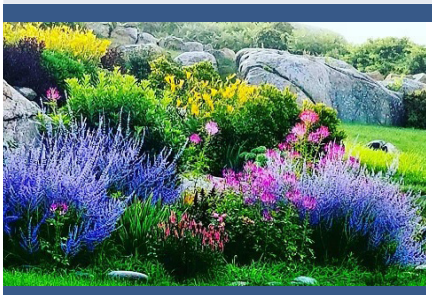
Cabot Quarterly Review

WEALTH MANAGEMENT

1ST QUARTER | 2020



IN THIS ISSUE

216 Essex Street | Salem, MA
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Dear Friends,

Not one economist or analyst in America forecast that the United States would intentionally shut down a very large part of our economy for close to 3 months this year. Yet, that is exactly what we are in the middle of – a full-blown, intentional "time out" for our economy. We, like many, believe this will likely not extend much beyond 2-3 months. Thus, it is likely government officials will, in all likelihood, be able to reopen our economy again in the not-too-distant future.

First, we hope that you and your family are safe and remain healthy. Please do follow all protocols to reduce the possible spread of Covid-19. The Cabot team is managing well. We, like many of you, have transformed to a mostly work-from-home remote model. Fortunately, we have a very capable manager of our technology (Sonia Ernst) who has properly prepared us to be ready to work remotely on our computers, laptops and phones. Further, like most of you, we are conducting Zoom meetings and phone conference calls on a regular basis. We can and are handling all normal service issues from our remote locations. If you need any help, please reach out to the Cabot team for assistance.

What are our thoughts on the economy and markets? Wow – where to start? After much consideration, the way we are looking at this is really a **temporary time-out for the economy.** We have never seen this type of behavior before; however, we do know what is coming. An **intentional economic recession** for a very short period. We will have a sharp drop in economic GDP in 2020 along with the bottom dropping out of earnings for many companies. It is still quite uncertain, but many economists believe our real GDP will drop dramatically (as much as -5.0%) for 2020 as companies adhere to the shutdown and keep staff social distancing. Then it is expected by many that GDP will ramp up again to the +5.0% percent level or more in 2021. There is a very wide range of forecasts, so not much consensus on the timing of the shutdown for now. We do expect that by mid-April we will have a much clearer view of when we will return to "normal".

As investors, we will not sell our well-researched investment positions at price levels which we believe are temporarily depressed. As we recently reviewed our holdings, we reaffirmed our belief in the longer-term earnings power of each company. Thus, we will choose to evaluate them on the earnings power of the full year 2021, not the 2nd quarter of 2020 during our temporary shutdown. We could endure further declines in portfolio values; however, we do believe once we can see the restart to our economy, prices and values will rebound sharply.

Thanks for your continued confidence. We are honored to watch over and help you manage your family's wealth.

Sincerely,

Robert T. Lutts
President, Chief Investment Officer

Craig Goryl, CFA
Portfolio Manager

Quality Businesses Have a Chance to Shine

Over the past several years I've used a lot of ink writing in these pages about the "high-quality" companies. What I like most about quality businesses is their resilience in the face of shocks like the Covid-19 crisis we face now. Just as in prior downturns, some companies will limp out of this crisis, others will gallop.

In the Q1 selloff, the market did not distinguish much between high and low quality. Everything got sold. But here are some of the characteristics that I think are particularly valuable in the tough times we face:

A Strong Balance Sheet. For companies, just like individuals, too much debt can be a killer. First, interest payments on debt represent a fixed cost: it stays high no matter how much sales crater. Secondly, companies with too much debt don't have the opportunity to borrow more to get them through a rough patch like the one we're in. Some companies spent billions of dollars- much of it borrowed- repurchasing their stock over the past few years. Today some of those same companies are desperate for cash to get them through the shutdowns. Other companies that have been prudent, now see an opportunity: **Chemed (CHE)** is one of our long-term holdings; it has a resilient business and conserved its capital wisely in recent years. Chemed announced a new buyback on March 13 to take advantage of their low stock price. Meanwhile, most companies were ceasing their buybacks, just as prices were down! Another example is **Berkshire Hathaway (BRK.B)**, which has been sitting on $100 BILLION of cash, for want of good places to put it. We can be assured that Berkshire's management team, including famed investor Warren Buffet, didn't lose a minute of sleep worrying about debt payments. Instead, they are looking for bargains.

