are gross of fees and include the benefit of franking credits. Past performance is not necessarily a guide to future performance.

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



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