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# THE NORTHWOOD STEPHENS PERSPECTIVE

FALL 2006

## President's Message



**Tom McCullough**  
President and CEO

Welcome to the second issue of *The Northwood Stephens Perspective*, a newsletter geared toward the interests of our clients, friends and colleagues. We hope this publication will stimulate your thinking and offer valuable insights, through articles written by our own staff and some outside specialists from time to time.

As one of the leading multi-family offices in Canada, we practice our unique Net Worth Management™ approach for families, individuals and foundations, looking at the entire ‘balance sheet’ of each client. But as you’ll see from some of the articles in this issue, the family ‘balance sheet’ encompasses much more than just financial assets. In fact, financial assets are nothing more than a tool to help people achieve their objectives. We help clients incorporate these other factors into their overall plans. They include such things as:

- **Strategic philanthropy** – Once they have a substantial net worth, many families turn outward and look for ways to have an impact in serving their community or the needy around the world. They often look for ways to pass on this charitable orientation to their own children and, in some cases, to leave a lasting legacy.
- **Health** – Anyone who has been through a health crisis personally or via a family member knows that health is one of the most valuable treasures in life. Good planning must include an eye to health issues, including education, prevention, wellness and insurance.
- **Family assets** – A family cottage is often one of the most memory-filled assets and is often worth more than the actual real estate value for that reason alone. It is therefore important that it be well planned for if you want it to stay in the family. Strategies to defer tax and to avoid family feuds are invaluable components of a well thought out plan.

So the family ‘balance sheet,’ in our view, really encompasses some of those very important assets – giving, health and family memories – that can’t always be quantified but that are often the most valuable.

We hope you enjoy the newsletter.

Sincerely,

**Tom McCullough**  
President and CEO

*Photograph courtesy of Frances Juriansz Photography*

## Risk Optimization: Don't Put All Your Eggs in One Bucket

*Brian Ginsler, MBA, CFA*

*Vice President, Northwood Stephens Private Counsel Inc.*



We’ve all heard the phrase “don’t put all your eggs in one basket”. Most people follow that mantra for their “investable assets” but there is a lot more to financial diversification than focusing on one’s stock and bond investments. To truly achieve optimal diversification, a family must take into account all its assets and liabilities.

In a recent article, originally published in the *Journal of Wealth Management*, Ashvin B. Chhabra introduces a *Wealth Allocation Framework* based on the concept of “Risk Buckets” into which all components of a family’s net worth can be segmented.

Chhabra concludes that without a proper understanding of how a family’s net worth is divided in terms of risk, the family cannot make informed decisions on asset allocation, investments, nor other financial issues.

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**There is a lot more to financial diversification than focusing on one’s stock and bond investments. To truly achieve optimal diversification, a family must take into account all its assets and liabilities.**

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The first step in working with this Wealth Allocation Framework is to start thinking about a family’s portfolio as all of the assets *and liabilities* that comprise its net worth, including public investments, private investments, home, mortgage, insurance and human capital (i.e., ability to earn a living). In this manner a complete picture of the distribution of a family’s risk can be achieved and the best possible decisions can be made.

### The Three Dimensions of Risk or “Risk Buckets”

So what are these Risk Buckets? The first is *Personal Risk*, which is the risk of experiencing a dramatic decrease in lifestyle. Assets falling into this bucket are intended to mitigate this risk and can include: short-term cash, personal use real estate (and any mortgage thereon), insurance and human capital. Not surprisingly, assets allocated to this Risk Bucket will typically earn lower returns but carry very low levels of risk.

In the second bucket, a family takes on *Market Risk* when investing in assets such as stocks and bonds. The purpose of investing in those market assets is to maintain the family’s lifestyle and keep up with inflation. In order to do so, it will need to take on the additional risk that those assets entail.

