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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.

For those who were unable to join us, we will soon be offering the presentations on-line. You may also email us to receive a hard copy of our presentation handout at any time.

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Dear Friends,

Nothing much has changed since last quarter. The key focus by all seems to be the endless stream of horrifying data on housing foreclosures and weak, although gradually improving, economic statistics. Our country is in a deleveraging mode, and we will continue to endure this condition for the next 5-7 years. This will mean slower growth and a more difficult employment environment in the U.S.A. and around the rest of the globe.

Where do we find our reason for optimism? How can we look past the current set of problems to see a better economic performance? It is quite simply two concepts: **adaptability and change**. Americans do this better than any other civilization in our world today. We examine the new set of conditions that we operate under, and we figure out a way to make it work.

Here are a few observations that we believe are most important today:

- 1 Conservative fiscal thinking continues to spread like wildfire.** The November elections will likely help accelerate this change. States, cities, corporations are building up cash reserves and developing very conservative budgets. Corporate cash levels have never been higher. Further, some in Washington D.C. are talking about more conservative fiscal thinking. It is about time!
- 2 Investors continue to be defensive.** You should not join them. Many investors have boosted allocations to bonds and lower-risk ST bonds and money markets. Equity mutual fund flows are about negative \$70 billion YTD, while YTD flows into bond funds exceeded \$256 billion. This is an extraordinary level of caution. Many professional and retail investors have given up on stocks. This often means opportunity!
- 3 Growth in China, India and Brazil continues along a strong path at a fairly brisk pace.** I will be in Beijing and Tianjin, China, in early November. I am meeting with many companies and participating in an alternative energy tour. Business activity in Asia, especially China and India, continues at a brisk clip. We favor auto, retail, banking, travel, internet, and infrastructure companies. Chinese and Indian CEOs I met with in May during my trip to Singapore and Malaysia painted a very positive economic landscape with strong growth opportunities.

So, what do we believe the future may hold? Employment growth will lag, and confidence will gradually improve in time. **Time is the key.** Longer-term we are very bullish and believe that stocks will return substantially higher returns than bonds in the coming decade. We will continue to deleverage and governments around the globe will continue to work toward "reflating" assets. They are working diligently to create growth in assets that drive economic confidence. We believe they will succeed.

We will continue to remain flexible and opportunistic in our investment thinking. 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.



Rob Lutts and his translator during his last trip to China. (2009)



Les Satlow, CFA
Portfolio Manager

FACT FOR THE QUARTER

The balance sheets of the emerging economies' governments are very strong. Average government debt-to-GDP ratio in the emerging economies is about **20%**. This, of course, is low compared to the debt levels of the developed economies which average closer to **85-90%** (U.S., UK, Germany and France). Japan is the king of debt with **200%** debt to GDP.

Source: Bloomberg statistics

RISK: Do You Really Know It When You See It?

Risk:

with reference to fluctuating market values of securities and portfolios, risk means exposure to uncertainty, which is manifest as [volatility]

Barron's Dictionary of Finance and Investment Terms, 2006.

What is that ubiquitous concept of "risk"? Most investors can't quite put their finger on what it means, but they sure know it when they see it. Or at least they think they do.

From our perspective, there is risk in theory and risk in practice, and then there is the *perception* of risk. And it's not a surprise that the three do not necessarily intersect, often to the detriment of investors' long-term objectives.

The idea behind risk *in theory* and its role in growing wealth is simple: it's the level of volatility that is measured by standard deviation of returns. Both intuition and theory suggest that the more "wild the ride" you expect, the higher the expected return has to be to justify getting involved – hence the conventional wisdom of the risk/return tradeoff.

And then there is risk, and perception of risk, *in practice*: that's very easy to **define** – it's losing money – but exceptionally difficult to **measure** (until after the fact!). And just because a security or asset class has exhibited high risk (i.e. performed poorly) in the past, it doesn't mean that it will in the future!

