



Australian Enhanced Income Fund Investor Update

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Executive summary

- Disclaimer.
- The year in review.
- Looking ahead.
- Breakeven analysis
- Best to outsource to a specialist manager.
- About the Fund.
- About the manager.



Disclaimer

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2017 FY in review

- The Fund's net (after fees) return plus the value of franking was 11.67% (2016 FY 2.7%).
 - This was a function of the prices of securities in which the fund invests rising consistently over the course of the year.
 - This was a direct function of a continuation of a demand/supply mismatch which had its beginnings late in the 2016 FY.
 - More recently investors have recognised the latent value of securities in which the fund invests on;
 - A material improvement in the capital levels and tenor and security of funding of bank issuers and
 - The strong relative performance of more senior, but 'like' securities issued by bank issuers.



Transitioning between 2017 FY and FY 2018

- While the 2017 FY produced an excellent return outcome we caution investors about expecting a similar return outcome in FY 2018.
- While most of the conditions remain entrenched for further price gains much of the 'easy' gains have been had.
 - We expect returns to be more circumspect in FY 2018 underpinned by a respectable income return including the value of franking of c 5.75% with a modicum of capital growth expected.
 - We are pleased to report that since 30 June the fund has returned, net of all fees but including the value of franking, 1.73%



Looking ahead: 12 month market performance expectations

- While prices have rallied strongly over the last 18 months we don't see, absent a major event shock, prices pulling back any time soon. We base our prognosis on;
 - Negative domestic primary (IPO) market supply in FY 2018,
 - De-risking of equity portfolios into more senior securities,
 - Historically low risk free rates of return and
 - Attractive comparative yields for;
 - More senior securities
 - Equities and
 - Hybrid capital instruments issued offshore.
- A combination of these factors means there is an ongoing prospect of some capital gain above and beyond the income generated by the fund over the next 12 months.

