DOUCET ASSET MANAGEMENT, LLC

Quarterly Newsletter
Q4 2011
Doucet Value Momentum Portfolio
Doucet Value Income Portfolio
Bienville Model

October 2011

Occupy Reality

In December 2010, a man in Tunisia set himself on fire to protest the lack of basic freedoms such as not being able to earn a living without paying bribes to and suffering humiliation from local authorities.[1] This profound act of reprisal caused pro democracy riots to erupt all over the Middle East in a movement known as the "Arab Spring." Citizens in seventeen countries protested against dictatorial regimes, human rights violations, and government corruption. Recently a dissimilar movement, known as "Occupy Wall Street" or "American Autumn," attempted to capitalize on the success of the protests in the Middle East to air grievances of their own. In the process, they managed to encapsulate much of what is wrong with developed economies around the world today. The Occupy Wall Street protesters admittedly lack leadership, have no definable goals and no clear discernable outcome they wish to achieve. Most agree some CEOs simply make too much money, others would like someone to pay off their student loans, many bemoan the lack of jobs, while a few just want better treatment for animals. Even the metaphor "autumn," in "American Autumn," was not very well thought out as autumn represents a time when foliage begins to die – not a good metaphor for a revolution. What is even more bizarre is politicians, labor unions and others have attempted to co-opt the rallies to further their own agendas. What is clear, based on interviews of the participants, is there is a high level of financial illiteracy in the U.S. Creating jobs and ensuring a sound economic future will require strong leadership, a clear vision and the ability of Washington to sell it to the People. Perhaps the desired outcome the Occupy Wall Street movement should adopt is to force Washington to "Occupy Reality."

It's Profits, Not Jobs

There is a story Milton Friedman is purported to have told. He went to Asia in the early 1960s and was proudly taken by a government official to see a public works project. Observing workers building a canal, Friedman was struck by the fact that everyone was digging the canal with shovels. Friedman said, "Why no heavy earth-moving equipment?" The bureaucrat replied, "Oh, this is a jobs program." Friedman thoughtfully replied, "If you really want to have more workers, why don't you give them spoons instead of shovels?"[2]

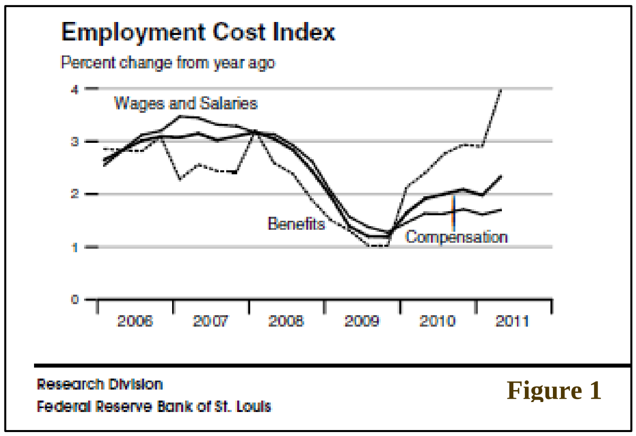


Figure 1

Mr. Friedman's story gives a fresh perspective to "shovel-ready jobs." The myopic solution of "give them spoons" which Washington advocates to create jobs will not, nor will it ever, foster economic growth. Creating temporary employment (that does not outlast a political cycle) does not create wealth. Sustainable production aimed at satisfying demand creates wealth. Contrary to what Washington, the media and the Occupy Wall Street movement might profess, it is not a moral imperative that the private sector create jobs. Companies only create new jobs when they see increasing demand for their products and services. Entrepreneurs – like the Rockefellers, Fords, and Morgans – started businesses because they saw the opportunity to make a profit. Demand for their products and services helped create entire industries and, in turn, helped build the wealthiest nation in the world. A by-product of these riches is taxes which pay for things like roads, bridges and the government-funded jobs to construct them.

