

Sampling of Billeaud Capital Management Quarterly Client Letters

2007 to Present

The following are excerpts from the Market Outlook section of our quarterly letter to clients.

1st Quarter 2007

Well, Mr. Market's been at it again. After enjoying a nearly uninterrupted rise of nearly 18% since last June's mid-year correction (through the middle of February), stocks have entered the inevitable corrective process once again (it happens on average about once a year).

For those of you who are long-time clients, you know that I monitor a number of economic, financial and market measures designed to indicate to me the risk/reward climate for stocks. I can tell you that during this most recent correction - just as it has been during the prior four corrections that have occurred since the bear-market bottom in the fall of 2002 - there is not at this time anything on my radar that would indicate long-term persistent trouble for the market.

2nd Quarter 2007

So, as was the case last spring, I remain bullish on the market. Now, that's not to say that at any time the market couldn't suffer a 5% - 10% correction. Of course it can. It has. Five times since the bear market bottom in the fall of 2002. And, it *will* happen again - maybe even this very year.

Yes there is a time to take chips off the table. But those times are the exception, not the rule.

3rd Quarter 2007

Well, it happened. A correction (such as the one that I alluded to in your 2nd Qtr 2007 letter) occurred.

If you've paid any attention at all to the summer's headline financial news, you probably know that the sell-off was triggered by problems in the "sub-prime mortgage market".

4th Quarter 2007

It was a volatile second half of the year and a very volatile fourth quarter in particular.

Long-time clients know that I keep and maintain a number of economic and financial measures that I use to help direct and guide me with regards to the market outlook. However, because we've been (mostly) in such a benign market environment since the spring of 2003, there's not been much need to discuss this work. That market environment has been slowly changing over the last few months, so it's time to have a short refresher course on our asset allocation model and discipline.

I use the readings of this model as a pilot uses his instrument panel. When the financial weather gets rough, I *watch it very closely*. It helps to keep me rational in an otherwise irrational market.

After having correctly viewed the risk climate for stocks as generally favorable since the spring of 2003, our Stock Market Asset Allocation model has slowly moved into the area where it is prudent for us to begin adopting a more cautious investment allocation.

Our task is to try and make an assessment regarding whether periods of weakness such as the last few months are likely to be contained and transitory, or do they have the potential to extend beyond a reasonable level of comfort. Based on the outlook of our market model, I have begun the process of repositioning our accounts in such a way as I believe appropriate for the current climate.

1st Quarter 2008

The problems in housing and the credit markets are indeed serious. They have spilled over and are affecting the general economy. And they may not yet be over.

Because our asset allocation model directed us some time ago to adopt a more defensive posture of cash and high quality bonds, we have been able to observe much of the market's recent duress from the position of interested observer rather than active participant as our cash and bond holdings have greatly buffered us from the current turmoil.

Our asset allocation model remains cautious in its outlook and we will maintain our discipline. We follow our model. At some point our asset allocation model will direct us to once again begin increasing our exposure to stocks. When that happens, we will. But we need to be, and will be, disciplined about it. That is *critically* important for long term investment success.

2nd Quarter 2008

We've been in a difficult market for nearly a year now. And we are currently focusing on *and accomplishing* the second part of our charge – relative outperformance during difficult markets. **While the market as measured by the Dow, the S&P 500 or the NASDAQ index is down by roughly 20% since last fall**, our accounts on average are off but a fraction of that.

At some point this financial duress, like all other similar periods in the past, will run its course. When it does, I am confident that our market model will be successful at redirecting us back towards a more fully invested posture.

3rd Quarter 2008

Looking back to the market's top (summer of 2007 -15 months ago), it is clear that the stock market has been in the grips of a classic bear market.

We'll get through this. Our defensive allocation posture has dug for us a pretty good foxhole to hide in.

At some point, the shooting will stop, the smoke will clear. That's when we'll lift our heads and assess the outlook.

4th Quarter 2008

In spite of my near term caution, I do believe that we have a real opportunity building. And it could be a dandy. In spite of the current sour economic outlook, the market will likely turn up (durably – not just a bear market rally) well before the economy finally does (and it will). And we'll be watching for that. But we'll maintain our discipline and continue to follow the guidance and outlook of our model. It's done a terrific job of keeping on the right side of the fence so far. I believe it will continue to do so.

1st Quarter 2009

The first two months of this year were absolutely brutal for many.

Recently I mentioned to a number of you that I thought we were soon due for a respite from the intense selling, a break in the clouds. Well it seems that the rally I was looking for has begun. After hitting a twelve-year low on March 6th, stocks have since been rallying.

Internal market dynamics have improved measurably since the recent March 9th lows. I expect that over the next several months, the market (S&P 500 index) might well be able to continue rallying, retracing a fair portion of the deep decline that virtually all stocks suffered since the Fall of 2007.

2nd Quarter 2009

Back in March, my best guess was that it would be a three-step affair, one counter-step up, one counter-step back followed by a third step up.

I think the first step up was likely completed in early June. We seem to be in the counter-step-back move right now. If my outlook is correct, then following this period of consolidation, I would guess that there is likely at least one more short-term bounce ahead (measured in weeks or months, not years) which might move stocks just high enough to get investors all hot and bothered once again.

Beyond that, *everything* will depend – in my opinion – on the outlook for the economy. If my economic concerns are not warranted, then perhaps the low set in March was THE bottom. If my concerns should turn out to be well-founded, then it is possible that THE bear market low lies ahead.

