



DOUCET ASSET MANAGEMENT, LLC

Quarterly Newsletter Q4 2009

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

October 2009

"This market will run like a "scalded cat," as my grandfather used to say, when our political "leaders" finally understand this is, and will continue to be, a capital problem, not a liquidity problem."

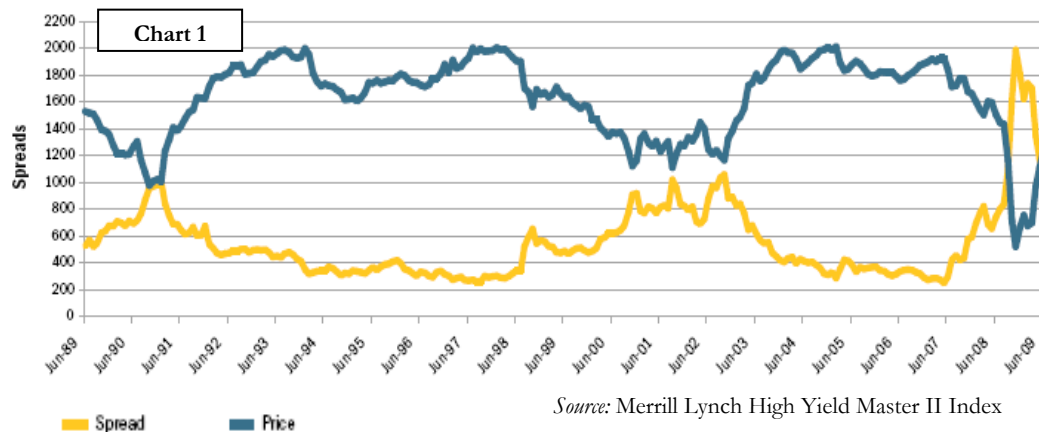
- Doucet Asset Management, March 9, 2009 Special Update

Eyes Wide Open

And run it has! Sparked by little more than Washington modifying mark-to-market accounting and *discussing* other capital destroying agents, the S&P 500 is up a meteoric 57% from its March low, making this rally the strongest market recovery in 45 years. Unprecedented steps have been taken by the government to strengthen the economy and bolster the consumer. Despite their efforts, the United States has seen its first absolute loss of jobs over the course of a decade since the Great Depression. This ever-growing gulf between the performance of the economy and the market requires investors to view the near term market outlook with "eyes wide open."

Market Rebound

Prices have increased over the past several months in nearly every asset class. The S&P 500 is up over 57% from its March 9th low, oil is up over 100% from its December low and the spread between high-yield corporate bonds and Treasuries has narrowed to 820 basis points from its high of over 2000 basis points last fall. While this rebound has provided welcome relief to beleaguered investors, the S&P 500 is still down 31% from its October



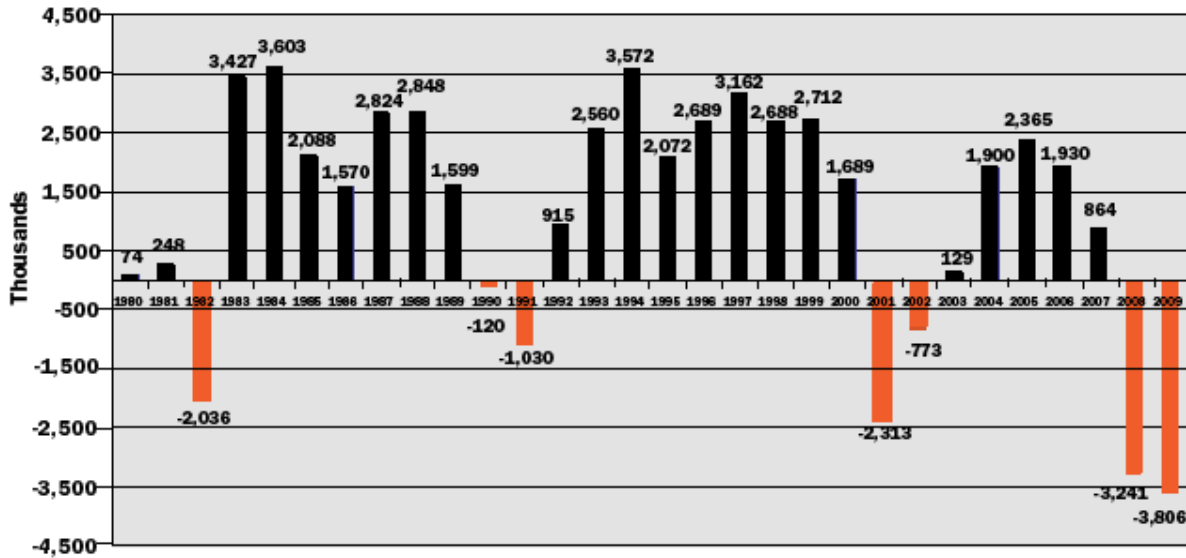
Source: Merrill Lynch High Yield Master II Index

2007 high, oil is down 51% from its July 2008 high and high-yield spreads, as seen in Chart 1, are still hovering near previously seen highs. At 820 basis points, the difference is still almost 300 basis points over its long-term historical average spread over Treasuries (558 basis points since 1989).

