December 11, 2018

Australian Enhanced Income Fund - ASX Code "AYF" November 2018 Investment Update and NAV

November 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on November 30, 2018 was $**5.907** per unit. This compares with the Fund's NAV of a unit at the close of business on 31 October 2018 of $5.932. The change in NAV over the month of November represents a return of (0.42%)**.** The franking benefit for November 2018 was estimated to be **0.11%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	(0.42%)	(0.96%)	2.85%	4.43%
UBS(A) Bank Bill Index	0.15%	0.48%	1.91%	2.17%

*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 (0.08%) for the month. This compares with the All Ordinaries Accumulation Index return of (2.45%) 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 5 years the Fund's rolling annual net return, which excludes the benefit of franking but is net of all fees, for the period ending 30 November 2018 was 4.43% p.a.

A micro and macro look through into our portfolio structure.

Perhaps the most interesting aspect this month is encapsulated in the 2 new hybrid security issues by CBA and WBC. Since March we have been interested in how the hybrid market would react to the ALP's proposal to remove franking credit rebates for zero taxpaying superannuants should it (the ALP) be elected at the next Federal election. Indeed, if the hybrid market thought it was going to be a major issue, we would see weak demand for new securities, particularly in view of the recent opinion polls which point to a high probability of an ALP victory and with it the implementation of the ALPs changed policies. However, both CBA and WBC issued $1.25b+ at market spread margins with little effect on pricing. The pricing would indicate strongly that there are sufficient investors who are not materially affected by the potential loss of franking credit rebates to worry about it.

The fact that issues by both CBA and WBC went at 'market margins' is now reflected in the structure of our portfolios. The observant among you will notice that the portfolio's structure changed over the month of November. The portfolio is now more heavily concentrated in highly rated, medium term (to maturity) bank issued tier 1 securities where we perceive the 'relative value' lies – the term (medium) of the securities reflects our view that while we respect the market's sanguine approach to a change of government and what it potentially means for zero tax paying superannuants, such an event does have the potential to be disruptive to the secondary market pricing of long term securities and as a manager of risk assets we must be cognisant of the risk posed by that.

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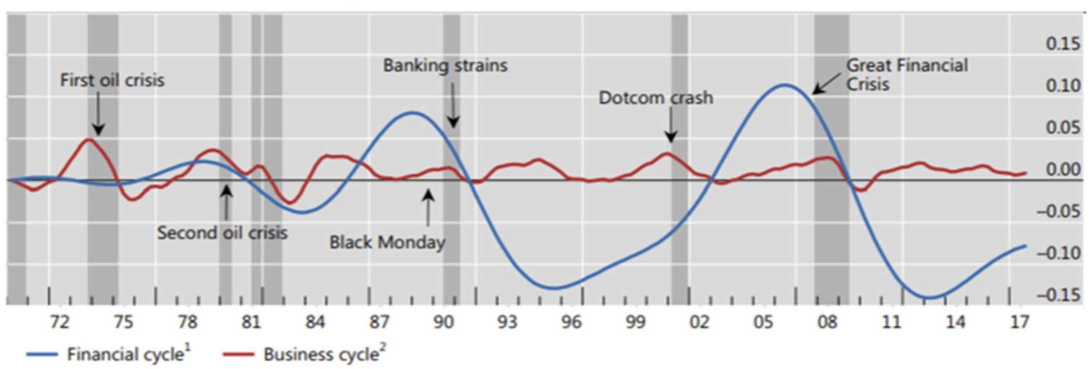
While just how the ALP's policy changes will be accepted by the market has influenced our thinking at a micro level an interesting piece of research undertaken by the Bank of International Settlements has influenced our thinking at a macro level. The concept and measurement of a business cycle (i.e economic growth, full employment, boom/bust) is well understood, but what is less understood is the financial cycle, despite the obvious interaction with the business cycle. Three economists from the BIS recently released a paper shedding some more light on the issue. The chart below shows the US business and financial cycles. Without going into detail about what the inputs are it is abundantly clear from the chart (if we are to believe the economists from the BIS) that the US is a long way from experiencing another financial market crisis. We understand of course that a crisis can emanate from other sources (such as China) but from what the 3 economists at BIS are telling us it is unlikely to be sourced in the US and we, as an investor in risk assets, gain some comfort from that.

The financial and business cycles in the United States Graph 1



[1] The financial cycle as measured by a frequency-based (bandpass) filters capturing medium-term cycles in real credit, the credit-to-GDP ratio and real house prices. [2] The business cycle as measured by a frequency-based (bandpass) filter capturing fluctuations in real GDP over a period from one to eight years.

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

	October 2018	November 2018
Net Asset Value (NAV) # Ex-distribution.	$5.932	$5.907
Change in NAV month on previous month (mopm)*	(0.46%)	(0.42%)
Total investment return includes the value of franking (mopm)	(0.45%)	(0.31%)
Dividend paid 15 October 2018	n/a	n/a
Percent franked (*quarterly estimate @ 30% tax rate*)	n/a	n/a
Ex-distribution cash yield per annum (basis NAV)	5.89%	5.92%
Ex-distribution grossed up yield basis NAV per annum (*estimated*)	6.73%	6.76%
Investment grade issuer (including cash)	88.9%	92.0%
Fund average term	3.58 years	3.70 years
Major Bank Tier 1 exposure	49.5%	54.8%
Property exposure	4.7%	1.7%

* 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.