A Wide Moat is what keeps competitors at bay. It is much easier for upstart competitors to gain traction in a strong economy with easy borrowing, than when the economy is in a downturn. Many of the stocks we hold are directly negatively affected by Covid-19 shutdowns: **Disney's (DIS)** theme parks, **Sysco's (SYY)** restaurant customers, **TJX Company's (TJX)** apparel stores are closed. But these stalwarts have assets that can't easily be replicated or replaced. They will see weaker competitors fall away and will emerge from the shutdowns in an even stronger competitive position than before. It won't be easy, and the timing is not predictable, but shareholders will be rewarded for holding on.

Today there are many excellent, high-quality companies on sale. Unfortunately, we already owned some before the sale started! We maintain our confidence in these leaders, and we are finding new ones, too. Their resilience, and our patience, will pay off in the long run.

ASSET CLASS UPDATE (continued on page 3)

INDEX	1ST QTR Return	1 YEAR Return	3Y ANN Return	5Y ANN Return	DESCRIPTION (What does this Index represent?)
US EQUITIES					
Dow Jones Industrial Average	-22.7%	-13.4%	4.4%	6.8%	US Large Cap Stocks (30 select large US corporations)
S&P 500 Index	-19.6%	-7.0%	5.1%	6.7%	US Large Cap Stocks (Largest 500)
Russell 1000 Index	-20.2%	-8.0%	4.6%	6.2%	US Large Cap Stocks (Largest 1000)
Russell 2000 Index	-30.6%	-24.0%	-4.7%	-0.3%	US Small Cap Stocks (2000 small public companies)
GLOBAL EQUITIES					
MSCI All Country World Index	-21.4%	-11.3%	1.5%	2.8%	Combination of major global markets: United States, Foreign Developed, and Emerging Markets
MSCI EAFE (Europe, Australia, Far East)	-22.8%	-14.4%	-1.8%	-0.6%	Large and mid-sized companies in mature foreign markets like Japan, Europe, Australia, etc.
MSCI Emerging Markets	-23.6%	-17.7%	-1.6%	-0.4%	Large and mid-sized companies in developing economies like China, India, Brazil, Russia, South Africa, etc.
MSCI Frontier Markets	-26.6%	-19.0%	-4.3%	-2.9%	Large and mid-sized companies in the world's least advanced economies like Kuwait, Argentina, Kenya, etc.

What Low Interest Rates Mean for Investors

Pat Creahan
Portfolio Manager

In the wake of the 2008 financial crisis, strong actions were warranted by the Central Bank and US government. One of these actions was a swift drop of the Federal Funds rate to 0%. This FOMC (Federal Open Market Committee) target rate ran for close to six years as the global economy and financial system restored its strength. After a timid rate-hiking cycle and a new once-in-a-lifetime event, we now find ourselves back at the 0% target. What does this mean for the economy and investors?

While the Fed was certainly wise to lower interest rates in response to the COVID-19 outbreak, the rate cut had minimal effect. First, interest rates were already low. Given the deteriorating credit quality of companies and individuals, borrowing costs have actually increased. The additional compensation required to lend in a time of crisis outweighs the 1.5% cut the Fed had to offer. Another limitation to lower interest rates is that no level of interest rates, even 0%, will spur demand for goods and services as long as citizens are under quarantine. The combination of these factors requires the economy to repay significant liabilities with little flexibility to refinance debt obligations at lower rates.

Assuming the US does not venture into the unknown territory of negative interest rates, the Fed has already exhausted one of its primary tools to manipulate the economy. As a result, the Central Bank has now engaged in large-scale asset purchases that include treasuries, mortgage-backed securities, corporate debt, and short-term municipal debt. This program injects money into the economy and keeps interest rates low across all maturities. As long as the FED continues to expand its balance sheet, expect interest rates for both short- and long-term debt to stay firmly lower. These monetary and fiscal efforts rival the deficit financing of World War II with estimates of a deficit north of 20% of GDP. While such an effort can weigh on the economy, an intelligent balance of taxes, borrowing, and money printing can smooth the recovery through the next economic expansion. We view this economic event as a temporary and intentional response to the COVID-19 outbreak. With no structural damage to the US economy, a strong economic rebound can quickly offset much of the damage incurred over this time.

