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## THE NORTHWOOD PERSPECTIVE

### President's Message

Tom McCullough

I have just finished teaching a course called 'The Management of Private Wealth' in the MBA program at the University of Toronto's Rotman School of Management. This is my third year of teaching this course and I have enjoyed it immensely. It is a pleasure to be around bright, enthusiastic students who will be the business leaders and family advisors of tomorrow. I also see it as part of Northwood's community service to build the quality of the wealth management profession and ensure we leave it in even a better state than we found it, for the benefit of the families we serve and those to come.



While there are many excellent graduate schools in Canada, one of the reasons I chose to teach at Rotman is their vision of 'Integrated Thinking'. Dean Roger Martin believes that most issues in business are not black and white nor are they win-lose, and that a static model cannot be mechanically used to solve issues in the real world. Rather we require 'integrative thinking' or the ability to draw from many disciplines and approaches to find creative solutions.

Anyone who has read this newsletter more than once will know how strongly we at Northwood believe in that integrated, holistic way of thinking. For the wealthy families we serve, the issues of their life do not fall neatly into professional silos, such as investment, tax, estate, and insurance. Rather they sprawl messily across the various disciplines and need to be addressed in a coordinated manner. Anything short of that risks wasted opportunities, outright mistakes and missed goals.

For instance, a family's estate planning must take into account multi-generational family objectives, risk management, cash flow planning, taxation, family law and family communication, to mention just a few. It also requires the interaction and cooperation among multiple professionals and advisors.

A number of these professionals have graciously volunteered to be guest speakers in the MBA class and I wanted to acknowledge them and thank them for their contribution - Grant Rasmussen from UBS Canada, Keith Martin from Evans Investment Counsel, Linda Betts from Heritage Wealth Management, Mark Tredgett from Vantage Asset Management, Bill Moriarty from University of Toronto Asset Management, and Scott Hayman and Eric Weir from Northwood.

I hope you enjoy this issue. Have a wonderful Spring.

### A Tale of Three Sectors

A look at the driving forces behind the TSX

Eric Weir, CFA, CFP

Daniel Gabay



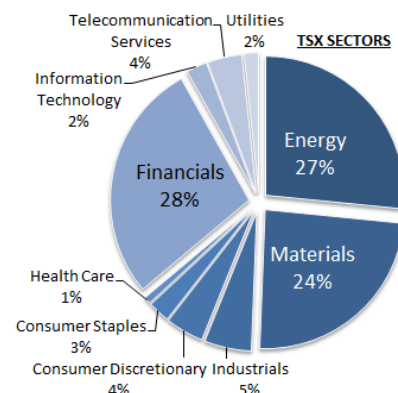
Canada has been an exceptional place to live and invest over the past 10 years. The list of reasons to be lucky to be a Canadian is longer than I could write in this article, but when we look at investing, the analysis is actually quite simple. Canadian markets have been a global stock market highlight over the past decade, advancing 6.6% annually as of December 31 2010, versus the S&P 500 (US) and MSCI World which advanced at a rate of 1.4% and 2.8% respectively in their local currencies.

Why has Canada done so well? When we look at the market a little more closely, it really becomes a tale of three sectors. Following the dot com boom which saw the tech sector (Nortel) all but disappear from the stock market, Canada has been dominated by three main sectors - Financials, Materials and Energy - that make up almost 80% of the value in the TSX. The story behind each of these sectors is unique, but Canadians have been lucky to benefit from world trends that have worked out in our favour.

•Financials (28%) - Canadian banks and their risk controls were the envy of the world as many countries saw their financial systems nearly collapse under the pressures of the 2008 financial market meltdown.

•Materials (24%) - Canada's abundance of raw materials and leadership in the gold mining industry has yielded us a healthy return as the price of gold and other commodities has advanced rapidly since the early 2000s.

•Energy (27%) - The story on the world's energy has become headline news as wars and natural disasters threaten supplies. Canada is home to one of the safest and most abundant supplies of energy in the world.



