CABOT MONEY MANAGEMENT, INC.

# Quarterly Review

THIRD QUARTER 2011

## IN THIS ISSUE



*Thank You*

On behalf of the Cabot team, we would like to thank our clients and guests for joining us at this year's conference in Salem. We enjoyed spending time with old friends and becoming acquainted with new ones.

Cabot Money Management, Inc.
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October 25, 2011

Dear Friends,

*Rob Lutts stands next to a development model during a research trip to China.*

As we write this there is much concern and worry about economies and markets across the globe. In spite of these worries there are many opportunities to build wealth and create value. Today, we believe the following offer unusual opportunity:

1. **Wealth and power are growing fast in many emerging economies.** During the last decade, *emerging markets outperformed developed markets by approximately eleven percent annually.* The conditions for building wealth and capital are very favorable in many of these economies – especially China and India. We believe this pattern of outperformance will continue in the coming years. Both Tim Moore and I will be traveling to China in the next few weeks, and Dennis Wassung will be traveling to São Paulo, Brazil in search of new investment ideas. These should be timely trips.

2. **We observe that governments around the globe are choosing to solve their large and growing debt problems by creating money** (they call this *quantitative easing* and other sophisticated terms). Central banks globally are essentially creating money out of thin air. This drives our belief that gold is a winning theme and will move higher over time. Today, smart investors are using gold to preserve portfolio purchasing power.

3. **In the technology area we are working to find and invest with the winners in the evolving technology world.** *We believe the companies that master the use and utilization of the internet can and will create huge value in the coming decade.* In spite of weak market conditions, many of these companies are hitting new highs today. We now own some of these companies in our portfolios.

4. **Energy (oil and gas) and energy efficiency are in the midst of some dramatic changes. We believe the next ten years will offer exceptional opportunity for those companies with winning energy technologies.** The Cabot research team is today looking for the new leaders and winners in the coming transition from old fossil-fuel based technology to new types of technologies. Battery technology, new materials, wind, solar and many others may offer exceptional opportunity.

We are putting these themes and ideas to work in our investment strategies. We believe the world is changing quickly and we aim to help you and your family benefit from these changes. Thank you for the honor of being stewards of your wealth and your family's financial future.

Best wishes,

Rob

Robert T. Lutts
President and Chief Investment Officer
Cabot Money Management, Inc.

Financial Planning

*Greg Stevens, CFP,® CRPS,®*
*Senior Financial Counselor*

# A Retirement Savings Vehicle for Small Business Owners

Small business owners and consultants: If given the opportunity, would you be willing to contribute more of your income to retirement savings? Are you frustrated by the contribution limits associated with SEPs, SIMPLE IRAs and 401(k) plans? Would you like to allocate a much larger portion of your schedule C income to a retirement plan and get a sizable tax deduction at the same time? Has anyone talked to you about the Solo Defined Benefit Plan?

The Solo Defined Benefit (DB) plan has been an option for small business owners for several years. Unfortunately, most business owners are too busy building and running their business to spend much time thinking beyond the more obvious retirement savings vehicles listed above. While the SEP, SIMPLE and 401(k) are certainly viable retirement savings options, they have relatively low contribution limits, especially for those who are a bit behind in their savings. Solo DB plans are a good option for business owners/consultants who can afford to contribute more than the $54,500 maximum a 401(k) allows.

## Who is the plan ideal for?

- Self employed individuals
- Income in excess of $200,000 per year
- At least 5 years away from retirement
- Ability to save a significant portion of their income

## What are the advantages?

- Contribution limit based on a projected retirement "income" (maximum yearly benefit of $195K for 2011)
- Yearly contribution can potentially exceed $200K (based on actuarial calculations)
- Higher contribution limit = more potential savings at retirement
- Significant tax benefits (contribution is tax deductible as business expense)

