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January 26, 2009

Dear Friends,

The year 2008 will not soon be forgotten. It will be remembered for the troubles created in so many parts of our economy. Banking, mortgages, retail, energy, industrial sectors, and many more, deteriorated significantly in late 2008. It will also be remembered for the extraordinary measures taken by our government to save our banks and financial institutions. We do need to remember that economic cycles are a natural part of free economies, and our job as wealth managers is to try to be on the right side of these cycles.

How do we evaluate 2008? Very likely, it will be remembered as a year that severely damaged the concept of buy and hold. Those investors who utilized some discipline, raised cash and took advantage of the limited opportunities to take some gains helped minimize the carnage. Unfortunately, many investors went along for the ride while holding onto the cold comfort that things may get better someday. This environment calls for nimbleness, not numbness, to reality.

As with all problems, there is another side of the equation. Each problem in this financial crisis will create some unique investment opportunities. Given the current valuations and the cumulative effect of federal actions, 2009 may offer us some exceptional investment opportunities. Already, there are some bright spots. The areas of convertible bonds, preferred stocks, bank notes, and the high yield market all have varying levels of attractiveness. In fact, many segments of the fixed income market look poised to provide a better value proposition than some equity sectors. As always, it will be the appropriate combination of the two that best satisfies investors' needs.

Despite our guarded optimism, we do believe that we will need to be careful in 2009 as the economic system is now in the midst of repair. Economic conditions will be fragile over the next several months. Where there is fear and uncertainty, there is always opportunity. We will try and work to uncover some of those opportunities for you. Thank you for allowing us to be the stewards of your wealth and your family's financial future.

Warm regards,



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



Rob Lutts has dinner with colleagues on his most recent trip to China in 2008.

“Chaos in the world brings uneasiness, but it also allows the opportunity for creativity and growth.”

~ Tom Barrett



by Robert T. Lutts,
President and
Chief Investment Officer

Top Five Lessons of 2008

2008 has provided us many lessons in managing financial matters. Here are just a few that rise to the top as we think about the events and results of 2008.

- 1 Asset Allocation is an important factor in investment success.** Those investors who had a well-thought-out and appropriate allocation were better able to avoid knee-jerk reactions to the market. Furthermore, having developed a strategy before the market troubles, many were able to revisit their strategy and assess if they needed to make changes based on the current financial crisis.
- 2 Debt** is problematic when used improperly. Financial firms led by the banking system, the housing sector, and the federal government are three parts of our economy that overused debt and are now in deep trouble. Debt should be used cautiously.
- 3 All Industries are cyclical.** Never forget this. A perfect example in 2008 was the roller coaster ride experienced in the energy markets. Buy-and-hold investors will do very poorly in markets where a cyclical downturn is severe. **Cash is king** during some of these periods.
- 4 Do not think you know what High or Low is in changing market cycles.** These are variable conditions that change in market cycles. Let trends, favorable and unfavorable, work themselves out.
- 5 Globalization has created one very connected financial community.** Past cycles touted the diversification benefits of international investing. In the 2008 cycle this diversification never materialized – all markets were connected.

A further lesson involves the *willingness to accept change*. It is critical in managing assets to be open to a new environment and understand that economic cycles can change dramatically in a very short period of time. To be fixed in our investment thinking and not open to change can be disastrous to one's financial wealth.



It may be a funny comic, but when we consider the hard truth about the financial management of our country's affairs in Washington, the Social Security system is really in trouble and needs serious reform. Does anyone believe that we will see social security reform in our lifetime?



Charting a Course for 2009

Brooks Atkinson, the battle-scarred *New York Times* reporter, wrote about the concept of New Year, “Drop the last year into the silent limbo of the past. Let it go, for it was imperfect, and thank God that it can go.”

We couldn't have said it better. Mercifully, 2008 is now over and we can look forward to the trials, tribulations, and opportunities of 2009. Most observers, naturally, will see more trials and tribulations than opportunities: after all, last year saw global equity and commodity markets lurching through uncharted waters in a panicked search for safety.

Unfortunately, the first week of 2009 brings with it just about all of the same problems that we had the last week of 2008. Still, with the markets regaining some calm relative to November's volatility crescendo, it's time to take sober stock of what to look for in 2009 for signs of emerging stability.

CABOT'S OUTLOOK



Les Satlow, CFA
Portfolio Manager

Here are a few navigation markers to keep an eye out for:

Housing Prices Stop Falling

Since peaking in June 2006, housing prices have dropped every single month, according to the Case-Shiller Index. Never fear: there *will* be a time that this index actually posts an increase, and there is likely to be a bout of panic buying on the publication of that data point. While one point does not a trend make, it will be an important trend-breaking event.

Banks Plug the Balance Sheet Holes

US banks have been hit with the one-two punch of bad securities on the books (join the rest of us) as well as the credit quality of their customers going south fast. This credit quality deterioration is quite normal, as underwriting standards always go in cycles, but the severity of this cycle likely will not be “normal”. We will be looking for initial signs that loan quality is nearing a bottom and that banks have adequately replenished their capital and can resume lending again.