Financial illiteracy is one of the biggest problems facing America today, and it starts at the top. As a direct consequence, consumers and businesses continue to be penalized with an *uncertainty tax* -uncertainty about what the future holds for everything from health care to the rate of taxation to Social Security and Medicare spending to the availability of credit to the general direction of the economy. In the near term, the tax promises to remain elevated with legislation like Obamacare and the political shenanigans (on both sides of the political aisle) that helped the U.S. lose its valuable AAA credit rating. For example, as depicted in Figure 1, despite rising corporate profits, wage growth has actually *declined* precipitously in the US since the downturn in 2008. However, due to legislation like Obamacare, the Employment Cost Index (which details the changes in the cost of labor in the US) has actually *risen* steeply in the same time frame due to costs of benefits. While our political leaders may know the steps needed to ensure a better long-term employment picture, these are not the kind of actions that get them re-elected. "You know, the problem with ***all politicians*** is that if they do the right thing at all, they do it at the very last possible second. And I just wonder whether they think they've gotten to that last possible second yet," says Ian Shepherdson, chief economist at High Frequency Economics.

A Short Economic History Lesson

On June 17, 1930, a bill was signed into law that raised U.S. tariffs on over 20,000 imported goods. The stock market had just crashed and unemployment had peaked at 9% earlier that year but drifted back down to 6.3% by the time of the bill's passage. Almost immediately after the bill's passage into law, other nations retaliated with trade barriers of their own and, within three years, U.S. exports *declined 50%* and unemployment *increased to 25.1%*. The law was the Smoot-Hawley Tariff Act of 1930.

