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THE NORTHWOOD PERSPECTIVE

President's Message

Tom McCullough



Every Tuesday, I teach an MBA course at the Rotman School of Management (University of Toronto), called 'The Management of Private Wealth'. I have thoroughly enjoyed the experience. Rotman is a world-class school, the downtown Toronto location keeps it connected to the real world of business, and the students are very bright and come from all over the world.

One of the school's core beliefs is 'Integrative Thinking' which also ties very nicely into what we practice at Northwood. It suggests approaching every problem in the context of the whole, not as a 'one-off' issue. Rotman dean Roger Martin says "in the real world, problems sprawl messily across the disciplines" and don't fall neatly into separate practice areas. They need to be handled with integrative thinking. In the context of a family office practice that might mean understanding the impact on family relationships of a major financial decision, taking taxes and inflation into account in investing, and ensuring that liabilities (i.e. future commitments) are matched with appropriate assets.

I find both the learning environment and the material very stimulating. It is rewarding to engage the 30 students discussing and debating how best to understand and meet the needs of private wealth holders. It is also great to be able to connect them with industry colleagues who come in as guest speakers, to help connect the academic and the practitioner worlds. I am grateful to John Benevides (Family Office Exchange), John Cook (Investeco), John Hierlihy (21st Ave.), Stephen Horan (CFA Inst.), Keith Martin (Evans), James McPhedran (Scotiabank), Grant Rasmussen (UBS), Mark Tredgett (Vantage), and Caird Urquhart (New Road). And of course, Scott Hayman (Northwood), who does a great job making personal tax and estate planning interesting and relevant!

The actual course material is also inspiring. It is exciting to be on the vanguard of what may be the biggest change in private wealth management in decades. Jean Brunel, editor of the Journal of Wealth Management (on whose editorial board I serve) calls it "the second major revolution in asset management" since Markowitz's MVO.

What is this new revolution? It is a recognition that the centre of the universe is actually *not public stock markets*, to which all investors feel they must react and which they must try to outwit. Rather, *the centre is actually the clients*, the private wealth holders, the families who live in the real world -- with taxes to pay, decisions that are interconnected, reactions that can seem irrational (=human), multiple goals at the same time, and objectives they want to be sure they'll be able to meet.

It is an exciting time to be on the front lines of the private wealth field, serving families today and helping to influence the young minds that will follow in the years to come.

What a Difference a Year Makes!

The 'End of The World' is Put on Hold For Now

Eric Weir, CFA, CFP



Just about one year ago, the end of the world seemed nigh. New financial disasters were emerging each day, global stock markets hurtled lower and investor fear was palpable. On March 9, 2009, the markets finally capitulated, with the S&P hitting an uncanny low of 666.

While most forecasters (many of them feeling bruised from the carnage of the previous 12 months) predicted a faltering economic recovery and a similarly hesitant stock market rally, they couldn't have been more wrong.



Obviously, stock markets around the world had been pricing in all the worst case scenarios, and the serious liquidity constraints in other asset classes (such as private equity, hedge funds, real estate, structured products etc.) forced investors to sell at fire sale prices. So when the tide turned and it seemed the end of the world was deferred (at least for now), stock markets rocketed higher.

As you can see from the chart on the next page, courtesy of FX Investments Strategies, the S&P is up 70% from its lows. Canada (not shown) is up 60%. Other markets are up over 100% from year-ago lows.