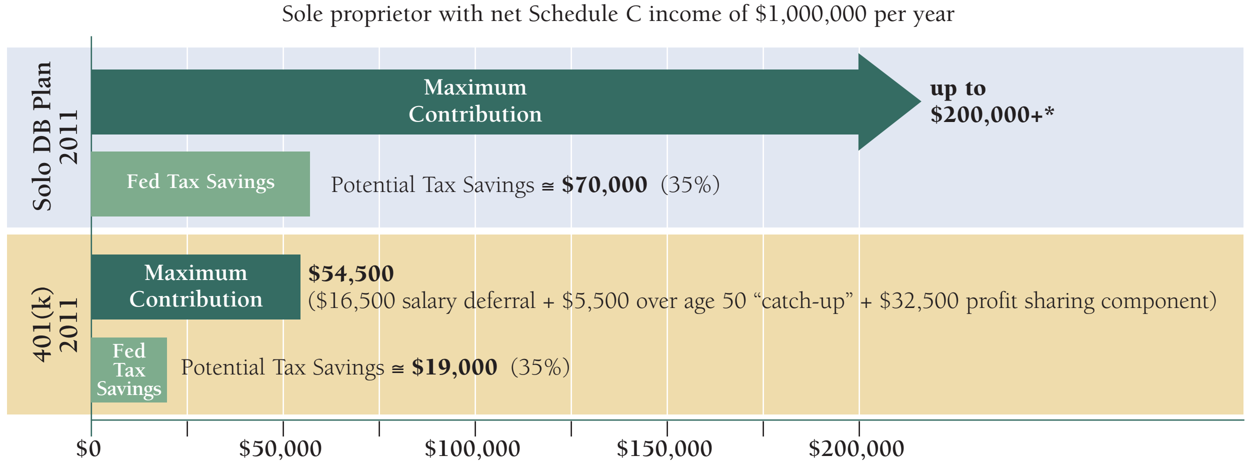
## What are the disadvantages?

- DB plans are complex and therefore more expensive to administer than a typical retirement plan.
- An actuary must be used to determine the contribution formula. Annual reports must be filed and detailed records kept by the trustee.
- Yearly contributions are required based on the funding formula (the formula can be adjusted if business conditions change but a contribution must still be made to keep the plan compliant).

The Solo DB plan, while complex, offers the biggest "bang for your buck" when it comes to retirement savings vehicles. Let's look at a very simple example.

### Solo Defined Benefit Plan vs. Solo 401(k) Plan

Sole proprietor with net Schedule C income of $1,000,000 per year




** Contribution could exceed $200,000, depending on projected retirement date & projected benefit at retirement (capped at $195K in 2011)*

This brief description of the solo DB plan is simply a high-level overview of the basics. It's critical to discuss your specific goals with your Cabot Financial Consultant or tax advisor.

# The Psychology of Fear and Investing

Our desire to be safe can sometimes lead us to make poor decisions. Safety is one aspect of a very complex investment process that may have all sorts of embedded dangers. If you sell and go to cash, for example, you have just created a few very serious problems. When do you get back into the market? With cash earning close to zero, how long can you afford to be on the side-lines with a broken investment strategy? Is this safe?

Collectively, investors, just like any social individuals, tend to find comfort in being and doing what others are succeeding at. Unfortunately, most of the success may have come from other variables or is no longer valid. The housing crash is an excellent example of an incorrect collective mindset that trapped millions of homeowners in either a bad financing package and/or overvalued property. This group behavior is hardwired to our internal survival instincts and is one of the key factors that drive bubble behavior.

When it comes to investing, following the crowd can often harm you financially. It feels good to be safe, but like millions of households that bought overpriced real estate that they truly believed was in their best interest, their flawed common logic put them into financial peril in a marketplace they thought would support their American dream.

Another superb example is the perils of not understanding the math behind stock market returns. If you sold close to the market bottom during the US Credit Crisis it would require your portfolio to earn an 87% positive return to break even. The rationale behind such a large return is the new base, which is now no longer the large sum it once was. A million dollar portfolio invested in the S&P 500 Index would be worth approximately $535,000 at the market trough. A return this large could normally be produced over a little more than a decade. Assuming a 45-year-old lives to the ripe old age of 84, that's approximately a third of his expected financial life. For most investors this is a loss that could not be made up. This loss would require a substantial change in a person's financial planning and expected future earnings.

