

Australian Enhanced Income Fund - ASX Code "AYF"

September 2018 Investment Update and NAV

September 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on September 28, 2018 was **\$6.047** per unit. Ex-distribution the NAV of a unit was \$5.959. This compares with the Fund's NAV of a unit at the close of business on 31 August 2018 of \$6.052. The change in NAV over the month of September represents a return of (0.08%). The franking benefit for September 2018 was estimated to be **0.25%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	(0.08%)	2.08%	4.38%	4.74%
UBS(A) Bank Bill Index	0.16%	0.53%	1.87%	2.19%

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

Relative performance

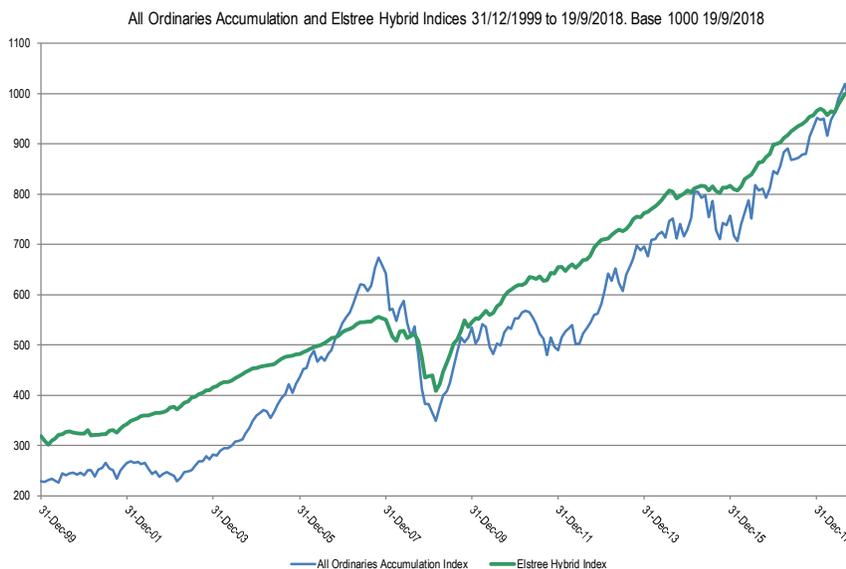
Including the value of franking the ASX listed hybrid sector returned 0.30% for the month. This compares with the All Ordinaries Accumulation Index return of (1.06%) and the UBSA Bank Bill Index return of 0.16%.

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 28 September 2018 was 4.74% p.a.

Looking backwards to move forwards.

On the 10year anniversary of the GFC there has been a lot of commentary about the catastrophic events of 2008. While hybrids performed very badly during the GFC they have performed extremely well since only being shaded by equities in recent months. On an annual basis, since the GFC's nadir, the All Ordinaries Accumulation Index returned 15.1% while hybrids, as represented by the Elstree Hybrid Index returned 13.8%. After adjusting returns for volatility however, there is no comparison. Hybrids out-perform comprehensively. The chart overleaf details the paths of the All Ordinaries Accumulation and Elstree Hybrid Indices since December 1999. The way to read the chart is that at any point on either line it shows how much you would have needed to invest at that point to generate \$1000 at the end point (19/9/2018). Clearly, lower is better and where the lines intersect (such as in late 2009) you would have needed to invest the same amount, only of course, hybrid return outcomes were materially less volatile. There are a couple of reasons for this seemingly incongruous outcome;

- Hybrids were heavily oversold in the GFC and
- Hybrids have consistently offered a margin greater than 3% over the risk free rate since the GFC which is broadly equivalent to the historical 'ex-post' premium investors receive over the risk free rate for investing in the riskier equity.



Hybrids performed very badly during the GFC for 2 reasons. Firstly, a much larger cohort of hybrids were issued by non investment grade issuers and secondly, forced margin call selling of hybrids. A little known fact is that hybrids were the security of choice for meeting margin calls - it was simply easier to sell a hybrid than trying to sell mid cap mining stocks at 70% discounts. It was forced margin call selling and inferior structure of the hybrid market which combined to push prices down to the oversold levels of 2009. We note, that neither of these requisite issues exist today. In Australia financial security leverage is $\frac{1}{4}$ what it was during the GFC and only 7% of all hybrid securities now on issue are issued by non-investment grade issuers. While we can't rule a GFC type event shock we can reasonably expect, if there is to be one, that the hybrid market will behave quite differently.

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

	August 2018	September 2018
Net Asset Value (NAV) # Ex-distribution.	\$6.052	\$5.959#
Change in NAV month on previous month (mopm)*	1.20%	(0.08%)
Total investment return includes the value of franking (mopm)	1.25%	0.17%
Dividend paid 15 October 2018	n/a	\$0.0875
Percent franked (quarterly estimate @ 30% tax rate)	n/a	0.49%
Ex-distribution cash yield per annum (basis NAV)	5.78%	5.87%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.61%	6.71%
Investment grade issuer (including cash)	90%	90%
Fund average term	3.9 years	3.6 years
Major Bank Tier 1 exposure	51%	51%
Property exposure	3.0%	3.0%

* 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.