

Australian Enhanced Income Fund - ASX Code "AYF"

July 2018 Investment Update and NAV

July 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on July 31, 2018 was **\$5.98** per unit. This compares with the Fund's ex-distribution NAV of a unit at the close of business on 29 June 2018 of \$5.924. The change in NAV over the month of July represents a return of 0.95%. The franking benefit for July 2018 was estimated to be **zero (0.00%)**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	0.95%	2.44%	3.90%	5.04%
UBS(A) Bank Bill Index	0.20%	0.52%	1.83%	2.21%

*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 1.01% for the month. This compares with the All Ordinaries Accumulation Index return of 1.22% and the UBSA Bank Bill Index return of 0.20%.

After fees but before the value of franking, the Fund performed in-line with 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 31 July 2018 was 5.04% p.a.

Investment Fund return outcomes - an overview.

As money managers we are always cognisant of the performance of our fellow managers irrespective of what asset they manage. While we monitor the managers of like assets closely we do take an interest across the breadth of the market. The 12 month return period to end June 2018 highlighted just how perfect a year it was with balanced super funds returning 10%+. One thing that did jump out however was the c20% discrepancy between the best and worst performing equity manager. Such a variance typically signals the 'beginning of the end'. It's not quite 2006 and 2007 when the median super fund returned 14% p.a. nor is it quite like 1987 when some 'go fast' managers returned c50% p.a. however we think we are reaching a point where investors are getting a little bit ahead of themselves.

Investments are driven by a combination of factors which determine their ultimate return outcome and their return path. For example, investment grade bond return outcomes are driven by how likely it is that an investment grade rated company will default (not very often). This means that the return outcomes of investment grade assets tend to be very stable (because securities rarely if ever default) while the return path variability is driven by the duration of the asset (the longer the duration the

August 14, 2018

greater the return variability and vice versa). The return path is of course influenced by sentiment which varies over time. Alternatively, the value of equity and infrastructure assets – both of which are very long duration assets - is driven by factors including macro-economics, management, demographics and politics. While sentiment and risk aversion drive the return path because these assets are long duration assets and their value is unknown the return path tends to be highly variable.

Hybrids are closer to investment grade bonds in that their ultimate return outcome is almost certain, but they have other influencing factors including equity conversion, default risk and event shock experiences associated with the issuer which impact their return path outcomes. However, because hybrids are short duration assets, they are far less volatile than equities. This explains why when hybrids have experienced poor return periods they have only tended to be poor for a short period of time (i.e 1 year).

The other takeaway from our analysis of Fund performance is that investors really should demand big premiums for illiquid investments such as unlisted property, private equity and infrastructure. Interestingly, investors don't seem to demand large premiums except in the immediate aftermath of a crisis when liquidity premiums rise appreciably. Being invested for example, in an illiquid asset can lead to extremely poor return outcomes as investors can be 'locked out' from redemption for extended periods (think 'property trusts' post GFC). One thing we can attest to is that hybrids were more liquid than Australian corporate bonds during the GFC (the last liquidity crisis) and arguably they are more liquid now than high yield bonds.

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

	June 2018	July 2018
Net Asset Value (NAV) # Ex-distribution.	\$5.924#	\$5.98
Change in NAV month on previous month (mopm)*	1.64%	0.95%
Total investment return includes the value of franking (mopm)	1.84%	0.95%
Dividend (N/A)	\$0.0875	n/a
Percent franked (quarterly estimate @ 30% tax rate)	49.99%	n/a
Ex-distribution cash yield per annum (basis NAV)	5.91%	5.85%
Ex-distribution grossed up yield basis NAV per annum (estimated)	6.75%	6.69%
Investment grade issuer (including cash)	93%	90%
Fund average term	4.1 years	4.0 years
Major Bank Tier 1 exposure	53%	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.

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