What do these persistently low rates mean for fixed-income investors? With government rates (the risk-free rate) at such low levels, returns have become increasingly dependent on credit spreads. Rigorous analysis of company financials can navigate investors to reliable returns while avoiding unnecessary risk. We prefer established entities with strong balance sheets, conservative financial management, and robust liquidity. A taxable investor can look to the municipal market to diversify risks, maintain credit quality, and find attractive tax-equivalent yields. While low interest rates have a very visible effect on bond yields, it is important to remember that they influence all asset classes. Asset allocations for both institutional and retail investors will likely respond to the new environment. In a universe of low-yielding investments, market participants tend to gravitate to the chance of higher-equity returns. For some institutional investors such as pension funds, increasing exposure to risky assets is now the only hope of reaching their long-term investment targets that often exceed 7%. For individuals, the current environment requires a more thoughtful process of managing risk and return.

Stay diversified. This pandemic is a reminder that no one can predict exactly what the future holds. Spreading investments across sectors, themes, and asset classes continues to be the cornerstone of prudent portfolio management and long-term investment success.

ASSET CLASS UPDATE (continued from page 2)

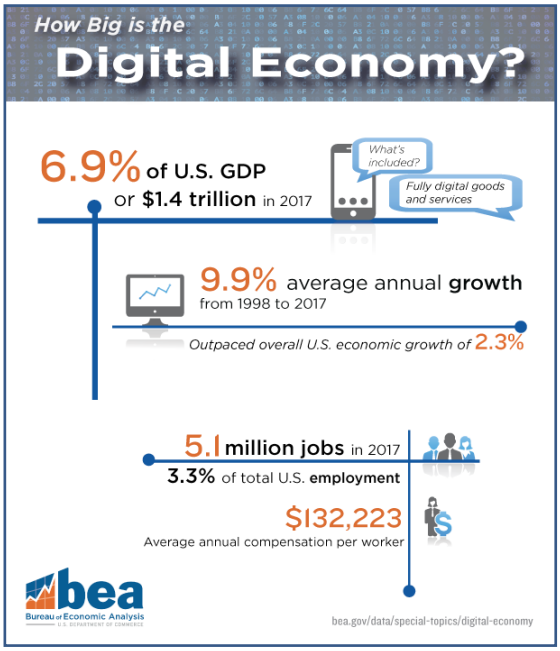
INDEX	1ST QTR Return	1 YEAR Return	3Y ANN Return	5Y ANN Return	DESCRIPTION (What does this Index represent?)
FIXED INCOME					
Bloomberg Barclay's US Intermediate Bonds	2.5%	6.9%	3.9%	2.8%	US Bond Market: government, corporate, and mortgage bonds
Bloomberg Barclay's US Aggregate Bonds	3.1%	8.9%	4.8%	3.4%	US Bond Market: government, corporate, and mortgage bonds
Bloomberg Barclay's US High Yield	-12.7%	-6.9%	0.8%	2.8%	Higher risk, higher yield "junk" bonds
"ALTERNATIVE" ASSETS					
GOLD, Dollars/Oz.	3.9%	22.0%	8.1%	5.9%	Gold bullion
NYSE Arca Gold Miners Index	-19.9%	6.3%	2.5%	6.5%	Companies that mine precious metals
Crude Oil, Dollars/Barrel	-66.5%	-65.9%	-26.0%	-15.5%	The price of a barrel of oil
Bloomberg Commodity Index	-23.5%	-23.7%	-10.2%	-8.8%	Commodities like Gold, copper, natural gas, corn, etc.
Dow Jones REIT Index	-23.3%	-15.7%	0.1%	2.1%	An index of Real Estate Investment Trusts
Alerian MLP Infrastructure Index	-58.1%	-62.0%	-29.9%	-21.1%	MLPs: Energy infrastructure assets such as pipelines

Rob Lutts
President, CIO

The Digital Economy Goes Into Hyperdrive

The digital economy was already pounding the physical economy before we experienced Covid-19.....the best example is seeing *the new **Tesla** auto dealership opening in Danvers, Massachusetts where the old **Sears** Automotive stood for 40 years.* A further example is Macy's continuing struggle to keep up with the digital success at Amazon and Walmart. A physical location clearly is a liability for many businesses these days. Then the health problems of Covid-19 descended on these companies. It was like the *knock-out punch* for many companies just when they had thought it was as bad as it could get. Macy's and many other stores deemed non-essential simply closed. The bailout package in Washington was described by famed investor Bill Miller as the "Amazon Enhancement Act". Like Amazon needed any help.

