August 14, 2019

# Australian Enhanced Income Fund - ASX Code "AYF"
# July 2019 Investment Update and NAV

## July 2019 NAV and Fund performance

The Fund's NAV of a unit at the close of business on July 31, 2019 was $**6.007** per unit. This compares with the Fund's ex-distribution NAV of a unit at the close of business on 28 June 2019 of $5.957. The change in NAV over the month of July represents a return of **0.84%.** The franking benefit for July was estimated to be **0.01%.** Including the value of franking the Fund returned **0.85%** over July 2019.

| Performance | 1 month | 3 months | 12 months | 3 Year p.a. |
|---|---|---|---|---|
| Australian Enhanced Income Fund* | 0.84% | 2.95% | 6.39% | 6.57% |
| UBS(A) Bank Bill Index | 0.12% | 0.40% | 1.90% | 1.84% |

*Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance.

## Relative performance

Including the value of franking the ASX listed hybrid market returned 0.69% for the month. This compares with the All Ordinaries Accumulation Index return of 2.96% and the UBSA Bank Bill Index return of 0.12%.

After fees but before the value of franking, the Fund outperformed the broader market this month. Over 3 years the Fund's rolling annual net return, which excludes the benefit of franking but is net of all fees, for the period ending 31 July 2019 was 6.57% p.a.

## To sell or not to sell? That is the question.

The last fortnight or so has been highlighted by the number of commentaries we have read telling investors to sell every hybrid security you own. We'd love to be absolutely certain that now is the right time to sell every hybrid we own. Maybe we aren't that clever? Perhaps we look at different things – the wrong things even, or perhaps we don't have the ability to pick the markets as well as some commentators. Even if we could somehow convince ourselves that now is the time and the market is only going to get cheaper, we think selling everything is going way over the top. If you asked some of the more learned commentators, they'd probably argue the market would be cheap if it fell by (say) 3% in price terms (implies a 75 basis point increase in spread margin). If you factor in the cost of selling and buying back and the opportunity cost of investing in cash, is it worthwhile? We'd argue probably not. Simply, stay invested and allow the higher income levels to work for you.

We have written about Japan before but it is as good a harbinger of the pricing of credit assets in a low interest rate environment that we have seen. Japan has had zero interest rates for almost 20 years resulting in the unusual pricing of credit assets. We ackowledge of course, that there are some events specific to Japan such as demographics and not everything that occurs in Japan will be repeated. However, we're reasonably certain that some of the trends will be repeated. As long time


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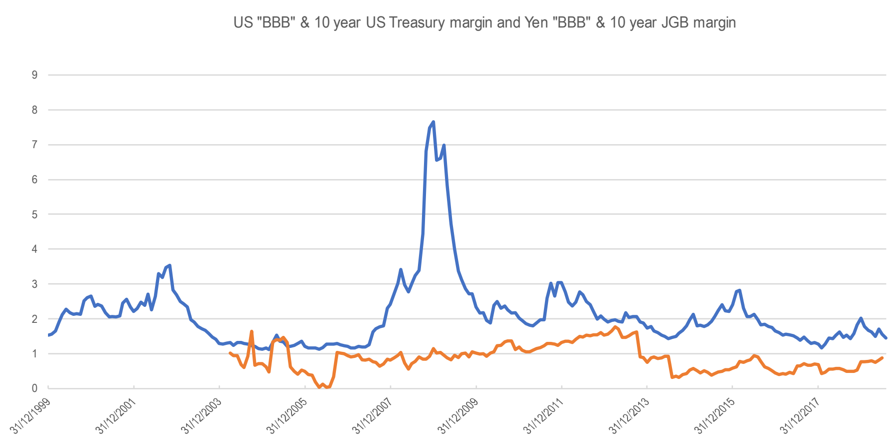
manages of credit assets we were taught that a "BBB" security was a "BBB" security no matter where it was issued or in what demonination it was issued in. Seems that doesn't always follow. The chart below shows the Japanese 10 year "BBB" margin and the US "BBB" equivalent. Japanese spread margins have been consistently lower than their US equivalents this century. The reason we think this is the case is a function of 3 things; (i) default loss rates are lower in Japan because interest rates have been so low for so long that fewer households and corporates default, (ii) the instatiable search for yield by Japanese investors and (iii) Japan being simply Japan. The first 2 points we think are eminently repeatable as the rest of the world grappples with the possibility of zero interest rates for an extended period and what that means for the pricing of credit and other risk assets.




***Fund ready reckoner. Fund metrics and portfolio characteristics at a glance***

| | June 2019 | July 2019 |
|---|---|---|
| Net Asset Value (NAV) | $5.957 (ex dist) | $6.007 |
| Change in NAV month on previous month (mopm)* | 1.14% | 0.84% |
| Total investment return includes the value of franking (mopm) | 1.34% | 0.85% |
| Dividend paid 15 July 2019 | $0.08cpu | n/a |
| Percent franked (*quarterly estimate @ 30% tax rate*). | 50.77% | n/a |
| Cash yield per annum (basis NAV). Dividend change announced 5 July. | 5.37% | 5.33% |
| Grossed up yield basis NAV per annum (*estimated*) | 6.20% | 6.16% |
| Investment grade issuer (including cash) | 90.0% | 89.0% |
| Fund average term | 3.70 years | 3.50 years |
| Major Bank Tier 1 exposure | 51.0% | 51.0% |
| Property exposure | 1.90% | 1.90% |

* Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance. # Refer to change of dividend announcement 5 July 2019.

For additional information please contact **Norman Derham** at Elstree Investment Management Limited on (03) 8689 1348 or by email info@eiml.com.au While the information in this report has been prepared with reasonable care Elstree Investment Management Limited accepts no responsibility for any errors, omissions or misstatements however caused. This is general securities information only and is not intended to be a securities recommendation. This information does not account for your individual objectives, needs or financial situation.