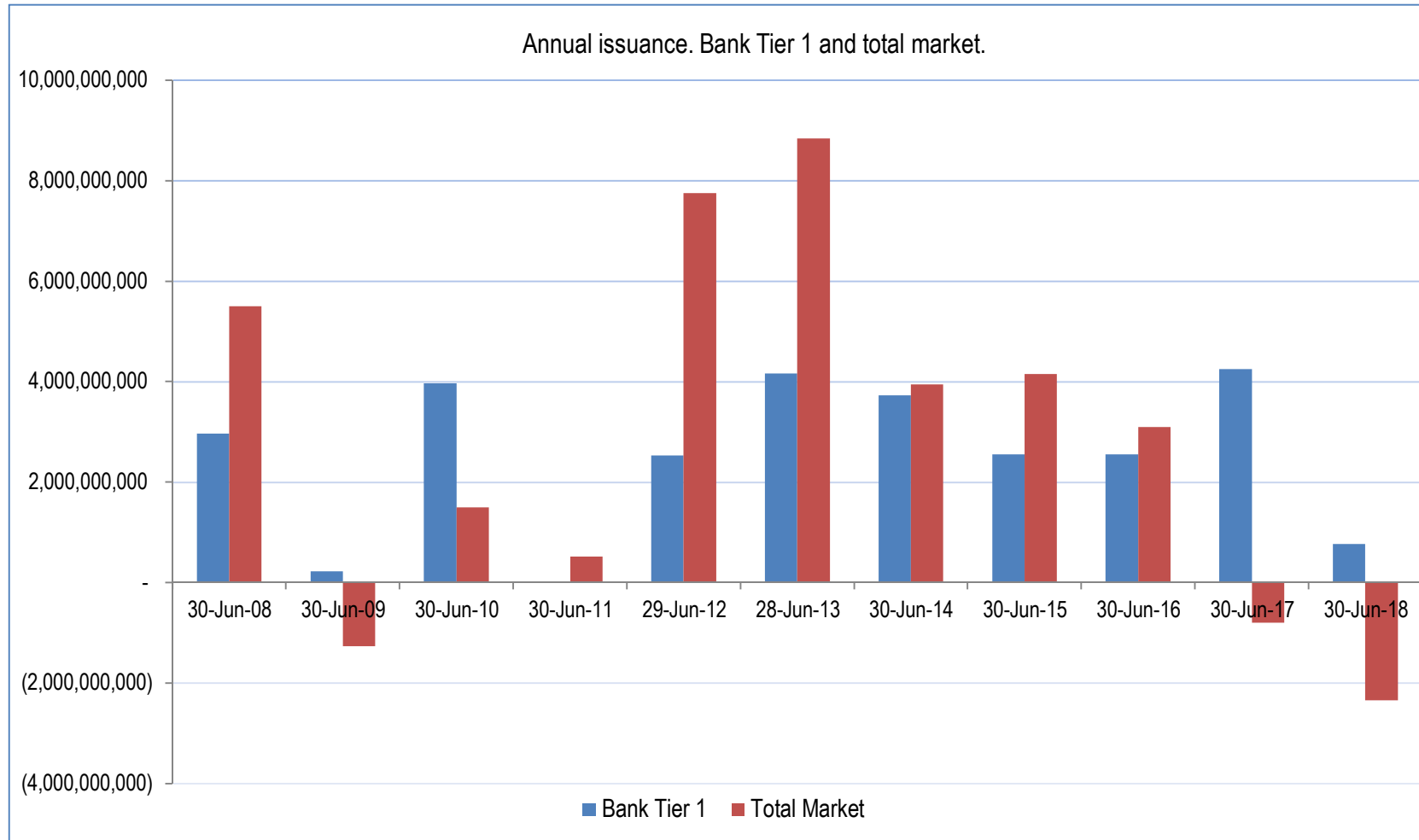


Factors influencing price performance of market at large

Factor	Likely price effect
Institutional demand	↑
ATO ruling on attaching franking credits to offshore issues	↑
De-risking of equity portfolios into more senior securities	↑
Historically low risk free, cash, TD and long term bond rates	↑
Investors seeking high yielding investments	↑
Event shock	↓
Reduced domestic IPO supply	↑
Secondary market supply	→