Tesla, Danvers, Massachusetts, February 2020



Source: U.S. Bureau BEA.gov

The point to be made here is that the events over the last three weeks have highlighted many of the advantages of the digital economy and its lack of reliance on the physical and people – which are large liabilities for brick-and-mortar companies during this health crisis.

So who are the winners in this phase? **Adobe** (digital everything experts), **Service Now** (automation experts), **DocuSign** (legal transactions without meeting), **Apple, Alibaba, Mercadolibre** (I need to communicate with the world at a distance) **Amazon** (just order and it comes to the door), **Salesforce.com** (I need to stay connected to all my employees), **Sony** (I am home and need to be entertained), **CDW** and **Nvidia** (masters of all digital equipment), **eBay** (sell anything without meeting anyone), **Alphabet/Google** (find it without talking to anyone), **Rockwell Automation** (have your products assembled by robots that do not get sick or scared), **HDFC Bank** in India (bank and pay people without meeting them), **Tesla** (a digital car – drive one and you will understand). All these companies are in Cabot's equity portfolio that invests in equities directly. There are many other digital-oriented companies shining today like **Amazon, Cisco, Microsoft, Accenture, PayPal, Netflix**, and **Cognizant** to name just a few. This crisis has simply acted to accelerate our move toward many digital companies and new technologies.

Source: Digital Republic

Should You Change Your Asset Allocation in 2020?

Tom Vautin
CPA, CFA®, CFP®
Sr. Financial Planner,
Portfolio Manager

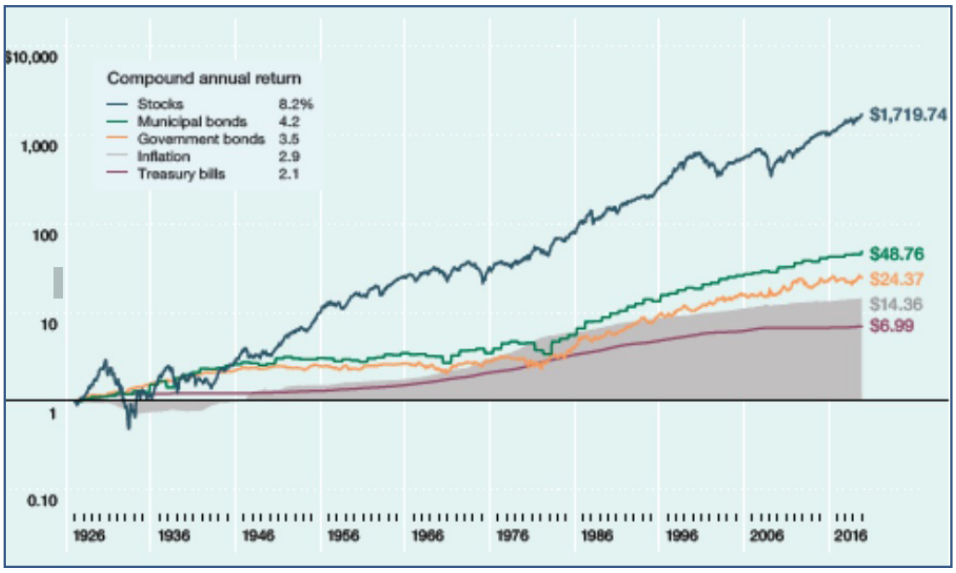
What a difference 3 months makes. Back in January everything seemed fine. As we rolled into 2020, the global stock markets had just experienced a very strong year to finish off a very strong decade. In our last quarterly newsletter, I wrote: *After a year where account balances increased sharply, it is natural to feel confident that we will continue to have good times going forward. Maybe we will. But it takes some effort to remember when the last time the markets were in turmoil. It will happen again, and the timing will be uncertain.* I guess we found the turmoil, and it doesn't feel very good. But it happened, so what can we do about it?