What's even more remarkable, if an investor stayed with his S&P 500 investment and did nothing, they would have reached their break-even of a million dollars in 27-months or 2¼ years. When stock valuations get crushed, they often lead to abrupt market rallies. Missing one of these powerful rallies would seriously limit an investor's ability to counteract losses.

Would an investor have been safer to have liquidated their portfolio during these extraordinary market declines or should they have remained invested? The answer is based on the unique makeup of the individual investor. Financially, it would have made more sense to stay invested, but each of us has a psychological profile that can withstand different levels of financial stress. This is an important facet of investing that becomes more important the older you become. Time is the element that allows younger investors to recoup their losses in the future and reinvest today, but older investors are forced to reconcile their financial situation with the realities of the current marketplace.

The main point is to understand that psychological factors play a critical role in shifting market dynamics. The secret is to work within an investment strategy that doesn't abandon its financial objectives, but is flexible enough to allow gradual shifts in risks that are planned and deliberate. This prevents investors from becoming emotional and ending up with a ruined financial plan and/or a broken investment strategy.

## Investment Strategies

*Bill Larkin, Jr.*
*Portfolio Manager*

INVESTMENT STRATEGIES

# The Secret Sauce: Characteristics of Successful Investors

*Tim Moore, CFA®*
*Portfolio Manager*

Wayne Gretzky said he was successful because he would "skate to where the puck is going, not where it has been." This influential advice was taken from his father at an early age. For those of you who are not hockey fans, Gretzky was nicknamed "The Great One" as he became the all-time leading goal scorer in the National Hockey League.

In baseball, the "on-base percentage" measures how often a player gets on base safely during a game. This statistic is typically the leading indicator for the teams most likely to be at the top each year. Winning teams improve scoring chances by consistently getting on base, rather than hitting homeruns. "Swinging for the fence" can frequently involve reckless abandon or too risky attempts. Instead, successful teams win with steady progress of singles, doubles and being walked to drive in total runs, not by swinging wildly with aggressive or greedy ambition.

This article captures the essence of scoring goals or runs within a portfolio using a proper mix of anticipation and evidence, just like Wayne Gretzky. It stresses a process for self-control and staying mindful of risks like "on-base percentage."

## COMMON TRAITS & CHARACTERISTICS OF SUCCESSFUL INVESTORS

- Defined and disciplined approach that can be consistently and repeatedly applied to each stock selection decision
- Acknowledge that process is as important as outcome
- Discover unexpected growth or underappreciated prospects before others
- Carry out thorough due diligence and do not cut corners or take things at face value
- Utilize a wide range of resources to avoid tunnel vision or being overly influenced by only one or two sources
- Write out their thesis and rationale for buying a stock with an upside/downside calculation of worth in good and bad scenarios
- Retain proper temperament without becoming "emotionally attached" to a stock
- Perform downside analysis
- Know what can and cannot be measured
- Acknowledge their mistakes – they do not cover up or downplay mistakes; otherwise, they are likely to repeat the same error and not learn from it
- Pattern recognition – successful investors have enough experience (not just reading accumulation) to spot trends as they emerge
- Do not extrapolate trends into infinity (either direction)
- Avoid groupthink and herding mentality
- Employ a consistent sell discipline
- Ignore the cost basis – "getting back to even" or staying fixated on original cost can become a downward spiral
- Retain diversification but some flexibility – too much diversification leads to mimicking the benchmark with lackluster performance
- Do not disregard valuations – an important backbone to capital appreciation or protection is valuations, which cannot be overlooked
- Do not constantly increase their sense of stock worth simply because the stock price goes up
- Be willing to act on imperfect data and uncertainty by performing adequate diligence and quantifying both the prospects and relevant risks

## KEY TAKEAWAYS

Successful investors not only need to recognize good characteristics of a company, but also need to have a consistent discipline in place for implementing buy and sells without emotional distractions. By avoiding the land mines and not swinging for the fence, a logical and unemotional investor can outperform the market over many years. It takes discipline, logic, commitment, passion, patience and emotional stability to avoid fear and greed traps. There is no surefire single strategy that will not lose money in all environments over the long-term. Even the best investments sometimes feel uncomfortable when first being purchased. Nevertheless, more successful investors display many of the aforementioned traits from their vast experience and not just wisdom.

