May 18, 2016

Australian Enhanced Income Fund - ASX Code "AYF" April 2016 Investment Update and NAV

April 2016 NAV and Fund performance

The Fund's NAV of a unit at the close of business on April 29, 2016 was $**5.865** per unit. This compares with the NAV of a unit at the close of business on 31 March of $5.759. The change in NAV over the month of April represents a return of **1.84%.** The franking benefit for April was estimated to be **0.04%**.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	1.84%	2.22%	-0.75%	3.28%
UBS(A) Bank Bill Index	0.20%	0.59%	2.26%	2.55%

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

Relative performance

- The ASX listed hybrid sector returned 1.82% for the month. This compares with the All Ordinaries Accumulation Index return of 3.24% and the UBSA Bank Bill Index return of 0.20%.

Fund performance

The Fund performed broadly in-line with the market this month. The Fund's rolling 3 year annual net return (excluding the benefit of franking but after fees) for the period ending 29 April 2016 increased to 3.28% from 2.86% previously.

Investing at IPO – a postscript.

In last month's review we commented on whether or not to participate in hybrid IPO's. The ability, we suggested, to know which IPO's to participate in and which ones to avoid was best left to an expert. While participating in majority of major bank tier 1 hybrid IPO's in the post GFC period has not been a profitable experience, participating in the recently issued CBA PERLS VIII certainly was. The PERLS VIII returned 2.6% from the listing date of 31 March to 29 April. Without sounding trite the Fund invested heavily in the PERLS VIII. Our decision was influenced by a 'soft' cap on the issue size, a record high coupon margin for a tier 1 bank capital instrument and the cessation of secondary market selling as equity market volatility subsided.

Vote of confidence

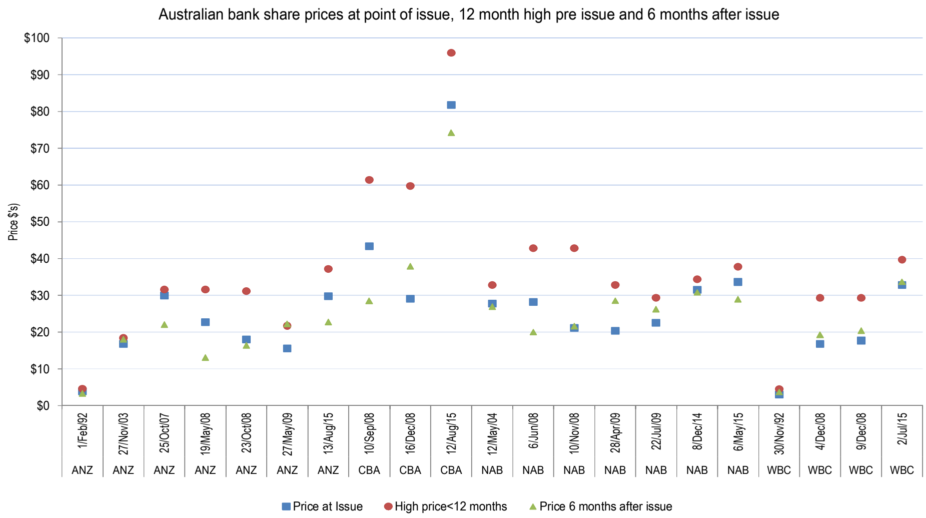
In vote of confidence for the market and the CBA it was revealed during the month that a large Superannuation Fund, Unisuper, purchased up to $285m of the PERLS VIII. We can only assume that Unisuper's rationale was that the PERLS VIII spread margin was above levels typically achieved, on a long term ex-post basis by equities and hybrids of course are senior to equity and are significantly less volatile.

The implications of changes in bank capital levels are different for equity and debt holders

We like to comment on bank capital levels as we feel as though we have a good understanding of where they are heading and why. One thing that has not escaped us after critiquing the 1990's "recession we had to have" and the GFC period is that bank capital levels were lowest just before these periods and highest after. In many ways we think this is an indictment of management where capital levels are permitted to decline as balance sheets become more levered over time almost as if to herald the next crisis. The precise timing too of raising capital is debatable and brings into

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

question the role that bank boards play in the process in setting remuneration policy. The interests of management and key stakeholders are not always aligned. A lot depends on where you are in the cycle. When the balance sheet is levered (capital levels are low) management and shareholder's interests are aligned at the expense of debt holders, but when capital levels are higher, as they are now, management and debt holder's interests are aligned with equity holders taking a back seat. The chart below demonstrates this using the bank share price at the point of the various equity capital raisings after the 1990's recession and the GFC with the maximum price achieved in the previous 12 month period and the price 6 months after the offering.



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

	March 2016	April 2016
Net Asset Value (NAV)	$5.757#	$5.865
Change in NAV (month on previous month)	0.88%	1.84%
Total investment return (month on previous month)	1.03%	1.88%
Quarterly dividend (declared 17 April 2015)	$0.10	n/a
Percent franked (*quarterly estimate @ 30% tax rate*)	31.6%	n/a
Cash dividend yield (basis NAV)	6.95%	6.82%
Grossed up dividend yield basis NAV (*estimated*)	7.81%	7.67%
Investment grade issuer (including cash)	90%	90%
Fund average term	3.7 years	3.8 years
Bank Tier 1 exposure	46%	46%
Property exposure	4%	4%

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

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.