



ALSO IN THIS ISSUE:

- Welcome to Risk Management 2.0.....2
- Selecting Your Personal Representative3
- New Additions to our Website4



The Northwood PERSPECTIVE

Chairman’s Message

Tom McCullough

Happy new year to all.

There were many positives in 2014, but let me tell you about one of the highlights for me. When we started Northwood 12 years ago, we had a vision of building a unique firm that could meet the needs of wealthy families. We wanted to offer integrated, objective and expert advice and to provide the confidence that clients needed in an uncertain world. As an advisor and entrepreneur, you always hope you can achieve your vision and serve clients well.

A few months ago, we asked some clients to write a specific testimonial to tell us (and others) what they think of Northwood and what they value most. It was a wonderful experience to read these comments and to see, in them, the fulfilment of our original vision. If I may, let me share a few snippets of their specific comments and you will see why I was so gratified to read their words. (The [full testimonials](#) are on our website.)



- “We first came to Northwood in 2003 after we had sold our family business. We weren’t exactly sure what we needed at the time, but Northwood has worked with us to build a comprehensive strategy for our family and our wealth, including investments, tax, insurance, estate planning, holdco management and family development. I don’t have to worry about all the individual pieces since they are all taken care of. Everything is 100% up-to-date and very well organized.”
- “Most firms are focused on investment management. While that is key for Northwood, they also understand that non-investment areas are just as critical to be able to sleep soundly at night. If someone asked me for my recommendation in choosing an advisor, I would tell them ‘Pick Northwood. You can’t go wrong.’”
- “Many advisors and institutions promise this integrated service, but Northwood actually delivers it. I have enthusiastically recommended Northwood to other families.”
- “They focus on what is good for our family, not on their own interests...and they seem to make a lot of things uncomplicated. In fact, it has all worked out even better than I thought it would and I am very pleased to be a Northwood client.”
- “I have now dealt with Northwood for over 12 years. I realize that I no longer worry about my investments. I used to pore through broker reports every Saturday morning, but now I have the confidence of a high quality portfolio carefully selected and managed by Northwood.”
- “Northwood has excellent people, they have delivered great low-risk performance, and they provide tremendous service in every area. They have earned my trust.”

It is with great appreciation and humility that I share these comments with you. We work hard every day to stay focused on our task and be open to new ideas. We are privileged to work closely with many other excellent professional advisors, we are proud of our fantastic staff team, and we are grateful for the confidence our clients place in us each day. It is truly rewarding to see a vision become reality.

Some Energy for the Conservative Investor

Dan Solomon, MBA, CFA, CFP



The rapid decline in oil prices in the last quarter of 2014 has created waves in the investment world and beyond. The effects are far-reaching. The energy industry across the globe has been forced to revisit the financial feasibility of their operations. Russia is facing a national crisis as the energy-dependent nation struggles with the swift and massive (50%) devaluation of its currency. Canada’s economic well-being is also heavily tied to oil and there are certainly regions within the country that will be facing harder times, while others will benefit from cheaper prices at the pump. And naturally, the investment community has paid close attention as the energy sector holds a prominent place in the equity portfolios of many investors.

As we are seeing now, and have experienced in the past, energy stocks can be quite volatile. For risk-averse investors in this country this can be a challenge, given that the sector makes up a large portion of Canada’s stock market. Of course there are several different ways to access the Canadian energy sector, depending on the degree of risk investors can withstand.



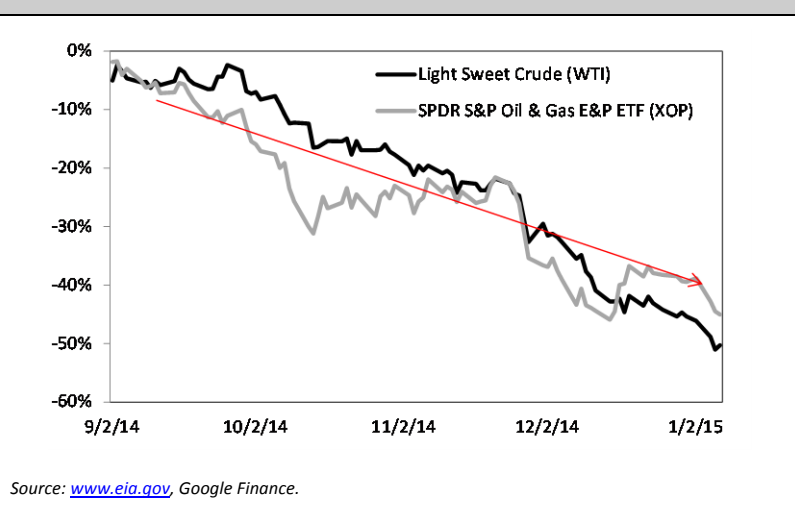
More aggressive investors typically choose to invest in upstream exploration and production (E&P) oriented companies that can offer significant payoff but are highly sensitive to the price of oil. Not surprisingly, E&P companies were hit the hardest late last year, and even well-established ones have seen material revaluations to the downside. For example, the XOP ETF that tracks the performance of E&P stocks listed on U.S. exchanges sustained a 45% decline

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between late August, 2014 and early January, 2105 closely tracking the 50% drop in oil for the same period (See Exhibit 1). This drop wiped out almost all the gains of the past five years.

