CABOT MONEY MANAGEMENT, INC.

QUARTERLY REVIEW

FIRST QUARTER 2011

IN THIS ISSUE

Cabot Money Management, Inc.
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April 29, 2011

Dear Friends,

As we monitor the global information on our Bloomberg machines, we are fed a daily dose of information on economies globally. We work to sift through this data to come up with longer-term themes we are confident will be profitable for your investment portfolio. Today, we believe the following:

I. **The U.S. economy and global economic landscape is currently in the midst of transitioning from lower to more moderate growth.** Low interest rates imposed by central bankers around the globe for more than two years are now having their intended impact and are creating more momentum in the economy. After hibernating for close to four years, corporate balance sheets are now flush with cash. As confidence in economic conditions builds, businesses globally are once again beginning to unleash growth with real capital investment. Since real capital investment has been deferred for such a long time, we anticipate it to build dramatically. We think this process will continue over the next few years.

Rob Lutts discusses what trends will drive the economy at the North Shore Business Expo. (March 2011)

II. **Investors, too, have been hibernating. Over the past two years, they moved hundreds of billions of funds into the perceived safety of bonds and other fixed-income investments.** We believe both individual investors and institutional investors have built large positions in their portfolios in two distinct areas: fixed income and hedge products that invest with lower levels of risk. Of course, lower risk also means lower returns. Today, we believe investors are unwinding these positions and reallocating to much more moderately priced equities. We believe growth stocks and value stocks today represent solid value, and we anticipate higher values over the coming years as hundreds of billions of dollars are reallocated into more normal equity weightings. Strong corporate profitability, healthy balance sheets, coupled with economic recovery position equities to perform well.

III. **Finally, we are observing a situation globally in most developed economies in which governments are struggling with large debt and budget problems. This situation has serious implication to values of currencies.** Today's focus is on Portugal, Ireland, Italy, Greece and Spain (the PIIGS). Each of these economies needs serious restructuring of debt to be able to remain viable. Sadly, not far behind these economies are both the United Kingdom and the United States and many other economies once thought to be economic titans. *It is evident today that it appears none of these governments has the fortitude to address their economic problems head on. Instead, the current plan for most of them is to take moderate steps to solve the immediate crisis by extending debt maturities and* ***"kicking the can (i.e. debt) down the road."*** Governments have decided to take the not-well-understood step of monetizing debt, printing money and, in effect, debasing (i.e. creating loss of value) their currency. We have concluded that currencies of these countries are now a major risk. We are protecting our portfolios with significant allocations to gold and precious metals. We believe institutional investors (who currently have virtually no gold or precious metals exposure) will soon understand these issues and act to protect portfolios as well.

IV. **There is much disagreement today about inflation.** Make no mistake about it – the debasement activity governments are undertaking will eventually create inflation. The unknown variable is how long it will take until inflation becomes more visible and priced into

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markets. We believe investors should position for the adjustment to higher levels of inflation now. Markets have a habit of discounting these events well ahead of the reality. We believe long-term bond investors (longer than 8-10 years) have a high level of risk today. We are positioning our fixed-income portfolios to be able to benefit from rising yields in the coming few years as we now hold shorter-maturity, higher-quality fixed-income investments.

Each of these situations above creates specific money flows which will move markets deliberately in the coming weeks and months. We are working diligently to position our portfolios in a manner to benefit from these long-term flows. We continue to invest in these three markets, which we have a high level of conviction in:

1. Emerging markets of China, India and Brazil
2. United States equities and select international equities
3. Gold and precious metals

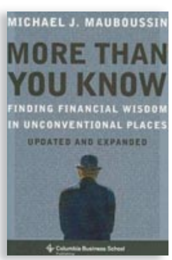
We believe the world is changing quickly, and we aim to help you and your family benefit from these changes. Thank you for the honor of being stewards of your wealth and your family's financial future.

Best Wishes.

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

CEO Reading Corner

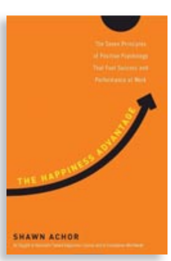
Rob Lutts highly recommends these books for new, fresh thinking about our world today.



More Than You Know – Finding Financial Wisdom in Unconventional Places

Michael J. Mauboussin, Chief Investment Strategists at Legg Mason 2008, Columbia Business School Publishing

Caution: This book is full of lots of great information on the financial markets, however, it is not for the casual investment reader. It is for the serious, hardcore market junkie. You'll find extremely well researched information, and you will discover valuable insights on Innovation, the S Curve, Creative Destruction and more. The author is clearly a scientist, as he likes to back up his theories with evidence. He has an excellent section on the Psychology of Investing with topics like "Let the Stress Begin," "Guppy Love," and "The Right Stuff."