Finally, to significantly grow a family’s net worth, it must accept *Aspirational Risk* to strive for higher returns through investments in private equity,

*CONTINUED ON PAGE TWO*

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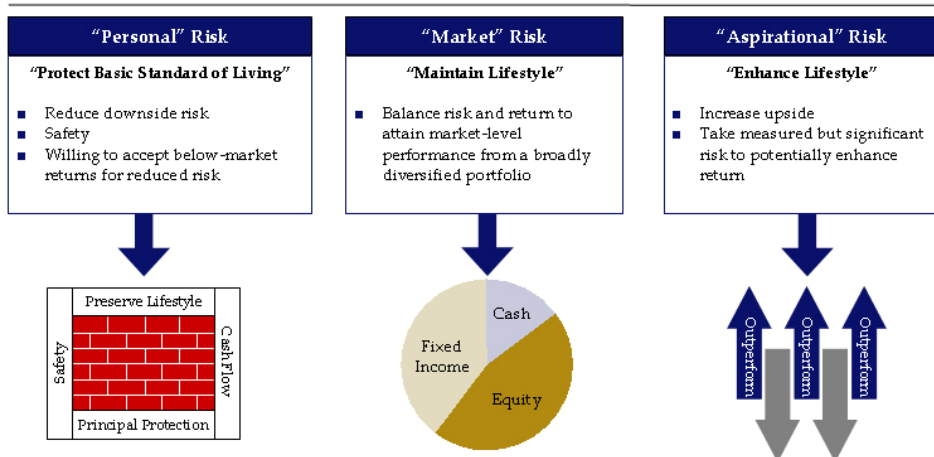
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investment real estate, concentrated stock positions, a personal business and/or other similarly riskier or, at least, less liquid assets.

Once assets and liabilities have been classified into their appropriate Risk Buckets, more holistic decisions can be made. The first of which involves determining the optimal allocation across the various Risk Buckets. For example, a family who has a disproportionately large percentage of its net worth in Aspirational Assets—either through a family business or other concentrated stock position—might be wise to begin to shift certain assets to the other two, less risky, buckets to reach a more prudent overall level of family risk.

So when spreading your “eggs” across various “baskets”, make sure those “baskets” are being allocated to the right “buckets”!

**Three Dimensions of Risk**



Source: Adapted from “Beyond Markowitz”, The Journal of Wealth Management vol. 7, no. 4 (Spring 2005), Ashwin B. Chhabra.

At Northwood Stephens, we use a Net Worth Allocation Framework and the concept of Risk Buckets to help our clients make decisions reflecting their whole net worth, as opposed to simply their investable assets. Please contact us for further information on our Net Worth Allocation Framework.

**Cottage Planning**

Bryan O’Neill, CA, MMPA  
Associate, Northwood Stephens Private Counsel Inc.



Like many families in Canada, yours may currently own a cottage or may be considering the purchase of one. Presumably, you would like to leave the cottage in the family but are concerned about the capital gains tax implications this may create. While there is no way to avoid capital gains tax forever, there are a number of strategies that will enable you to influence both the timing and the ultimate responsibility for this tax.

The first thing a cottage owner needs to know is that at the time of death, the property is deemed to be sold at market value. The tax owing on any capital appreciation is payable by the deceased’s estate, to the extent that the property is not transferred to the surviving spouse. Therefore, if you transfer your cottage to your spouse through your will, there will be no capital gains tax implications until he/she sells the property, transfers the property, or passes away.

One strategy that you can use to deal with any potential tax liability is to purchase life insurance. The proceeds of the policy would pay the tax liability, avoiding a sale of the cottage to pay Canada Revenue Agency (CRA). The disadvantage of this approach is that it is difficult to match the insurance amount with the ultimate gain since it is unknown. As well, the insurance premiums can be costly.

The principal residence exemption is another cottage planning strategy that should be considered. Many Canadians don’t realize that they can potentially elect to apply this exemption to their cottage. This option needs to be considered with great care, as the tax benefits of electing this exemption for your cottage versus your primary home, could have significant implications.

