

Australian Enhanced Income Fund - ASX Code "AYF"

July 2020 Investment Update and NAV

July 2020 NAV and Fund performance

The Fund's NAV of a unit at the close of business on 31 July 2020 was **\$5.905** per unit. This compares with the Fund's ex-distribution NAV of a unit at the close of business on 30 June 2020 of \$5.889. The change in NAV over the month of July represents a return of **0.27%**. The franking benefit was estimated to be **0.01%**. Including the value of franking the Fund returned **0.28%** over July 2020.

Performance	1 month	3 months	12 months	3 Year p.a.
Australian Enhanced Income Fund*	0.27%	3.15%	3.07%	4.44%
UBS(A) Bank Bill Index	0.009%	0.025%	0.74%	1.49%

*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 0.41% for the month. This compares with the All Ordinaries Accumulation Index return of 0.95% and the UBSA Bank Bill Index return of 0.009%. After fees and before the value of franking, the Fund under-performed the broader market returning 0.27%.

Followers of Australian Rules Football (AFL) vernacular will be familiar with the term, "a lot is happening off the ball". What is meant by this term is that while much of the focus is on the contest for possession of the ball or the player with the ball, a lot goes on around the perimeter, that, for all intense and purpose, looks to have little or no influence on the outcome, but actually does influence the outcome. In football parlance things like blocking and shepherding make it much easier for (say) the ball carrier to either exit the area or pass the ball onto another player in a better position. And so it is with the pandemic. There is a lot going on "off the ball". While we, as a community are naturally drawn to all that is covid-19 (like we are to the ball carrier in AFL football) the administrations are doing a lot of heavy lifting and paving the way forward. In Australia, the proactive Government and central bank initiatives have to be applauded and so too should the initiatives of APRA, and the recent announcement by the Australian bankers' association (ABA).

We commented previously on the RBA's term funding facility or TFF. This is a sound initiative designed to ensure that the banks have access to sufficient cheap funding remembering that it was the inability of the banks to fund that was at the epicentre of the GFC. APRA has arguably been ahead of curve providing guidance to the banks on a regular basis. It's one thing to preside and enforce a stringent set of regulatory guidelines but it is important to have the foresight and understanding to recognise that the current circumstance dictates the need for flexibility. With economic growth set to decline sharply creating a raft of issues for the banks that put downside pressure on profitability and ultimately capital levels, APRA was prepared to 'look through' that, announcing as early as 19 March, that banks would be permitted to run down their capital levels by using their "current large buffers". This meant that the banks could write new risk weighted loans

without having to access capital markets to maintain their “unquestionably strong” capital levels at a time when capital markets were dislocated. Similarly, APRA’s recent announcement of 29 July that banks retain at least 50% of their earnings for capital preservation purposes when making decisions on capital distributions is sound. From suggesting the banks be careful with their distribution policy APRA has now assigned ‘guidance’. While this will impact the ways in which the banks distribute their capital (i.e DRP’s will be encouraged) it has at the very least reduced the cloud of uncertainty that has dogged bank dividend policy since April. As an investor in bank preferred capital instruments we were pleased to hear of this initiative.

Likewise, the ABA announced recently the second phase of bank treatment of loan deferrals. The ABA proposed that (i) customers who can afford to pay their loans, pay their loans and (ii) customers who are genuinely having difficulty be allowed to extend the moratorium for a period of up to 4 months. Allowing customers most in need to extend the moratorium would involve the bank working with the customer to renegotiate the terms of the loan which is a reasonable and sensible thing to do. It may also include, for example, using an ‘offset’ account. If a workable solution cannot be determined then it may be in the best interest of both parties for the borrower to attempt to sell the property in advance of a negative equity situation developing or worsening.

Similarly, the recently announced extensions to the government’s “Jobkeeper” (JK) and “Jobseeker” (JS) programs. While the extensions come with caveats and are at reduced levels they will at least provide support to those businesses and individuals most in need until end March 2021.

Clearly there are risks after a state of emergency was recently declared in Victoria resulting in the implementation of stage 4 restrictions. While we understand the economic impact is likely unprecedented, we simply point out that the interests of the administrations and the banks are all aligned. This alignment too is likely unprecedented.

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

	June 2020	July 2020
Net Asset Value (NAV). ** denotes “Ex distribution”.	**\$5.889	\$5.905
Change in NAV month on previous month (mopm)*	1.76%	0.27%
Change in NAV including the value of franking (mopm)	1.94%	0.28%
Dividend payable 15 July 2020*. Next dividend due - 15 July 2020.	\$0.055	n/a
Percent franked (quarterly estimate @ 30% tax rate).	56.02%	n/a
Cash yield per annum (basis NAV and annual cash dividend of \$0.22cpu).#	3.73%	3.73%
Grossed up yield (basis NAV) per annum (estimated)	4.58%	4.57%
Investment grade issuer (including cash)	92.3%	93.3%
Fund average term	3.40 years	3.38 years
Major Bank Tier 1 exposure	54.1%	55.2%

* 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.