CABOT MONEY MANAGEMENT, INC.

Quarterly Review

SECOND QUARTER 2011

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July 29, 2011

Dear Friends,

Cabot Team at Fenway Park

As we have just enjoyed another 4th of July, we are reminded of the principles that made our country one of great stature and wealth. There are many provisions of our founding constitution that combine to create a country which used to be governed "for and of and by the people." Today sadly, we have moved a far distance from our original government more than 200 years ago.

Today, government is influenced by many special interest groups that try to provide for far too many people in our country. Consequently, we are losing some of our independent spirit. Further, there is far too much money involved in politics today to really represent you or me. This problem has created a situation in which the freedoms that brought great prosperity and strength to our country are now being diluted by large entitlements and an unwieldy government bureaucracy. The most significant repercussion from this is that we are *losing some of our economic freedoms in the United States.* A large, untamable government has created many burdens for our economy that limit potential: **growing income and property taxes, a growing U.S. debt level of close to $15 trillion, war costs** as a result of being global police officers, and **new and growing healthcare and social security entitlements.** The bottom line is that we simply have too many financial obligations. The result is slower growth and potentially less entrepreneurship, innovation and creativity.

We believe wealth and power in the world continues to move from the west to the east. This is a powerful trend that is impacting markets significantly. **Today, we see the economies of China, India, Malaysia, Singapore and Brazil in the enviable position of having much less economic difficulties than of those in the developed economies of the U.S., U.K., and other European countries.** After several trips to Asia, most recently in May, I have observed many things about China, Malaysia, India, and Singapore. There are **low government tax rates and fiscal incentives** for investors to invest and grow capital. There are no real estate taxes in China, and there is only a small transfer tax upon purchase or sale. **There are also modest government regulatory burdens.** Regulations are building gradually, but they are not overly demanding in many areas of Asia. **Central bank policies of most of the emerging economies are fiscally sound** and are not destroying currency values. In fact, the conservative and fiscally sound policies of governments are acting to improve and build values of local currencies. **Strong government finances are building confidence** among outside investors that the current positive conditions will continue. **Large and growing foreign exchange reserves mean strength and power.** China now has over $3 trillion in Foreign Exchange Reserves, Brazil has $330 billion, and India has about $280 billion. This is a sharp contrast to the $49 billion for the United States. **Healthy attitudes toward debt** are refreshing. In China, ninety percent of automobile buyers are paying for their new cars with cash! Further, real estate debt is used sparingly by many and is a reflection of personal beliefs against debt. Chinese citizens save and then buy. This, frankly, is a refreshingly constructive situation.

We continue to believe we need a global equity focus to maximize our investment potential. Thank you for the honor of being stewards of your wealth and your family's financial future.

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

Cabot's Outlook

Robert T. Lutts,
President and
Chief Investment Officer

Many Positive Catalysts Ahead for United States

We are often quoted about our opinions on global investment opportunities in China, India, Malaysia and Singapore. And perhaps after reading the President's letter, you may think we do not invest much in the United States. However, nothing could be further from the truth. We have a great deal of equity money in the United States and still continue to find great opportunities amid the challenging economic conditions.

It seems like there is a steady flow of negative economic news: poor job numbers, weak retail sales, weak manufacturing, poor confidence data and more. So, why are stock markets advancing amid all of this negative news? Markets look ahead and are digesting the outlook for the economy in 12 months.

Here are just a few good things we see along with reasons we are confident that a generally long equity position is the right strategy today.

1. **Large cash balances on the sidelines will eventually be deployed into our economy and create demand for equities.** More than $2.7 Trillion in the United States is earning close to a zero rate of return on an absolute basis. In fact, this money is really earning a negative return after factoring in 3.00 percent inflation.

2. **Deferred capital spending** from corporations, government and the household sector should soon be released as confidence in the recovery slowly grows. Equipment, technology and software and healthcare spending are three areas which have experienced high levels of deferment.

3. **Merger and acquisition** activity is building across many sectors of the economy. Technology and telecom, energy, electric utilities and healthcare have all experienced acquisition activity. This is good news on the relative value of public equities. In fact, some of the acquirers have been private equity money.

