



DOUCET ASSET MANAGEMENT, LLC

*Quarterly Newsletter*  
*Q3 2008*

DOUCET VALUE MOMENTUM PORTFOLIO  
DOUCET VALUE INCOME PORTFOLIO  
DOUCET MANAGED PORTFOLIO  
BIENVILLE MODEL

**July 2008**

*America's Crisis of Confidence*

Our last several newsletters have considered the causes and effects of the widespread repricing of the housing and credit markets. While the bloat in these markets continues to shake out, they are exhibiting signs of capitulation and reckoning that is the foundation for recovery.

In this newsletter we consider the “crisis of confidence” taking shape as the American consumer struggles with a cruel troika of economic pressures: declining home prices, illiquidity, and escalating energy costs. The value of the chief asset of most households – the family home – has declined, on average, a record 16% over the past 12 months<sup>1</sup>. This fact alone would be enough to cause any economy to slow and investor confidence to wane, but it has been coupled with an equally alarming rise in oil prices during the same period, directly affecting everything from the gas pump to the grocery store.

Consequently, the Consumer Confidence Index fell to a 50-year low as reported in June, and recent polls have shown that 81% of Americans hold a negative view of the economy. We believe that this “crisis of confidence” drove the worst performance by major US stock indexes in the month of June since 1930.

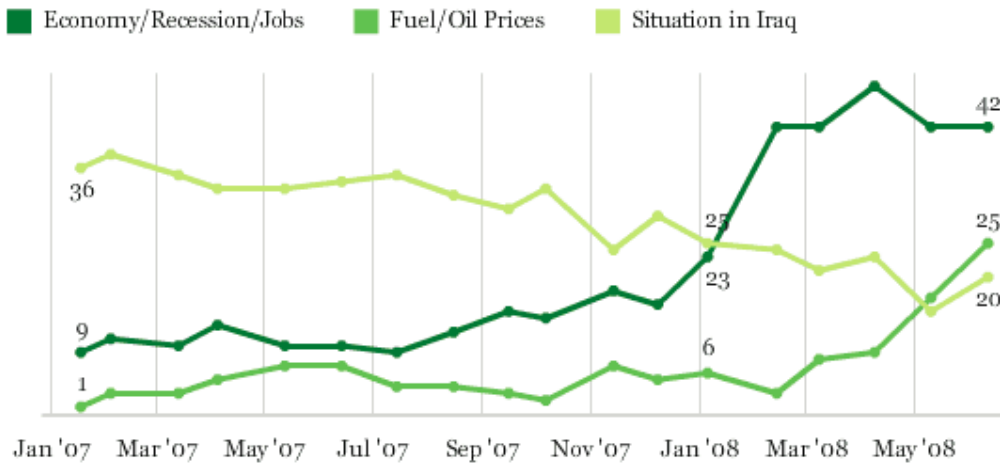
Consumer confidence will continue to be the primary driver of US stocks, and that – at this point – the level of this confidence will primarily be a reaction to the price of a barrel of oil, most directly experienced through the price of a gallon of gasoline. There have been enormous fluctuations in the price of oil in the past twelve months, with prices recently climbing to the record levels of nearly \$150 earlier this month. We will examine the circumstances surrounding the price volatility in this omnipotent commodity, with a view to predicting where it, and the stock market, is headed.

*The Oil / Confidence Connection*

Changes in oil prices have an almost immediate impact on consumer confidence and thus, the view of the economy. According to a recent Gallup “Most Important Problem” poll, when oil prices crossed the \$100 per barrel mark in January, “the economy” surged past the war in Iraq to become the #1 concern of Americans. In May, as oil prices passed \$130 per barrel, “fuel prices”

overtook the Iraq war as the #2 concern of Americans, cited more often than anytime since 1981. As of June 2008, these top two concerns of Americans – “the economy” and “fuel prices” – represented 67% of all responses, up from 31% in January.