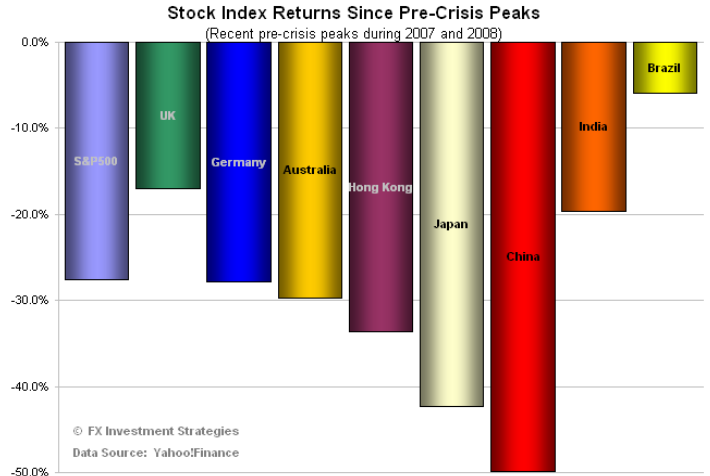
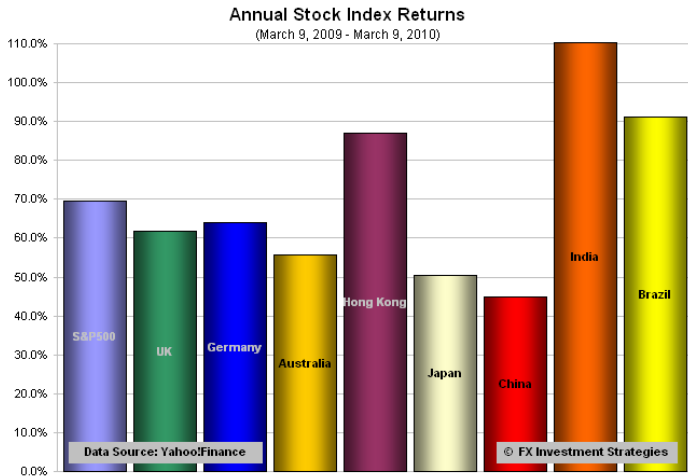
While the recovery in share prices is encouraging (and certainly helpful to portfolios), let's not break out the champagne quite yet. There are two other factors that must be considered – first, the rally has only returned some of the losses investors have already suffered, and second, what is the future prognosis for investment returns.

The next chart shows that, despite the gains over the last year, investors are significantly underwater, from the stock market highs achieved in 2007 and 2008. The S&P 500 is still almost 30% below its high and the S&P/TSX (again, not shown) is 20% below. Even more significant, the S&P 500 index is at the same level it was in 1998 – over 11 years ago. It tempers the enthusiasm over the stellar 2009 returns.

So, what is the prognosis for the years ahead? Can the returns of 2009 continue at their torrid pace? Will we slip back into doomsday fears as the impact of massive sovereign debt works its way through the global financial system? Either of these extreme scenarios is possible, but it is more likely we'll see something in between.

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CONTINUED FROM PAGE ONE....WHAT A DIFFERENCE A YEAR MAKES!



So how does a private wealth holder make decisions in the aftermath of two of the most extreme years in history?

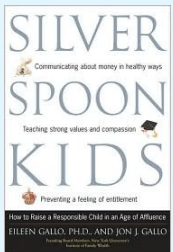
- 1. Make sure you have the right asset mix.** Exposure to fixed income and other asset classes can reduce the volatility in your portfolio. Exposure to growth assets can help mute the effects of inflation. Determining the right mix for you requires a detailed understanding of your family’s assets and goals.
- 2. Remember you’re in this for the long term.** Once you have the right asset mix, you’ll know that you can withstand short term volatility in the markets. Equities have a role in most portfolios but making short term decisions in emotional markets will typically be harmful in the long term.

- 3. Understand your equity style.** Investing in equity markets can take many different routes. Choosing managers that remove some of the market volatility by buying stable companies can help ease the hesitancy of investing in uncertain markets.

Getting yourself in shape with the three points above will give you and your family a much clearer financial vision and allow you to manage your wealth for the long term. Let’s all hope the equity rally continues, but as spring cleaning approaches, also be sure to dust off your financial plan and make sure you have the right asset mix and investment managers working for you. 🌲

Book Review: “Silver Spoon Kids”

Tom McCullough



It is natural as parents that we want to give our children the best of everything. And in this age of unprecedented wealth, affluent parents (that probably includes most of us!) can indulge that urge like never before.

At the same time, many of us have become alarmed over the impact this newfound affluence may be having on our children. We fear that through our generosity we risk training our children to be selfish spendthrifts.

The above is an edited version of the description of Silver Spoon Kids, and captures the ideas of the book but also the feelings and concerns I have heard from many of you about raising a generation of kids who we hope will (but we worry won't) have a balanced perspective of money. The subheadings on the front page of the book also give you a hint of the direction it is headed: Communicating about money in healthy ways, Teaching strong values and compassion, and Preventing a feeling of entitlement.

