September 13, 2018

Australian Enhanced Income Fund - ASX Code "AYF"
August 2018 Investment Update and NAV

August 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on August 31, 2018 was $**6.052** per unit. This compares with the Fund's NAV of a unit at the close of business on 31 July 2018 of $5.98. The change in NAV over the month of August represents a return of 1.20%**.** The franking benefit for August 2018 was estimated to be **0.05%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	1.20%	3.85%	4.91%	5.07%
UBS(A) Bank Bill Index	0.17%	0.51%	1.85%	2.20%

*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 1.20% for the month. This compares with the All Ordinaries Accumulation Index return of 1.71% and the UBSA Bank Bill Index return of 0.17%.

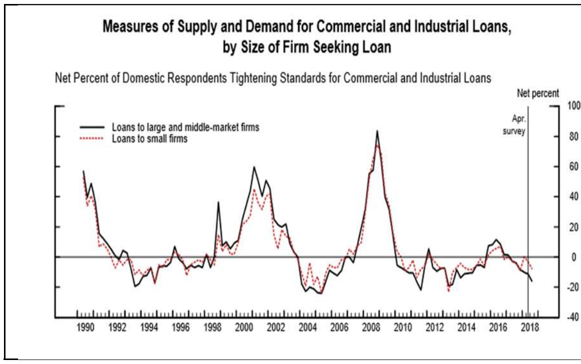
After fees but before the value of franking, the Fund performed in-line with the broader market this month. Over 5 years the Fund's rolling annual net return, which excludes the benefit of franking but is net of all fees, for the period ending 31 August 2018 was 5.07% p.a.

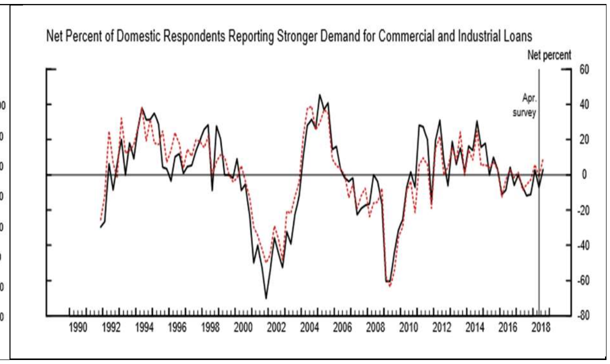
Investment Fund return outcomes - an overview.

We've read a lot lately about just how expensive the asset markets are. From excessive exuberance to recessions, we've heard it all and while we conclude that a bursting of the asset bubble might be bad for some asset classes and a recession bad for most we might not, in fact, be that close to either. We draw on our favourite example of excessive exuberance, the Japanese stock market in the 1980's to prove the point. If the Nikkei was expensive in 1983 trading at a PE of 37 times with profit expected to grow by c4% just how much more expensive was it 6 years later when the index was 300% higher and the market's PE a mind boggling 67 times? The point we make is that as an investor you had better be pretty sure of the extent of excessive exuberance or there could be a lot of lost opportunity by selling when perhaps you shouldn't have.

We have a view that dangerous bubbles are usually characterised by an abundance of borrowed money and particularly loose lending. The US sub-prime crisis is a classic example with non-prime lending increasing 24% p.a. in the 5 years before it concluded with the GFC. This is one reason why we think the US Federal Reserve Senior Officers Lending survey is a great forward indicator of exuberance. We've attached two charts (overleaf) showing the net percentage of banks (i) tightening lending standards and (ii) reporting higher demand for commercial and industrial loans.

Australian Enhanced Income Fund (ARSN: 115 632 990)
Responsible Entity: Elstree Investment Management Limited (ABN: 20 079 036 810)
Level 10, 30 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au





On the face of it the data presented by the Federal Reserve points to fewer signs of a bubble in 2018 than in 2006. We understand that things are happening outside the banking system (think high yield bonds and leverage loans) that could be construed as a bubble, but we think much of that is largely explainable. At the end of the day banks have to compete with corporate bond and other markets for their lending, so it is reasonable to assume that lending standards and demand for credit would be similar across all markets. In our opinion the growth in corporate debt (including non-bank debt) is not that worrying. The amount of bond debt (including high yield) outstanding grew 16% over the last 4 years which is not yet, in the bubble category.

And the 'so what' for hybrids is that hybrid spread margins are slightly below post GFC averages, so there's no sign of material overvaluation. Nor do we think a recession in Australia is imminent. We think that leads to c5%+ total return outcomes for the next 2 - 3 years with a 2% - 3% annual variance. Not at all exciting, but well above term deposit (TD) and cash rates and not too far away from the kind of equity market returns you should get in a low interest rate environment.

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

	July 2018	August 2018
Net Asset Value (NAV) # Ex-distribution.	$5.98	$6.052
Change in NAV month on previous month (mopm)*	0.95%	1.20%
Total investment return includes the value of franking (mopm)	0.95%	1.25%
Dividend (N/A)	n/a	n/a
Percent franked (*quarterly estimate @ 30% tax rate*)	n/a	n/a
Ex-distribution cash yield per annum (basis NAV)	5.85%	5.78%
Ex-distribution grossed up yield basis NAV per annum (*estimated*)	6.69%	6.61%
Investment grade issuer (including cash)	90%	90%
Fund average term	4.0 years	3.9 years
Major Bank Tier 1 exposure	51%	51%
Property exposure	3.0%	3.0%

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

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.

Australian Enhanced Income Fund (ARSN: 115 632 990)
Responsible Entity: Elstree Investment Management Limited (ABN: 20 079 036 810)
Level 10, 30 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au