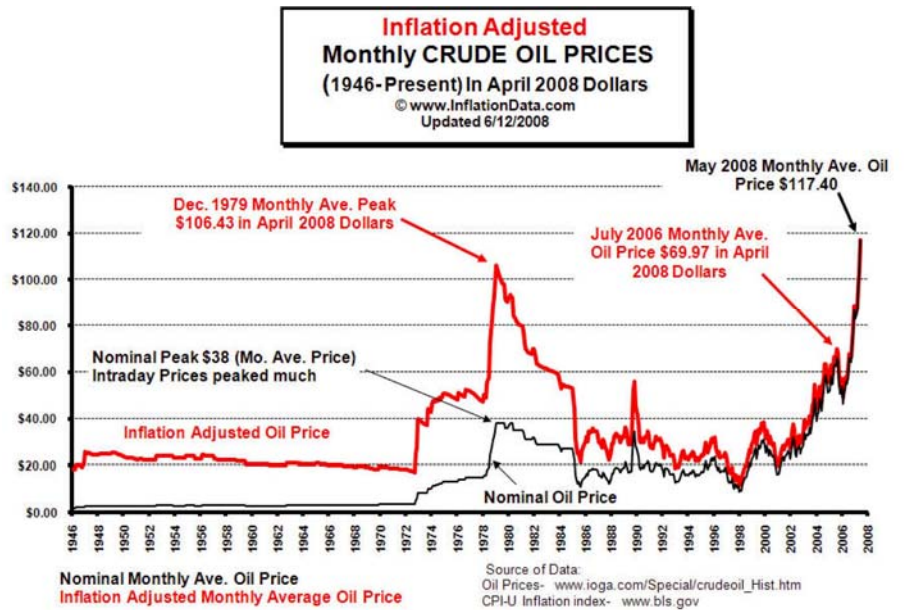
*Top Three Issues Named "Most Important Problem"*



GALLUP POLL

***Oil Crisis: New Heights***

Earlier this month, oil prices topped \$147 per barrel, soaring approximately 40% higher than at any other time in history (measured in inflation-adjusted April 2008 dollars). The previous record average monthly oil price was \$106 a barrel, set in December 1979. The only other time in U.S. history oil had surpassed the \$100 dollar level was during the midst of the Civil War. As recently as 1998, the real price of oil was as low as it was in 1946.



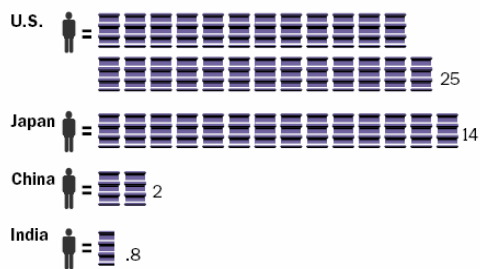
***Causes: Oil Demand***

There is general agreement that the fundamental driver of the crisis is a simple function of supply and demand. World demand is predicted to increase dramatically in the coming years, particularly due to increased consumption from emerging nations like China and India, while the commodity itself is a dwindling resource, the production of which can not be meaningfully increased over the long-term.

The margins of the fundamental supply and demand analysis are clouded with confusion and disagreement about other factors contributing to the crisis, and what the solutions are. Politicians have reacted by playing the “blame game,” pointing fingers at oil companies, futures markets, and the other political party. Americans have reacted by demanding party politics be put aside and solutions be put in place immediately to help get the situation under control.

U.S. consumption habits and the country’s continued dependence on foreign oil fall squarely in the blame zone. The United States now imports almost 70% of its oil requirements,

**Oil Consumption** (per capita annually)



representing 25% of worldwide demand for only about 5% of the global population. The average American consumes about 25 barrels of oil annually, with the Japanese consumer a distant second, consuming on average only about 14 barrels annually. In the much-discussed developing markets of China and India where demand for oil is exploding, annual consumption per capita is currently only about 2 barrels and 0.8 per person, respectively.

Sources: Bloomberg; International Energy Agency; Masters Capital Management; Lehman Brothers

There is the view that the economic reality of high prices is the best medicine for over-consumption by Americans, and the consequent dependence on foreign sources. Only a few months into the crisis, U.S. consumers have significantly changed their behavior and are consuming significantly less oil – so called “demand destruction.” Americans are already driving significantly fewer miles, with gasoline usage falling for 11 consecutive weeks as of July 14<sup>th</sup>, right in the heart of summer driving season.

***Causes: Oil Supply***

The supply side of our current oil situation is reminiscent of the Arab Oil Embargo of 1973 and the supply shortages in years that followed. During the Arab Oil Embargo, for political ends, several OPEC nations restricted the sale of oil to the U.S. and other western countries, going as far as to use the term “Oil Weapon.” The extreme sensitivity of oil prices to supply shortages became evident when the price of a gallon of gasoline in the U.S. rose 400% in six months! The Arab Oil Embargo also showed that given the U.S.’s demand levels, it had no ability to control crude oil prices, and that such control was in the hands of the supplier nations.