The authors, Jon and Eileen Gallo, are well equipped for the challenge of writing the book. They are affluent, they are parents themselves and they are married, so have wrestled through these thorny money

issues together. In addition, Eileen is psychotherapist who counsels people with money-related emotional problems and Jon is a lawyer specializing in estate planning.

The book has a mix of practical tips, real-life stories, anecdotes and effective advice on how to:

- Talk to your child about money in general--and *your* money specifically
- Be sure your child doesn't become spoiled
- Use an allowance to teach your child to use money responsibly
- Foster a philanthropic outlook in your child
- Define your family's most important values and communicate them effectively
- Avoid your nightmare of an unmotivated, underachieving, materialistic child

Also included are helpful checklists, self-tests, and Silver Nuggets -- brief bits of wisdom and advice -- that you can quickly put to use.

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Guest Column

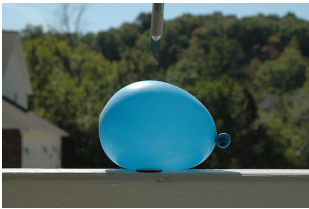
A Ticking Water Balloon:

The Environmental Risk in Investment Portfolios

John Cook, president of Investeco Financial Corp.

Investing in environmental sectors may be more about prudent risk management than just fashionable global economic development.

Newspapers remind us daily that we still face many economic risks, including the possibility of inflation or deflation, currency volatility, and interest rate tightening. It is a very tricky time.



But there are three risks that most bankers, politicians and investors may be missing:

- Increasing energy costs
- Increasing water costs
- Increasing carbon costs

These issues are very real and could have a dramatic impact on our lives; particularly *our* lives -- the upper middle class in Western economies, those of us with savings, those of us who consume more than our relative share.

Consider that the world uses about 8.5 billion tons of oil-equivalent energy each year. This is an astonishing number which, at current prices, is about 5% of our \$60 trillion global GDP. Perhaps more alarming, the energy we use in industrial production costs equals about 20% of global profits. That means that any increase in oil prices can have a significant impact on profitability of our economy. And it's not hard to see how 'peak oil' could mean 'peak GDP'.

And power production requires vast amounts of water, which in some parts of the world, is becoming increasingly scarce and expensive. We use trillions of gallons to run our coal and nuclear generators. It requires considerable electricity to pump, filter and desalinate the water we need. Water touches the bottom line of almost every business. Yet most of us believe water is virtually free.

Over the last 5 years, municipal water rates have increased significantly around the world:

- 27% in the United States
- 32% in the UK
- 45% in Australia
- 50% in South Africa
- 58% in Canada

In countries where water is less available, rates are increasing even faster (eg. water prices in Israel went up 25% on Jan. 1st and will rise another 16% in August as new desalination plants are introduced).

Last year, JP Morgan published a study ("Watching Water") on the impact water has on several industrial groups. They concluded that most companies had significant exposure to increasing water prices, but that most investors were completely unaware of these risks.

One industrial example highlighted in the report was computer chip manufacturing. Two companies alone (Intel and Texas Instruments) use over 42 billion litres of water annually in their chip fabrication plants. And their plants are mostly located in dry areas like New Mexico, California, Texas and Israel - places where water will certainly be more expensive in the future. Computer chips have become so cheap and are found in the most surprising places. Imagine if you put a cost on the water used to make them. Many

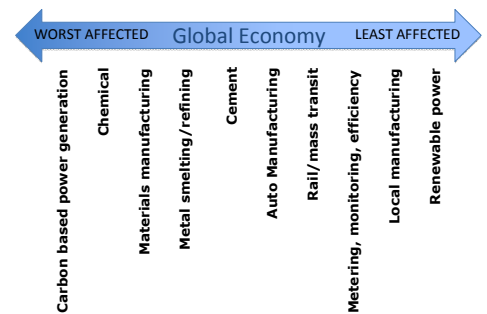
things we use every day will become a lot more expensive! And many other industries will face similar challenges.

Like water, carbon emissions are also closely related to energy production. Carbon emissions have been a hot topic in recent years but the economic impact is still widely misunderstood. Most North Americans would be surprised that the total value of global carbon credit trading exceeded \$125 US billion last year. But they would be shocked to learn that it could easily reach \$1 trillion in the next 5 years as 'cap and trade' markets expand to countries like the United States. That's \$1 trillion of new costs to a global economy that currently produces about \$3.6 trillion of industrial profits.