If you are in the process of purchasing, or have recently purchased a cottage, you may want to consider creating an Inter-Vivos Trust (Living Trust) and moving the cottage into the trust. The main benefit, assuming the property is not sold, is that there would be no capital gains tax implications until the trust is deemed to have disposed of the

property (under trust regulations) twenty-one years after the trust inception date. The primary disadvantage is that if you or your spouse live beyond the twenty-one year deemed disposition date and still hold the appreciated property in the trust, you would incur capital gains tax which would have otherwise been deferred to a later date, unless the property is rolled out to the beneficiaries (e.g., your children).



Another strategy available, if you have recently purchased or are in the process of purchasing a cottage, is to put the cottage in your child’s/children’s name(s). The primary benefit is that your and your spouse’s death will not trigger a deemed disposition of the property. The main disadvantage of this strategy is that you are giving up ownership and, potentially, control over use.

These are just a few of the planning strategies that are available to a cottage owner to address the inevitable capital gains tax implications. Often the solution is a combination of strategies.

Please contact us for more information on cottage planning, or to address your specific situation.

## Strategic Family Philanthropy

Tom McCullough, MBA, CIM, FCSI

President and Chief Executive Officer, Northwood Stephens Private Counsel Inc.



Philanthropy is big news again these days. Movie stars and rock stars are making donations of money, time and talent. Microsoft founder Bill Gates and his wife Melinda now shepherd a foundation that has grown to \$30 billion. And Warren Buffett promises to add another \$30 billion over the next twenty years. This has to be good news for needy organizations and recipients around the world.

But despite the rise of charitable urges and role models, we find many of our clients in a muddle about their charitable giving.

Common concerns include:

- How much should we give? How does that fit with what others like us are giving?
- How do we decide what causes to focus on? How do we find something that fits with our values?
- How can we be more proactive versus reactive with our giving? How can we ensure we have an impact?
- Should we start a foundation versus giving directly? And, if so, should we go the private or public route?
- How do we make this a family affair and help involve and teach our children about giving?

By and large, our clients are generous and want to support causes and people who are in need. But most find that they are more reactive than they would like to be – often giving in response to requests, pressures and end-of-year deadlines, instead of a well thought out proactive plan that captures their charitable passions.

We work with clients to help them be more strategic about their giving. We have developed a Guide to Family Philanthropy that walks through

all the steps necessary to turn a sometime frustrating and often ad hoc *donation* experience into a satisfying and effective *philanthropic lifestyle*.

The seven steps toward strategic philanthropy are summarized below:

### Seven Step Philanthropic Process:

1. **Set family objectives** – What do you want to achieve by your giving? How do you make those decisions?
2. **Define the focus** – What causes do you care most about?
3. **Understand your resources** – How much do you want to give and over what period of time?
4. **Evaluate giving mechanisms** – What are the most effective and efficient ways to give for your family?
5. **Formalize a charitable giving strategy** – What is the decision-making process? Who should be involved?
6. **Evaluate and select recipients** – Who will actually receive the funds and how will it happen?
7. **Monitor and evaluate** – How effective was our giving? Did it meet our objectives and the needs of the recipients? What changes should be made?

The above seven steps are helpful for all levels giving and family types, not just for Bono, Warren, Bill and Melinda. They are simply designed to give clients confidence that their philanthropic endeavours are having the desired effect. 🙌

Please contact us for further information or if you are interested in receiving a copy of the Northwood Stephens Guide to Family Philanthropy.

## Your Best Interest – Dividend Paying Stocks

Joe Connolly, MA

Director of Research, Northwood Stephens Private Counsel Inc.



The current low interest rate environment has led investors, in search of income, to re-visit the value of dividend paying securities. Long before price/earnings (P/E) multiples and other valuation metrics became popular, investors valued companies based on a stock's yield (dividends divided by share price). A stock with a higher yield was considered a better value. Throughout the past few decades, investors largely ignored dividends and rewarded companies that reinvested capital in pursuit of higher growth rates. However, in many instances, retained capital was not invested prudently by corporate management. With the current focus on corporate governance, the importance of dividends is being rediscovered – both by investors and corporate boards.