4. **Productivity in this country is booming.** We have become accustomed to high productivity numbers as we experience the incredible benefits of the internet, great software and the incredible automation advances of integrating business and manufacturing activities into smart computers with valuable software. We are only just beginning to see large advances in this area. ***It is not fully appreciated, but the United States leads in innovation for the internet globally!*** Google, Facebook, LinkedIn, Twitter, Ancestry.com, Salesforce.com, Opentable.com and more are all U.S.-owned companies. We may have missed the boat on high-speed trains, but we did get on board the high-speed internet network.

5. **Earnings have been strong** and are likely to continue to build, although at a slightly slower pace. Additionally, ***corporate balance sheets are very healthy*** and have more cash than any other time in the past 30 years.

So, do not expect today's dismal economic news to help you identify good times to invest. You are simply looking in the rearview mirror. By our measure, the glass is far more than half full, and the equity market is in a fairly strong position. Keep an optimistic outlook and put your confidence in the ability of the American entrepreneur to adapt and adjust to the new norms.

Can Emerging Markets Shine Again?

There is no "bell ringing moment" to easily tell you when to buy or sell stocks. No emergency broadcast to evacuate. No figurehead stating that we have reached the low and to invest today ahead of an upcoming rally. Unlike sales at stores, we are not told in advance that the sale is being extended another week or that they are out of stock for popular items.

As we approach August, I have formed a more favorable long-term view on Emerging Markets. As such, I anticipate them to outperform Developed Markets over the next 12-18 months (on a total return basis including dividends) due to the following:

- Emerging Markets are poised to grow *twice as fast* in 2011 and 2012, compared to the US and Europe (GDP growth). Underlying growth is from the burgeoning middle class and also the population still flocking into cities for better standards of living (urbanization).
- Savings rates are very high in many of these countries (20-30% in India, China, Mexico) versus 1-8% in the US the past five years. Savings is an important source of investment and even consumption by the population, which in turn fuels economic growth.
- Emerging Markets are 30% of the global private consumption versus 18% two decades ago. Their larger, younger populations should spur more spending than in developed countries with bigger retired populations. Eighty-five percent of the world's population lives in emerging markets.
- Emerging Markets comprise 45% of Global GDP (at purchasing power parity) but only 20% of total global market capitalization. It is unlikely that there will ever be "full convergence" of Emerging Markets stock value to coincide with GDP percentage, but ample room to grow.
- Over the past 10 years, emerging markets stocks have outperformed developed markets (US, Europe, Japan, etc) by 13% annually.
- Fifty-five percent of global capital expenditures come from emerging markets (double that of a decade ago).
- Emerging countries are not weighed down by the housing problem that exists in the US.
- Productivity and trade among bordering nations continues to improve. Return on equity in emerging markets has been higher than developed markets for the past decade.

What are the Risks?

As we saw in 2008, emerging markets are not immune to global shocks and cannot fully decouple from consumption halts in the rest of the world. There are more risks in emerging markets than in developed ones. These risks include volatility in currencies, political instability and less predictable governments, lack of regulation, potential corruption, litigation and less accounting transparency.

Combating the rising inflation has been a top priority for countries like China and India. While there are still a few more rate hikes on the horizon, and investors are concerned about overheating growth, the majority of emerging markets now seem well positioned to continue their economic growth pace ahead of the US and Europe.

Their debt levels (debt/GDP) are much lower than that of the US and Eurozone. While recent policy tightening (raising interest rates to better control rising inflation and stricter bank lending constraints) in China, India and other countries has short-term dampening effects on growth, *it should lengthen the growth cycle over several more years.*

Valuations of emerging markets stocks today are attractive at 15% less than historically. Even growth prospects of emerging markets are becoming compelling again after 8 months of stock price underperformance (9% less performance than S&P 500).

Exposure to emerging markets improves diversification and allows access to the faster-growing countries. It also alleviates both deficit spending and heavy debt load concerns of the US and peripheral European countries.

Cabot's Outlook

Tim Moore, CFA®
Portfolio Manager

CABOT
SURVIVING EMOTIONAL INVESTMENT MISTAKES

For an excerpt from Tim's new white paper, "Surviving Emotional Investment Mistakes," see page 7.

Cabot's Outlook

Bill Larkin
Portfolio Manager

Cash Management Investments Generate Unseen Losses

Do you understand the impact of aggressive Fed easing and zero interest rates? How about negative real returns on your money market and other cash management investments? Not only are investors lining up to get zero, but also happy because they actually believe they are not losing money. These investors may not be aware that stable value doesn't necessarily mean you're preserving your wealth.