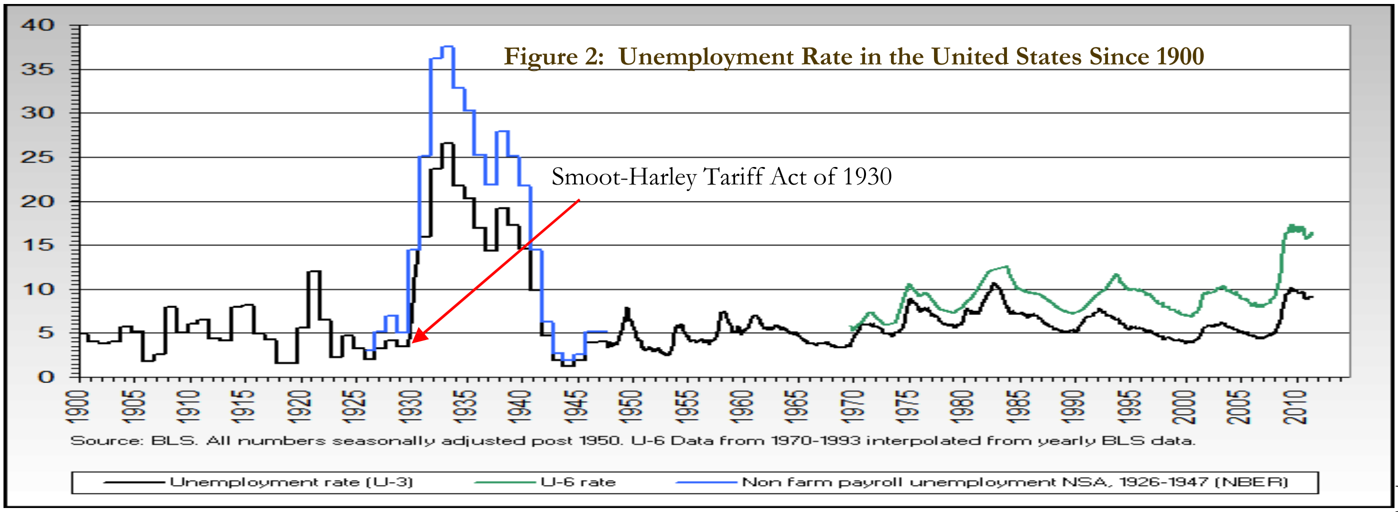


Figure 2: Unemployment Rate in the United States Since 1900

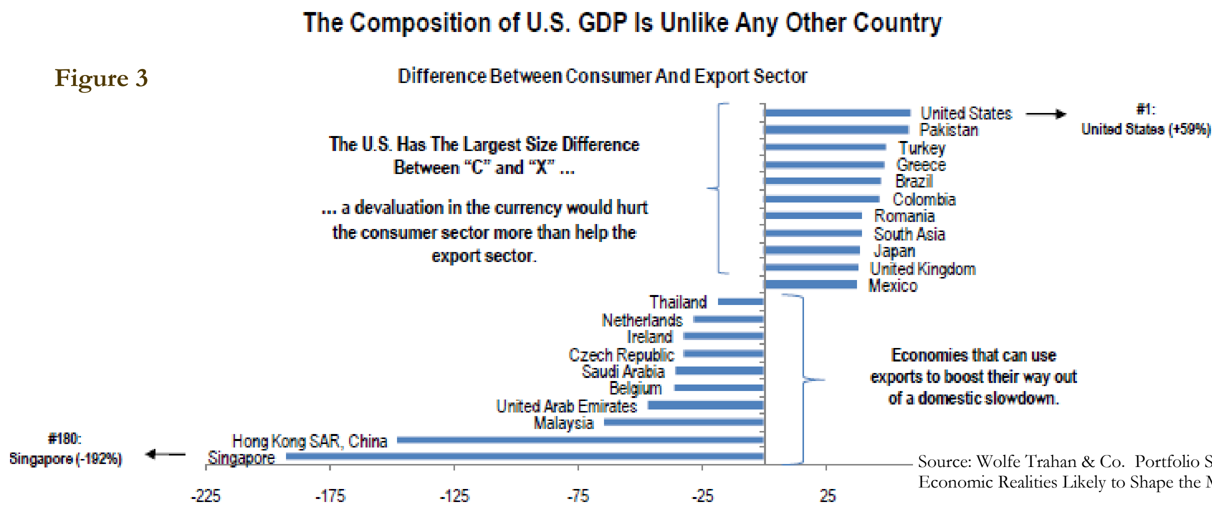
On October 6th, Senator Charles Schumer introduced the Schumer Bill, requiring the Treasury and Commerce Department to impose retaliatory tariffs on nations, like China, that have manipulated their currencies to create a competitive trade advantage. The Senate passed the bill and sent it to the House. At its core, the bill is eerily similar to Smoot-Hawley. Yet, other countries are quick to point out that the U.S. started modern currency manipulation when U.S. President Richard Nixon cancelled direct convertibility of the United States dollar to gold ($35 per ounce) in 1971. As the years have progressed, the U.S. has mistreated its currency even more – as evidenced by the now market rate of over $1,600 per ounce of gold– suggesting that Mr. Schumer is either just pandering to his voting base or historically and financially illiterate.

A nation's currency cannot be depreciated into prosperity especially if the nation exports little and imports much.

At the turn of the 20th century in the United States, the vast majority of Americans were employed in agrarian industries, working on the farm. Today, that number is less than 3%.[3] The transition was not without its pains and similar protectionist efforts on the part of politicians, but the simple fact was, tractors proved significantly more efficient than the family mule in plowing fields. There has been a similar painful shift in manufacturing away from the United States. Furthermore, it is highly unlikely that many of those jobs will come back to the U.S. en masse because simply Americans would prefer to pay less versus paying more. The combination of cheap labor, lower regulations abroad, declining education superiority of the US, and advanced technologies continue to make America less competitive in the world manufacturing community when it comes to low tech products. According to a McKinsey Global Institute study, in the U.S. over the last 20 years, with each recession more employers have used the downturn to replace workers with machines and software, making it unlikely those jobs would be sustainable even if they did come back.[4]

In the absence of job creation, the one of the most certain ways to put more money in Americans' pockets is to *strengthen* the U.S. dollar. Many economists argue the weak dollar policy in the United States was one of the causes that helped accelerate the Arab Spring as commodity prices soared and unrest among the people grew. At the same time, Americans saw disposable income shrink. A strong dollar is in the interest of all markets. As the chart below suggests, the U.S. has an alarming difference between the contribution from consumer spending and the contribution from exports, higher than any other country in the world. Thus, debasing the dollar to help the export sector has no chance to offset the harm to the consumer sector. A nation's currency cannot be depreciated into prosperity especially if the nation exports little and imports much.