Contrary to popular belief, dividend-paying stocks have performed better in the long run than non-dividend-paying stocks – and those with the highest payouts have provided the best total return. Most academic studies confirm that between 35% and 70% of stock returns can be traced to dividends. In Ontario, the income received from dividend stocks has the added benefit of being taxed at only 25.0% (thanks to recent Federal and Provincial tax cuts), in comparison to 46.4% for bond income, for those in the highest marginal tax bracket.

Studies on US dividend stocks have also confirmed that companies that have paid higher dividends in the past, tend to generate higher earnings growth in the future. It seems that most of this information was ignored or forgotten by investors and corporate management during the last bull market.

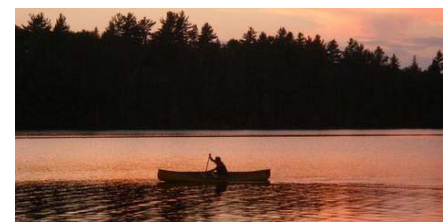
Stock prices are predominantly an indication of how much investors think a company is worth at any given moment. This creates stock price volatility, especially as investors focus on short term expectations. Sometimes profits go up but the stock price stays depressed; sometimes there are no profits and prices go up. Dividends, however, are not based on investor perception; they're based on a company's actual operations and available cash – so they tend to change much less radically than stock prices.

Not only have dividends been a main component of the stock market's long-term return over the years, but they are also a critical indicator of a company's financial health, and thus can, and should, be a key factor in evaluating a company for investment. 🙌

Dividend paying stocks are a core component of Northwood Stephens' Enhanced Income Mandate. Please contact us for more information.

**GUEST COLUMN:****Health: Why is it “Off Balance Sheet”?**

Peter J. Cooper, President & CEO and Elaine Chin, M.D., Medical Director  
Scientia Health Group



Nobody disputes that “health is our most valuable asset”. Yet, as individuals, investors, and employers, we often do not walk the talk.

Absent good health, our other “assets” are simply not worth much!

- Our ability to function at peak energy levels and our opportunities to enjoy what we build in life are seriously impaired by symptoms of disease or premature aging.
- Responsibility to our families is undermined when we fail to identify and mitigate disease risk.
- Commitments to co-investors, business associates and employees cannot be fulfilled if we fail to safeguard our health and that of our key people.

Nevertheless, we take health for granted – until confronted by personal crisis or one affecting somebody close. And unfortunately, our overall North American approach to healthcare is flawed and based on this expensive, reactive approach.

- Medical education and practice focus on disease treatment, not on health management.
- Financial arrangements create incentives to act only when symptoms are visible, but not in time to prevent them.
- Professional specialization perpetuates a silo (“organ care”) approach – as consumers we have no “advocate” who thinks about the whole person.

The bottom line – if we managed our financial assets the way we manage our health, we would be bankrupt! What *should* the model for effective health management comprise? We need to change our

way of thinking from *disease treatment to health enhancement and disease prevention*:

- Knowledge and information – we cannot all be health experts but we can be informed on what is important in nutrition, lifestyle and the key metrics we should be monitoring to guide us in our personal health management.
- Rigorous, risk-detecting screening – we need to change the view of what the “annual executive check-up” should be. Science has given us the techniques – genetic risk identification, diagnostic imaging, biochemical assessments, and more. They need to be accessed wisely, but also more effectively.
- A multi-disciplinary approach – our traditional medical practitioners are steeped in treating disease with drugs. What about nutrition, exercise and natural treatments before drugs?
- Individual responsibility and a commitment to change – we need to “own” our health from an early age. In our 20’s we’re infallible. In our 30’s we’re too busy. In our 40’s the first crises hit! We start paying attention ten or twenty years too late!

The challenge – payback will take time to measure. We will have to wait a decade or two before we see the impact on society and the cost of healthcare. Individually, we may never know what diseases we might have averted through our prevention efforts. But health is an investment and it should be front and center on our balance sheets! 🌲

Scientia Health Group – [www.scientiahealth.com](http://www.scientiahealth.com) – is a pioneer in prevention-based personal health management.



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