Economic Rebound?

While inflating security prices have helped heal anemic balance sheets and ailing consumer confidence, nearly 4 million jobs have been lost in 2009 alone and the number is rising. Unemployment is currently at a 25 year high, with 7.2 million Americans having lost jobs since the recession officially began in December 2007. Broader definitions of unemployment - which include part-timers who need full-time work- estimate the level is near 17%, or 26 million Americans. And if that news is not bad enough news, nation currently has \$1.3 million *fewer* private-sector jobs than it did in December 1999 (Chart 2).

Chart 2



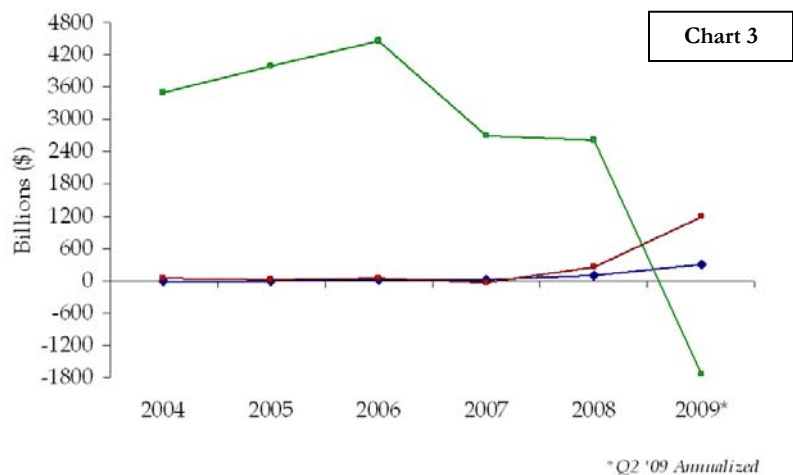
Source: U.S. Bureau of Labor Statistics

To “grease the wheels” of economic progress, the U.S. government has responded to this crisis by utilizing an unprecedented degree of artificial means to reduce interest rates, provide liquidity to the markets and stimulate the economy. Some examples are:

- Fed Funds Rate reduced to a historical low target rate of zero to 0.25% as of December 2008.
- Guaranteed newly-issued senior unsecured debt of banks, thrifts, and certain holding companies through the Temporary Liquidity Guarantee Program (TLGP).
- Bought \$862 billion of a \$1.25 trillion agency mortgage-backed securities program and \$129.2 billion of a \$200 billion program to purchase U.S. agency bonds. The Fed is still the “buyer of first resort” in the mortgage markets.
- Federal deficit in Fiscal Year 2009 already exceeds \$1.42 trillion (that’s trillion with a “T”).
- The \$787 billion stimulus, Cash-for-Clunkers, TARP, PPIP and the rest of the alphabet...

The ultimate goal with all of these government machinations is to produce “positive” inflation, including additional buoying of stock, bond and real estate prices. Most economists would agree that a moderate level of inflation is healthy for a growing economy. But while the Federal Reserve has increased the monetary base (bank reserves plus currency in circulation – or in other words, print money), bank lending has shrunk at a record annual rate of 16% in the past three months alone, with business lending plunging at an alarming 22% pace. The crux of the matter is in order for banks to resume lending – and the economy to recover – asset prices need to increase. Asset inflation bolsters bank balance sheets, thus firming the capital base from which to lend. As you can see in Chart 3, the private sector is on pace to contract at a rate approaching \$2 trillion. The government will continue to be the lender of “first resort” until asset prices and the economy improve.

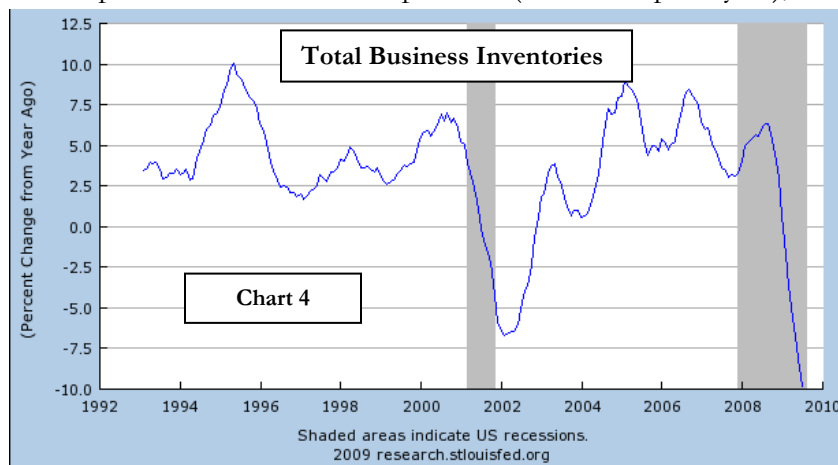
Total Lending in Credit Markets
Federal Government vs. Monetary Authority vs. All Else



Source: www.economicpicdata.com, Federal Reserve

The Market In the Near-Term...

