

## Australian Enhanced Income Fund - ASX Code "AYF"

### February 2018 Investment Update and NAV

#### February 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on February 28, 2018 was **\$6.048** per unit. This compares with the NAV of a unit at the close of business on 31 January 2018 of \$6.091. The change in NAV over the month of February represents a return of **(0.71%)**. The franking benefit for February 2018 was estimated to be **0.05%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	(0.71%)	0.46%	5.86%	4.91%
UBS(A) Bank Bill Index	0.13%	0.43%	1.75%	2.30%

\*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 credits the ASX listed hybrid sector returned (0.38%) for the month. This compares with the All Ordinaries Accumulation Index return of 0.18% and the UBSA Bank Bill Index return of 0.13%.

After fees but before the value of franking, the Fund underperformed 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 28 February 2018 was 5.86%.

#### It always pays to be invested in investment credit

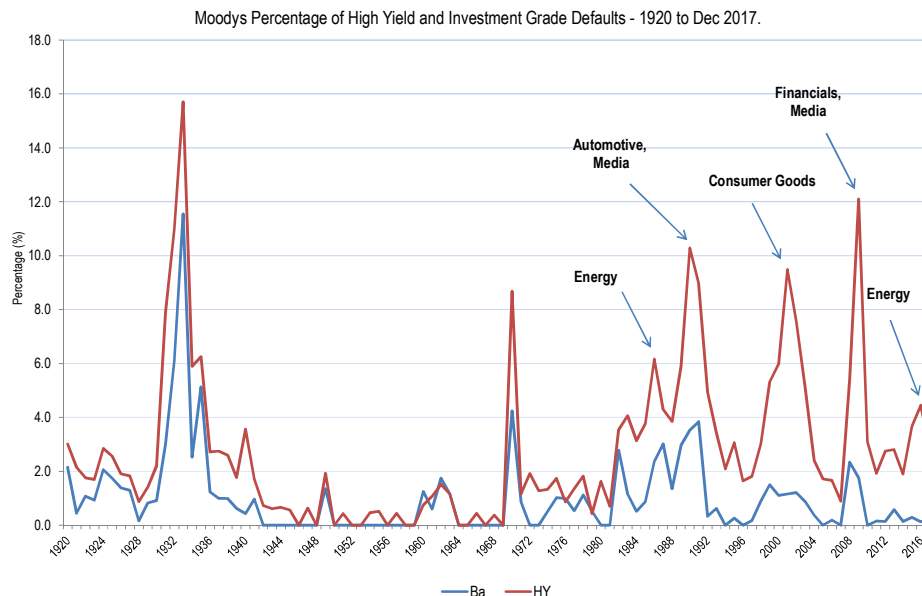
We'll start with the observation that the default position for an investment in investment grade credit is to always be invested. The reason is that the margin over the risk free rate is sufficient to compensate for the risk of default. If, as an investor, you had bought every 5 year "BBB" bond at the start of every year since 1950, you would have outperformed the risk free government bond for that 5 year period in every year but one. The default cost on this cohort of bonds has (almost always) been less than the additional yield investor's receive over the risk free government bond rate.

As you would expect it becomes more 'cyclical' the lower you go down the credit spectrum, but over the long run there is always a gain. The caveat to always being invested is if you can accurately forecast a recession or near recession, in which case selling can be extremely profitable.

Notwithstanding the extremely positive non recession forecasts, there are some issues. These issues are; (a) The non-default cycle is now very long lived, (b) there has been an overall increase in leverage and other negative debt metrics over the past few years, and valuations are expensive, (c) there's no recession in sight and if that continues, we'll see little stress on investment grade or

March 14, 2018

high non-investment grade debt and (d) We can't see any obvious industry bubbles and the 2 largest debt widow makers (energy and Commercial Real Estate) seem okay and within normal valuation parameters.



Although we expect disappointing growth, a recession looks unlikely and bank credit metrics are still strong. There's over valuation everywhere, but real bubbles are hard to find (outside of some real estate pockets). In these circumstances, we expect most of the downside to be taken by bank share prices with limited effect on hybrid security prices.

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

	January 2018	February 2018
Net Asset Value (NAV) * Ex-distribution.	\$6.091	\$6.048
Change in NAV month on previous month (mopm)*	0.29%	(0.71%)
Total investment return includes the value of franking (mopm)	0.29%	(0.66%)
Dividend (declared March 2018 and payable April 2018)	n/a	n/a
Percent franked (quarterly estimate @ 30% tax rate)	n/a	n/a
Ex-distribution cash yield per annum (basis NAV)	5.75%	5.79%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.57%	6.61%
Investment grade issuer (including cash)	92%	93%
Fund average term	4.4 years	4.3 years
Major Bank Tier 1 exposure	58%	57%
Property exposure	1.5%	1.5%

\* 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](mailto: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.