First, understand how you are feeling right now. This is a good opportunity to calibrate your investments with how well you are sleeping at night. The key is finding the middle ground where you are comfortable with your investments at all times - both in years like 2019 when the stock markets returned close to 30%, and in times like the last couple of months. Because the timing of terrible events like terrorist attacks, natural disasters, or Covid-19 is always uncertain and unexpected, there is no easy way to predict exactly when to take more risk and when to take less.

Second, it helps to mentally compartmentalize investments into buckets, because they serve different purposes. It's all about when you plan to spend your money. Expenses over the next 1-2 years? Choose stable investments like FDIC insured bank accounts, Treasury bills, or short maturity Treasury notes. On the other extreme, for cash needs 10+ years out, you will likely be better off investing in stocks, which are more volatile in the short term but tend to increase in value more than cash and bonds over time. The point is that even though there is that one number at the bottom of your statement each month that stands out, it doesn't tell the true story.

Finally, remember that time heals all wounds. When turmoil in the investment world is happening, we are thinking, How far is it going to go? How long is it going to last? and This time is different.

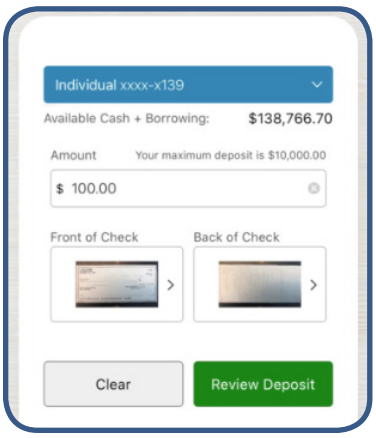
What we are going through now might last another month or (hopefully not) several years. But no matter what, throughout history the world has been very successful at solving problems, and we will do it again this time too.



Source: Morningstar ®

Past performance is no guarantee of future results. Hypothetical value of $1 invested at the beginning of 1926, with taxes paid monthly. No capital gains taxes are assumed for municipal bonds. Assumes reinvestment of income and no transaction costs. This is for illustration purposes only and not indicative of any investment. An investment cannot be made directly into an index. ®2020 Morningstar Inc. All rights reserved.

Schwab Mobile Deposits



Source: Schwab.com/mobile

With the restrictions to stay home, we wanted to remind our readers that Schwab offers mobile banking. Schwab Mobile Deposit™ is a quick and easy way for Schwab account holders to deposit checks from the comfort of your home using the Schwab Mobile App. It uses the same strict security measures you rely on at Schwab.com and is available for Schwab Bank, Schwab Brokerage, and IRA Accounts using your Android™ device, iPhone® or iPad®. To get started, just download the Schwab Mobile App from the App store on your mobile device. There are deposit amount limits which will be shown at the top of the deposit screen once you are in the app. For instructions on using Schwab Mobile Deposit™ watch this video at:

http://www.schwab.com/schwab-mobile-deposit

Greg Stevens, CFP®, CRPS®
Sr. Wealth Advisor

Putting Things in Perspective During These Challenging TImes

It goes without saying that we're living in very uncertain times. The nonstop news cycle allows us little reprieve from the onslaught of bad news. Many families are already struggling to make ends meet and others are coping with the fact that it might be several months before they can breathe easy again. Our clients have spent lifetimes working and the fruit of their labor is an investment portfolio put in place to meet their short- and long-term spending needs. Seeing the markets spend day after day seemingly in free fall is enough for anyone to lose sleep over.

In the words of Winston Churchill, "Success is never final. Failure is never fatal. Courage is the only thing." I think this quote is appropriate for the times we're in. We've all benefited from a very strong bull market in recent years. Money was made (in varying degrees) no matter where you were invested. Asset allocation was important during the bull market for one major reason… it prepared you for what we're dealing with now. Success now relies on having a sound asset allocation based on goals, timeframe and, ultimately, tolerance for risk. Those who tossed their safe, secure (and low-yielding) investments out the window over last few years in favor of high-flying equity investments are now seeing the results of that strategy. Those who diligently stuck with the plan are able to weather this storm, meet their goals and come out on the other side.