**Northwood recognized in 2010 Euromoney Private Banking and Wealth Management Survey as a Premier Canadian Family Office Service Provider**

# #1

Specialized Services for Entrepreneurs  
 Specialized Services for Inherited Wealth  
 Specialized Services for Corporate Executives

CONTINUED FROM PAGE ONE... A TALE OF THREE SECTORS

The year 2010 provided a shining example of how having only a few dominant sectors can influence the overall return of a market. The TSX saw the Materials sector advance 37% during the last year, while the overall market advanced 17.6%. If the Materials sector is removed from the index, the overall return of the TSX would have been reduced to 12.9%.

With a stock market that is made up largely of just three sectors, it is expected that there will be additional risk and potentially higher volatility. The challenge to Canadian investors is that over the past decade, being concentrated has been rewarding, and it's often hard to look beyond what's been working well for the past decade.

While Energy, Materials and Financials have been among the best sectors to invest in, prudent management of a portfolio argues for investors to diversify into additional areas that go beyond Canada's three sectors. We don't have to go back very far to see what the benefits of diversification can do for a portfolio. In 2008, when the three main sectors in Canada were declining as much or more than world stock markets, there were a number of sectors that didn't experience the same decline as the market. Health Care and Consumer Staples stood out as two areas that performed well on a relative basis and acted as a buffer to other sectors which performed poorly. For example, in Canadian dollar terms, the 2008 performance of the MSCI World was -26% while the Health Care sector returned -2% and Consumer Staples returned -4%. There were only two other sectors whose return was better than -20% and those were Telecommunications and Utilities which returned -16% and -12%, respectively. Although these sectors have some minimal representation in the Canadian marketplace, they are significantly overshadowed by the three dominant categories.

Given the lack of diversification in the Canadian marketplace, the real question is, are there better options? The first obvious place to look is south of the border at US companies. As can be seen in the comparison chart, the S&P 500 index is much more diversified with no sector representing more than 20% of the index and seven different sectors each accounting for approximately 10% of the index. Further, the US market can fill some of the holes where the S&P/TSX index is lacking, namely, the Health Care and Information Technology sectors.

Similar diversification benefits are available by looking at companies around the globe. The diversification benefits of the MSCI World index are similar to that of the S&P 500 in terms of sector exposure, with

marginally higher weightings in the Materials and Financials sectors and a lower weighting in the IT sector.

Sector Weights of Indices (as at December 31, 2010)			
Sector	S&P TSX	S&P 500	MSCI World
Energy	26.6%	12.0%	10.9%
Materials	24.1%	3.7%	8.3%
Industrials	5.5%	11.0%	11.4%
Consumer Discretionary	4.5%	10.6%	10.5%
Consumer Staples	2.5%	10.6%	9.8%
Health Care	0.8%	10.9%	9.1%
Financials	27.9%	16.1%	20.1%
Information Technology (IT)	2.4%	18.7%	11.7%
Telecommunication Services	4.0%	3.1%	4.2%
Utilities	1.7%	3.3%	4.0%

In addition to the sector diversification benefits, investing globally provides the added benefit of diversification of country-specific risk, which can arise from a number of different factors, including the political arena, decisions made by central banks, and as we have seen more recently in Japan, even natural disasters. However, investing outside of Canada doesn't come without its risks, which can include:

- Currency Risk
- Political Risk
- Market Efficiency (access to timely and reliable information, poor enforcement of insider trading and price manipulation)
- Withholding Taxes
- Higher Transaction Costs (including trading costs and lack of liquidity)

Although investing in the Canadian markets has been the best place to be over the last decade and Canadian companies have become a popular destination for international capital, it is prudent for Canadians to look outside of their borders to achieve a more well-rounded portfolio which is better able to withstand the volatility of the global financial markets. It is important to remember that Canadian companies only represent 5% of the world's market capitalization. Although impressive on a per capita basis, this represents a small basket of securities, concentrated in too few sectors, leaving a world of diversification to be found beyond our borders. 🌲

