October 12, 2016

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

September 2016 NAV and Fund performance

The Fund's NAV of a unit at the close of business on September 30, 2016 was $**5.97** per unit. This compares with the NAV of a unit at the close of business on 31 August of $5.978 The change in NAV over the month of September represents a return of **(0.13%).** After the payment to unit holders registered at the close of business on 30 September of the $0.0875 cent per unit cash distribution the Fund's NAV of a unit was **$5.883**. The franking benefit for September was estimated to be **0.21%**.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	(0.13%)	2.59%	5.85%	3.49%
UBS(A) Bank Bill Index	0.14%	0.49%	2.19%	2.44%

*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 0.27% for the month. This compares with the All Ordinaries Accumulation Index return of 0.40% and the UBSA Bank Bill Index return of 0.14%.

Fund performance

The Fund underperformed the broader market slightly this month. The Fund's rolling 3 year annual net return, which excludes the benefit of franking but is net of all fees, for the period ending 30 September 2016 decreased to 3.49% from 4.05% previously.

Lower for longer?

The 'lower for longer' scenario has been touted for some time and while, as an investor we aren't particularly enamoured with it, we might have to get used to it. There can be no denying that government bonds around the world are horrendously expensive. Of course they have been expensive in Japan now for almost 2 decades. It is only in the post GFC period due to quantitative easing strategies adopted by the global central banks that they have become expensive in other countries around the world. Interestingly, most asset classes including corporate bonds, hybrids and equities as depicted by the yield (i.e the equity yield is determined to be the inverse of the PE ratio) are expensive. However, if you take the yield of each asset and express it as a margin over the government bond rate, it tells quite a different story.

What can we conclude?

The chart overleaf details the yields of various asset classes as a margin over the risk free or government bond rate with the green square representing the 'last' traded margin. This margin, often called the 'excess margin', is the margin that investors demand for investing in the riskier asset over the risk free rate. In other words it is an indicator of the perceived riskiness of the asset. The chart overleaf tells us a lot and is a potential 'window to the future' for the western world. Government bond rates in Japan have been near zero for 20 years which is an indication that investors are prepared to pay 'over the odds' for security of cash flow and capital. By contrast investors in Japan are less willing to pay for assets where the cash flows are uncertain and volatile as they are with equities than their western counterparts.

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

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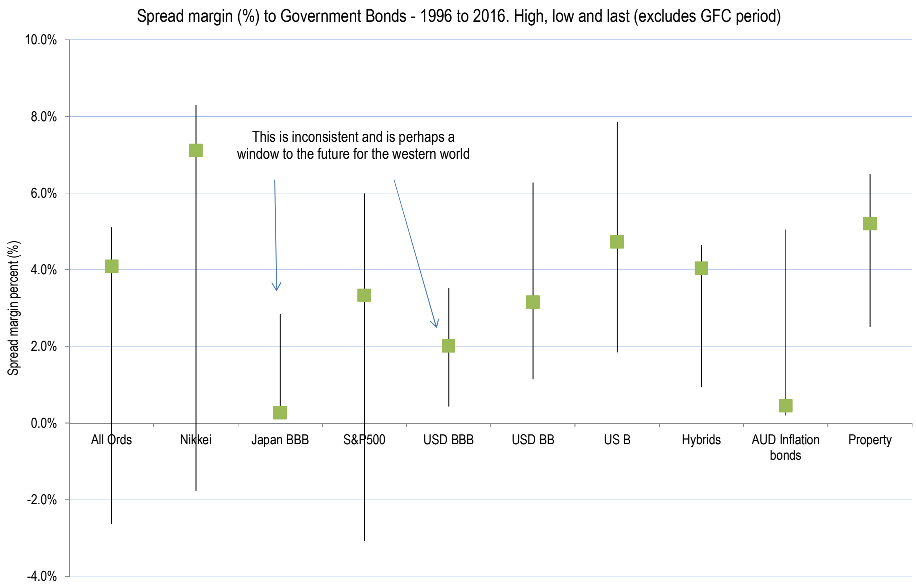
Margin over the government bond rate tells quite a different story.



What can we conclude?

Perhaps the most obvious takeaway from the chart is that Japanese investors are prepared to pay 'over the odds' for "BBB" rated corporate debt. Japanese "BBB" rated securities trade at a much narrower excess margin than do US "BBB" rated securities. A "BBB" is a "BBB" no matter what and the excess margin should be the same across geographies. Clearly it isn't. We think this is indicative of where excess returns are trending on well rated corporate debt in the western world. This of course includes hybrid capital instruments issued by highly rated entities such as the Australian banks, which based on the excess margin shown in the chart above, look cheap.

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

	August 2016	September 2016
Net Asset Value (NAV)	**$5.978**	**$5.883#**
Change in NAV month on previous month (mopm)*	**1.25%**	**(0.13%)**
Total investment return includes the value of franking (mopm)	**1.30%**	**0.08%**
Dividend (declared September 2016 and payable 17 October 2016)	**n/a**	**$0.0875**
Percent franked (*quarterly estimate @ 30% tax rate*)	**n/a**	**37.37%**
Cash yield per annum (basis NAV)	**5.85%**	**5.95%**
Grossed up yield basis NAV per annum (*estimated*)	**6.52%**	**6.80%**
Investment grade issuer (including cash)	**90%**	**90%**
Fund average term	**3.6 years**	**3.7 years**
Bank Tier 1 exposure	**46%**	**46%**
Property exposure	**4%**	**4%**

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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.

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