The Happiness Advantage: The Seven Principles of Positive Psychology That Fuel Success and Performance at Work

Shawn Achor, 2010 Crown Publishing Group

We all want more of it. It is elusive and very difficult to quantify. It means different things to different people. If you are serious about the Happiness factor this book is a great start. I do not know of a single person on the planet who has too much of it. Yet, for many of us we simply do not know how to maximize our happiness. Shawn Achor is a master at analyzing the questions: "How do we achieve happiness?" and "Are happy people more successful?" He gives great practical advice on how to put more happiness into your life.

Big Ideas for Investing

Attending conferences and research trips helps reinforce our team's thinking and continues to grow our investment knowledge on many fronts. Here are some key takeaways from the Howard Weil and Co. energy conference I attended in New Orleans this past March.

1. The biggest development in energy is the breakthrough in **horizontal drilling technology.** Horizontal drilling has been used in natural gas exploration over the last decade, but has been increasingly optimized in the last couple of years for oil drilling and is now being rolled out across American and global resources. For investors in oil exploration, it means great opportunity to reach newly expanded reserves in shale formations. We believe this is very early in the development and expansion of these new resources. Some older resources have been revitalized and have been able to expand their expected reserve base more than twenty-fivefold. This is not a small development.

2. We believe the long-term picture for oil is strong and that oil prices will remain high and move higher in the coming year. The key reason for this is the expanded use of oil from the emerging economies. **Today more than 50% of global capital expenditure comes from the emerging markets. *This is up from about 25% ten years ago!*** Is it any surprise that these economies are starting to consume vast quantities of oil and other resources? We anticipate this trend will continue.

3. Andrew Gould, CEO of Schlumberger LTD (the world's largest energy services company) told us that by his estimates *our world needs to spend almost **$500 billion per year over the next ten years (close to $5 trillion) to find the resources** needed to replace our current consumption and plan for modest growth.* The greatest opportunities are in horizontal drilling, deep-water drilling and tools utilized to find resource in challenging places like deep water. I am fairly confident that this huge investment means one thing – higher energy prices. This will eventually lead us to implement changes in our energy use, but it will take time.

An Energy Revolution is Underway

New Cabot White Paper written by Dennis Wassung, Jr.

While there is much discussion about energy today, two things remain very clear: we continue to consume a great deal of energy resources, and this is very unlikely to change anytime soon. The fact still remains that traditional energy sources, such as oil and natural gas, are critical components and requirements for our way of life today – and it will take a long time to offset our traditional energy needs with other sources. Associate portfolio manager Dennis Wassung introduces his new white paper which focuses on the opportunity for traditional energy in North America.

Download this and other white papers from the Investment Management section of our website, www.eCabot.com/white_papers. You can also subscribe to other Cabot literature in order to receive future updates.

Cabot's Outlook

by Robert T. Lutts, President and Chief Investment Officer

Cabot White Papers

- An Energy Revolution is Underway
- OTT Video: That Movie Was Over the Top!
- Demystifying Gold
- LEDs: Opportunity Could be Bright
- China's Internet: The World's Largest Internet Community
- The Currency Crisis: Manage Your Investment Risk

You may also subscribe to our white paper updates by clicking on the

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button on the left side of our website's home page.
www.eCabot.com

Dennis Wassung, Jr., CFA
Associate Portfolio Manager

Conference Themes and Takeaways

The Cabot Portfolio Management team traveled to a number of investor conferences in the first quarter, enabling us to further research many of our top investment themes, and reinforce our viewpoint on many of our client holdings. I attended the Morgan Stanley Technology, Media & Telecommunications conference, the Canaccord Genuity Sustainability Conference, and the Credit Suisse Data & Networking Equipment Conference.

Morgan Stanley Technology, Media & Telecom Conference

Overall, the conference had a positive tone and most companies had a positive view on their businesses and the outlook for 2011. Not surprisingly, the **tablet computer (such as Apple's iPad)** and smartphone themes were the most bullish across the board, from the companies levered to the devices themselves, to the companies levered to the increasing demands on and complexities of the networks delivering the wireless data, to the companies with software or applications benefiting from the mobile transition.