The Return of Inflation

It may not seem intuitive, but the return of inflation is one of the most important elements of a long-term

recovery for the US economy. Deflation, or a decline in prices, is considered a real killer, as it deters buyers (if you thought that a house was going to come down in price tomorrow, why would you buy today?). The government's efforts to pump money into the system are intended to reignite inflation by letting more money chase the same amount of goods. While the longer-term impact of this policy may lead to uncomfortably high *inflation*, it's generally fair to say that prolonged deflation should be avoided at nearly all costs.

Credit Markets Will Normalize

The hysterical flight to so-called quality—money market funds and Treasuries—has left many other credits at the altar. High yield, convertible, lower quality bank loans were virtually abandoned, and spreads blew out while the lucky US government was able to borrow for 30 years at just over 3%: now that's an attractive mortgage! Make no mistake, though: this will reverse course at some point, and investors will tire of these yields when they can receive double that in blue chip stocks or even high quality debt in some cases.

Finally, a word on these “signs”: they won't arrive at our doorstep with a bow on them. In fact, the economic indicators that we discuss above are actually *trailing* indicators, and we may see the markets move up with no indication that any of these are showing signs of improvement. The market speaks a language in which nobody is fluent.

2009 will be a year of piecing together the clues we are given, and positioning our portfolios to take advantage of various dislocations in the market that present opportunity for the patient and risk-tolerant investor. It will probably be a very choppy year, and it hopefully will mark the end of this recession.

Municipal Bonds: Trouble or Opportunity?



*Bill Larkin
Portfolio Manager*

Veteran market participants are scratching their heads as they attempt to establish new guidelines to determine fair value for beaten-down municipal bonds. Bond yields have risen to levels out of line with historical normal valuation and offer considerable value over high-grade corporate debt. To gain a better perspective of the market, let's review four events that caused the municipal market to drastically selloff.

1 CREDIT-RISK CONCERNS

The municipal bond market enjoyed triple-A credit support from third-party insurance companies that for a small fee guaranteed the municipality from the risks of defaulting on interest and principal payments. Unfortunately, these insurance firms also delved into the mortgage mess and destroyed their market credibility.

2 LIQUIDITY RISKS

Municipal bonds have historically been less liquid than Treasury securities, US agencies debt and corporate bonds. This lack of market liquidity associated with limited daily trading volumes was aggravated by the credit market shock that caused a deluge of risk-averse investors to sell positions into a thinly traded market.

3 INVESTOR PSYCHOLOGY

Municipal securities tend to be held by investors who are primarily concerned with wealth preservation and tax avoidance. These conservative investors were easily spooked by the abrupt change in market conditions generated by a void of buying interest and a cascade of selling.

4 MARKET RISK

The failure of the auction-rate securities market accompanied by the September market plunge sent a large majority of the tax-free, closed-end mutual funds to simultaneously fall 40% over a thirty-day period of time. These funds are required to maintain specific leverage ratios and were forced to sell substantial holdings of municipal bonds into an illiquid market.

It was once believed that the political linkage between the local and central government entities was fastened together with the highest intentions and the outmost credibility. But, like so many other aspects of the American economy, municipalities are being questioned for their ability to endure the current economic climate. This fear is overblown, especially if you believe that municipalities are the foundation of the American political system.



Municipalities were constructed to last in perpetuity, controlled by elected representatives, with the intention of servicing their specific stakeholders. General obligation bonds in particular are issued from municipalities that have the ability to raise fees, collect taxes and levy fines. The secret of discovering value in this market is to stick with issuers that have this power and look like viable entities going forward. General obligation bonds offer a compelling value especially when considering the limited historical risk associated with this asset class. Economic assumption shouldn't be made from historical data that may be irrelevant in current times, but can help guide where the true opportunities exist in today's municipal bond market considering the heavy premium risk-averse investments now command.

WHEN GOOD INTENTIONS YIELD BAD RESULTS:

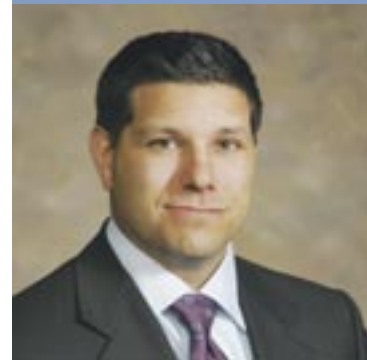
How Trustees of Trusts and Endowments can Protect Themselves from Fiduciary Liability

Individuals offer to serve as trustees or directors on boards for any number of reasons. Many do it to serve family commitments or to give back to the community. Others see it as an opportunity to network and further their full-time careers. Regardless of the motivation, anyone serving as a trustee of a private trust or on the finance board of an endowment or charity must take important steps to ensure that their actions will not lead to liability for breaching a fiduciary duty. In addition to the steps outlined below, individuals should also consult with their attorney to determine if fiduciary liability insurance is warranted.

