

Australian Enhanced Income Fund - ASX Code "AYF"

April 2018 Investment Update and NAV

April 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on April 30, 2018 was **\$5.924** per unit. This compares with the ex-distribution NAV of a unit at the close of business on 29 March 2018 of \$5.877. The change in NAV over the month of April represents a return of **0.79%**. The franking benefit for April 2018 was estimated to be **0.02%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	0.79%	(1.29%)	3.64%	4.56%
UBS(A) Bank Bill Index	0.14%	0.43%	1.74%	2.28%

*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 sector returned 0.76% for the month. This compares with the All Ordinaries Accumulation Index return of 3.49% and the UBSA Bank Bill Index return of 0.14%.

After fees but before the value of franking, the Fund performed in-line with the broader market this month. The Fund's rolling annual net return, which excludes the benefit of franking but is net of all fees, for the 12 month period ending 30 April 2018 was 3.64%.

The relationship between bank equity and loan loss rate provisioning

In most cases banks get themselves into difficulty when they do 'dumb' things. Despite the findings of the Royal Commission the large Australian banks are not yet doing dumb things and are still well managed. While it is clear there have been some issues with the banks there has been no systemic fraud or no "low doc" type loans uncovered by the Commission. By and large, Australian banks continue to lend <80% LVR loans to people who have sufficient wealth to service the loans.

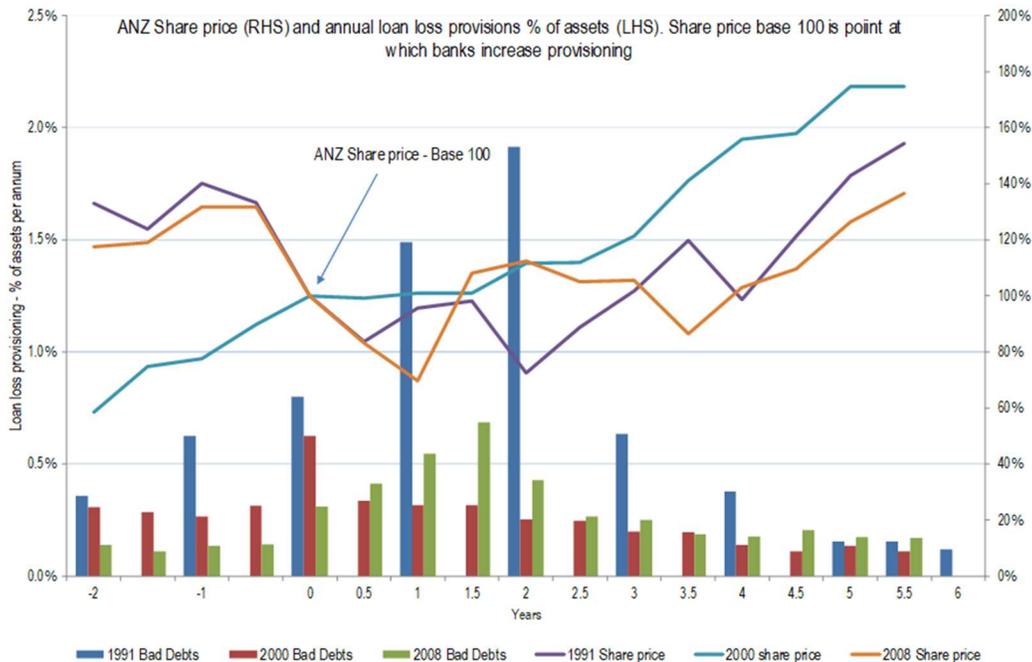
Loan losses however, are always an issue, notwithstanding we have yet to discover a bank which has gone broke from prime residential mortgage lending (<80% LVR, and reasonable serviceability etc). There's a cycle to loan losses and not surprisingly the ordinary equity leads the way.

The chart below shows ANZ's annual loan loss provisions (as a % of assets) and the share price for the last 3 cycles including the recession of 1991, the dot com downturn in 2000, and the GFC in 2008. The horizontal axis is based to zero at the time that loan losses first begin rising and we've shown the 2 years before and 4 years after for each cycle. For example, in the 1991 recession, ANZ's first increase in loan losses was reported in September 1990 when loan losses increased to 0.8% of assets ("0" on the horizontal axis). The share price had fallen 40% in the year prior as markets

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anticipated a worsening and bottomed 2 years later with a further 20% fall in equity prices. Loan losses increased until September 1992 falling quickly thereafter with the share price recovering.

While there is a relationship between share prices and hybrid values, the relationship is not straightforward and not material. Fundamentally, hybrid securities remain supported by high and higher capital levels, high profitability and more conservative management structures. Interestingly, the Royal Commission's findings have had no material impact on hybrid security prices.



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

	March 2018	April 2018
Net Asset Value (NAV) * Ex-distribution.	\$5.877*	\$5.924
Change in NAV month on previous month (mopm)*	(1.37%)	0.79%
Total investment return includes the value of franking (mopm)	(1.06%)	0.81%
Dividend (declared April 2018 and payable 16 April 2018)	\$0.0875	n/a
Percent franked (quarterly estimate @ 30% tax rate)	50.23%	n/a
Ex-distribution cash yield per annum (basis NAV)	5.94%	5.91%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.79%	6.75%
Investment grade issuer (including cash)	93%	93%
Fund average term	3.7 years	3.6 years
Major Bank Tier 1 exposure	52%	51%
Property exposure	2.0%	2.0%

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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.