Beyond the mobile driver, the **Internet** space is alive and well, benefiting from continued shift to online activities from traditional offline activities, the mobile internet acceleration, and the explosion of social media (like Facebook, Twitter, and LinkedIn). On the **media** side, technology is driving the theme as well, with the move to Over-the-Top (OTT) video and more interactive media. Netflix is the biggest beneficiary today, though there is a big push across the media industry in this segment.

Canaccord Genuity Sustainability Conference

A primary focus of the conference was the LED (light-emitting diode) industry and the **adoption of LED lighting.** The conference was a great opportunity to meet with senior management of some typically difficult to reach companies and/or executives focused on the lighting industry – such as **Nichia** (a leading private Japanese LED company), **Philips Electronics** (Lighting Group CEO), and the **China Solid State Lighting Alliance** (Chinese Government-based consortium focused on LED lighting). The key takeaway was that LED lighting is moving forward – as a now meaningful portion of the revenue of several of these companies comes from LED-based technology, and the percentage is growing quickly. China is clearly still focused on supporting the LED industry through a range of markets – including street lights, residential, industrial and commercial (hospitality, hotels, offices) adoption. In China, street lights today represent about 20-30% of total LED lighting. All in, the conference supported the notion that the broader LED and LED lighting segments – still early in a very large, decade-long transition – represent solid investment opportunities for the coming years.

Credit Suisse Data & Networking Equipment Conference

Next-generation networking infrastructure and wireless data continue to be important investment themes in the technology sector, and the Credit Suisse conference further bolstered the idea that these are major shifts and represent strong, long-term growth opportunities for investors. As consumers and enterprises use the Internet for an increasingly complex set of communications, multi-media, and other business/productivity applications, the need for higher capability, secure and flexible network infrastructure continues to grow. This sets the stage for investment opportunity across a range of equipment, software and services companies.

Crossing the Pond

It remains important to periodically meet the management of some companies, whether before purchasing their stock or as a current shareholder. Having the opportunity to interview them about trends in the industry, the evolving competitive landscape, their unique attributes or advantages, opportunities they envision emerging and any mounting threats is helpful in testing one's thesis on the stock. This opportunity in turn allows us to make more informed decisions of whether to buy a new stock, add to a current stake, or quickly exit the position if fundamentals are eroding or the stock valuation is too lofty for its prospects or expectations.

In late March, I spent a week in London speaking with CEOs and CFOs of 14 different companies across 10 distinct industries. Attending conferences fuels idea generation and thought-provoking updates on emerging themes across the world. For example, many companies I met with insisted that China is now their number-one focus country despite being only 4-8% of total revenues. A couple of years ago, many European companies said the U.S. was the number-one focus or that China was lower on the list because of low profit margins there, regulatory barriers and expensive start-up costs.

Another commonality of my meetings included management teams less concerned about revenue growth than they were ten months ago, but more concerned about operating margins. Several CEOs and CFOs noted that inflation has accelerated the past four months from higher energy costs and the need to reinvest back into marketing, innovation, capital expenditures for growth and employee salary raises after two years of "freezes." This could lead to margin contraction or less opportunity for expansion as 2011 unfolds despite more robust topline growth.

In April, the European Central Bank raised its interest rate for the first time in nearly three years to combat rising inflation as their top priority. Even consumer prices in the United Kingdom were +4.0% in March and +4.4% in February. The rate hike could also slowly incentivize saving again later. Yet, the U.S. is not expected to raise rates for the first time until late 2011 compared to other countries which already began (China, India, Australia and Canada).

Europe continues on the track of a "two-speed" recovery (peripheral anemic countries versus growing ones with low unemployment and manageable deficits). Unwavering complacency often eventually rears its ugly head. This has been the case with slowness of governmental austerity measures taken in the PIIGS (Portugal, Italy, Ireland, Greece, Spain) over the past 12 months. While the PIIGS only comprise 14% of the Eurozone's GDP, the cavalier attitude and pride of government officials in those countries forced a third bailout in the past year as Portugal needed support mid-April. The Euro currency at $1.45 today versus $1.29 early January (+12% recovery) demonstrates some progress on containing the PIIGS debt crisis, but also a general flight away from the depreciating US Dollar. Restructuring or haircuts to debt terms remain a possibility in the PIIGS. During the first quarter, Europe's stock markets corrected -7% from peak December as I anticipated in the last newsletter, which gave us attractive entry points into buying a few compelling European stocks.

Tim catches a great view of Westminster Abbey. Wasn't there some kind of big event there in April?