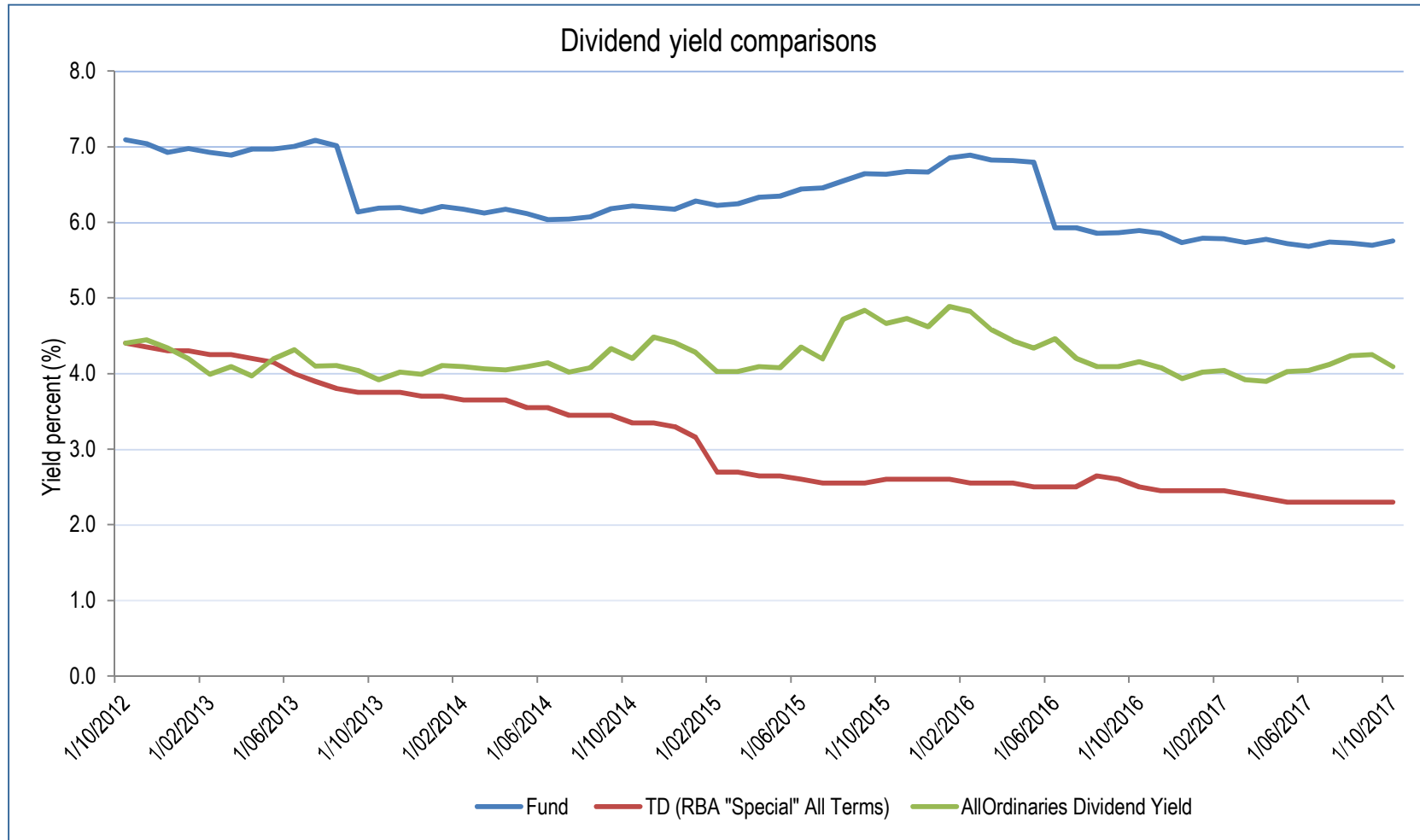


Net supply will be negative in 2018 FY



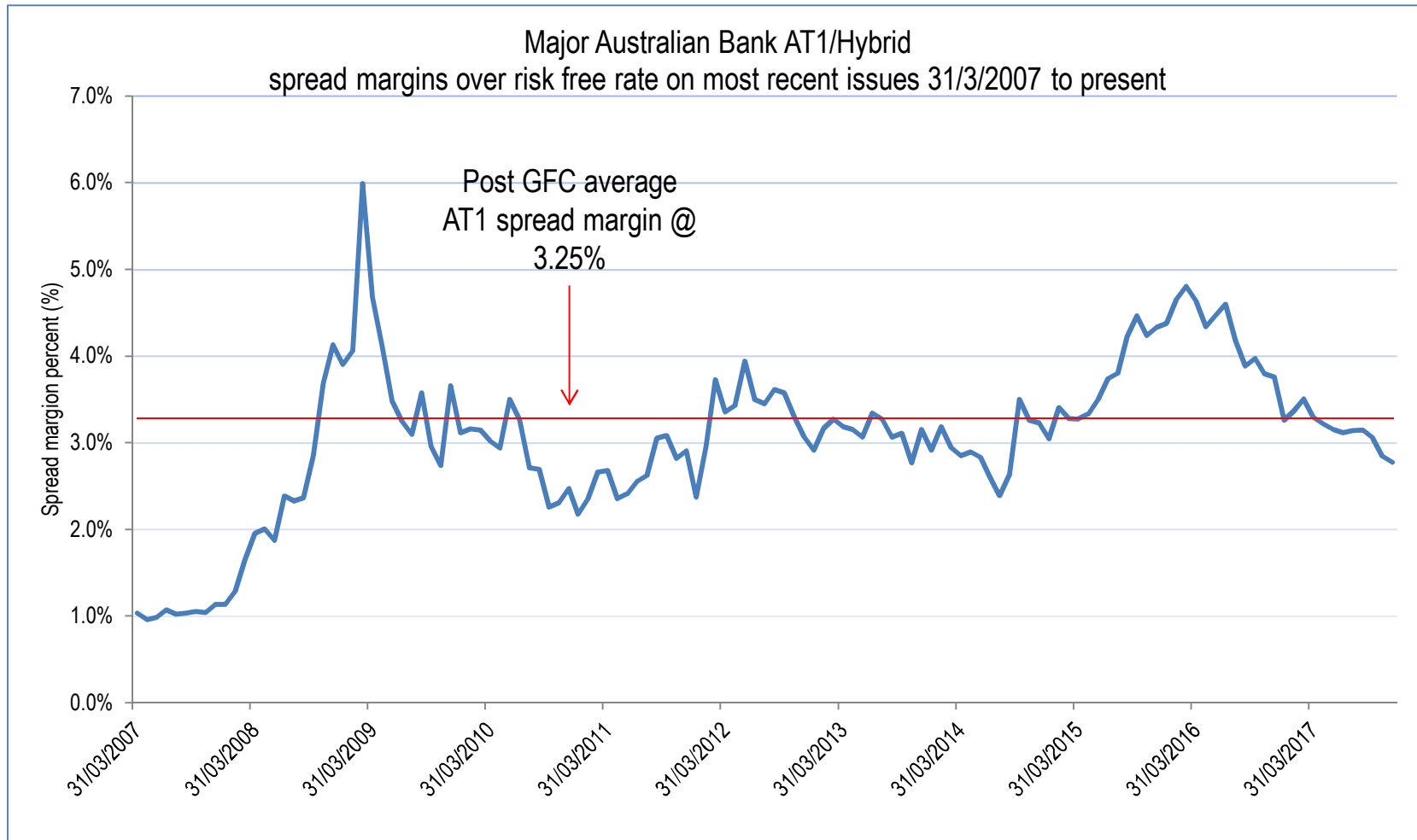


Fund yield looks attractive historically compared with TD's and equities



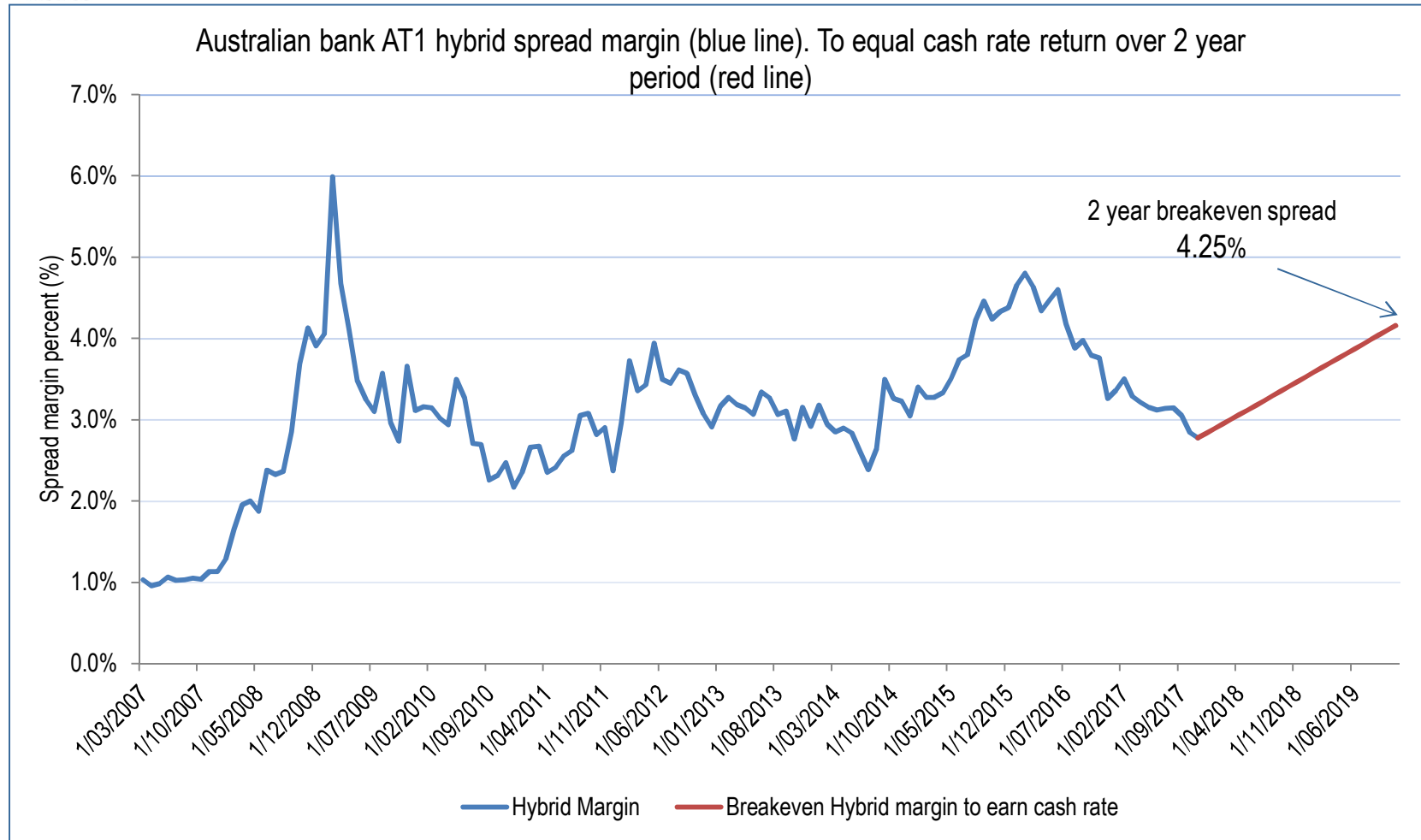


Spread margins of Australian AT1 Hybrids are around post GFC average levels





...but are sufficiently wide to afford investors protection in a drawdown event





Protection afforded in a drawdown event

Tier 1 bank capital instrument	Change in spread margin	Spread margin over BBSW (approx)	\$ loss per \$100 (approx)	Total return (approx)
Current spread margin	No change	300	\$0.00	5.00%
To equal cash or TD	+125	425	\$6.00	2.00%
To equal zero (0%) return	+250	550	\$10.00	0.00%

