July 12, 2017

Australian Enhanced Income Fund - ASX Code “AYF”
June 2017 Investment Update and NAV

June 2017 NAV and Fund performance

The Fund’s NAV of a unit at the close of business on June 30, 2017 was $**6.158** per unit. This compares with the NAV of a unit at the close of business on 31 May of $6.122. The change in NAV over the month of June represents a return of **0.59%.** After the payment to unit holders registered at the close of business on 30 June of the $0.0875 cash distribution the Funds NAV was **$6.071**. The franking benefit for June was estimated to be **0.17%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	0.59%	2.37%	10.54%	6.23%
UBS(A) Bank Bill Index	0.14%	0.44%	1.82%	2.53%

*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 0.63% for the month. This compares with the All Ordinaries Accumulation Index return of 0.28% and the UBSA Bank Bill Index return of 0.14%.

Fund performance

After fees but before the value of franking the Fund performed in-line with the 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 June was 10.54%.

The Australian property market

The extent of the Australian residential property market boom continues to occupy the thoughts of regulators and commentators alike. While we are concerned about the state of the market we are perhaps less concerned than a number of the doomsayers. We argue that, yes the market is experiencing a boom period but by comparison with a number of other OECD countries it is not a bubble. There is a difference. The difference, we think, lies in credit creation and bank lending behaviour. Typically, a bubble is financed by excessive and irresponsible bank lending, a feature being high LVR’s. Indeed the Irish boom in the mid 2000’s was accompanied by extremely high LVR lending at the death, resulting in a bust scenario culminating in the Irish banking system being nationalised. In terms of high LVR lending – defined as greater than 90% - at the time of the collapse of the Irish property market almost 25% of Irish bank balance sheets constituted high LVR lending. This compares with the Australian banks at currently 1/3rd that. The annual rate of credit growth too extended by the Irish banks for housing (before the crash) dwarfs that of the Australia at 24% per annum versus Australia at relatively pedestrian 6%.

Observations

The other interesting observation within the OECD group of countries is that the decline in property prices post the peak, tend to be relatively orderly. Falls of between 10 - 15% are common place but they tend to occur over a 5 - 10 year timeframe. Such an orderly decline has little impact on bank balance sheets, especially balance sheets that are heavily represented by low LVR lending such as is apparent in Australia.

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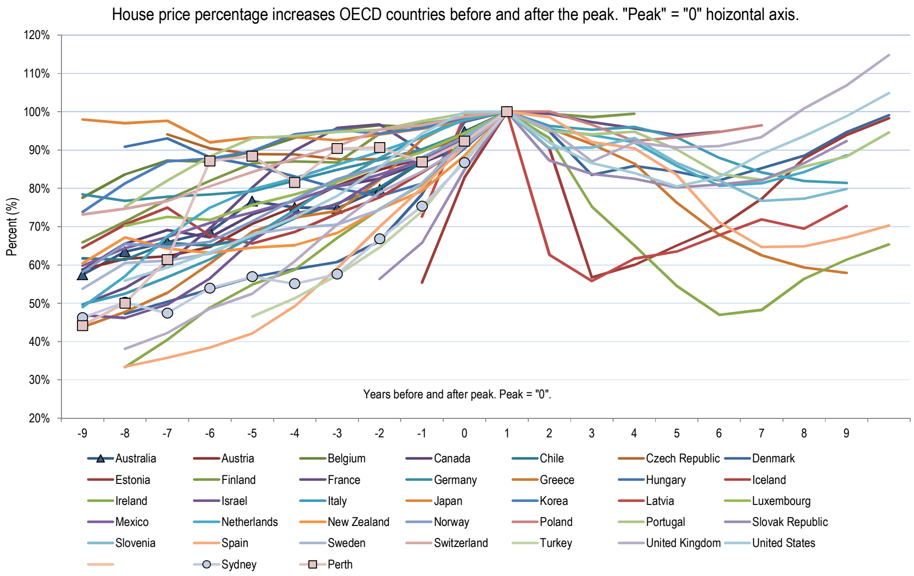
The chart

The chart below, which is messy we will admit, details the path in property prices to the peak and beyond for the 33 OECD economies (we've also included Sydney and Perth) for the 10 years before peak house prices and up to 10 years afterwards. We've based the peak year at 100%, so a value of 80% 3 years before indicates a 20% increase in house prices over that period.



Conclusion

From Australia's perspective it looks to us as though we are experiencing large house price increases without an explosion in lending and at relatively low LVR's. So while it's clear that it's a boom and it might not be sustainable and it is concerning, it's not quite a bubble in the US or Irish sense. Importantly, the nature of the owners of the assets (and accompanying debt) means a decline in prices will not be fatal for banks.

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

	May 2017	June 2017
Net Asset Value (NAV) - ex-distribution#.	$6.122	$6.071#
Change in NAV month on previous month (mopm)*	1.09%	0.59%
Total investment return includes the value of franking (mopm)	1.15%	0.76%
Dividend (declared June 2017 and payable 17 July 2017)	n/a	$0.0875
Percent franked (*quarterly estimate @ 30% tax rate*)	n/a	40.45%
Ex-distribution cash yield per annum (basis NAV)	n/a	5.77%
Ex-distribution grossed up yield basis NAV per annum (*estimated*)	n/a	6.59%
Investment grade issuer (including cash)	90%	90%
Fund average term	4.1 years	4.3 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 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.