*To read the full version of this white paper, visit ecabot.com and subscribe to our white paper updates.*

# Middle Class Expansion

## *Not just a "Made in China" economy anymore*

CABOT'S OUTLOOK

***Dennis Wassung, Jr., CFA®***
***Portfolio Manager***

At Cabot Money Management, we have long discussed the growth and investment opportunities in the Emerging Markets. Specifically, we have often pointed to Brazil, Russia, India, and China – known as the "BRIC" countries (using their initials) – as these are the larger players in the broader emerging markets. One of the traditional myths or viewpoints on the emerging markets is that these are countries where large, global companies manufacture their goods to sell in the developed economies like the U.S., Europe, and Japan. In fact, this used to be the case, for the most part. However, with the significant economic growth that the emerging markets have experienced over the last ten years (and longer), there is a fast-growing middle class in many of these countries – a growing population of people who now have the financial strength to consume goods and services, and spend on discretionary goods – in some cases, for the first time. China, the bellwether emerging markets country, is the poster child for this transition. With these trends in place, China is not just a "Made in China" economy anymore.

### From "MADE IN CHINA" to "CONSUMED IN CHINA"

Many people think (or thought) of China and the broader emerging markets as simply countries that had cheap labor, low-cost manufacturing, and were places where global companies were increasingly making their goods. This is effectively, a "Made in China" economy, where goods are manufactured in China (or other emerging markets countries), and then exported to the developed world. While this was more often than not correct in the past, things have changed. With the rising wealth and population growth in the middle and upper classes, China is transitioning to a "Consumed in China" economy. This transition is also occurring in countries like India and Brazil, as well as others.


Beyond looking at the big picture data, some of China's industries are becoming substantial markets on a global basis – and illustrate that there is a substantial opportunity for global companies to sell to the Chinese consumer. We see the rapidly expanding middle class representing a range of interesting investment opportunities in the coming years. While the equity markets in emerging market countries have had a tough year, given current global macroeconomic concerns, many industries and trends may represent high-growth, long-term investment opportunities. We look for potential investment opportunities in a number of areas:

**HEALTHCARE** – Many people in the emerging markets are just beginning to get access to a range of healthcare products and services. As more of the population gets healthcare coverage and access to advanced treatments and services, the healthcare industry is ripe for growth.

**AUTOS** – Many people are buying cars for the first time in the emerging markets. With China becoming the largest market and other countries representing growth opportunities, the auto industry could be an interesting opportunity.

**RETAIL** – With retail sales growing 17% in China, nearly twice as fast as GDP growth, the consumer is buying retail goods at a rapid rate.

**TECHNOLOGY** – Technology enables many of the goods and services that the expanding middle class will consume – from online retail, to online travel, smartphones and computers/tablets, Internet services, etc.

**ENERGY** – As the population buys cars and becomes more urban, more energy will be consumed – both traditional and alternative energy sources. The emerging markets will likely grow in importance in energy consumption in the coming years, potentially driving investment opportunities.

*To read the full version of this white paper, visit ecabot.com and subscribe to our white paper updates.*

