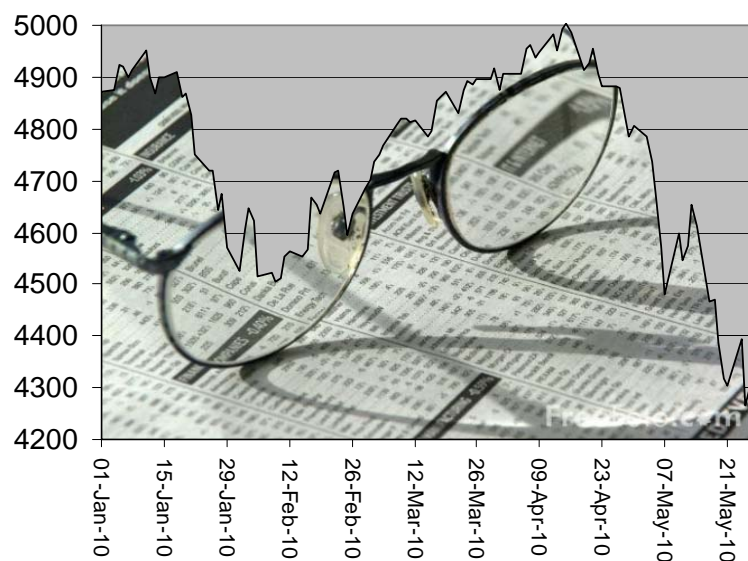


Investment Managers Weekly Review

28 MAY 2010

PERFORMANCE AT A GLANCE

WEEKLY MARKET WRAP		
Aust Market	4379.2	1.5%
US Market	10258.99	1.9%
US Nasdaq	2277.68	3.3%
UK Market	5195.17	2.4%
GOLD	1211.9	2.0%
OIL	74.55	9.6%
A\$US\$	0.8515	4.1%



THE AUSTRALIAN SHARE MARKET - YEAR TO DATE

Market Wrap

Australian Market Performance (S&P/ASX 200): 4,379.2 +1.5%

Although the numbers above reveal that the Australian market had a flat performance during the week, this belies the underlying volatility during the week. This week we spend some time discussing the issue of volatility as it relates to the stock market. The themes dominating the market this week were continuing concerns about European sovereign debt issues, some brighter economic statistics from the United States and the public debate over the resources super profits tax. This latter issue has influenced the prices of BHP Billiton (the world's largest mining company) and RIO Tinto (the third largest) during the week.

During the week, RIO held its Annual General Meeting. The company is cautiously optimistic about the longer term prices of the industrial commodities they produce while also noting various short-term risks. Also during the week, Wesfarmers – owner of Coles & Bunnings amongst other businesses – held an investor briefing. They noted lower consumer confidence and rising interest rates were impacting retail sales but the company remains optimistic about the Australian economy in general.

Market Volatility

A feature of various markets (currency, equity, debt) over recent times has been the high level of volatility. Volatility simply refers to the degree to which prices move both up and down over time. A feature of the high level of volatility experienced recently in global equities markets has been its compression into a short time period, making its effects dramatic.

The underlying causes of market volatility are many and varied but include the move to computerized trading systems, the global nature of large flows of funds and instant access to information via the web. For instance, these days it's possible to move literally billions of dollars around the world in an instant at the command of a few keystrokes on a computer keyboard. Multiple markets can be accessed and traded this way over a time span measured in seconds. Indeed, a higher proportion than ever of share ownership is now in the hands of institutions rather than individuals. Additionally, institutions (with monthly or quarterly results reporting) overwhelmingly have a shorter investing timeframe, sometimes measured in days or hours, that encourages high turnover on the markets. Individuals tend to hold onto their stocks for the longer term.

At the local level many more people these days have margin loan accounts allowing share purchases to be financed with borrowed funds. When the value of stocks fall significantly, the margin lender is more likely to require the account holder to sell their stock. It follows that the effect of this forced selling is largest near or at the bottom of the market, perversely the worst place to sell. Conversely, as the value of stocks rise and more funds can be borrowed against them, many people tend to take up the offer to buy more, purchasing their shares with optimism often near the top of the market with borrowed funds. These features of today's market need to be considered as they all add to a larger number of transactions taking place which has the effect of increasing the volatility. Prices are more likely to extend to lower levels on panicked selling and push through to higher levels on feverish buying today than previously.

In regards the stockmarket specifically, it needs to be emphasized that risk, in its purest definition refers to the likelihood that an investor will suffer a loss of their capital if they purchase a security. So, establishing the value of a security is essential in measuring the implied risk of any investment decision. To illustrate, if we purchase \$1 of value in a security, we need to be confident that \$1 will be retained in the asset and realized on the market at some future point in time. In short, measuring risk involves evaluating value.

The present volatility forcing prices dramatically lower on the Australian stockmarket, while emotionally disconcerting, is actually acting to reduce the risk to investors. As prices for equities on the market fall, less cash is needed to acquire a stake in some of Australia's best businesses, thereby lowering the risk for any investors with an investment time horizon greater than a few weeks or months. So, while it's easy to make a link between increased volatility and increased risk, this nexus is false when applied to the equities market.

The important things to bear in mind are that we invest in equities for the longer term and that we should be more inclined to buy as prices become cheaper. While this behaviour sounds perfectly rational and sensible on paper, the theory tends to be obscured and modified by natural human emotions as undoubtedly, decisions concerning money often tend to be emotional ones. Certainly, many decisions concerning money are rarely purely rational.

To summarise, when considered through a purely rational assessment, the present market volatility is definitely providing cheaper prices and should therefore be seen as an opportunity rather than a risk. The right path for investors to follow is not to panic, to maintain a long term investment horizon and to take advantage of market buying opportunities as they arise. This will always be the way to create long term wealth.

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