Investment Strategies

Tim Moore, CFA
Portfolio Manager

INVESTMENT STRATEGIES

William Larkin, Jr.
Portfolio Manager

Navigating the Changing Interest-Rate Environment

Changing *inflation expectations* have a powerful influence on the bond market. As investors become more concerned about rising future inflation, they tend to reduce their demand for interest-sensitive securities. This natural reaction causes an inverse relationship where long-term bond prices fall and bond yields rise as lenders demand more compensation for future inflation risks. This shift in inflation expectations is the first and primary market concern for the Federal Reserve because it impacts not only bonds but also institutions and individuals that depend on affordable financing. It's a dangerous balancing act between stable prices caused by stricter interest rate controls (raising interest rates) and being overly accommodative (keeping rates too low) causing prices to rise (inflation).

The second variable front and center in the bond market is *comprehension of a post-QE2 America*. The QE2 liquidity facility was designed by our central bank as an unconventional monetary tool to offset deflationary pressures caused by the credit crisis. Basically, the QE2 is a giant pool of money ($600 billion) that is deployed by the Federal Reserve at their discretion to buy bond securities in the open market. These transactions remove bonds from the market, decreasing supply and pushing the purchase proceeds into the banking system. This QE2 practice of buying bonds is forcing investors (savers) and banks (lenders) to seek higher-risk options that offer a more reasonable return. This means lenders across a broad spectrum are seeking higher-risk borrowers and this lending pushes capital into the economy. Recipients of this cheap capital hypothetically invest in new business ventures that historically create new employment opportunities. This is the one cause-and-effect variable that the Fed is patiently waiting to improve and an indicator of success or failure of their current polices.

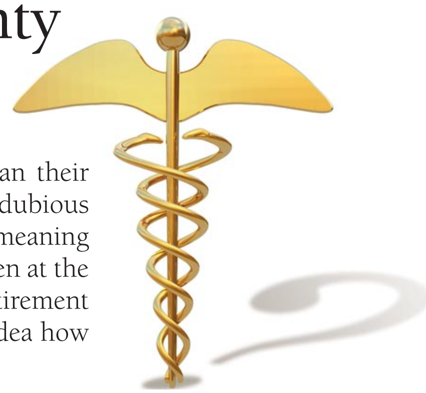
What does this mean for bond investors? It means careful consideration of the impact of higher inflation and making sure that bonds being purchased today in your portfolio have an adequate yield and reasonable time horizons. It means adapting a new approach towards managing risks, such as adding more diversified holdings. It means thinking outside the box and utilizing different approaches that better position a fixed-income portfolio for the coming changes. Listed below are three approaches best utilized to address the end of the QE2 and hedging against the risks of higher future inflation:

- **Short-term bonds –** The number one choice of all fixed-income options in an inflationary market is to own short-term bonds. They are the least impacted by rising inflation expectations because the period to maturity is short. They also benefit the investor by providing an option to hold until maturity. This almost always ensures that the investors will not lose money and provides an option to reinvest the bond's maturity into a high-yielding market. This investment option is better executed by buying actual bonds and not mutual funds that can be influenced by specific mandates and other shareholders' actions.

- **Bank Loan Securities –** These are bank loans usually secured by a company's physical assets (asset-backed) that adjust periodically to a short-term bond market index (e.g. 3-month LIBOR). This allows investors to be completely insulated from rising interest rates. As interest rates rise, so does the coupon paid on the underlying bank loans. These securities are best held within a mutual fund or exchange traded fund because bank loans can be difficult to transact.

- **International Government Inflation-Protected Bonds –** TIP securities (Treasury Inflation Protected) from foreign governments are better options to protect from rising inflation because the US measurement of inflation (CPI – Consumer Price Index) often underestimates rising prices and inflation is also more difficult and elevated outside the United States. This option is also best owned within either a mutual fund or ETF (Exchange-Traded Fund) because the bonds can be difficult to transact.

Coping with the Uncertainty of Health Care Planning



Retirees today can expect, on the whole, to live longer than their parents did. The first wave of "baby boomers" also has the dubious distinction of being part of the "sandwich generation," meaning many will be forced to care for their parents and their children at the same time. Unfortunately, many individuals approaching retirement have not planned properly for their own care and have no idea how expensive that care will be.

Even prior to the recent economic meltdown, the typical idealistic view of "retirement living" was becoming more and more difficult for many to reach. Longevity and health care costs growing at a rate far above that of inflation is making it impossible for programs like Social Security and Medicare to remain in their current form. The question, then, is how do we prepare for the uncertainty surrounding long-term care?

