August 14, 2015

Australian Enhanced Income Fund
July 2015 Investment Update and NAV

July 2015 NAV and Fund performance

Fund's NAV at the close of business on July 31, 2015 was $**6.195** per unit. This compares with the ex-distribution NAV of a unit at the close of business on June 30 of $6.11. The change in NAV over the month of July represents a return of **1.37%.** The franking benefit for July was estimated to be **0.00%** (zero).

ASX trading details

The Fund traded on market at a premium to the most recently published NAV of a unit over the month of July 2015. The volume weighted average price (VWAP) for July 2014 was **$6.20**.

	1 month	3 months	12 months*	3 Year p.a.
Australian Enhanced Income Fund	1.37%	-0.36%	-0.33%	6.59%
UBSA Bank Bill Index	0.18%	0.55%	2.55%	2.82%

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

Events of July

- The ASX listed hybrid sector returned 1.12% for the month. This compares with the All Ordinaries Accumulation Index return of 4.23% and the UBSA Bank Bill Index return of 0.18%.

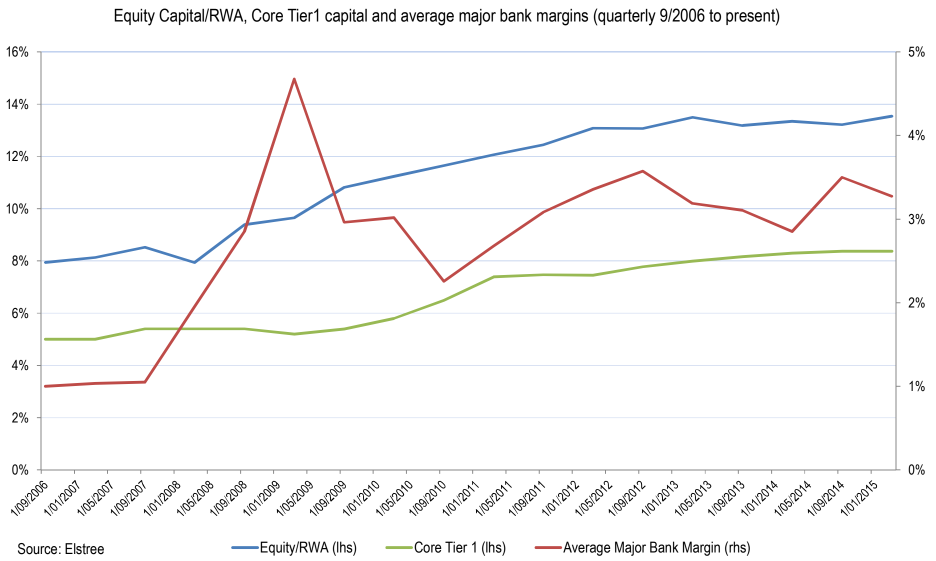
Fund performance

The Fund out-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 31 July 2015 increased to 6.59% from 6.37% previously.

Increased bank capital levels should be good news for subordinated debt and hybrid capital instruments. But….

There's been a lot of talk about bank capital with NAB, WBC and ANZ all involved in capital raising initiatives. It is interesting to note just how much better capitalised Australian banks have become since the GFC. Ratings agency S&P is so impressed in fact it has hinted that the banks' 'standalone' credit rating would be raised as a consequence. While the regulator has become tougher since the GFC there are few signs that the capital accumulation process is over. Increased capital levels should lead to safer banks and narrower spread margins on subordinated and hybrid securities issued by the banks (i.e) there should be an inverse correlation between the level of capital and the spread margin. The chart below shows both the regulatory capital or CET1 and Bank Shareholder Funds (i.e equity) as a percentage of risk weighted assets (RWA) since 2006 and the average aggregate spread margin of the major bank listed subordinated debt and hybrid securities. As the chart clearly shows despite the banks being better capitalised the spread margins on listed subordinated and hybrid securities have widened in the post GFC period. We appreciate that the risks of Basel III compliant subordinated notes and hybrids are different to the 'old style' hybrids but, in our opinion, the risks are not material enough to justify such a significant widening of spread margin. So what is the reason?

Australian Enhanced Income Fund (ARSN: 115 632 990)
Responsible Entity: Elstree Investment Management Limited (ABN: 20 079 036 810)
Level 10, 30 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au



Why is this so?

So if bank credit risk is unambiguously better why have spread margins increased? Given the improvement in credit quality, we think that the widening of spread margins is purely a function of supply. The ASX listed hybrid market has increased 125% since the GFC as banks clambered to raise non-dilutive subordinated and hybrid capital. But this phase has now finished as any bank issued capital will most likely be in the form of common equity. We think that spread margins will contract (prices rise) over the next 12 – 18 months on reduced supply and increase demand from retirees grappling with record low cash and TD rates.

Issued capital and NAV as at close of business 31 July 2015

	31 July 2015	Previous month	Monthly change	Change over Quarter
Total number of ordinary units	2,901,648	2,898,519	3,129	18,895
Net Asset Value (NAV)	$6.195*	$6.11#	1.37%	-0.36%

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

Performance History

	March 2015	April 2015	May 2015	June 2015	July 2015
Change in NAV	-0.34%	+0.24%	-0.30%	-1.41%	+1.37%
Change in UBSA Bank Bill Index	+0.21%	+0.18%	+0.20%	+0.18%	+0.18%
Comparison to Bank Bill Index	-0.55%	+0.06%	-0.50%	-1.23%	+1.19%
Franking benefit (*estimated*)	+0.19%	+0.02%	+0.09%	+0.07%	Zero
Total Return including franking	-0.15%	+0.26%	-0.21%	-1.34%	+1.37%

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.

Australian Enhanced Income Fund (ARSN: 115 632 990)
Responsible Entity: Elstree Investment Management Limited (ABN: 20 079 036 810)
Level 10, 30 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au