Likewise, many investors continue to believe that ultrasafe bonds pose little or no "risk" in spite of the fact that in a recent survey only 21% of respondents even knew that when interest rates rise, bond prices actually *fall*. After all, they are nearly certain they will receive a predictable income stream and the eventual return of their principal (at least in the case of US Treasuries). And, above all, they know that bonds are less risky than stocks, right?

Not exactly: if "risk" is measured solely by the probability that you will not lose money on a nominal basis when your bonds mature, this is likely true. However, this entirely removes the concept of *return* from the discussion of risk, which is a dangerous disconnect. Remember, "risk-free" bonds are only free from *default* risk, not the risk that rates rise, bond prices fall, and inflation erodes purchasing power, damaging *real* returns.

In addition, as mentioned above, the *perception* of risk is badly tainted by investors' tendency to extrapolate the past. That is a diplomatic way of saying most people chase good performance (buy stocks in 1999-2000) and flee from bad performance (avoid stocks in 2009-2010): after all, boring 10-year Treasuries have nearly doubled in the last 10 years while stocks have gone nowhere.

Our point is that while longer-term conventional metrics of "risk" still apply, the next 10 years very likely are going to be quite different from the last 10 years, given the exaggerated movements in the capital markets. Put differently, the "risk" that what worked in the last decade will work less well in the coming decade is rising. And the conventional notion that higher volatility is synonymous with higher risk, while theoretically valid, is missing the big picture: the ability to grow wealth over the long haul requires greater flexibility, and the ability to assess risk both in theory and *in practice*. And this means challenging common perceptions in order to achieve uncommon success.

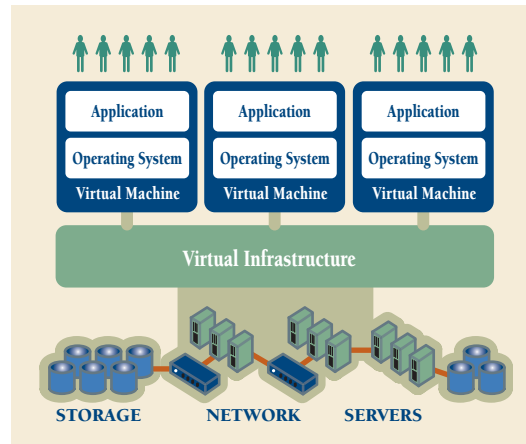
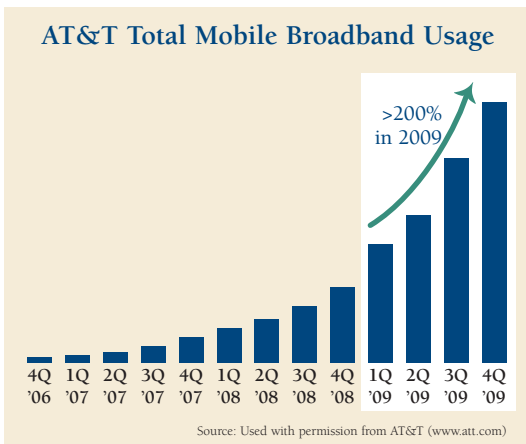


The “New” Internet

The Internet, as we came to know it in the mid-1990s, has continued to evolve and now offers an entirely new set of capabilities and applications. The Internet has developed into an expansive, intelligent infrastructure enabling productivity enhancements for businesses and consumers, as well as a seemingly ever-increasing set of applications. Effectively, the way people use the Internet today has changed dramatically from how they used it ten, five, or even two years ago. This evolution continues and sets the stage for a range of investment opportunities today and in the coming years. There are three primary themes and massive shifts underway today, that each play a major role in the evolution of this new Internet – the proliferation of **cloud computing**, the **mobile Internet** revolution, and **virtualization**.

“Cloud computing” is Internet-based computing: a user accesses data and applications that reside on the Internet – not on the user’s own computer. As the Internet evolves, more companies offer applications that run “in the cloud,” or on the Internet. This allows a consumer or an employee of a company to access applications and data from wherever they are, no matter which computer or access device they are using. Cloud computing opens a large opportunity for new business formation and many of the old leaders in the software industry are forced to adapt or potentially be surpassed by the “new” way of doing things.