While this virus pandemic is like nothing we've ever seen in our lifetimes, so was 911 and the housing/banking meltdown of 2008-2009. During both events the global economy was shocked initially, governments stepped in to maintain order and the private sector adapted. Investors with a proper allocation were rewarded with new market highs and solid investment returns. Those with portfolios too aggressively positioned for their risk tolerance or with money they needed in the short term tied up in risky assets, felt the pain of having to sell into a falling market.

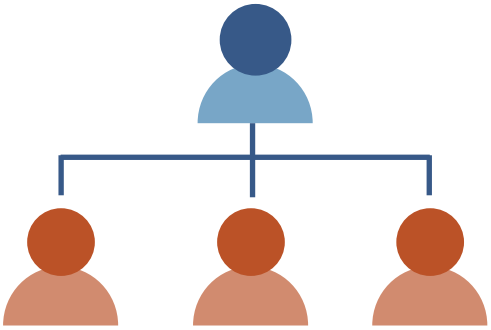
Courage and discipline go hand in hand in a market like this. At Cabot, we work with our clients to develop an asset allocation that makes sense. It takes courage to stick to the plan when your gut tells you to "sell out and buy back later". It takes discipline to keep investing money into a falling market when that is actually the exactly right thing to do for the longer-term portion of your portfolio.

Our lives and economy will be reshaped by current events… likely for the better. New companies may emerge as leaders and many others will evolve and thrive. Keep the "big picture" in perspective. Don't sacrifice the long-term success of your financial plan by falling into the trap of making drastic changes to your financial plan during uncertain times.

Are Your Beneficiary Designations Up to Date?

An often-overlooked aspect of a sound financial plan is understanding the importance of proper beneficiary designations. Retirement plans, IRAs and life insurance policies allow the owner to specify to whom those assets pass when the owner dies.

Be sure to coordinate your beneficiary designations with your overall estate plan to make sure you fully understand where your assets go at your death. Feel free to contact your Cabot advisor with questions about your specific situation.



Contact your Cabot Wealth Advisor today with questions or to refer our Wealth Management services.
800-888-6468 | info@ecabot.com

The Effect of Coronavirus/Relief on Taxation

Steve Davis
Senior Tax Manager

Steven Ross
Tax Advisor

In mid-March, the Treasury Department and Internal Revenue Service announced that the federal income tax filing due date has been automatically extended from April 15, 2020 to July 15, 2020 in response to the challenges taxpayers face due to the coronavirus. Taxpayers do not need to file any additional forms or take any other actions to take advantage of this extended filing date. This not only allows extra time to file a final 2019 tax return, but also extends the due date of any final 2019 payments of tax due of any amount, which can be made up to July 15 without accruing any additional interest or penalties that would normally be associated with a late payment. Additionally, all Quarter 1, 2020 estimated tax payments normally due on April 15 have been deferred to July 15, 2020.

However, this is not the only relief that taxpayers are being offered. In addition to the extended filing date for income tax returns, taxpayers are now allowed to make tax year 2019 contributions to traditional IRAs, Roth IRAs, and HSA accounts until July 15, 2020. The maximum annual contribution for IRAs for 2019 is $6,000, plus an extra $1,000 if the taxpayer is over age 50. This will allow taxpayers additional time to fill their 2019 "bucket" of contributions before all contributions must be applied to 2020. For those taxpayers enrolled in a high-deductible health plan, this might be a good time to contribute to an HSA for tax year 2019. Like traditional IRA contributions, HSA contributions are potentially tax deductible. For tax year 2019, HSA contributions of $3,500 for single taxpayers or $7,000 for those with a spouse or dependents on their health plan are allowed, with an additional $1,000 catch-up limit for those 55 years of age and older.