Understanding the *real return* of your investments is a fundamental when it comes to attempting to preserve your wealth. It's ensuring that the dollars you own today will be able to preserve their purchasing power in the future. This is an important logic that needs to be applied to your investments to protect your future standard of living. Allowing losses to accumulate transfers your wealth to the banks, individuals, countries or corporations you are lending to (bond issuers).

If you agree to receive 2% from a certificate of deposit or bond investment, and the inflation rate is 2%, you simply have a zero percent return in real terms and this doesn't take into consideration the tax consequences. This inflation adjustment is referred to as the real rate of return. The real return is the estimated annual return of your bond (yield) less the annual inflation rate. But, how do investors judge inflation or determine if it's eroding their wealth?

The Bureau of Labor Statistics (www.bls.gov/cpi/cpi_dr.htm) calculates the value of the Consumer Price Index so policy makers, individuals and investors can get a better indication of where inflation has been and likely trending. Inflation is the element that causes losses for either the *lender* (bond holder) or the *debtor* (bond issuer). To gain insight into this logic it's important to understand that the bond market has two primary parties: a buyer (the investor) and seller (the debtor).

The best example of this logic is your home's mortgage, which is your personal debt (debtor). If you hold a fixed-rate mortgage with a 7% rate, you, the debtor, are losing money relative to the owner of your loan (investor) who is benefiting. This is because you are servicing a loan rate that far exceeds the current market rate. According to Bankrate.com, the average 30-year fixed-rate mortgage is being offered at 4.5%. The reason for the 7% mortgage, leaving your credit situation out of this equation, is the loan was likely issued when inflation was considerably higher. An informed consumer would have refinanced to a lower rate.

The opposite is also true. If you refinanced your mortgage with a rate of 3.5% when interest rates were historically low, your loan is below the current market rates. This means you, the homeowner, (debtor) are benefiting while the lender (investor) or owner of your loan is losing. It's a simple equation, bond investors always want as much yield as they can get and borrowers (debtors) always want to pay back the lowest possible loan rate they can get. The determination of value is calculated by the current inflation rate, which has a direct impact on establishing a productive lending environment.

It's important to understand that changes in inflation represent a risk to both the lender (bond investor) and the borrower (debtor). The more unstable inflation becomes, the more difficult it is for the two parties to agree on a reasonable lending arrangement. This is the main reason investors spend so much time analyzing where inflation is likely to trend. They want to make sure they are protecting their wealth and entering into transactions that offer value. In today's market it's difficult to find value, and banks are reluctant to lose money, so the lending arrangement could be construed as disrupted, but they are very willing to offer you deposit rates well below the current inflation rate. This is an investment environment that deserves lots of caution for conservative investors seeking reasonable returns who wish to preserve their wealth.

Attention Small Business Owners: Are You are a Fiduciary?

Financial Planning

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

For business owners with a retirement plan in place for their employees, the answer to the question above is yes. In short, a fiduciary is any individual or entity that is involved in managing or administering an ERISA retirement plan (i.e., 401(k), 403(b), SEP, etc.). This could be the business owners themselves, the advisor on the plan that recommends the funds or the plan administrator that handles the recordkeeping and tax filing or any combination of the three. The question becomes, then, how does a small business satisfy their fiduciary obligations and insure that their plan stays compliant?

The Department of Labor defines the role of a fiduciary as someone who is in place to act solely in the interest of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them. This involves following the specifics in the plan document, prudently investing the plan assets, offering a diversified mix of investment options and making sure plan fees are reasonable. For a small business owner, these requirements may seem daunting. The business owners I work with are focused on running their business. Many are overwhelmed by the potential legal liability involved with establishing and running a plan. This is where professional help comes in handy.

Investment Advice

Instituting a retirement plan requires expertise in several areas. If the business owner lacks the knowledge (or time) to oversee something like the investment choices, for example, they may be shortchanging their employees by not offering a well-diversified menu of investment options. They have the duty to offer a mix of investments that allows each employee the option to allocate their funds to an aggressive or conservative mix, depending on their risk tolerance. It is important for the fiduciary to document their rationale for the investment options they choose, including the screening criteria they use.