It is pretty clear as you look around today that the Internet is now a mobile phenomenon. The Apple iPhone is perhaps the most impactful, clear example of this evolution – it has redefined how people use their mobile device. A growing list of new mobile devices – including smartphones, tablet computers (Apple’s iPad and others), and eReaders (like Amazon.com’s Kindle) – has given consumers access to a new mobile world. The mobile phenomenon drives exponential growth in the amounts of data transmitted across wireless networks. This thirst for mobile data provides numerous opportunities for suppliers of network infrastructure, and other technology required to enable this fast-growing market.



The virtualization of datacenters and servers is another key transition underway today. Historically, a server might be dedicated to a certain task, application, or location. Today, through the use of virtualization software, a small number of physical servers can effectively be turned into a much larger number of “virtual” servers – and these physical resources can be deployed much more efficiently. The result is a more flexible, intelligent, and capable network. To accomplish this feat, new software and hardware capabilities must be implemented throughout the network, representing growth opportunities for numerous suppliers.

The Internet is evolving, and the technology implemented to accomplish and further this evolution will continue to be in demand in the coming years. We anticipate that this will continue to be an important growth area and investment opportunity in the coming years.



Dennis Wassung, Jr., CFA
Associate Portfolio Manager



CABOT WHITE PAPERS

- The “New” Internet
- LEDs: Opportunity Could be Bright
- China’s Internet: The World’s Largest Internet Community
- The Currency Crisis: Manage Your Investment Risk
- China Healthcare: A Growing Market
- The Mobile Revolution

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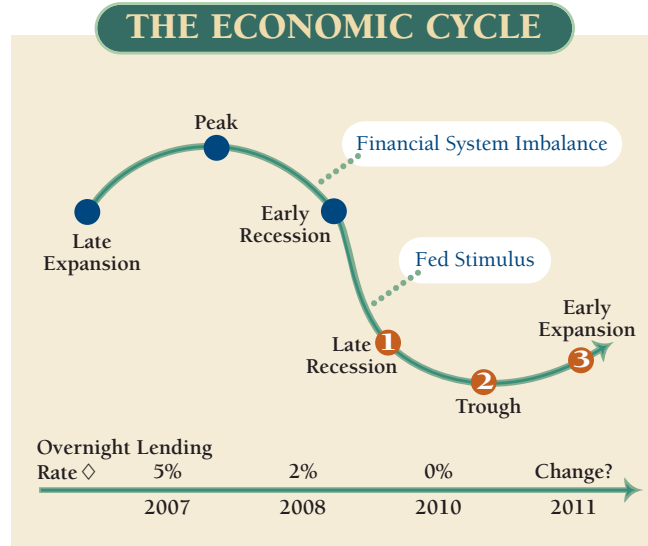
Cabot Money Management, Inc. recommends that individuals consult with their advisor, attorney, accountant, or other professional to determine their own particular situation. It is important to note that any performance reporting or implied performance is not indicative of future results. Investments are not insured and may lose value. Asset allocation and diversification does not protect against loss.



Bill Larkin, Jr.
Portfolio Manager

Late Recession, Trough, or Early Expansion?

Investors seeking opportunities in the bond market today are in a state of bewilderment, as quality institutions issue debt with yields at lows not experienced since the 1960s. The low-yielding environment and the immense demand for low-risk investment is frustrating conservative investors struggling to find fair and reasonable returns. The big question facing these investors now is: When will the US economy have enough strength to allow the Federal Reserve to start raising interest rates? Investment perspectives and outlooks are crafted based on where you believe the recovery resides on the economic cycle.



Referencing the above chart, those who believe we are currently in a **late recession phase (#1)** will require more economic stimulus from the Fed and a lot more patience from investors. An **economic trough phase (#2)** will also require additional economic stimulus but less patience on the timing of the recovery. An **early expansion phase (#3)** means the recovery is currently in play and signs of improvement should continue. In this third phase, bond investors need to be more cautious because the interest rate outlook is likely to change. This adjustment could startle unsuspecting bond investors that expect a prolonged period of stability.