Finally, a major form of relief is being offered for retired taxpayers. The "Coronavirus Aid, Relief, and Economic Security Act" ("CARES Act") was signed into law on March 27, and includes a waiver of required minimum distributions (RMDs) for 2020. This waiver applies to company savings plans like 401(k) plans as well as traditional IRAs. The waiver also includes both Inherited Traditional IRAs and Inherited Roth IRAs, as well as RMDs for taxpayers who reached age 70½ in 2019 and were required to make distributions beginning April 1, 2020. Any 2019 RMD amount not withdrawn by January 1, 2020 has been waived. From a tax perspective, this allows taxpayers more control over their income and ultimately their tax bill. From a retirement perspective, it allows continued asset growth in a tax-deferred account.

Beware of Stimulus Payment Scammers

Here's what taxpayers need to know about stimulus payment processing in order to protect themselves from scammers:

01 **Be alert for phone scams.** The Internal Revenue Service (IRS), Treasury Department, or any other government agency will not contact you by phone to collect information for stimulus payment processing. Period.

02 **Be alert for phishing scams.** Government agencies will not email or text you to collect information for stimulus payment processing. Watch for suspicious emails or texts with links or attachments requesting information for processing stimulus deposits or checks. If you receive one, do not click the link or open the attachment. It's a scam. Delete it.

03 **Be alert for state-related scams.** State agencies will also not call, email or text you to collect information or a fee to process a stimulus payment. To date, no state has introduced their own version of a stimulus payment.

As of now, we are aware of only one communication a taxpayer will receive from the IRS. No later than 15 days after distributing a stimulus payment, the IRS is required to mail a notice to the taxpayer indicating the payment amount, whether the payment was mailed or deposited, and a phone number to call if the taxpayer did not receive the payment.

Victims or targets of stimulus payment scams should report it immediately to the Federal Trade Commission, www.ftc.gov/complaint.

AROUND CABOT

Patrick Creahan Joins the Cabot Team

We are pleased to welcome Patrick as Portfolio Manager for Cabot's Core Fixed Income and Bond Growth strategies. He is responsible for the implementation and guidance of the firm's fixed-income portfolios. Prior to Cabot, Patrick spent 3 years at Appleton Partners as a Fixed Income Research Analyst in the Municipal Bond group. He has experience performing fundamental research and providing investment recommendations for the development of bond portfolios. Prior to Appleton, Patrick was an associate at US Bank in their Structured Products Banking Division. Patrick holds a B.A. in Economics from Lafayette College. He is a CFA® Charterholder and a CAIA® Charterholder.

Welcome aboard Patrick!

SAVE-THE-DATE: An Evening Event with the Cabot Team

Thursday, October 8, 2020 | 6PM-9PM

Save the Date for our "*Evening Event with the Cabot Team*". The event will be held at the Hawthorne Hotel, one of the North Shore's most historic hotels. Clients and attendees will gain access to insights and perspectives on the economic landscape, investment opportunities, and strategies for managing wealth.

Mark your calendar today for Thursday, October 8th!

We encourage our clients to mark their calendars so they can plan travel arrangements accordingly. If you need assistance with booking hotel accommodations for your stay, please contact your wealth advisor directly.

IN THE COMMUNITY

Children who attend the various YMCAs around the North Shore will be receiving free books to help them become more "financially fit". Rob Lutts, president and CIO of Cabot recently met with Chris Lovasco, President and CEO of the North Shore YMCA to deliver over 200 books to the "Y". Starting with the younger children, Cabot donated *The Berenstain Bears'* books titled: The Trouble with Money and Dollar$ and ene. In these classic Berenstain Bears' books, Mama and Papa Bear help teach Brother and Sister how to budget their money and understand the value of a dollar. The kids at the Salem YMCA were thrilled to receive their very own books to take home. These same books will be given out at the YMCAs in Gloucester, Marblehead, Beverly, Haverhill, Ipswich, and Plastow, NH. Cabot will also be donating books for the older children as well. We are making it our mission to improve financial literacy. Teaching kids to save their money is a valuable first step toward learning how to manage their money as adults. It's also important to teach them at a young age about investing and how money can grow over time. The books we donate touch on a variety of financial topics, lessons, and values that provide children and young adults the know-how to make wise financial choices.

Rob Lutts, President and CIO of Cabot Wealth Management (left), and Chris Lovasco, President and CEO of the North Shore YMCA (right) kneel next to some of the children as they receive their free books.

Cabot
WEALTH MANAGEMENT

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