An investment advisor can take this burden off the business owner by doing the work for them. The advisor can screen the universe of several thousand mutual funds and ETFs available and boil it down to a handful of investments appropriate for the plan participants. The advisor can then work with the employees to make sure they understand their options and help them determine which mix of investments is appropriate.

Plan Design and Administration

When it comes to a company-sponsored retirement plan, the two most important documents are the Summary Plan Description (SPD) and ongoing benefit statements for the employees. The SPD is distributed to the plan participants and basically tells the employees about the plan (i.e., eligibility, plan entry dates, vesting period, participant rights and responsibilities under ERISA). The benefit statements must be distributed to employees regularly and must clearly outline the participants' vested balance in the plan along with the balance in each of the investments they own.

Beginning in 2012, participants must be made aware of the fees associated with their plan options. Fees can no longer be buried in the investments and not disclosed. A competent Third Party Administrator (TPA) is equipped to handle the various requirements set forth by the Department of Labor and ERISA as it relates to plan reporting and record keeping, thereby taking the burden off the business owner.

Keeping a retirement plan compliant with the DOL and ERISA can be a challenge. Business owners today should consult an advisor or TPA for help with the various plan options available and form a partnership with these trusted professionals to craft and implement a plan that fits their needs. Not only will this take a significant load off their minds but they will also get help with their fiduciary obligations by bringing in professionals equipped to handle that responsibility.

Around Cabot

Mikki L. Wilson, Marketing Coordinator

SAVE THE DATE
for Cabot's Conference in September

Save-the-Date postcards for our upcoming conference have been mailed out. Clients should receive them within the next couple of weeks with our formal invitations to follow. If you would like more information or to register for our conference, please contact us at (800) 888-6468 or RSVP directly at (978) 619-6300.

GET CONNECTED!

Recently launched:
The "Investment Talk with Cabot Money Management" group on LinkedIn

We invite our clients, peers and colleagues to join the group and join the conversation about wealth management and a variety of other investment topics. This group is intended to be a resource for you to learn more about current wealth management issues, discuss business news of the day and ask the Cabot Team questions about investment topics.

At Cabot, we are constantly looking for new industries, emerging business trends and technologies to bring innovation to the investment strategies we employ on behalf of our clients. We frequently post content highlighting current and relevant investment topics, including stocks we're watching, emerging markets, and observations on the global economy.

Feel free to join the group, ask questions, engage with other members and share personal insight on current industry trends. Should you read an article, watch an interview or come across any other content you find relevant and interesting, please share it with the group.

To connect with Cabot on LinkedIn and join our group, visit:
www.linkedin.com/company/cabot-money-management

Cabot White Papers

CABOT
Surviving Emotional Investment Mistakes

- Surviving Emotional Investment Mistakes
- An Energy Revolution is Underway
- Demystifying Gold
- LEDs: Opportunity Could be Bright
- China's Internet: The World's Largest Internet Community

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www.eCabot.com

Surviving Emotional Investment Mistakes

by Tim Moore, CFA,® Portfolio Manager

"Emotional reactions and biases of investors can frequently create mispriced stocks. Mispricing either creates attractive buying opportunities or is worth avoiding ahead of price drops. Recognizing damaging biases and pitfalls is not as easy as it sounds. It is a daily challenge as different sets of circumstances and experiences trigger unique propensities within a person.

Inconsistencies in processing information, self-deception and raw emotions are all part of human nature, as are erroneous assumptions, biases, anxiety, fear, greed, excitement and despair. These, coupled with the inherent volatility of stock prices, spark our reflex reactions and fog us from an informed logical perspective. Hence, it is not easy to detect these mental tricks and biases."

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

Around Cabot

Cabot's 17th Annual Scholarship Winner

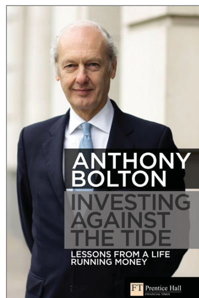
Congratulations to **Cameron Secorsky**, the proud recipient of the 2011 Cabot Money Management Scholarship Award. Rob Lutts presents this award annually to a Salem High School senior who displays an interest in finance and/or investing and has excelled during his or her high school career.