Figure 3



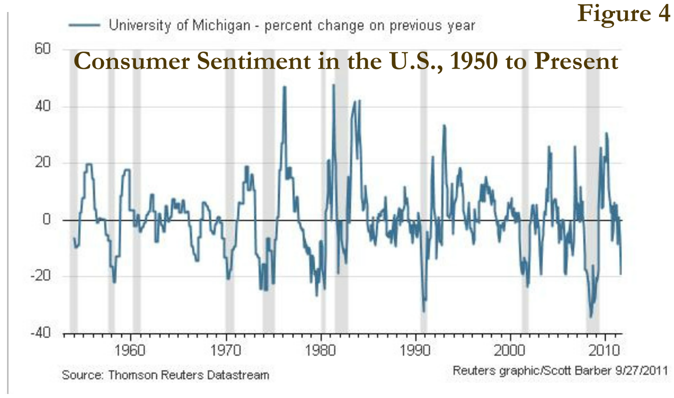
Source: Wolfe Trahan & Co. Portfolio Strategy September 2011, "10 Economic Realities Likely to Shape the Market Outlook"

Slow Growth is Still Growth

It is easy to forget the economy has been bombarded with both man made and natural disasters almost every month in 2011 – from pro democracy rallies across the Middle East, earthquakes in Japan and the East Coast, the debt ceiling fiasco in the U.S. and the continuing Eurozone financial crisis. "The economy is paying a high uncertainty premium right now. With such uncertainty, people delay as many decisions as possible," stated Mohamed El-Erian, C.E.O. of the world's largest bond fund, Pimco. But despite the uncertainty tax that exists, with the exception of consumer and investor confidence (which can change on a dime), the economy is actually improving, albeit at a less than robust pace. If a person awoke from a coma today and had no knowledge of what occurred over the past three years, what would he see?

- Retail sales were up strongly in September and August's figure was revised upwards. Compared with a year ago, retail sales are up 8 percent. They were led by strong car sales. [5]
- The economy added 103,000 payroll jobs in September, including 137,000 private sector positions. The public sector, mostly state and local governments, have shed jobs in 10 of the last 12 months. [5]
- The Conference Board Leading Economic Index pushes higher every month. [5]
- Macroeconomic Advisers, which tracks and continually updates estimates in real time with each new data point, currently has the third quarter expanding at a 2.7 percent rate. [6]
- Industrial production has increased 12.8 percent since June 2009.
- Construction spending rebounded in August, fueled by the biggest jump in state and local government outlays in over two years. [6]
- Equity markets are cheap versus historic measures. Not only in the U.S. - MSCI World Index – sits at 12.2 times the past year's profits vs. an average of 19.5 times over the past decade. [7]
- But, sizable headwinds of demographics, unemployment and debt (or the DUD syndrome) exist in developed countries.

Figure 4



Where Do Investors Hide?

As we suggested in our second quarter newsletter, we continue to keep bond maturities extremely short in portfolios. If there are positive resolutions to both the European debt crisis and the domestic debt crisis, the "fear trade," which has caused money around the world to flee to Treasuries and cash, will be off, and the "risk trade" will be on. In this scenario, Treasuries will fall significantly in price, making them one of the worst total return vehicles in which to invest. We sold many equity positions in the beginning of the second quarter and built significant cash position in those portfolios because of the uncertainty in the market. We stated this buildup of cash in our portfolios was an offensive weapon, not a defensive one, suggesting the U.S. and Europe debt problems could cause a "neon swan" event in the market. Our predictions played out and the markets tumbled 20% from their highs. This market pullback gave us an opportunity to reinvest in primarily cash-producing stocks at discounted entry levels. Our sense is both the EU and Washington have exhausted all other possibilities and the only options left are what is best for the economy. If politicians in the US and Europe can brush up on their economic history, begin to "occupy reality" and at least temporarily lifts their collective economic IQs, what they will discover is these headwinds they currently face are imminently fixable. Since the middle of the third quarter, our portfolios have been significantly long US equities. If the right decisions are made, the risk trade could be on again and Christmas could come early this year for us.

Sincerely,

Chris L. Doucet
Chief Executive Officer

Footnotes

[1] "Slap to a Man's Pride Set Off Tumult in Tunisia," Kareem Fahim, New York Times, January 21, 2011
[2] Excerpt taken from Wall Street Journal article (http://quoteinvestigator.com/2011/10/10/spoons-shovels)
[3] Wikipedia: Agriculture in the United States (en.wikipedia.org/wiki/Agriculture_in_the_United_States)
[4] "The Uncertainty Tax," Thomas L. Friedman, New York Times, June 11, 2011
[5] Bloomberg Data
[6] "Hey, the U.S. Economy Does Have a Pulse," Rich Miller and Viven Lou Chen, Bloomberg / Businessweek, October 17 – 23, 2011
[7] Bloomberg Data

Admin Notes

- 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.