Assumes c4 year average life and is 'market' data



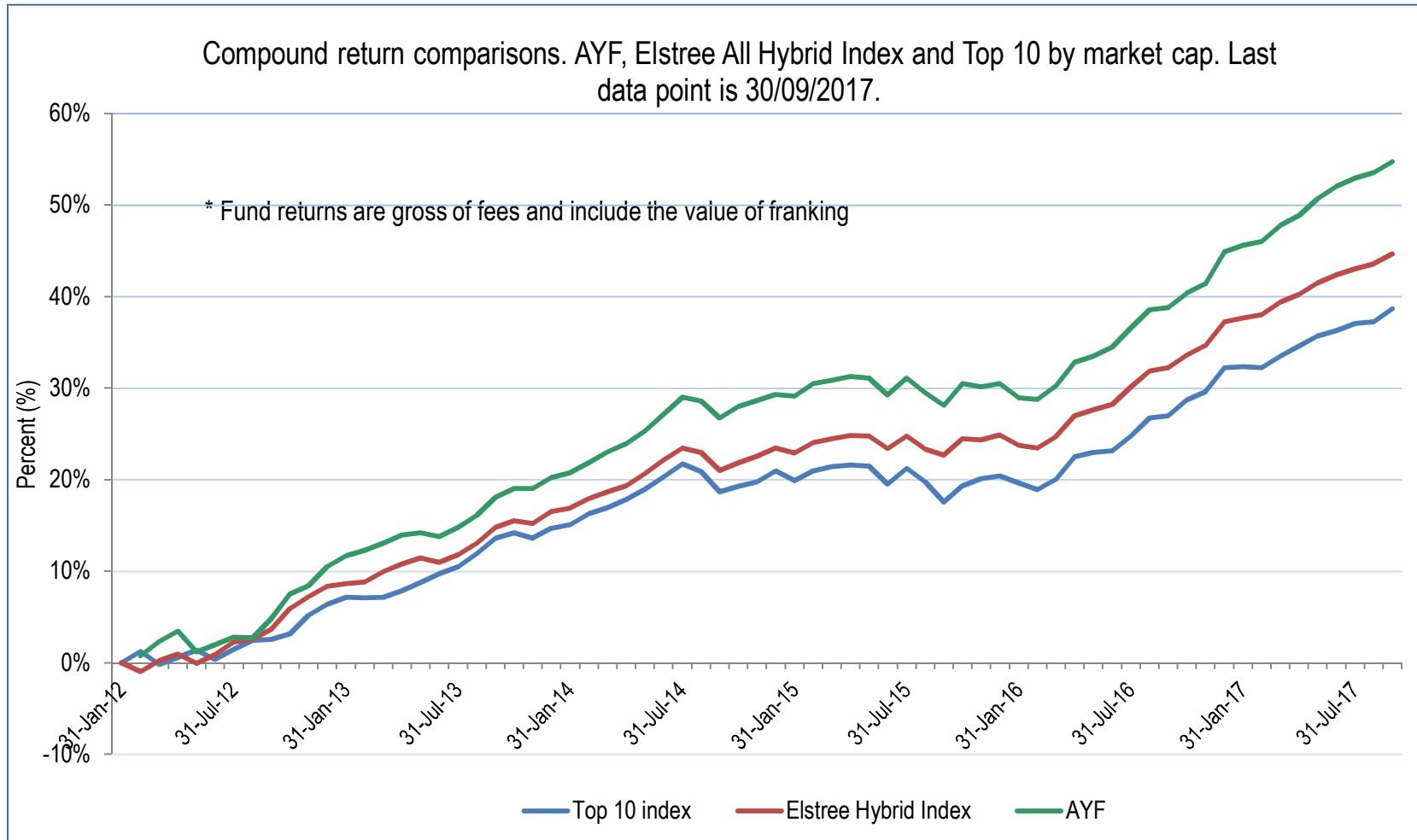
Long term investment performance – data is to 30/9/2017

Investment period	Fund (Gross return)*	Top 10 Hybrid Index*	UBS(A) Bank Bill Index
12 months to end 30 Sept 2017	11.50%	9.20%	1.76%
3 years to end 30 Sept 2017	6.88%	5.30%	2.14%

* Fund return is gross of all fees and includes the value of franking credits. Index includes franking.



Best way to get hybrid exposure is to use a manager





About the Fund

- The Australian Enhanced Income Fund has been operative since October 2006
 - Trust structure.
 - ASX code “AYF”.
 - Fund is subject to the strict ASX listing rule requirements.
- Minimum cash distribution of \$0.35 cents per unit per annum
 - Franking is expected to add around \$0.05 cents to the cash distribution.
- Distributions payable 15 days after 31 March, 30 June, 30 September and 31 December.
- Fund’s current NAV is \$6.085 (31 October 2017)
 - Cash yield is 5.75% (including the value of franking the yield is c6.57%).
- Off market redemption facility available where there is insufficient liquidity on market.



About the manager

- Elstree Investment Management Limited (Elstree) is both the Responsible Entity (RE) and the manager of the Australian Enhanced Income Fund (Fund).
- Elstree has been managing portfolios of listed hybrid debt securities since 2003.
 - The investment managers have over 60 combined years experience managing portfolios of such securities.
- Securities are selected based on Elstree's 4 step filtered security selection process
 - Securities are weighted in the portfolio based on their;
 - Level of cheapness,
 - Market capitalisation,
 - Credit rating and
 - Liquidity.
- Strong risk management emphasis with processes in place to measure and quantify market risk, liquidity risk and event risk.



Appendix. Hybrid and equity return outcomes comparable over most timeframes

