April 9, 2020

Australian Enhanced Income Fund - ASX Code "AYF" March 2020 Investment Update and NAV

March 2020 NAV and Fund performance

The Fund's NAV of a unit at the close of business on 31 March 2020 was $**5.469** per unit (after the cash payment of $0.07 cents per unit to unit holders registered at the close of business on 31 March 2020 the Fund's NAV of a unit was $5.399. This compares with the Fund's NAV of a unit at the close of business on 28 February 2020 of $5.844. The change in NAV over the month of March represents a return of **(6.42%).** The franking benefit for March was estimated to be **0.17%.** Including the value of franking the Fund returned **(6.25%)** over March 2020.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	(6.42%)	(7.01%)	(3.54%)	2.01%
UBS(A) Bank Bill Index	0.10%	0.26%	1.23%	1.66%

*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 market returned (6.15%) for the month. This compares with the All Ordinaries Accumulation Index return of (20.94%) and the UBSA Bank Bill Index return of 0.10%. After fees and before the value of franking, the Fund performed in line with the broader market this month. Over 3 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 March 2020 was 2.01%.

Making sense of the pricing behavior of March 2020.

What can we say about the events of March 2020 that hasn't already been said. From 2 March to the close of business on 23 March the ASX listed hybrid market as represented by the Elstree Hybrid Index declined by an unprecedented (15.67%). A mere six trading days later on 31 March the index had managed to claw its way back such that it was down, over the month, by a relatively pedestrian (6.15%). Over the same period the equity market delta ranged from 0.1 at the beginning of the month to in excess of 1 on 23 March. Over the month it averaged about 0.3.

It's a given that some downwards hybrid security price pressure was to be expected as a consequence of Covid-19. However, it was the addition of a number of 'other' one off factors, that triggered the dramatic transacted volume surge as supply swamped demand forcing prices materially lower precipitating extreme dislocation. These factors included;

- The selling down of securities to fund the purchase of the 'upsized' NABPG when investors became aware of their entitlements on or around February 25 (as a goodwill gesture amid concerns about the pricing of the NABPG the NAB sensibly decided to withdraw the issue on March 12, however at that point investors would have been well advanced in the selling of their existing securities to fund their 'upsized' entitlements).
- There was margin lending based 'forced' selling of hybrid securities (to fund margin calls on equities) coinciding with the equity market drawdown which began to gather momentum

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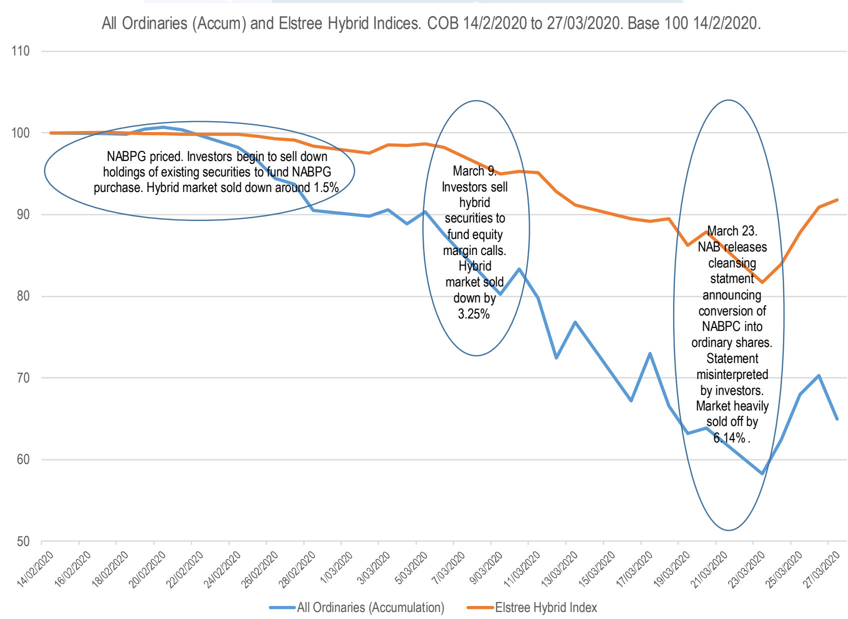
exceeding 20% around the week beginning 9 March. On March 9 the hybrid market as represented by the Elstree Hybrid Index declined 3.25%. On the same day the All Ordinaries Accumulation Index declined by 7.38%

- On Monday 23 March the NAB released a cleansing statement confirming the conversion of capital notes (the NABPC) into ordinary equity. A number of investors erroneously interpreted the NAB's communication (which included a general comment about how Covid- 19 might impact NAB's business) to mean that the NAB would convert their redemption proceeds (being $100 plus the last coupon payment) into ordinary shares at price of $21.34 representing a c30% premium to NAB's last traded share price. This spooked investors into selling everything "NAB" and the market at large (including the equity market). This price behaviour that ensued was the direct result of investors not understanding the documentation or perhaps not even having read the documentation released on 12 March in relation to the NAB withdrawing the NABPG issue and detailing the NABPC's redemption process. The issue of shares is commonplace where maturing hybrid securities are purchased and converted into equity by a 3rd party provider appointed by the issuer (usually an investment bank, in this case UBS). It has nothing whatsoever to do with investors receiving less than 100 cents in the $ as many invested had erroneously interpreted. On Monday 23 March the hybrid market declined 6.14%. On the same day the All Ordinaries Accumulation Index declined by 5.98%



With the GFC providing much of the data and after consideration of the changed structure of the listed hybrid market since the GFC our modelling suggested that the hybrid market would perform significantly better than it did during the GFC should there be an event shock of similar magnitude (i.e any drawdown would be less – this has much to do with the changed structure of the market

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which is now represented by 95% investment grade quality issuer compared with 65% during the immediate GFC period). Typically, the hybrid market displays an equity market delta of around 0.1 (what this means is if the equity market falls by 10% the hybrid market will decline in value by 1%). Should the equity market fall by 20% or more than 20% the delta increases to around 0.2 – 0.3. The delta in the middle of March approached 0.4% which, based on our modelling, we though, was too high (of course on 24 March the equity delta exceeded 1).

It's important to understand that the listed Australian hybrid market is majority populated by unsophisticated and (sometimes) poorly informed investors – certainly the surge in transacted volume, which we observed was panicked in nature highlights just that. In 2 trading days, albeit 2 weeks apart, the listed hybrid market as represented by the Elstree Hybrid Index declined by a staggering 10%. This simply serves to highlight the inefficiencies and nuances that are inherent in listed hybrid market and investors are better served leaving the management of their hybrid securities exposure to a professional fund manager.

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

	Feb 2020	March 2020
Net Asset Value (NAV). "#" denotes "Ex distribution".	$5.844	#$5.399
Change in NAV month on previous month (mopm)*	(1.40%)	(6.42%)
Change in NAV including the value of franking (mopm)	(1.38%)	(6.25%)
Dividend payable 15 April 2020*. Next dividend due - 15 July 2020.	n/a	$0.07*
Percent franked (*quarterly estimate @ 30% tax rate*).	n/a	33.69%
Cash yield per annum (basis NAV and annual cash dividend of $0.22cpu).#	4.76%	4.07%
Grossed up yield (basis NAV) per annum (*estimated*)	5.61%	5.00%
Investment grade issuer (including cash)	92.9%	94.9%
Fund average term	2.21 years	2.89 years
Major Bank Tier 1 exposure	30.5%	42.5%
Property exposure	0.00%	0.00%

* Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance. # Refer to change of dividend announcement 6 March 2020.

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.