

## Australian Enhanced Income Fund

### May 2015 Investment Update and NAV

#### *May 2015 NAV and Fund performance*

The Fund's NAV at the close of business on May 29, 2015 was \$6.30 per unit. This compares with the NAV of a unit at the close of business on April 30 of \$6.319. The change in NAV over the month of May represents a return of **(0.30%)**. The franking benefit for May was estimated to be 0.09%.

#### *ASX trading details*

The Fund traded on market at a premium to the most recently published NAV of a unit over the month of May 2015. The volume weighted average price (VWAP) for May 2014 was **\$6.36**.

	1 month	3 months	12 months*	3 Year p.a.
Australian Enhanced Income Fund	-0.30%	-0.41%	2.47%	7.10%
UBSA Bank Bill Index	0.20%	0.59%	2.65%	2.89%

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

#### *Events of May*

- The ASX listed hybrid sector returned (0.07%) for the month. This compares with the All Ordinaries Accumulation Index return of 0.58% and the UBSA Bank Bill Index return of 0.20%.

#### *Fund performance*

The Fund under-performed the broader market this month. The Fund's net return on an annual basis (excluding the benefit of franking but after fees) for the rolling 3 year period to end 29 May 2015 increased to 7.10% from 6.42% previously.

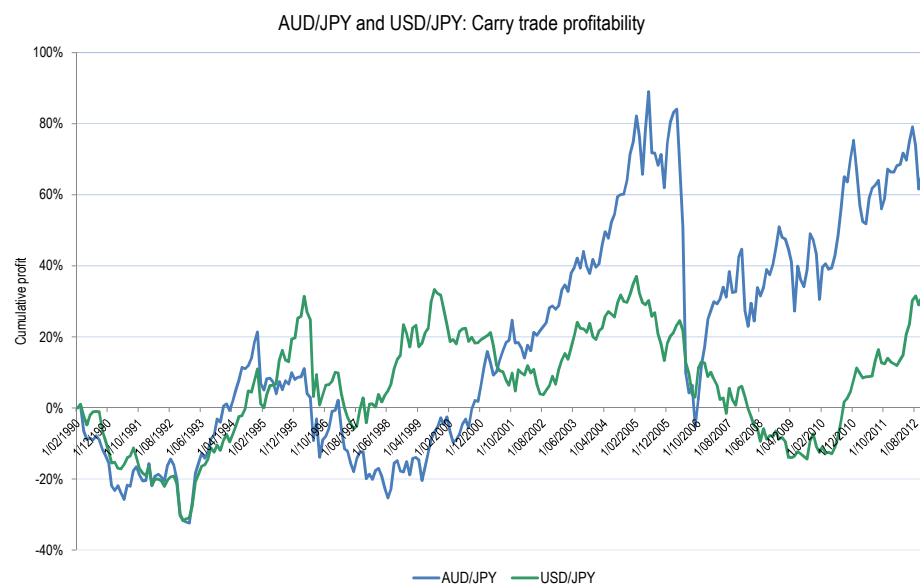
#### *The 'carry trade' concept*

The so called 'carry trade' is not a new concept. The idea of borrowing in a low interest rate market and currency and investing in another higher yielding market or currency is nothing new. The most recent example being the USD/JPY and AUD/JPY trade that has been successfully conducted since the early 1990's. But the carry trade analogy can be extended to markets where investors are faced with investing in low yielding assets such as cash or bonds or investing in higher yielding assets such as equities and high yielding corporate bonds.

#### *Analogy of carry trade extended to high yielding asset markets*

The migration of investors away from low yielding cash and bond markets to high yielding asset markets has the propensity to turn those asset markets into carry trade markets. The interesting thing is this changes both the return dynamics and the pricing of these markets. Instead of behaving in a passive manner these markets tend to more volatile and they have a propensity to become increasingly more expensive. This behaviour is akin to carry trade behaviour which tends to be "up the stairs and down the elevator shaft" (refer chart overleaf of the USD/JPY and AUD/JPY carry trade). We think there are significant caveats to simply buying high yielding assets. In support of this, recent academic research undertaken on the carry trade revealed that buying asset classes that look "fundamentally cheap" consistently produces a superior outcome than simply indiscriminately throwing money at higher yielding assets.

*Relevance for hybrids*



While hybrids definitely fall into the high yield category they are fundamentally cheap particularly now that the banks will have to raise more equity capital. In-line with our thoughts on the behaviour of high yielding asset markets some sub-sectors of the hybrid market are displaying increased volatility (a carry trade trait). The difference being that these sub-sectors are cheap (not expensive) with spread margins as wide as they have ever been in the post GFC period. We are convinced that spread margins will contract as the high yield ‘carry trade’ analogy continues to play out.

*Issued capital and NAV as at close of business 29 May 2015*

	29 May 2015	Previous month	Monthly change	Change over Quarter
Total number of ordinary units	2,882,753	2,882,753	Zero	353,355
Net Asset Value (NAV)	\$6.30	\$6.319	-0.30%*	-0.41%

\* Returns exclude the franking benefit. Past performance is not necessarily a guide to future performance.

*Performance History*

	Jan 2015	Feb 2015	March 2015	April 2015	May 2015
Change in NAV	-0.22%	+0.93%	-0.34%	+0.24%	-0.30%
Change in UBSA Bank Bill Index	+0.25%	+0.21%	+0.21%	+0.18%	+0.20%
Comparison to Bank Bill Index	-0.47%	+0.72%	-0.55%	+0.06%	-0.50%
Franking benefit (estimated)	0.00%	+0.14%	+0.19%	+0.02%	+0.09%
Total Return including franking	-0.22%	+1.07%	-0.15%	+0.26%	-0.21%

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