

Australian Enhanced Income Fund - ASX Code "AYF"

January 2018 Investment Update and NAV

January 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on January 31, 2018 was **\$6.091** per unit. This compares with the ex-distribution NAV of a unit at the close of business on 29 December 2017 of \$6.0735. The change in NAV over the month of January represents a return of **0.29%**. The franking benefit for January 2018 was estimated to be **0.00% (zero)**.

| Performance | 1 month | 3 months | 12 months | 5 Year p.a. |
|----------------------------------|---------|----------|-----------|-------------|
| Australian Enhanced Income Fund* | 0.29% | 1.54% | 6.71% | 5.22% |
| UBS(A) Bank Bill Index | 0.16% | 0.43% | 1.75% | 2.32% |

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

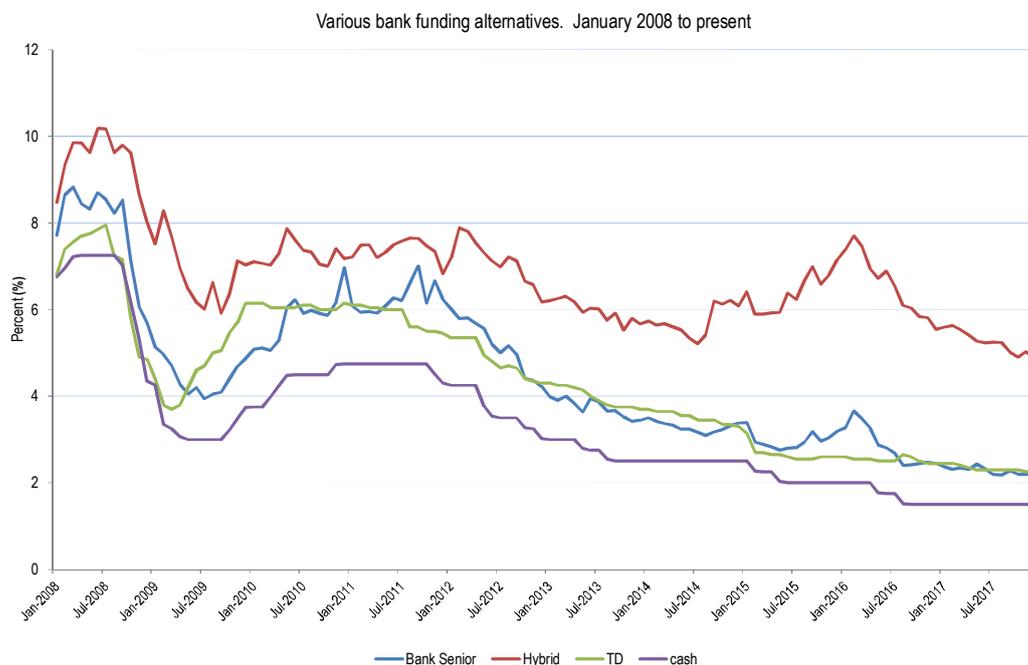
Relative performance

Including the value of franking credits the ASX listed hybrid sector returned 0.29% for the month. This compares with the All Ordinaries Accumulation Index return of -0.33% and the UBSA Bank Bill Index return of 0.16%.

After fees but before the value of franking, the Fund underperformed the broader market marginally 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 31 January 2018 was 6.71%.

TD's – a walk down memory lane

Most term deposit (TD) investors would have fond memories of the immediate post GFC era: 6%, no risk returns were prominent from 2009 until the end of 2011. The chart overleaf shows the cost of various ways banks fund themselves: cash, bonds (as measured by Westpac 5 year CDS), Term Deposits (RBA average "special" TD rate) and Hybrid capital (the average yield of the latest major bank AT1 issues). While it is clear from the chart that cash rates have fallen, it is less clear that the spread margins over cash for senior debt and term deposits have narrowed. In 2012 the term deposit rate as denoted by the RBA Average "Special" rate was around 1.25% higher than the cash rate. That margin has been in a gradual downtrend since and is currently only 0.75% over the 1.5% cash rate. The cost of senior bond funding has followed a similar path. This is not that surprising as there is an explicit linkage. Banks need a high amount of "certain" funding and deposits and senior bonds are considered equally "certain". So if either the margins on bond funding or term deposits get majorly out of synch, the bank should switch funding strategies to minimise costs.



We acknowledge there is a strong cause and effect relationship with senior debt rates, but there have been times when TD/Senior bond funding costs (green and blue lines above) have diverged. In the immediate post GFC period, TD rates were well above senior bond rates, in the main because banks couldn't actually issue bonds at that time. Today, both TD and senior bond rates are about 0.75% over cash or 2.25% in nominal terms.

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

| | December 2017 | January 2018 |
|--|---------------|--------------|
| Net Asset Value (NAV) * Ex-distribution. | \$6.0735* | \$6.091 |
| Change in NAV month on previous month (mopm)* | 0.88% | 0.29% |
| Total investment return includes the value of franking (mopm) | 1.10% | 0.29% |
| Dividend (declared January 2018 and payable 15 January 2018) | \$0.0875 | n/a |
| Percent franked (quarterly estimate @ 30% tax rate) | 43.08% | n/a |
| Ex-distribution cash yield per annum (basis NAV) | 5.76% | 5.75% |
| Ex-distribution grossed up yield basis NAV per annum (estimated) | 6.59% | 6.57% |
| Investment grade issuer (including cash) | 92% | 92% |
| Fund average term | 4.3 years | 4.4 years |
| Major Bank Tier 1 exposure | 57% | 58% |
| Property exposure | 1.5% | 1.5% |

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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.