Elstree

September 8, 2020

Australian Enhanced Income Fund - ASX Code "AYF"
August 2020 Investment Update and NAV

August 2020 NAV and Fund performance

The Fund's NAV of a unit at the close of business on 31 August 2020 was $**5.957** per unit. This compares with the Fund's NAV of a unit at the close of business on 31 July 2020 of $5.905. The change in NAV over the month of August represents a return of **0.88%.** The franking benefit was estimated to be **0.02%.** Including the value of franking the Fund returned **0.90%** over August 2020.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	0.88%	2.94%	3.76%	4.67%
UBS(A) Bank Bill Index	0.009%	0.026%	0.66%	1.44%

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

Relative performance

Including the value of franking the ASX listed hybrid market returned 0.63% for the month. This compares with the All Ordinaries Accumulation Index return of 3.71% and the UBSA Bank Bill Index return of 0.009%. After fees and before the value of franking, the Fund out-performed the broader market returning 0.88%.

As we wrote in last month's commentary "there is lot going on off the ball". In continuing with this thematic we note the results of independent stress test undertaken by the RBA recently on the Australian banking system. While the RBA's assumptions of 8% unemployment and a 40% decline in house values might seem extreme they are plausible in the light of the economic impact of Covid-19. The results of the stress tests were pleasing with the RBA announcing that bank capital ratios remained well above the conservative 8% buffer. As an investor in hybrid capital instruments we were pleased by this outcome. In other 'news', we note that the RBA's Term Funding Facility or TFF remains less than 50% drawn ahead of the September 30 deadline for the initial allowance of A$84 billion. The banks however, have indicated their willingness to fully avail themselves of the facility ahead of the deadline. This undertaking is expected to provide a significant fillip to 'syetem' liquidity with an additional A$43 billion in circulation. We note there remains material excess capacity beyond this under the TFF arrangement with the RBA. The ceiling stands currently at $154 billion.

As a way of highlighting that perhaps things might not be all that bad we thought we would call upon one of our perennial favourites the Kamakura Troubled Company Index for confirmation. The Index measures the percentage of more than 40,000 public firms in 76 countries that have an annualized one month default rate of over one percent. The model inputs include such things as stock price data, a raft of leading economic indicators and financial ratios. The graphic overleaf, sourced from Kamakura, is from 1990 (the commencement of the series) to August 2020.

The graphic clearly depicts the crises of 1998 through to 2003 (i.e Long Term Capital Management, Asian crisis and the Dot Com boom and bust). The GFC period is clearly visible, so too is the recent

Australian Enhanced Income Fund (ARSN: 115 632 990)
Responsible Entity: Elstree Investment Management Limited (ABN: 20 079 036 810)
Level 5, 30 Collins Street Melbourne VIC 3000
Telephone: 61 3 8689 1348
Email: info@eiml.com.au

September 8, 2020

Covid 19 induced crisis. There are a couple of takeaways. The first is that the index has an equity market bias and equity indices have performed well since late March. The bias (to equities) is understandable and reasonable because equity markets are forward looking and are viewed as a predictor of the future level of economic activity. The second point we make is that after peaking in late March the Index value has declined steadily since. It is currently 13.63%. The average since the inception of the Index in 1990 has been 14.53%. The third takeaway is that since we began using the model in the early 2000's we have found it to be as near a perfect predictor of default activity with a lead time of 6 - 12 months. While we continue to remain circumspect and vigilant to ongoing developments, the model, if previous history is any guide, is indicting that the worst, certainly in terms of corporate default activity, may be over.

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

	July 2020	August 2020
Net Asset Value (NAV). ** denotes "Ex distribution".	$5.905	$5.957
Change in NAV month on previous month (mopm)*	0.27%	0.88%
Change in NAV including the value of franking (mopm)	0.28%	0.90%
Next dividend due - 15 October 2020.	n/a	n/a
Percent franked (*quarterly estimate @ 30% tax rate*).	n/a	n/a
Cash yield per annum (basis NAV and annual cash dividend of $0.22cpu).#	3.73%	3.69%
Grossed up yield (basis NAV) per annum (*estimated*)	4.57%	4.53%
Investment grade issuer (including cash)	93.3%	93.5%
Fund average term	3.38 years	3.41 years
Major Bank Tier 1 exposure	55.2%	54.5%

* Returns do not include the benefit of franking. Past performance is not necessarily a guide to future performance. # Refer to change of dividend announcement 6 March 2020.

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.