## How and When to Talk to Your Kids About Money

### Money Matters: Three Steps to Foster Financial Responsibility in Kids

Tom McCullough, MBA



*This article appeared in the Spring 2011 Launch issue of Canadian Capital magazine. Tom is a member of Canadian Capital's Advisory Board, and is a contributing author. The original article can be found here: <http://www.capitalmagazine.ca/provide/family-and-generational-wealth/the-last-taboo-829>*

Despite an increasing willingness in our society to talk about pretty much anything, adults often struggle to decide when—or even if—they should have a conversation with their kids about wealth and exactly what they should say. But talking about family wealth is a must—and not just once, but regularly. Those conversations will help

your kids develop the skills, experience and maturity to handle whatever money they ultimately receive, whether it's a salary, a bonus or an inheritance.

### 1. Communicate values.

Many parents believe their kids will pick up the family's values about money by osmosis, but competing messages, particularly from the media and friends, can send confusing signals. "Television is already



CONTINUED FROM PAGE TWO... KIDS AND MONEY

teaching kids that the purpose of this life is to be a consumer,” says Jon J. Gallo, co-author of *Silver Spoon Kids: How to Raise a Responsible Child in an Age of Affluence*, “and this may not be the message you want to communicate.” Consider writing down the values you want to establish about money, such as, “Don’t spend more than you earn” or “Be sure to set aside a portion of your money for the less fortunate.”



To facilitate this, take your kids on trips to the developing world. To share my passion for helping the poor, I did this with my children when they were younger. Now my daughter, Kate, 21, says these experiences made her more conscious of the needs of other people.

You may also want to talk specifically about your own family money policies and incorporate your kids' views on money as much as possible into the family's values.

skills, so they will be prepared to handle the complexities—both practical and emotional—of wealth. Unfortunately, these skills aren't taught in school, so give them some instruction at home. For instance, when kids receive their allowance or gifts of money, encourage them to divide the funds into three boxes—one for spending, one for saving and one for giving—so they can learn about planning, the value of a dollar and delayed gratification. As they get older, help them work out a budget or financial plan. It's helpful to give each child an amount of money to manage themselves, so they can learn about investing first-hand.

*“Financial knowledge is one of the best gifts you can give your children”*

### 3. Develop their independence.

While wealth can have a positive impact in a child's life, it can also protect them from hardship and the associated valuable life lessons that challenges bring.

If you give your teenager a monthly allowance and she runs out by the middle of the month, let her feel the pinch for the rest of the month, instead of topping up her fund. Helping kids learn they can't necessarily have their cake and eat it too, is an invaluable life lesson.

Or if your son drops out of university after an unsuccessful first semester, teach him money doesn't always come easily in life, and insist he pay his own tuition for the first year if he goes back.

The earlier you start these steps the better. Financial knowledge is one of the best gifts you can give your children. 🌲

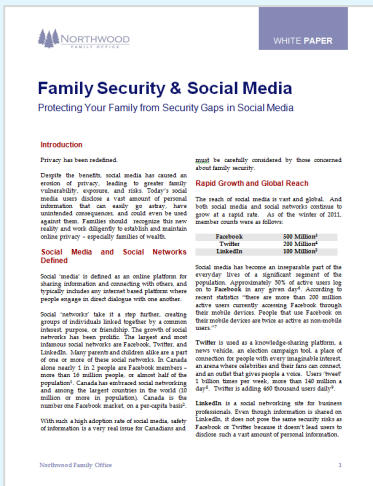
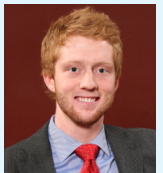
## 2. Establish financial literacy.

If you plan to leave money to your children, it's important to set them up for success, not failure. They need good financial management

## Has Privacy Become Obsolete?

Northwood releases 'Family Security & Social Media' Whitepaper

Daniel Moulton, MAT



Privacy has been redefined. With the advent of social media and social networking, everyone knows everything about everybody.