CABOT'S OUTLOOK

# The Changing Landscape of Vehicle Technologies

*Dennis Wassung, Jr., CFA®*
*Portfolio Manager*

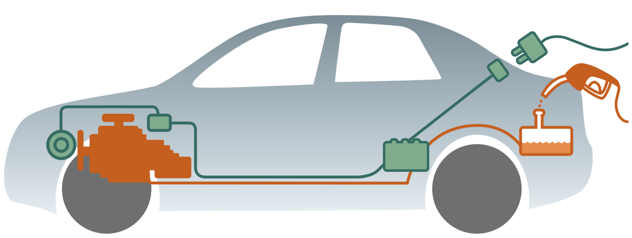
About two years ago, we published a report on the emerging hybrid/electric vehicle market, and the opportunities that could lie ahead. Interestingly, oil prices had just returned from their 2008 trip to $147 per barrel, and fell all the way to the $40 level. Oil prices, and the corresponding impact on gasoline prices, clearly have an impact on consumer buying behavior – notably, whether they purchase hybrid/electric vehicles or continue to buy those big, gas-guzzling SUVs. Fast forward two years, oil has once again made a run to the $115 level (in April), causing another spike in gasoline prices to the $4.00+ level, and again raising the debate over alternatives to the traditional gasoline-powered vehicle. The trials and tribulations of high oil prices and corresponding gas prices are likely to stay with us in the coming years.

Hybrid gasoline/electric vehicles, and some emerging all-electric vehicles, continue to grow as an alternative to the traditional gasoline engine, and will likely be a key growth opportunity going forward. However, that is not the entire story. Today, auto manufacturers are aggressively bringing a growing list of small (very small, in some cases), high miles-per-gallon (MPG) gasoline engine vehicles to market. Additionally, several auto manufacturers are offering a growing set of clean-diesel cars to the market that deliver 40+ MPG performance, and claim significantly reduced emissions. There is also a sizable push from a number of sources to support a transition to natural-gas-powered vehicles – most notably trucks like 18-wheelers, and a range of other commercial vehicles. Legislation is currently in Congress on this topic, in a third attempt to gain government support for such a program.

There are a number of new or improved vehicle technologies coming to market today or in the near future – all in an effort to offset the growing challenges of high oil prices, environmental concerns, and a growing global automobile market driven by emerging markets.

While the ultimate winners and losers are not necessarily decided across vehicle and fuel technologies, there will likely be many investment opportunities across this dramatically changing industry for advanced vehicles. We look for potential investment opportunities in a number of areas:

| ELECTRIC vs. | GASOLINE |
|---|---|
| No Tailpipe Emissions | Greenhouse Gases/Pollution |
| Utility Company | OPEC |
| 100+/– Mile Range | 300+/– Mile Range |
| 7.5 Hours to Recharge | 4 Minutes to Refuel |
| 2 cents per mile | 12+ cents per mile |



- **Vehicle manufacturers –** Most (but not all) of the hybrid and electric vehicle manufacturers are also traditional auto manufacturers. Those developing the winning hybrids and EVs could outperform their competitors.
- **Engine technologies –** Whether migrating to clean diesel, natural gas, or efficient gasoline vehicles, advanced engine technologies could be a/the differentiator that determines the winners.
- **Powertrain technologies –** Electric vehicles require a largely different powertrain from traditional internal combustion-engine-based vehicles.
- **Battery and related component suppliers –** Batteries are a key technology required for the success of the hybrid/electric market, and the leading suppliers could represent investment opportunities.
- **Biofuels and other alternative fuels –** As the industry works to offset petroleum based fuels with blends or replacement with biofuels, these manufacturers could pose interesting growth opportunities.
- **Infrastructure providers for electric and natural gas vehicles –** If the transportation industry makes progress in migrating to electric and natural-gas vehicles, the corresponding infrastructure will need to be put in place to support these vehicles. This includes charging stations and power hookups for EVs and natural gas fueling stations for NGVs. These could provide substantial growth opportunities.

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# Cabot's 22nd Annual Investment Conference & Luncheon


Cabot hosted its 22nd Annual Investment Conference and Luncheon here in Salem, MA at the end of September. The event was well attended with over 100 clients and guests anxious to hear about Cabot's outlook on the future and an open forum in which attendees could have their questions and concerns directly addressed by our portfolio management team.