Opinions on the economic cycle can be emotional and heated because it impacts what degree of influence you believe the Fed needs to apply to induce a healthy recovery. This debate continues to be driven by economic policy discussions, political posturing and social concerns.

ARGUMENT #1

Too little action means more economic pain and a continuation of more stimulus strategies that tend to be very expensive and add to our already disturbing debt burden. Failing to produce an economic recovery at this point in the economic cycle, considering the vast amount of economic resources already applied, will end up creating serious long-term consequences and, potentially, **deflation**.

ARGUMENT #2

Too much economic stimulus means a rise in inflation expectations and could threaten a healthy recovery. Free-market economists are becoming concerned that the government role is too large, too expensive, reduces America's competitiveness, and will likely cause a painful transition once the process ends and even a potential surge in **inflation**.

These are both valid concerns at this phase in the economic cycle and likely a product of improvements, not deterioration, in economic fundamentals. In the meantime, it may be wise to position your bond portfolio more defensively and keep your cash levels a little higher than normal until economic indicators give us a clearer gauge of tomorrow's investment environment. The economic backdrop that develops over the next twelve months will produce many surprises and challenges, and it's prudent at this stage in the economic cycle to be more flexible and opportunistic as developments unfold.

Cabot Money Management, Inc. recommends that individuals seek the advice of their advisor before considering any investment idea or making any investment decision resultant from information contained herein. All bonds, mutual funds and ETFs that utilize individual bonds are subject to availability, credit risk, interest rate risk and market risks. As with any investment, market value will fluctuate during the period held and, if sold prior to maturity, the price received may be more or less than the yield calculated at time of purchase and can cause an investor to realize a loss. Discretion with respect to suitability should be prudently exercised and fundamental research of the issuer's ability to maintain their financial obligations for the term of the bonds estimated life is strongly suggested.

Should I Consider a Roth Conversion?

Perhaps the most asked question recently (after “Where will the markets go from here?”) has been “Should I convert my IRA to a Roth?” Unfortunately, there is no simple answer. The viability of a Roth conversion varies with each individual investor’s financial situation. Before we get into the nuts and bolts, let’s take a step back and explain what a Roth conversion actually is.

Like a traditional IRA, a Roth IRA has some significant tax benefits for investors wanting to set aside money for retirement. When we invest money in a traditional IRA, the contributions may be tax deductible (if the account owner is not eligible for a 401(k) plan through their employer). After the contribution is made, the growth compounds on a tax-deferred basis. In other words, you don’t pay taxes on the growth until you withdraw money. If you were eligible for a tax deduction on the original contribution, that amount is also fully taxable when it is withdrawn.

A Roth IRA is a bit easier to describe. You don’t get a tax deduction on the contributions, but all the growth compounds tax free. When you make a “qualified” distribution, the money comes out totally tax free. The longer the money is left to grow, the larger the inherent tax benefit.

Investors have always been able to convert money from a Traditional IRA to a Roth, with one very large hurdle to overcome. Until 2010, individuals and married couples would only qualify for a conversion if their adjusted gross income was less than \$100,000. In 2010, there is no income limit and anyone with an IRA can convert to a Roth (as long as the conversion is completed by 12/31/2010).

So, why wouldn’t everyone convert their IRA to a Roth and take advantage of the tax-free growth? The answer is very simple: TAXES! Every dollar that moves from an IRA to a Roth is taxed as ordinary income. In other words, if a married couple has \$250,000 in earnings from their jobs and they convert a total of \$100,000 to a Roth, they must claim a total income of \$350,000 on their tax return. The tax impact makes the decision difficult.

Whether to convert to a Roth is made easier by answering the following questions:

What is my current effective tax rate?

This is a very important consideration. It is important to discuss the impact of a Roth conversion with your tax advisor to ensure that the benefit gained by converting to “tax-free” growth is not outweighed by the tax impact.

Should I expect to pay more or less taxes in the years to come?