The following is an excerpt from Anna Grossman's, *Obsolete*, a self-proclaimed encyclopedia of once-common things. Privacy, according to Grossman, has become obsolete: “Secrets were once precious nuggets that existed only in whispers and in the pages of the locked diary you kept under your mattress. You didn't have to worry that anyone would look in your bag at the airport... Not everyone had to know via eVite that you were attending Helen's Surprise Party ('With bells +1'); there was no instant public announcement that you'd transmuted from 'married' to 'single'... The Privacy Act and other amped-up security measures that have come into existence in the last decade have further enforced the idea that private information can be a dangerous thing.” (p.143-144)

In light of this cultural transition, we've authored a white paper, titled, *Family Security & Social Media*. Social media, most notably Facebook, has led to an erosion of privacy, leading to greater family vulnerability, exposure, and risks. Families must recognize this new reality and work diligently to establish and maintain online privacy.

The paper is available on our website: [http://www.northwoodfamilyoffice.com/re\\_whitepapers.asp](http://www.northwoodfamilyoffice.com/re_whitepapers.asp) 🌲

## The Finer Points of Choosing a Personal Representative

Finding the right Estate Executor for your family

Barrett Lyons, CA



While undertaking research for a course that I am taking, I stumbled across numerous articles that listed the tasks and responsibilities of personal representatives, including the factors and qualities one should consider in selecting such a person. In my search, I noted some finer points about choosing a personal representative I found interesting and wanted to share them.

With respect to estate planning, the term personal representative varies, but in this context I am referring to an estate executor and trustee (note these terms also vary by legal jurisdiction).

- **Specific assets** – If your estate includes an asset that requires specialized knowledge (i.e. an art collection or business), you might want to consider appointing an expert as a representative for that asset only, while another representative manages the remainder of the estate. The more 'general' representative might otherwise overlook details in dealing with that specific asset that may be detrimental to the estate.
- **Number of decision makers** – If you feel the need to appoint multiple personal representatives, you should provide in your will that decisions are made by majority rule; otherwise decisions will have to be made unanimously which is not realistic. Additionally, try to limit the number of representatives to three, as the more representatives you have, the more potential difficulty there can be in decision making and coordinating schedules to administer the estate.
- **Business partners** – If you have a partnership or shareholders' agreement that includes a buy-out provision upon death of the other partner, beware of the potential conflict of interest that this will create upon death if you select this partner as a personal representative. The business partner may be dealing both on your behalf and their own behalf in negotiating the purchase of your interest in the business from the estate. Practically, business partners are frequently appointed as a personal representative because they have the knowledge, skills, and ability to quickly carry on the business in your absence, but this conflict of interest should be considered.
- **Blended families** – If you settle a spousal trust upon your death for a second marriage, be careful of your choice of trustee. If the spouse is appointed trustee, they will have a bias to encroach on capital for their benefit. If adult children from a first marriage are the trustees, then they will have a bias to limit the capital to the spouse, as the capital will pass to them upon the death of the second spouse.
- **Residency of trustee** – If you settle a testamentary trust in your will and the trustee appointed is a non-resident, the trust may be deemed resident in the jurisdiction of the trustee because Canadian tax law indicates trusts reside where the 'mind and management' of the trust is resident. This can limit the planning that was originally created to settle the trust.



In many circumstances, there may not be an obvious or perfect choice for a personal representative, but only a 'best' choice. If you are tasked with choosing a personal representative, your best option may be simply to compile a list of desired requirements, create scoring system and determine which names received the largest number of points. Alternatively, you can create a list of all available candidates and cross off the least desirable options until you reach your personal representative and alternate.

Above all else, when dealing with estate planning, communication is king. Having a dialogue with your family, representatives, and business partners with respect to your estate wishes goes a long way. We are often not prepared for the unfortunate events that befall us. If possible, speak to your children about the decision of why you are selecting a person to be your personal representative as the explanation can be reassuring to them and can help prevent or minimize family conflict and angst once you are gone. These can often be difficult discussions to have, but there are resources to assist in this manner; a family office being one. 🌲🌲🌲



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