BARNETT LILLEY & ASSOCIATES Pty Ltd

Email update 7th May 2010

We apologise for cluttering your inbox for a third time this week, however given a recent surge in email traffic over the last 24 hours we believed it appropriate.

It is not our intention to address the issues happening overseas in this email. This was covered in our earlier email this week and very little has changed since that time. It is pointless to speculate on how quickly this will be resolved, or what measures will ultimately be taken.

What is important however, is to remove the considerable “noise” taking place in the media at the moment and look at what is going on in the cold hard light of the real world.

At the time of writing this email, the ASX All Ordinaries accumulation index is at 4500. There are two significant points to make about this.

Firstly, at 4500, we are at a level that we were in February this year, less than three months ago. The recent falls have wiped out the February - April gains, but the capitalisation of the share market is no worse off than where we were less than three months ago.

Secondly, and probably most importantly, the falls over the last week reflect human nature, not economic rationale.

To explain this point in more detail.

Since the opening bell on Monday morning, the Australian share market is down some 6.4% for the week.

There was a very small fall on Monday, which was expected. As you are aware, on Sunday the Government announced its plans to impose a “super profits” tax on the mining industry. Logically we expect the price of mining shares to fall in the face of this.

Walking through this logic is a very good exercise. A company’s share price is effectively determined by the likely amount of that company’s future profitability. An announcement (such as the one made on Sunday) would mean that mining companies would pay more tax in the future, meaning that their future profitability would be reduced. Logically, their share price would fall on the next trading day (the Monday), reflecting the fact that investors had factored in the impact of the reduced profitability going forward.

The real falls however have been on Tuesday (1.5%), Wednesday (2%), Thursday (1.6%) and today (2% at time of writing). These falls follow similar falls in overseas markets, again in reaction to the European issues.

The question that we all have to ask ourselves, is whether these falls are attributable to economic rationale, or hysteria and panic. We are strongly suggesting that it is the latter.

The ASX All Ordinaries accumulation index is a composite made up of the largest 500 companies listed on the Australian stock exchange. If these share price falls were based on economic rationale, this would mean that, since Tuesday of this week, these 500 companies are now 6.4% less profitable than they were four days ago. If we could block out the noise coming from overseas, would there be any reason to suggest that the top 500 companies in Australia are now 6.4% less profitable? Surely if Sunday's announcements imposed a higher level of company tax right across the board, it would be logical to suggest that the market should fall by some amount, as by definition these companies will be less profitable going forward. However, the reality is that the European situation has very little real impact on the running and profitability of our companies, certainly not 6.4% in four days. If we can exclude logic from the share price fall, we are left with hysteria and panic as the culprit.

The good thing about hysteria and panic is that it creates a mismatch. Knowing that the economic environment in Australia has not changed in the last four days, we can safely assume that if the share price level was correct on Tuesday morning (correct in line with our current economic position), then it is actually 6.4% undervalued today. When hysteria dies down and commercial reality again takes over, market investors will know that shares are cheap for no valid reason. Buyers move back in, share prices rebound.

At this point in time this is a very different situation to the GFC. The GFC was caused by a recession in consumer driven countries. Given that Australia supplies raw materials for the world's producers to make consumer goods, falling share prices of Australian companies was logical. During the GFC, the economic conditions had deteriorated, flowing through to reductions in company profitability and lower share prices would. However, to suggest that there is 6.4% of economic deterioration in the Australian economy in four days is illogical.

As such, if it makes you feel better, cancel the paper for the next few days, disconnect the television and radio, take a few long walks. Bad news sells papers and drives markets down in the short term. Economic fundamentals are long term.

Please do not hesitate to contact us if you have any questions whatsoever.

The BL&A team