December 14, 2016

Australian Enhanced Income Fund - ASX Code "AYF"
November 2016 Investment Update and NAV

November 2016 NAV and Fund performance

The Fund's NAV of a unit at the close of business on November 30, 2016 was $**5.976** per unit. This compares with the NAV of a unit at the close of business on 31 October of $5.94. The change in NAV over the month of November represents a return of 0.61%**.** The franking benefit for November was estimated to be **0.05%**.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	0.61%	1.45%	6.20%	3.82%
UBS(A) Bank Bill Index	0.15%	0.46%	2.14%	2.41%

*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 0.74% for the month. This compares with the All Ordinaries Accumulation Index return of 2.46% and the UBSA Bank Bill Index return of 0.14%.

Fund performance

The Fund underperformed the broader market slightly 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 November 2016 increased to 6.20% from 5.41% previously.

Bond and real rates have been falling for 35 years

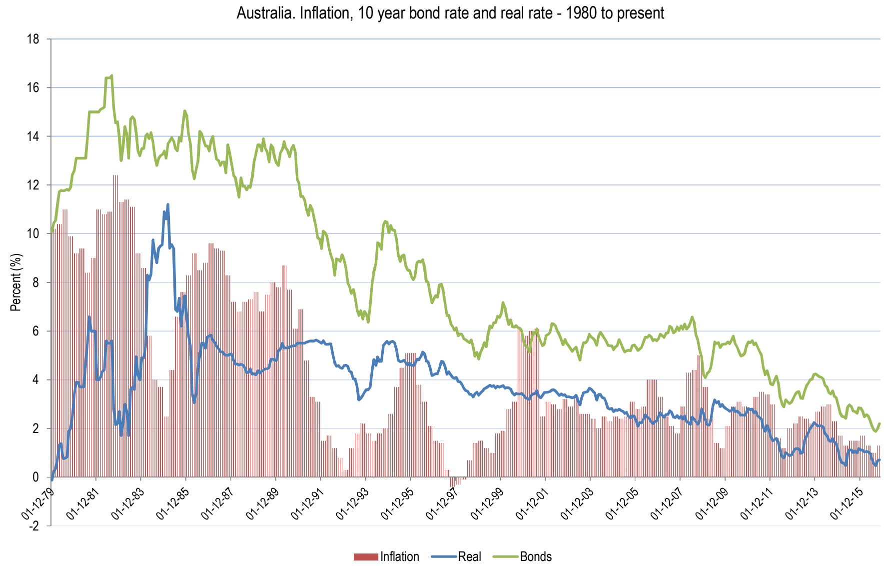
For the last 35 years the world, of which Australia has been a part, has experienced declining bond yields. A 10 bond yield is made up 2 components, a real rate component which compensates the investor for locking up their investment for a fixed 10 year period and an inflation component. The real rate component is the rate of return investors receive after inflation. What is really interesting is that despite inflation being relatively sanguine, real rates of return have been declining for the last 20 years or so (refer to the chart overleaf). Since the mid 1990's inflation in Australia has averaged around 2.5% per annum while the 10 year bond yield has fallen from 7% to 2% over the same period, dragged lower by the real rate of return component.

What happens if..??

Commentators are at a loss to explain why real rates have fallen so much. Perhaps, the inflation targets of the central banks has reduced inflation risk such that investors are prepared to bid up the price of long duration assets where their investment is tied up for a long time. Whatever the reason the effect on the performance of long duration assets has been nothing short of spectacular. But what happens should real rates rise as they did the 1970's? Now, it's inconceivable with central bank inflation targets in place that real rates could rise to the extent that they did in the 70's but some retracement is possible. And what would such a rise do to the value of long duration assets such as bonds, infrastructure, REIT's and equities? We did some calculations using the post GFC period as a template where real rates in Australia fell from 2.7% to 0.7%. If we adjusted the discount rate on a 30 year infrastructure asset by that 2% change in the real yield, the value of the asset would decrease by around 50%. While we understand it is not quite that simple it nonetheless bears consideration.

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

December 14, 2016



A sobering reminder of rising rates from Warren Buffett

After a 35 year hiatus, it is sobering to be reminded as to what happens when discount rates go up as opposed to down. We came across a December 2001 Fortune article referencing an essay written by Warren Buffett in 2000. It his essay Buffett analysed two 17 year periods in the US. The first, from 1964 to 1981 revealed that despite US GNP increasing by 373% the US Stock Market remained virtually unchanged over the period. The next, between 1981 and 1998 revealed that the US Stock Market went up more than 10 times while GNP increased a relatively modest 177%! The difference between the two periods can be explained quite simply. 10 year bond rates rose from 4.2% to 13.65% in the first period and fell from 13.65% to 5.09% in the second period!

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

	October 2016	November 2016
Net Asset Value (NAV)	**$5.94**	**$5.976**
Change in NAV month on previous month (mopm)*	**0.98%**	**0.61%**
Total investment return includes the value of franking (mopm)	**1.02%**	**0.66%**
Dividend (declared December 2016 and payable 16 November 2017)	**n/a**	**n/a**
Percent franked (*quarterly estimate @ 30% tax rate*)	**n/a**	**n/a**
Cash yield per annum (basis NAV)	**5.89%**	**5.85%**
Grossed up yield basis NAV per annum (*estimated*)	**6.70%**	**6.69%**
Investment grade issuer (including cash)	**90%**	**90%**
Fund average term	**3.6 years**	**3.9 years**
Bank Tier 1 exposure	**44%**	**45%**
Property exposure	**4%**	**4%**

* 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