3rd Quarter 2009

As of this writing, our main risk-management tool, our stock market risk model continues to register a *favorable* outlook for stocks. Now this model doesn't forecast, it only measures current conditions. When the risk climate for stocks changes in an unfavorable way, I expect that our model will pick that up and signal us accordingly. When that happens, we'll move to reposition our portfolios more defensively – as we did back in early 2008 – just in case the markets once again should turn hostile. But, until our model changes, we'll hold our invested positions and enjoy the current investment climate.

4th Quarter 2009

One of the real investment lessons I've learned over the last 25 years of investing is to never second-guess or try and outsmart the future. Wall Street has been surprised more than a few times at the durability and longevity of a new market moves. For example, in 1983 virtually no one envisioned a bull market that would triple over the next four years. And in 1991, as the market climbed through seemingly unsustainable valuation levels and an impending S&L crisis, no one was forecasting an ensuing 9-year bull run that would become the longest on record, increasing market prices by more than four fold.

Fortunately, sound investment does not require an accurate forecast of the future. It is enough to simply align your investment position with the prevailing, observable evidence. We attempt to accomplish that by following the outlook of our Market Risk Model.

The fact that no one knows how much longer this current bull market will last should not dictate an investment strategy. For us, a bull market should be given the benefit of doubt, until our model indicates otherwise.

As of this writing, our stock market risk model continues to register a *favorable* outlook for stocks.

1st Quarter 2010

As always, we continue to monitor the market's risk profile through the readings of our model. As of this writing, *our stock market risk model continues to register a favorable outlook for stocks.*

Now when the risk climate for stocks changes in an unfavorable way, we expect that our model will pick that up and signal us accordingly. When that happens, we'll move to reposition our portfolios more defensively.

But until our model changes – *we will continue to hold our current invested positions.*

2nd Quarter 2010

Economic growth is where it's at, as far as the financial markets are concerned. **At the end of the day, what it usually takes to really bust the market is a full-blown economic recession.** It is no coincidence that the recession of 2008 (the most serious economic downturn since the 1930's) was accompanied by a decline in stock prices that rivaled that era as well.

The economic consensus of professional economists currently calls for a second-half GDP growth rate on the order of about 3% for our economy. This number is important, because it is from this anticipated growth rate that earnings forecasts are made, and these anticipated earnings forecasts are the basis that many investors price stocks.

If the economy does in fact grow by 3% or so for the second half, great. However, if the growth rate of the economy disappoints, it is highly possible that stock prices could once again adjust downward.

Now here's the rub - after experiencing a robust growth in GDP for the fourth quarter of 2009 and the first quarter of 2010, certain leading economic indicators are suggesting a measurable slowdown in GDP growth for the second half of this year. So, risk for financial markets, at this point, to a large degree hinges upon whether or not the economy does in fact measurably slow - and if it does - is that slowdown simply a temporary pause in growth, or the beginning of a slump back into a full-blown, double-dip recession. It is a difference with a *major* distinction.

While there is no way to know (at this point) with certainty how our economy will fare in the months just ahead, the dichotomy of that outcome is, we believe, exactly the culprit behind the marked increase in market volatility experienced in recent weeks.

3rd Quarter 2010

Stock Market Risk Model indicates that over the near term, a potentially more constructive environment for stocks *may* be developing.

In a secular bear market, such as we have been caught in since 2000, **a well-diversified portfolio is crucial to long-term investment success.** The key to sufficient diversification lies in having exposure across many independent asset classes (stocks, bonds, real estate, gold, cash, etc.), such that if any one or more of those areas are experiencing difficulties, other areas presumably can still carry the load.

Our portfolios, while lighter on stocks than historically normal, are certainly not sitting idle. We have exposure to a variety of different asset classes such as bonds (both short and intermediate term), real estate, oil and gold through the various funds that we hold.

This diversification is important, and is exactly what we expect will carry us through this challenging time. While we of course alter our exposure to stocks based on the outlook of our model, nonetheless, a balanced diversified approach is exactly the approach that we've chosen to adopt as we adjust to what has been referred to as the "New Normal" of risk management.

As always, please remember our investment goals here at BCM - to realize positive investment returns over entire market cycles, coupled with rigorous risk management.

4th Quarter 2010

Regarding the financial markets, in September, we reported that our market model was indicating that a potentially more constructive environment for stocks might be developing. Well, that in fact occurred, and we adjusted our portfolios accordingly. Regarding bonds, so long as our financial system is still deleveraging (and it will be for many years to come) and employment remains soft, risks continue to lean towards deflation rather than inflation. That is a favorable environment for bonds. Our portfolios have exposure to both stocks and bonds at this juncture, and many also hold gold, silver, real estate, oil and foreign currencies as well.

1st Quarter 2011

At this time, our BCM Stock Market Risk Model continues to register a favorable outlook for risk assets such as stocks. As such, all BCM accounts (as a matter of clarification, we will from time to time be referring to our three standard investment portfolios as Conservative, Balanced and Growth) are allocated so as to benefit from a broad array of asset-class market gains, should that in fact continue to occur.

Commensurate with the favorable outlook still registered by our Stock Market Risk Model, BCM Balanced accounts hold roughly a 47% allocation towards stocks, a 44% allocation towards bonds with the remaining 9% of the portfolio being held in real estate, gold, resources and cash.

BCM Conservative accounts hold roughly a 20% allocation towards stocks, a 55% allocation towards bonds with the remaining 25% of the portfolio being held in real estate, gold, resources, short-term government bonds and cash.

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