Today, OPEC countries like Saudi Arabia have reacted by stating they have no desire to significantly increase oil production to help ease prices, and making matters worse, much of the

supply of oil today is found in unstable or unfriendly regions of the world, such as Nigeria, Venezuela and the Middle East. Thus, while high oil prices are painful in the short term, they provide the impetus to develop more environmentally and politically-sound energy alternatives. Energy suppliers are increasingly pursuing alternative energy sources and fuels such as solar, wind, natural gas and nuclear power, the goal being a decreased dependence on foreign suppliers.

There is also a great deal of pressure on Washington to open up new domestic supply sources, including drilling in increased offshore areas and in the Alaska National Wildlife Refuge (“ANWR”) as part of a comprehensive energy plan. Although we do not believe that this additional drilling will have an immediate effect on supply, or will necessarily provide a long term solution to the oil conundrum, we believe that it will have a tremendous psychological effect on the long term view, and will dampen prices significantly.

### ***Causes: The Usual Suspect***

Finally, as we have discussed in previous newsletters, since the price of oil is quoted in U.S. Dollars (“USD”), the erosion of the USD versus other world currencies has greatly contributed to the rise in the price of USD denominated oil. Unfortunately, the Fed has been caught between a rock and a hard place on this one – to help alleviate the problems caused by the subprime debacle and the credit crunch, the Fed has been lowering interest rates in the U.S. – but while this provides relief in the credit arena, it has a weakening effect on the USD, and, consequently, exacerbates the rise in oil prices. With the subprime and credit crises seemingly having found their bottom, and with the concerns about the USD, inflation and the price of oil on the forefront, the Fed has indicated that it will not continue to cut interest rates which will at least stem these weakening policy influences. We also believe that the relative weakness in the USD will create the same economic incentives that will lead it to reverse its fall and begin rising again against world currencies.

### ***Where is Oil Headed?***

As billions of people in developing nations begin to drive cars and adopt a more consumerist lifestyle, those bullish on the continued climb in oil prices point to dwindling supplies and increasing demand. More immediately on the horizon, geopolitical instability, such as a scenario in the Middle East in which Israel attacks Iran, would be highly disruptive to the world oil markets. This type of external shock to the balance between supply and demand makes it impossible to predict how high oil prices could go in the short term.

Those bearish, on the other hand, recognize the “demand destruction” created by current higher prices will continue to cause consumers to shift away from over-consumption of oil. In fact, the last time America witnessed such a rise in oil prices, total supplies of crude went up as OPEC’s resolve splintered and production increased. At the same time, consumer demand diminished and the oil shortage eventually turned into an “oil glut.” Within nine years of the 1979 spike, oil prices declined almost 80% on an inflation adjusted basis.

### ***Restoration of Confidence***

The subprime and credit crises, rising oil prices, and the declining dollar have all contributed to the American consumer's crisis of confidence. However, we believe the bottom in the subprime and credit crises has been found, and that the top in the oil crisis has been reached. If consumer confidence can begin to emerge from current depths, trends in the U.S. stock markets will follow.

As we have discussed, the current market environment has created opportunities to buy great companies at steep discounts to their historical valuations. In a scramble to reduce risk, equities have been discarded in the rush to safe havens such as cash and T-bills, leaving much value strewn about the wreckage. Now, more than a record \$3.44 trillion dollars sits in money market funds<sup>2</sup>. In the near term, we will continue to keep healthy cash balances in accounts for opportunistic buying and to defend against the damage of inflation by maintaining shorter bond maturities. We believe it is prudent at this time to invest in stocks that have good balance sheets, produce good cash flows in a challenging economic environment, and companies that will benefit from a normalization of the credit markets and energy prices.

If you have any questions regarding your account, the securities or the portfolio in general, please do not hesitate to call Rebecca, David, Roland or myself.

Sincerely,



Chris L. Doucet  
Chief Executive Officer

<sup>1</sup> S&P Case-Schiller Housing Report, Released June 24<sup>th</sup>

<sup>2</sup> Wallstreet Journal Money Fund Report published by iMoneyNet, Inc.

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