June 14, 2018

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

May 2018 NAV and Fund performance

The Fund's NAV of a unit at the close of business on May 31, 2018 was $**5.914** per unit. This compares with the NAV of a unit at the close of business on 30 April 2018 of $5.924. The change in NAV over the month of May represents a return of (**0.17%).** The franking benefit for May 2018 was estimated to be **0.10%**.

Performance	1 month	3 months	12 months	5 Year p.a.
Australian Enhanced Income Fund*	(0.17%)	(0.76%)	2.35%	4.54%
UBS(A) Bank Bill Index	0.17%	0.48%	1.78%	2.24%

*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 (0.15%) for the month. This compares with the All Ordinaries Accumulation Index return of 1.40% and the UBSA Bank Bill Index return of 0.17%.

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 May 2018 was 4.54% p.a.

Higher interest rates and the impact on investments. History tells an interesting tale.

We wrote previously about how higher interest rates impacted investments from infrastructure, to bonds to property to equities. Clearly, bond prices fall as interest rates rise and equity prices should, everything being equal, fall as well because of the discount rate effect. While this is the conventional wisdom the experience in the US over the last 50 years or so, is that this hasn't always held true. In the US there have been 8 periods since 1980 where bond rates rose more than 1% (and the 1960 and 1970 decades when they rose by around 3% each decade). In 3 of the 8 episodes, equity markets were flat or negative but in the other 5 episodes, equity markets faired reasonably well. The chart overleaf shows the outcomes with changes in the bond yields on the horizontal axis and the change in the S&P500 on the vertical axis. While higher interest rates will lower the value of equities because of the discount rate effect, equity market performance is also influenced by;

- Changes in earnings and
- to a lesser extent, changes in risk aversion.

To demonstrate the influence that earnings and risk aversion have on equity markets we need to look no further than the 1993 and current examples in the US. In 1993 the S&P500 fell by just 3%

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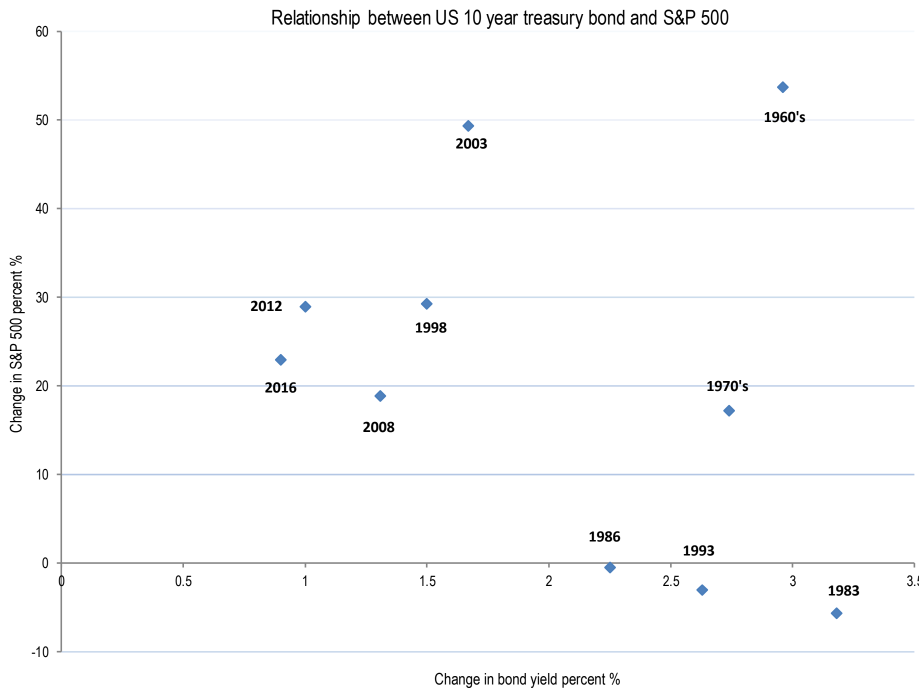
despite bond yields rising 2.6%. Normally, a rise in bond yields of that magnitude would be fatal to equity valuations, but earnings increased 41% and risk aversion fell (adding 12%). The combination of higher earnings and declining risk aversion almost completely offset the 56% decrease in equity value attributable to a rise in bond rates (i.e) -56% + 41% + 12% = -3%). The current 23% increase in the S&P500, which had its beginnings in 2016 when bond yields began to rise, can be attributed to a 27% decline in the value of equity - because of higher rates - being offset by a 25% increase in earnings and a 23% reduction in risk aversion.



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

	April 2018	May 2018
Net Asset Value (NAV) * Ex-distribution.	$5.924	$5.914
Change in NAV month on previous month (mopm)*	0.79%	(0.17%)
Total investment return includes the value of franking (mopm)	0.81%	(0.07%)
Dividend (N/A)	n/a	n/a
Percent franked (*quarterly estimate @ 30% tax rate*)	n/a	n/a
Ex-distribution cash yield per annum (basis NAV)	5.91%	5.92%
Ex-distribution grossed up yield basis NAV per annum (*estimated*)	6.75%	6.76%
Investment grade issuer (including cash)	93%	93%
Fund average term	3.6 years	3.5 years
Major Bank Tier 1 exposure	51%	51%
Property exposure	2.0%	2.0%

* 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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