It may make sense to consider a conversion if you expect to pay taxes at a higher rate in the future. Investors with a large IRA may be forced to take more than they need from their portfolio to simply satisfy the IRS-mandated required minimum distribution (RMD). This withdrawal would be taxed at the rates in place at the time. Converting to a Roth would decrease the amount of the IRA, thereby lowering the tax hit of the RMD.

Do I have the resources set aside to pay the taxes?

Having money available outside of your IRA to pay the tax means that the entire amount of your conversion can be invested right away. Those under 59½ would be subject to a 10% penalty on the amount set aside from the conversion to pay the tax. The IRS has given investors the option to claim 50% of the taxable income generated from the conversion in 2011 and the remaining 50% in 2012. Keep in mind that we don’t know where tax rates will be next year, but it’s a safe bet they’ll be higher than 2010.

Does converting offer me an estate planning opportunity?

Some of our clients intend to pass their IRA onto their children or grandchildren and don’t intend to touch the money. Converting to a Roth will allow the money to grow tax free for their beneficiaries and they can pay the tax out of their pocket, thereby lowering the value of their estate for tax planning purposes.

As you can see, converting to a Roth requires some thoughtful analysis and planning. At Cabot, we encourage our clients to use our resources to help them determine whether converting is in their best interest.

ESTATE PLANNING



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

It is important to note that income tax planning is unique for each taxpayer and the strategies above might not apply to your individual circumstances. We recommend consulting your personal tax advisor to review your portfolio in more detail if you have any questions.

AROUND CABOT

Michael Rose
Financial Counselor



Getting to Know the Cabot Team

MICHAEL ROSE has recently joined the Cabot team as a financial counselor and is responsible for working with Cabot clients to provide financial planning and investment advisory services, including the development of asset allocation and retirement planning strategies. Michael received both his undergraduate and graduate education at Bentley University in Waltham, where he received a Bachelor of Science in Finance, completed the coursework necessary to receive a Graduate Certificate in Financial Planning, and is presently pursuing a Master of Science in Taxation. Prior to joining Cabot, Michael interned at Jackson Financial Advisors where he was involved in financial planning for clients, and as a Research Analyst at IDC, where he covered the software market. Michael serves on the Board of Directors of the Financial Planning Association (FPA) of Massachusetts.



Kathy Mealey
Financial Counselor

KATHY MEALEY has also joined our team of financial counselors and is responsible for providing clients with financial planning and tax preparation support and working with the financial counseling team. She received her Bachelor of Arts degree in Economics from the University of Vermont. Kathy also pursued her Master's in Business from Lesley University in Cambridge, MA. She holds a Certificate in Financial Planning from Boston University and is a member of the Financial Planning Association of Massachusetts. She also recently passed the Series 65 Exam. Before joining Cabot, Kathy worked for Optimum Growth Advisors, LLC, an investment management firm with offices located in Massachusetts and New York.



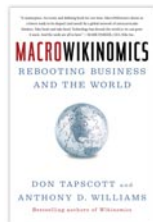
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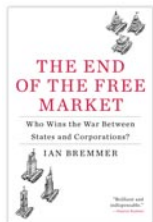
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CEO Reading Corner

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



MacroWikinomics | Don Tapscott & Anthony Williams, Portfolio/Penguin 2010
A great book on the collaborative nature of the internet and its implications. The book explores the ways in which companies may grow their businesses with the help of the internet. As investors, we need to understand the incredible productivity gained from the internet. The authors have an academic and consulting background and this means their book contains some "pie-in-the-sky thinking" – but still very worthwhile and has some good insights.



The End of the Free Markets: Who Wins the War Between States and Corporations? | Ian Bremmer, Portfolio/Penguin 2010
For a tried and true capitalist, this is a difficult book to buy. The end of free markets is inconceivable in my world. Nevertheless, I bought the book and am glad I did. I now have a bit better understanding of how the Chinese, Brazilian, Mexican, Indonesian and Russian governments think about capitalism and how they will use the free markets and manage them to reach their desired goals. Investors need to fully understand that governments use capitalism like they would any other tool, and they have limitations and methods by which they achieve what they are looking for.

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