

December 14, 2017



## **Australian Enhanced Income Fund - ASX Code "AYF"** **November 2017 Investment Update and NAV**

### November 2017 NAV and Fund performance

The Fund's NAV of a unit at the close of business on November 30, 2017 was **\$6.107** per unit. This compares with the NAV of a unit at the close of business on 31 October of \$6.085. The change in NAV over the month of November represents a return of **0.36%**. The franking benefit for November 2017 was estimated to be **0.07%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	0.36%	1.33%	8.25%	5.55%
UBS(A) Bank Bill Index	0.13%	0.42%	1.76%	2.37%

\*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 0.25% for the month. This compares with the All Ordinaries Accumulation Index return of 1.91% and the UBSA Bank Bill Index return of 0.13%.

After fees but before the value of franking, the Fund outperformed 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 30 November was 8.25%.

### Volatility: What's going on?

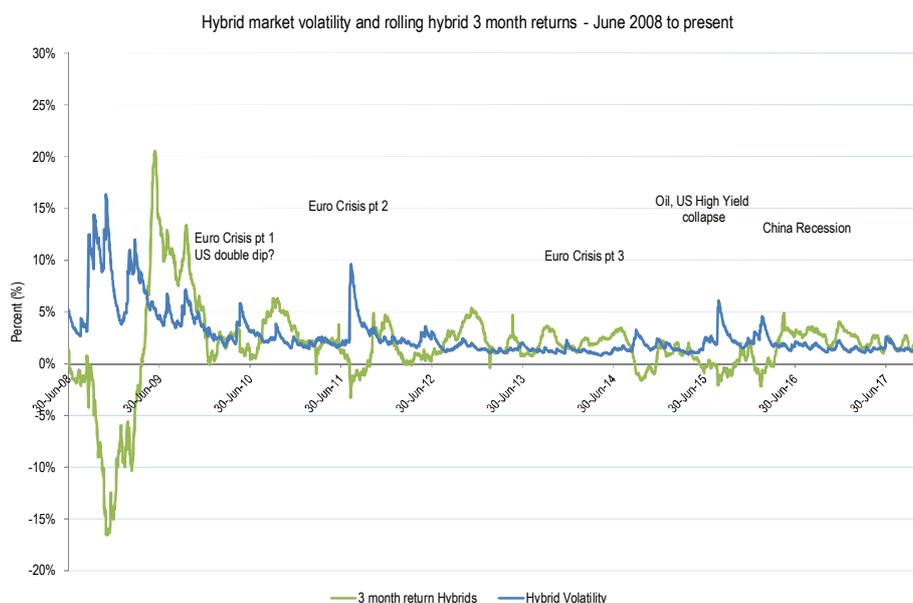
Everyone's talking about it but no one really knows what it actually means. We are of course talking about volatility. Record low levels of volatility are occurring in all markets including the listed Australian hybrid market. The GFC notwithstanding hybrids have always been low volatility investments. However, this has accelerated recently such that return volatility is now at historical lows of 0.9% p.a. This compares with "normal" equity market volatility of around 15% p.a. The chart overleaf shows the path of hybrid market volatility from just prior to the GFC. We have also included rolling 3 month hybrid market returns. The data is drawn from the Elstree Hybrid Index.

Volatility has clearly fallen since the GFC. There have been some spikes along the way but basically it has been falling. An important question for hybrid investors (and all other investors for that matter) is whether the GFC experience was part of a normal pattern of market events or whether it was an "outlier". In the immediate post GFC period there are a number of examples of investors overreacting to relatively minor events. Returns of course tend to be distorted (negatively) by volatility and the post GFC period is littered with examples (refer chart). Given we tend not to see volatility spikes when prices rise it suggests to us that being able to predict changes in volatility can be a valuable aid in predicting market weakness. When there are either large falls in, or

1

December 14, 2017

extremely low volatility, there is a negative reaction within the next 3 months. That's perfectly rational if you think about it. If markets are priced for perfection, as a period of extremely low volatility would seem to suggest, they will sell off on the slightest imperfection. Clearly, we're in that period now. While we are well aware that low volatility is finite, we're less sure why and how it unwinds. The excess return over the risk free rate provided by the hybrid market makes being uninvested expensive as you have to be very sure of impending market weakness to outperform a "stay invested" strategy. Overall, we think the risk of hybrid market weakness is low, despite spread margins falling below post GFC averages and volatility falling to record low levels.



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

	October 2017	November 2017
Net Asset Value (NAV) - ex-distribution.	\$6.085	\$6.107
Change in NAV month on previous month (mopm)*	0.54%	0.36%
Total investment return includes the value of franking (mopm)	0.55%	0.43%
Dividend (declared November 2017 and payable 17 November 2017)	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%	5.73%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.57%	6.55%
Investment grade issuer (including cash)	90%	91%
Fund average term	4.2 years	4.1 years
Bank Tier 1 exposure	48%	49%
Property exposure	6%	6%

\* 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.