"He [Cameron] is a soft-spoken, unassuming young adult," says SHS teacher Carol Carr, who teaches the 10-week "Investing Your Money" class that Cameron was part of. He also took the U.S. Treasury Department Financial Literacy Challenge test in April and scored 98%. This is a test that is administered by the Treasury to promote financial literacy in schools (www.challenge.treas.gov/). Cameron will spend his summer working at Salem Library and Abercrombie & Fitch until he starts attending Boston University this fall.

Cabot has a strong commitment to education and the development of our youth. As a graduate of Salem High, Rob also embraces the idea of supporting the local public institution. By providing assistance to a deserving student, Cabot rewards a job well done and hopes to inspire the hard work and dedication it will take to succeed in the future.

Cabot's Reading Corner

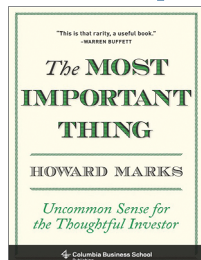
Tim Moore, CFA®, highly recommends these two books for more practical insights into investing.



Investing Against the Tide – Lessons from a Life of Running Money
Anthony Bolton
(Financial Times/Prentice Hall, 2009)

While the market is flooded with investment books offering few new insights, this publication uniquely focuses on the lessons and best practices applied over a 30-year career at Fidelity UK. All the important investment aspects of companies, management teams, valuations and sentiment are covered in this book. A concise sampling of the many anecdotes of money management.

The Most Important Thing



Howard Marks
(Columbia University Press , 2011)

I heard this author speak in February at the annual Columbia Business School Investment Management Conference. I have enjoyed reading his shareholder memos for years and found them both timely and insightful. This book synthesizes decades of Mark's time-tested approach, and covers important topics like risk awareness, less probable events and outcome versus reasoning. His extra emphasis on risk arising from multiple outcomes and "knock on" consequences of extreme events reminds us of overlooked investment pitfalls.

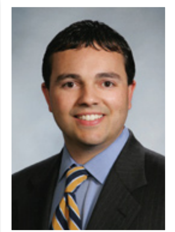
Around Cabot

Natalie Rubel Joins the Cabot Team

Natalie Rubel

Many of you may hear or have already heard a new voice when you call Cabot. For those who haven't met her already, we would like to introduce you to Natalie Rubel, the newest member of our Client Services team. Natalie works collaboratively with Cabot's financial counselors in order to deliver high quality service and provide guidance and solutions to fulfill clients' needs. She has a strong background in both client service and compliance within the financial services industry and is licensed with FINRA Series 7, 63, 9 and 1. Prior to joining Cabot, Natalie worked in Boston at Charles Schwab & Co., Inc. and LPL Financial. She is a graduate of Connecticut College with a bachelor of arts degree in Economics and a minor in Sociology. We feel that her experience will be of great value to the Cabot Team, and we encourage you to meet her personally at our upcoming conference in September.

Dennis Wassung Promoted to Portfolio Manager



Dennis Wassung, Jr., CFA®

We are very pleased to announce the recent promotion of Dennis Wassung, Jr. from Associate Portfolio Manager to Portfolio Manager in April. Dennis is responsible for managing growth equity portfolios, and co-manages Cabot's global growth equity strategy along with Rob Lutts. He focuses on identifying and researching those companies that are positioned to take advantage of growth opportunities throughout the globe, in both developed and emerging markets. With over a decade of equity research experience, Dennis has been a great addition to the Cabot Team since joining the firm in 2008.

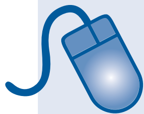
Find us under
Cabot Money Management

Mikki Wilson Appointed to Northeast Arc Board of Directors

We would like to congratulate Mikki Wilson, Cabot's marketing coordinator, on her appointment to Northeast Arc's Board of Directors. The Northeast Arc is a not-for-profit organization dedicated to providing lifelong support to people living with disabilities. The Northeast Arc Board of Directors is a group of volunteers who contribute their time and expertise to further the organization's mission.

"We are honored to have Mikki's marketing and client service savvy coupled with her incredible energy and enthusiasm to enhance the efforts of our Board of Directors," said Executive Director Jerry McCarthy. Spending a fair amount of her free time volunteering her marketing expertise to small business owners and non-profit organizations within her community, Mikki is looking forward in helping create and build awareness of the Northeast Arc's mission and the extensive services they provide to those with developmental disabilities.

You can now follow us
@cabotmoneymgmt
for our latest updates, articles, and media clips.



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