

Australian Enhanced Income Fund

August 2015 Investment Update and NAV

August 2015 NAV and Fund performance

Fund's NAV at the close of business on August 31, 2015 was **\$6.106** per unit. This compares with the NAV of a unit at the close of business on July 31 of \$6.195. The change in NAV over the month of August represents a return of **(1.44%)**. The franking benefit for August was estimated to be **0.12%**.

ASX trading details

The Fund traded on market at a premium to the most recently published NAV of a unit over the month of August 2015. The volume weighted average price (VWAP) for August 2014 was **\$6.13**.

	1 month	3 months	12 months*	3 Year p.a.
Australian Enhanced Income Fund	-1.44%	-1.49%	-1.27%	6.17%
UBS(A) Bank Bill Index	0.18%	0.54%	2.51%	2.78%

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

Events of August

- The ASX listed hybrid sector returned -1.15% for the month. This compares with the All Ordinaries Accumulation Index return of -7.30% and the UBSA Bank Bill Index return of 0.18%.

Fund performance

The Fund underperformed 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 August 2015 decreased to 6.17% from 6.59% previously.

A not unexpected outcome

If we look at hybrids within the prism of a month during which the All Ordinaries Index fell 7.30% hybrid market behaviour was not unexpected. The hybrid market, as determined by the Elstree Hybrid Index, declined by 1.15% after being down by as much 2.35% at one point. For those who still believe that hybrids display equity risk, this is yet another event that should have them reevaluate their conclusion. Ultimately, total return outcomes from the hybrid market will be driven by the income yield. This means that flat or negative return periods, such as the one we just experienced, will result in higher yields. Absent a default event, investors will receive that yield until maturity or redemption of the investment. Unlike equities, the concept of permanent gains or losses doesn't exist, only timing differences as securities are eventually redeemed at their PAR value.

How to make sense of that?

The chart below shows the drawdowns for the S&P ASX200 Accumulation Index and Elstree Hybrid Index since the GFC. It shows the time (duration) and movement (depth) from previous all time highs (100 = all time highs). The ideal asset class produces good returns accompanied by shallow (depth) and short (duration) drawdowns. The chart summarises the interesting relationship hybrids have with equities: it's small, it's lagged, and it's affected by bank dividend yields.

S&P ASX200 and Elstree Hybrid Index. Drawdowns from all time high. October 2009 to present



*Little supply
next year*

Despite the volatility of the capital markets, we are sanguine about the hybrid market for the simple reason that supply in FY 2016 will be the smallest in years. We're looking at a net issuance program of around \$2b for major bank Tier 1 hybrids, well below the \$3 - \$4b seen over the last few years. It will take its time to wash through the secondary market but with no issues on the horizon until next year and very attractive spread margins, we think it's just a matter of time before we see higher security prices and above income returns.

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

	31 August 2015	Previous month	Monthly change	Change over Quarter
Total number of ordinary units	2,884,760	2,901,648	(16,888)	+2,007
Net Asset Value (NAV)	\$6.106*	\$6.195*	-1.44%	-1.49%

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

Performance History

	April 2015	May 2015	June 2015	July 2015	August 2015
Change in NAV	+0.24%	-0.30%	-1.41%	+1.37%	-1.44%
Change in UBSA Bank Bill Index	+0.18%	+0.20%	+0.18%	+0.18%	+0.18%
Comparison to Bank Bill Index	+0.06%	-0.50%	-1.23%	+1.19%	-1.26%
Franking benefit (<i>estimated</i>)	+0.02%	+0.09%	+0.07%	Zero	+0.12%
Total Return including franking	+0.26%	-0.21%	-1.34%	+1.37%	-1.32%

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.