*Please take a moment to visit our website and download our presentations if you were unable to attend our Salem Conference. You may also contact us at info@ecabot.com or (800) 888-6468 for a hard copy, which we can mail to you. This year's presentations included:*

## CABOT'S YEAR-IN-REVIEW & THE STATE OF CABOT

- Middle Class Expansion in the Emerging Markets
- Financial Planning in Unpredictable Economic Periods
- Market Brew with Cabot's Portfolio Management Team
- Lining Up for Zero Percent!
- KEYNOTE PRESENTATION:
  The New Economic Order: Currency, Stocks, Governments, and Gold
  Three Global Changes and Capitalizing on a Changing World

# GETTING TO KNOW THE CABOT TEAM

*Craig Goryl*
*Equity Analyst, CFA®*

## Introducing Craig Goryl, Cabot's Newest Equity Analyst

Cabot Money Management is happy to welcome **Craig Goryl** as the firm's newest equity analyst. In this capacity, he will prepare analysis reports about the current market, investment opportunities, and assist in the management of Cabot's equity portfolios. Before joining Cabot, Craig worked for Gerson Lehrman Group as a senior research manager. He has also worked at Putnam Investment Management, LLC as an equity analyst. Craig graduated from Cornell University with a Bachelor of Arts in Economics and has been a CFA charterholder since 2004.

*Richard Morrell*
*Marketing Manager*

## Meet Richard Morrell, Cabot's Newest Marketing Manager

Cabot Money Management is excited to announce **Richard Morrell** as our newest marketing manager. Richard will use his experience in business communication to enhance Cabot's marketing resources with a focus on the firm's client-centric approach. Richard graduated from Gordon College in Wenham with a Bachelor of Arts in Business Administration and a Minor in Visual Arts.

# Around Cabot

## Cabot White Papers

- Middle Class Expansion of the Emerging Markets
- The Secret Sauce: Characteristics of Successful Investors
- The Changing Landscape of Vehicle Technologies

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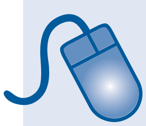
# Around Cabot



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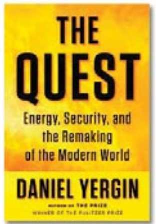
# CEO Reading Corner

*by Rob Lutts, President and Chief Investment Officer*




### The Quest: Energy, Security, and the Remaking of the Modern World

by Daniel Yergin, HIS Energy Research Associates, 2011 Penguin Press

If you are like us and believe we are on the verge of some extraordinary changes to our energy complex, then this book is for you. Daniel Yergin tackles the difficult task of analyzing the quickly changing global economy and its energy use. He takes on government policy, geopolitical issues and science breakthroughs, and in the process develops some interesting ideas. He does a nice analysis of new and developing technologies including the automobile that utilizes hybrid batteries technologies. He describes unique political aspects of China, India, Russia and the favored energy uses in each country. Nuclear, natural gas, coal, oil and alternative energy technologies are all part of the analysis he puts forward. Overall, an interesting book, but he lacks clear cut conclusions, and instead presents interesting possibilities.

# Our Commitment to Education

In order to provide the highest level of service possible, we continually expand our knowledge both within each of our particular fields as well as the market environment. This helps us to better understand our clients concerns and issues while providing well-thought-out solutions and advice that will assist with solving problems. Below are educational events that our employees have attended in the last quarter:

| EMPLOYEE | DATE | EVENT | LOCATION |
|---|---|---|---|
| **Anne Boris** *Client Services Specialist* | July 19 | **Schwab Solutions Training** | Boston, MA |
| **Natalie Rubel** *Client Services Specialist* | July 19 | **Schwab Solutions Training** | Boston, MA |
| **Tom Vautin** *Senior Financial Planner* | Aug. 8-10 | **NAEA Annual Conference** | Las Vegas, NV |
| **Dennis Wassung** *Portfolio Manager* | Aug. 9-10 | **Canaccord Global Growth Conference Meetings** | Boston, MA |
| **Tim Moore** *Portfolio Manager* | Aug. 9-10 | **Canaccord Global Growth Conference Meetings** | Boston, MA |
| **Tim Moore** *Portfolio Manager* | Sept.7-9 | **Deutsche Bank Global Emerging Markets Conference** | Boston, MA |
| **Dennis Wassung** *Portfolio Manager* | Sept.7-9 | **Morgan Stanley Global Health Care Conference & Merrill Lynch India Conference** | Boston, MA |
| **Sonia Ernst** *Principal, Manager of Operations and Trading* | Sept.12-14 | **Advent Conference** | Boston, MA |

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