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These costs will not be spread equally through our economy. In fact, you can effectively place industry groups and businesses on a continuum of those 'most' to 'least affected'. For example, carbon-based power generators, chemical manufacture, and agriculture will be very hard hit. And businesses that ship goods (particularly large, low-margin products) will also be challenged.

At the other end of the continuum are companies with environmental advantages. There are the obvious ones like renewable energy, including wind and solar. But many traditional businesses have invested in technologies to reduce their resource consumption, creating future competitive advantage over those that haven't. And the companies that supply these technologies or services (like Siemens, ABB, and Veolia Environmental) are also likely to do well, as the savings advantages become more obvious.

In effect, the environmental soundness of industries will partially determine whether they are winners or losers in the future. So investing in environmentally superior companies may be the best hedge against the environmental challenges outlined above. Perhaps it is time for investors to include an environmental perspective into their economic deliberations.

John A. Cook, president of Investeco Financial Corp., is an investment management executive and cleantech venture investor. Prior to this, he was president of MaRS, a public-private partnership which helps create successful global businesses from Canada's science, technology and social innovation.

CONTINUED FROM PAGE TWO...BOOK REVIEW: "SILVER SPOON KIDS"

They also provide a list of questions they encourage parents to answer for themselves to help develop a 'family money narrative'. And if you think the proverbial 'horse has already left the barn' (i.e. that your children are too old and that you've missed your chance), the authors have ideas for 'kids' of all ages, even those that have become adults themselves.

While people will agree these are generally important issues as we all strive to produce the next generation of world and local citizens, it is also very fundamental in the work we at Northwood do with our family office clients. Thinking through kids and money is usually the first step in estate planning (do we want our kids to inherit, if so

when and how much, should it be under the control of a trustee or in their hands directly etc.?). It clearly has a direct impact on decisions about philanthropy and family legacies. And it often leads to plans for family education on money matters when the time is right.

There are many ways to engage kids in money discussions. The book *Silver Spoon Kids* is one source of ideas, as are conversations with other families. Also, if you are interested in talking about this further, give us a call. 🌲🌲

A Different Breed: The Family Office Advisor

Scott Hayman, CA, CFP



We are regularly called upon to answer the question, "How exactly is a family office different than other advisors?"

We can certainly cite the range of services we offer, from integrated planning to selection and oversight of investment managers to consolidated reporting (-- not to mention the myriad of customized services we undertake to simplify and improve our clients' lives).

We could also cite the types of clients we serve - typically entrepreneurs and executives with \$5 to \$500 million in net worth.

While both of these explanations provide some level of clarity as to the distinctiveness of a family office, it doesn't tell the whole story. Because the family office is in the business of providing advice to families, so much of 'what we are' is 'who we are'.

I recently came across an article that had a very interesting perspective on what kinds of people are successful family office (or integrated wealth management) advisors. The list of characteristics resonated with me and my partners, and seemed to provide a pretty good insider's view of what makes a family office work and ensure that it serves the needs of wealthy families. The article suggests that an 'effective integrated advisor' possesses:

- a fundamental drive to solve problems
- a healthy dose of natural curiosity, so that fresh ideas are continually generated
- a broad range of interests, many in the areas commonly touching client families
- superior listening skills and empathy - because it is really all about the client and doing what is best for him or her
- a good measure of jaundice and a lack of contentment with the status quo

- a willingness to make hard, thoughtful decisions
- a strong sense of self, so that when working as a team member, the advisor can admit to being off-base if necessary and can give others credit before himself or herself

It also goes on to say that these advisors often have:

- a wide range of managerial and professional skills
- superior organizational skills and detail orientation
- an ability to prioritize the normal daily flow of projects and client needs
- material levels of competency in key technical areas, including taxation, investment theory and practice, insurance, property laws, and accounting
- some experience in certain adjunct areas, including family governance, philanthropy, education, and performance reporting
- useful exposure to the structuring of commercial transactions, the litigation process, dealing with trusts and estates, usually garnered through working with multigenerational families whose circumstances are truly complex

As you might imagine, no one family office advisor has all of these traits. We work as a team to ensure that the broad base of experience required for this integrated service is there for every single client.

Reference: The "Integration" in Integrated Wealth Management: How Does It Work in Practice? By Miles C. Padgett and Louisa Wright Sellers 🌲🌲



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