

Australian Enhanced Income Fund - ASX Code "AYF"

December 2018 Investment Update and NAV

December 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on December 31, 2018 was **\$5.962** per unit. After the payment to unit holders registered at the close of business on 31 December of the \$0.0875 cash distribution, the Fund's ex-distribution NAV of a unit was 5.875%. This compares with the Fund's NAV of a unit at the close of business on 30 November 2018 of \$5.907. The change in NAV over the month of December represents a return of **0.93%**. The franking benefit for December 2018 was estimated to be **0.20%**.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	0.93%	0.04%	2.58%	5.92%
UBS(A) Bank Bill Index	0.15%	0.48%	1.92%	1.92%

*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 1.18% for the month. This compares with the All Ordinaries Accumulation Index return of (0.45%) and the UBSA Bank Bill Index return of 0.15%.

After fees but before the value of franking, the Fund under-performed 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 December 2018 was 5.92% p.a.

Making sense of asset class return outcomes over the 2018 year and the period since the GFC.

The table below shows the returns for a range of asset classes each year since the GFC. The return outcomes have been colour coded for each year since 1 January 2008 into Gold, Silver and Bronze with the poor performers being represented by the unshaded area. By way of example, over the year to end 31 December 2018, the best performers (in gold) were listed and unlisted property, hybrids and unlisted Infrastructure while listed infrastructure, commodities and listed private equity were poor performers. The best asset class in 2018 was unlisted infrastructure which returned 11%. We note that despite a recovery in asset prices in late December, the median return of all asset classes over the year to end 31 December 2018 was 0% (zero). This is the 2nd worst year since 2008 when the median asset return was a staggering -28%. Like 2008, 2018 was a year when diversification clearly didn't work.

The key takeaways from the table below are;

- Risk broadly hasn't paid off. The higher risk sectors, that should have benefitted from 11 years of constant, albeit below trend growth, have barely beaten the 'income' sectors.

January 8, 2019

- Alternatives (as loosely described) have experienced (in general) haphazard and patchy return outcomes and haven't been great diversifiers.
- Hybrids have been the best performing asset class in risk (volatility) adjusted terms. In layman's speak, this means that while hybrids haven't shot the lights out, they haven't capitulated either (this is the income at work). This translates to excellent long-term return outcomes compared to higher risk assets.
- In risk adjusted return terms growth assets have had 11 poor years; probably not so much because the 'risk' numbers are high, but because the 'return' outcomes have been so low.
- Interestingly, there are huge differences between listed and unlisted versions of the same asset class. One return profile is wrong: while we're not sure which, we can speculate!
- In overall terms there seems to be some mean reversion, with bad years being followed by good years. This being the case, 2019 might be a good year, given the lower valuations and lower risk tolerance apparent in markets today. The caveat would be a recession, in which case 'all bets are off' and the markets will most likely experience another poor year.

	All Ords	Bonds	Cash	Bank Hybrids	MSCI (AUD)	Listed Property	Unlisted Property	High Yield	Leveraged Loans	Commodities	Unlisted Infra	Listed Infra	Listed Private Equity
11 year return (p.a)	4%	7%	4%	7%	4%	2%	9%	8%	5%	2%	9%	-9%	4%
11 year risk (std dev p.a.)	20%	4%	2%	6%	18%	22%	5%	19%	19%	28%	4%	21%	46%
31-Dec-08	-40%	15%	8%	-8%	-28%	-54%	0%	-21%	-29%	-46%		-45%	-68%
31-Dec-09	40%	2%	3%	17%	-1%	8%	-2%	58%	52%	70%		21%	127%
31-Dec-10	3%	6%	5%	13%	-4%	0%	9%	15%	10%	17%	15%	28%	22%
31-Dec-11	-11%	11%	5%	6%	-7%	-1%	10%	6%	2%	-9%	5%	-16%	-10%
31-Dec-12	19%	8%	4%	7%	11%	33%	9%	13%	10%	5%	4%	-3%	27%
31-Dec-13	20%	2%	3%	7%	45%	7%	9%	9%	5%	0%	12%	-2%	22%
31-Dec-14	5%	10%	3%	6%	12%	27%	11%	-2%	2%	8%	8%	-27%	3%
31-Dec-15	4%	3%	2%	1%	9%	14%	14%	1%	-1%	-14%	18%	-20%	-4%
31-Dec-16	12%	3%	2%	10%	7%	13%	12%	13%	10%	15%	13%	9%	22%
31-Dec-17	12%	4%	2%	7%	11%	6%	12%	7%	4%	23%	10%	4%	13%
31-Dec-18	-3%	4%	2%	4%	-4%	6%	9%	-4%	0%	-9%	11%	-10%	-10%

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

	November 2018	December 2018
Net Asset Value (NAV) # Ex-distribution.	\$5.907	\$5.8745#
Change in NAV month on previous month (mopm)*	(0.42%)	0.93%
Total investment return includes the value of franking (mopm)	(0.31%)	1.13%
Dividend paid 14 January 2019	n/a	\$0.0875
Percent franked (quarterly estimate @ 30% tax rate)	n/a	49.83%
Ex-distribution cash yield per annum (basis NAV)	5.92%	5.96%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.76%	6.81%
Investment grade issuer (including cash)	92.0%	91.0%
Fund average term	3.70 years	3.60 years
Major Bank Tier 1 exposure	54.8%	56.2%
Property exposure	1.7%	1.8%

* 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.