Assume the Worst When It Comes to Saving and Investing

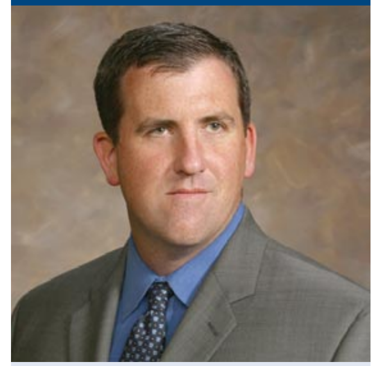
We've all heard the expression "underpromise, overdeliver." When calculating future cash flow needs and the savings needed to get there, take into account a conservative rate of growth and a higher-than-expected inflation rate. Base your assumptions in reality and prepare for uncertainty. Doing this exercise well before retirement and updating the analysis on a regular basis (typically each year) will help you gauge how much more you need to save now in order to retire comfortably. Stress-testing the portfolio to account for the randomness of the markets will give you a probability of success of meeting your goal, which is by no means a guarantee. It is used merely as a benchmark for future comparison.

The actual length of retirement continues to increase while the retirement savings landscape continues to change. The ironclad pensions of the past have been replaced by defined contribution plans requiring individuals to take responsibility for putting more of their own money away. Unfortunately, many plan participants don't spend nearly enough time researching investment options and learning about the markets. As a result, the median balance in 401(k) plans is only about $70,000, based on a study conducted by Hewitt and Associates in 2010. Furthermore, most employees save very little outside of their company-sponsored plan.

Consider Long-Term Care Insurance

According to a study conducted by the Center for Retirement Research at Boston College, experts estimate that 24% of today's 65-year-olds will need nursing home care for one year or longer at some point. With the average daily rate of nursing home care in Massachusetts approaching $300 ($109,000 per year), an extended stay can exhaust savings very quickly. Long-Term Care insurance can help lessen the blow. A quality product will provide a daily benefit, adjusted for inflation if desired, and will also pay for in-home nursing care.

The thought of planning for the expenses associated with long-term care can be daunting. The "perfect storm" of increasing life expectancy, health care costs rising at an alarming rate, and the uncertainty of the future benefits offered though the government entitlements of social security and Medicare make for a very unpredictable future. The focus for all individuals should be to plan early, save as much as possible, and manage the savings effectively. Work with a financial planner to discuss the benefits of using insurance to subsidize a portion of health care costs in the future. None of us knows when and how much care we'll need in the future. We do know, however, that the costs associated with long term care aren't going down! The sooner we prepare, the better.



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

> *"The market selloff in 2008-2009 made us all realize that nothing is certain when it comes to retirement savings."*

Around Cabot

Mikki L. Wilson,
Marketing Coordinator

Congratulations to the New Inductees of Salem State's Delta Mu Delta International Honor Society!

Earlier this month, I had the pleasure of attending the 36th Annual Delta Mu Delta Beta Sigma Chapter Induction Ceremony at Salem State University. As a Delta Mu Delta alumna and past president, it gave me even greater pleasure to be in the presence of three other past presidents who gave individual keynotes on how being part of the chapter shaped both their academic and professional careers. The underlying message: hard work brings its own rewards.

Each year, Cabot makes a contribution to support Delta Mu Delta's LaPorte and Murphy Scholarship awards, which are presented to two of the honor society's most deserving business students. Arthur LaPorte and William "Doc" Murphy were both long-term Salem State business faculty who helped start and develop the Delta Mu Delta chapter at (then) Salem State College. Both men were also instrumental, over a period of many years, in helping educate thousands of business majors.

Several members of Delta Mu Delta, including students, advisors and faculty, pose together after the traditional induction ceremony.

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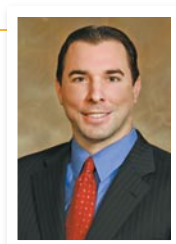
Tim Moore Promoted to Portfolio Manager



Tim Moore, CFA

We are very pleased to announce the promotion of Tim Moore from Research Analyst to Portfolio Manager in mid-February. Tim now oversees the Core Growth equities and alternative strategies. He joined the firm in November 2010 and is a great addition to the Cabot Team. Tim also brings over a decade of equity research experience to our firm.

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

Mark your Calendar for the Cabot Conference!

We will be hosting our **22nd Annual Investment Conference and Luncheon** on **Friday, September 23, 2011**, at the historic Hawthorne Hotel in downtown Salem, Massachusetts. Presentation themes will focus on and address current economic events and topics. Attendees have several opportunities to have their questions and concerns addressed directly by members of the Cabot Team.

We will begin sending Save-the-Date reminders to clients near the end of June.

For more information:
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