

Australian Enhanced Income Fund

June 2014 Investment Update and NAV

June 2014 NAV and Fund performance

The Fund's NAV at the close of business on June 30, 2014 was **\$6.628** per unit. This compares with the NAV of a unit at the close of business on May 30, 2014 of \$6.542. The change in NAV over the month of June 2014 represents a return of **1.31%**. After the payment of the \$0.10 cash distribution to unit holders registered at the close of business on 30 June 2014 the Fund's ex-distribution NAV of a unit was **\$6.528**. The franking benefit for June was estimated to **0.08%**.

ASX trading details

The Fund traded on market at the ASX at a slight discount to the most recently published NAV of a unit over the month of June 2014. The volume weighted average price (VWAP) for June 2014 was **\$6.43**.

	1 month	3 months	12 months*
Australian Enhanced Income Fund	1.31%	3.05%	10.03%
UBSA Bank Bill Index	0.22%	0.67%	2.69%

*Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance.

Events of June

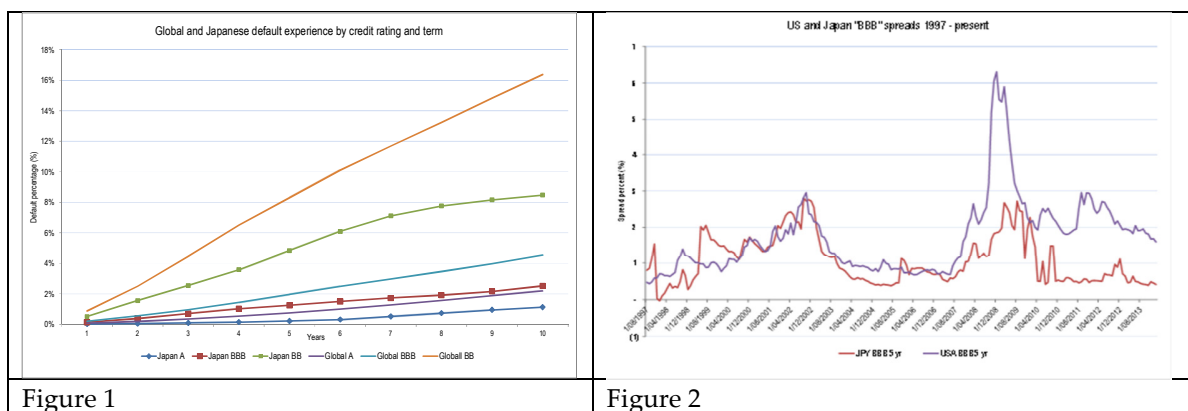
- The ASX listed hybrid sector returned 1.24% for the month. This compares with the All Ordinaries Accumulation Index return of -1.41% and the UBSA Bank Bill Index return of 0.22%.
- The new Westpac hybrid listed at a healthy premium (but still it returned less than the market return since the book build date) and Suncorp finalised its buyback.
- TPI and ALZ both look likely to redeem their hybrids next quarter at PAR.

Fund performance

The Fund outperformed the broader market this month. The Fund's net return (excluding the benefit of franking but after fees) for the year to end 30 June 2014 increased to 10.03% from 8.05% previously.

Japan: the window to the future for credit?

Amid recent downward revisions to global economic growth by the IMF the zero interest rate policies (ZIRP) of the global central banks seem entrenched for a little while yet. Against this backdrop we thought it might be interesting to examine what happens to the price of credit. We don't have to look very hard as Japan provides an excellent recent example of what happens to the price of credit when interest rates remain at zero or near zero for an extended period. The most interesting thing is that default loss rates are lower in Japan than they are anywhere else in the world for securities of the same credit rating. And reflecting that fact that default rates are low the spread or margin that securities trade over the risk free rate are narrower than they are anywhere else in the world for securities of the same credit rating and same term (refer charts overleaf).



What can we conclude?

Why are loss rates lower in Japan than elsewhere? While there are possibly a number of circumstances peculiar to Japan which should be acknowledged we think the answer is relatively simple: if rates are low enough for long enough then households, corporates and indeed governments are less likely to default. The rationale is simply that it is easier (cheaper) to raise capital when rates are low, it is easier (cheaper) to refinance when rates are low and a borrower's interest costs are lower when rates are low. In a low interest rate environment credit performs exceptionally well. This is true of Japan where spreads are tighter (Figure 2) than they are for an equivalent security of the same credit rating and term in the US. If the world is to head down the Japan path of zero interest rates for an extended period it is reasonable to expect credit to perform well as spreads contract still further amid declining default loss rates.

Issued capital and NAV as at close of business 30 June 2014

	30 June 2014	Previous month	Monthly change	Change over Quarter
Total number of ordinary units	2,249,528	2,219,124	+30,404	+33,051
Net Asset Value (NAV)	\$6.528#	\$6.542	+1.31%	+3.05%

• Returns exclude the franking benefit. Past performance is not necessarily a guide to future performance. # Ex-distribution.

Performance History

	Feb 2014	March 2014	April 2014	May 2014	June 2014
Change in NAV	+0.67%	+0.79%	+0.72%	+0.99%	+1.31%
Change in UBSA Bank Bill Index	+0.20%	+0.22%	+0.22%	+0.22%	+0.22%
Comparison to Bank Bill Index	+0.47%	+0.57%	+0.50%	+0.77%	+1.09%
Franking benefit (estimated)	+0.14%	+0.10%	Zero	+0.03%	+0.08%
Total Return including franking	+0.81%	+0.89%	+0.72%	+1.02%	+1.39%

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.