Protecting the Assets

As the Madoff scandal has shown, even the “smartest” investment professionals can be swindled when they do not take steps to protect themselves and the assets they supervise. The crucial first step is to make sure that the assets are held by **an independent custodian**. This will always allow the trustee independent verification of the value of the assets they oversee and provide protection from misappropriation by the advisor. It is important to remember that as a fiduciary it is your responsibility to:

ESTATE PLANNING



*Michael C. Kozak, Esq.
Director of Wealth
Management*

1. **Keep Good Records**

Trustees should always document everything they do. Good documentation provides a contemporaneous record of the investment decisions that they made. In general, trustees have a fiduciary duty to act prudently in how they manage and oversee funds. It is easier to defend yourself if you have a document showing how the actions you took were prudent at the time you took them. Remember, no one is asking you to be clairvoyant. Therefore, being able to back up your decisions based on the information available at that time is important.

Since many trustees choose to utilize advisors to make the day-to-day decisions, it is important to keep records of communications and also good practice to type up a quarterly memorandum documenting your own periodic review of the investments. These are important because trustees cannot be passive passengers in the investment process. Rather, they must consistently take the wheel and steer the ship as they alone are often accountable for both the positives and negatives of their decisions.

2. **Use an Investment Policy Statement**

One of the most important records for any fiduciary is the Investment Policy Statement. This document is used to outline the process for managing the funds. A good investment policy statement should show:

- Who is managing the assets,
- The tax constraints for the portfolio,
- Income or distribution needs,
- How investments should be selected, and
- What the overall allocation should be.

In addition, the Investment Policy Statement should outline when investments will be reviewed and against which benchmarks they will be compared. I also think it is useful to set some restrictions on fees and type of investments. For example, many Investment Policy Statements can set a cap on using back-end loaded funds or commissioned products. This is important if you are utilizing a broker as opposed to a fee-only advisor.

3. **Use a Prudent Management Strategy**

All the records in the world won't help if they simply document a faulty and imprudent strategy. The key to any strategy is to diversify. While diversification cannot eliminate the possibility of losses, it can reduce volatility and enhance the predictability that is so important for endowments and some beneficiaries who rely on trust income to meet their daily expenses. In addition, you should always utilize some prudent disciplines, such as trimming losses and keeping positions to reasonable percentages of the overall portfolio.

Conclusion

There is no magic to avoiding liability when serving in a fiduciary capacity. By applying diligent professionalism, you can insure that you not only have taken steps to avoid a cause of action but also have the documentation needed to protect yourself if one is raised. While some are capable of meeting this challenge, others should seek out professional help to avoid having what should have been a moment of giving back to the community become a potential negative to their own personal finances.

AROUND CABOT

Florida Financial Conference Recap

Cabot recently held its annual Florida Financial Conference at the Naples Grande Resort & Beach Club. Clients and guests were invited to attend presentations that included a tax regulatory update, a review of events occurring in 2008 as well as possible opportunities in 2009 stemming from these events. The keynote presentation given by Rob Lutts focused on “Embracing Change and Overcoming Challenges,” a very important theme during these difficult times.

If you would like to download a copy of one or all of these presentations, please visit our new website and go to our **Company News** page. If you prefer a hard copy to be mailed, contact us at (800) 888-6468.

*Plan for 2009
Mark your calendar!*

**Cabot's Investment
Conference & Luncheon
Salem, MA**

*Friday, September 25, 2009
~ At the historic ~
Hawthorne Hotel*

www.eCabot.com



eCabot.com Gets a Facelift!

In an effort to better serve our clients, we have redesigned the Cabot Money Management company website. The newly redesigned site provides online visitors with remarkable improvements in navigation and appearance as well as informative web content that is delivered in a clearer, more organized fashion.



Our new site was developed based on feedback since the last redesign launched in 2003 and has been rebuilt from the ground up, in an effort to remain consistent with today's Internet technology. In addition to enhanced technology, the website is intended to be more user friendly; therefore, a simpler navigation system was crucial for our content-rich website. We feel visitors should be able to find what they are looking for without having to navigate through numerous pages.

More additions to the website can be expected over the coming months, but please feel free to click through and let us know your thoughts.

Our Commitment to Service



Michael Kozak, our Director of Wealth Management, recently attended the *43rd Annual Heckerling Institute on Estate Planning* held in Orlando, FL, in mid-January before heading off to our own conference. The Heckerling Institute on Estate Planning is the nation's leading conference for estate planning professionals and is designed to meet the education needs of sophisticated attorneys, trust officers, accountants, insurance advisors, and wealth management professionals. This year's series of programs addressed planning issues and opportunities presented by recent economic developments, changing demographics and the prospect for wealth transfer tax legislation in 2009.



Equity analyst **Dennis Wassung** attended *JP Morgan's 27th Annual Healthcare Conference* held in San Francisco, CA, in mid-January. More than 300 companies, both public and private, delivered presentations to more than 3,500 investors during this event which is tailored to bring together established industry leaders, emerging fast-growth companies, innovative technology creators and globally minded service providers.

Log on to www.eCabot.com for our latest articles, interviews and reports. Email info@eCabot.com if you would like to receive Cabot updates.



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