Our government's actions will likely have a very different impact on the present versus the future. Gold's recent breakout is further proof that reflation of assets may be working. Gains on the S&P 500 Index have now pushed valuations to more than 19 times reported profits from the past year (Bloomberg data), the most expensive it has been since 2004. But due to the number and sheer magnitude of artificial mechanisms being employed, and the fact that banks are still not lending, we fully expect bullish trends in markets to continue in the near-term. Third quarter earnings began this week, and although most companies face difficult comparables (versus the prior year), expectations remain low. Additionally, non-financial companies in Q2 2009 had a surplus cash flow of \$156 billion (after capital spending), the largest surplus on record. Combined with the fact that business inventories have fallen by the largest amount ever recorded (Chart 4), a potentially powerful wave of "restocking" is possible. Likewise, companies should have a much easier time during the next two quarters (Q4 2009 and Q1 2010) exceeding the prior year's results and thus providing some encouragement for the market.



Source: U.S. Dept of Commerce, Census Bureau

Proceed, But With Caution

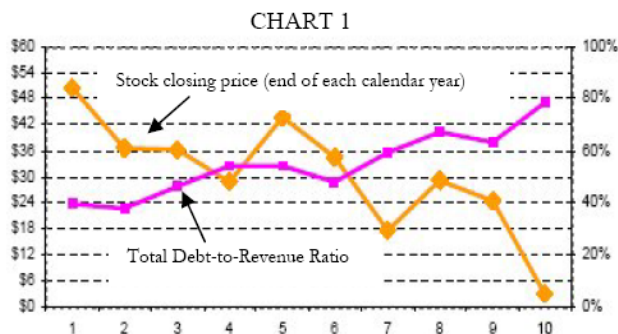
It is a delicate balancing act deciding how long to stay with a profitable trend when clearly bearish signals are in the peripheral. The government is walking a tightrope trying to create healthy asset reflation without setting off harmful run-away inflation. I read an article recently that paralleled the U.S. government's holding of interest rates at zero to someone holding a ball underwater. The harder you push the ball down, the more explosive the ball shoots up when it breaks free of your grip.

Treasury auctions continue to be well absorbed, with no real pressure yet being applied by foreign investors for the U.S. to raise interest rates. They can vote with their "feet," but have yet to do so. In reality, there is no other "safe haven" alternative to the U.S. Dollar. Gold is not a large enough market, the Euro is arguably more unstable than the U.S. Dollar (for many reasons), no other major country is raising rates and many other nations are creating paper currency at the same rate as the U.S. All temporarily offset the inflationary measures of the Fed.

How long can the current interest rate environment persist? How long can the dollar decline and Treasury auctions remain unscathed? For now, we believe it continues to last. We live in a fiat currency world (since the end of the Gold Standard in the 1970s), one in which the global economy operates off of a playbook where export-driven economies depend on the U.S. consumer and the U.S. consumer depends on low interest rates. It seems unlikely to change in the immediate future although we are convinced when it changes, it will change quickly.

If the United States were a stock, would you be a buyer or seller?

History is replete with examples of countries who live beyond their means; are bankrupted by wars they cannot afford; where too large a percentage of the population is supported by the government via a shrinking productive base (small business owners and entrepreneurs); and printing of currency without regard to reserves of gold or silver. These behaviors are not sustainable. To illustrate this point further, compare the two charts.



Source: "What If Anything Is Gold Saying," The Applied Finance Group



Notice how Chart 2 looks quite similar to Chart 1? In Chart 2, the green line depicts prices (left axis), while the blue line captures debt-to-revenue (right axis), during a time horizon of 40 years. Specifically, the green line represents the Yen/USD exchange rates, and the blue line. Prices (green line) have been falling consistently over the 40-year time span, while leverage continued to climb. Chart 2 depicts a steady decline of the US dollar against the Japanese Yen since 1970, accompanied by a consistent increase of our country's leverage. Unless our trajectory changes significantly, the question is not if a currency crisis occurs, but when.

Conclusion

Markets overcorrect on both the downside *and* the upside. There are ample fundamental reasons for a market correction, but nevertheless, there are several reasons (many of which are artificial) why the market could continue to rally. We will be shortening maturities in fixed income investments, ensuring we are in a position to redeploy in a higher interest rate environment. We expect the asset reflation environment to continue, so in equities, we will harvest gains as positions run up, especially ones with higher levels of debt on their balance sheet. As always, we seek value opportunities, but primarily those with near term catalysts and a defined exit strategy. We continue to monitor the present, eyes wide open.

Sincerely,

Chris L. Doucet
Chief Executive Officer

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- Form ADV: Please contact our office at (205) 414-9788 if you would like to receive a current copy of our Form ADV II or the Schedule H Brochure.
- Proxy Solicitations: If you receive calls regarding proxy voting, we suggest that you inform the caller that you have delegated Doucet Asset Management full authority to vote the proxy on your behalf. Please note that we are not able to prevent these calls from being placed to you directly.

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