Northwood's approach has been to focus on a more conservative way of investing in energy stocks in the context of our clients' diversified, risk-managed portfolios. We believe that holding a core of large and relatively stable integrated oil and gas companies can provide the benefits of portfolio diversification, growth potential, dividend income and inflation protection. These companies participate not just in E&P but also in the refinement and distribution of oil and gas. Due to their global and diversified operations they are less leveraged to the price of oil than E&P companies. Many also generate significant cash flows, which enables them to pay meaningful dividends and also cover their debt payments during turbulent times. Because of these features, their share prices tend to better withstand energy price shocks, as has

Exhibit 1: Light Sweet Crude (WTI) Oil Price vs. XOP ETF



been the case through the most recent drop. The pipelines, while not as diversified, should also be considered as an energy-related investment option as they have similar characteristics. In the

comparable period, the large integrated and pipelines experienced much less severe declines. For example, energy giants Exxon Mobile and Chevron fell 9% and 17% (in USD), respectively, while Canadian pipelines TransCanada and Enbridge dropped 15% and 6% (in USD), respectively. Of course, the selection of the specific companies is equally important as the choice of the sub-sector.

This conservative approach to investing in energy stocks

allows portfolios to enjoy some of the positive long-term attributes of the sector (and will provide some exposure if and when the sector eventually rebounds), while helping to protect portfolios against the types of air pockets we have seen over the past several months. 🌲

Welcome to Risk Management 2.0

Dr. Erwann Michel-Kerjan

This is an adaptation of one of the many thought-provoking guest essays originally featured in Tom McCullough's book, Family Wealth Management – 7 Imperatives for Successful Investing available on Amazon (<http://amzn.com/0470824298>).

As recently as a few years ago, few world leaders would have pegged the accelerating rhythm of large-scale catastrophes as one of the biggest economic challenges in the foreseeable future. But one of the hallmarks of this new century will be more and more such unthinkable events, previously unseen contexts, and pressure for individuals, private companies, and government authorities to react extremely quickly, even when they cannot predict the cascading impact their actions will have. The Global Financial Crisis (GFC) is just one of the latest – and perhaps most devastating – illustrations of incredible consequences of myopic behaviors.

Don't think only financial crisis, but also food and energy security, intercontinental pandemics, megaterrorism, and new war type; think worldwide global warming and large-scale natural disasters, to name just a few. In the first few years of the twenty-first century, the world has faced a string of catastrophes of a totally new dimension.

For instance, if you consider the 20 most costly insured catastrophes since 1970, more than half of them have occurred in the last decade.

And this trend toward more catastrophes will continue, in large part because of hyperconcentration of population/value in high-risk areas, climate change, and because globalization is making the world much more interconnected than ever before.

In order to do a better job at preventing or mitigating the cost of future disasters, there is an urgent need to better understand the new risk architecture. There are *six defining features* of the new world of risk we live in:

1. *Extreme cost/ extreme benefits.* There will be a much wider variance in possible losses and gains. The events in the past decade in the United States have translated into unprecedented economic consequences. It might be difficult to imagine that when Hurricane Hugo hit the country in 1989, it was the first catastrophe to inflict more than \$1 billion of insured losses. But times have changed. Hurricane Katrina in 2005 killed 1,300 people and forced 1.5 million people to

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evacuate the affected area – a historic record for the nation. Economic damages are estimated in the range of \$150 billion. With increasing urbanization and concentration of social and economic activities in high-risk areas, costs of catastrophes will continue to increase. It is also no wonder that new business opportunities around catastrophes are proliferating with a huge growth in catastrophe bonds ('cat bonds'), which are financial instruments transferring catastrophe exposure to investors in the financial markets.

2. *Confusing distribution of the roles and responsibilities of the public and private sectors.* In almost all catastrophes that occurred in the past 10 years, it has been almost impossible to dissociate the economics of catastrophe management from politics, which contributes to a fuzzy distribution of the roles in preparing against future disasters.
3. *Growing interdependencies/ globalization.* We are becoming more dependent on each other. At the annual meeting of World Economic Forum in Davos in 2007, former British prime minister Tony Blair stated that "interdependency is the defining element of the twenty-first century." While this is not totally new, we have reached a degree of interdependence that no other society has experienced before us. What happens on one continent today can affect those on another continent tomorrow. Certainly one of the most illustrating examples is the 1988 Pan Am 103 catastrophe, where an uninspected bag containing a bomb was placed on Malta Airlines at a small unsecured airport in Malta, transferred in Frankfurt to a Pan Am feeder line, and then loaded onto Pan Am 103 in London's Heathrow Airport. Pan Am 103 crashed over Lockerbie, Scotland.
4. *Change in scale from local to global risks.* One of the consequences of these increasing interdependencies is that disasters and crises are likely to affect a higher number of people. Dealing with large-scale disasters is much more challenging than dealing with a series of local small accidents. Resources and collaborative effort needed simultaneously are not simply cumulative but exponential. Furthermore, global response and global reaction capacity are needed. Multinational coordination becomes critical. Another important element is how information is shared on a larger

scale and among many more stakeholders whose actions are ultimately likely to affect the level of loss.

5. *Speed/ just-in-time.* The development of rapid transportation and cheap communication has created a 'just-in-time' society. People and products are moving faster and faster from one part of the globe to the other. While this provides a wide range of positive returns, there is also a flip side: Risks are more likely to spread across the globe very rapidly. Thanks to jet travel, for instance, viruses now fly business class too, so a pandemic starting in Asia today might very well spread extremely rapidly. The just-in-time society also puts pressure on us to make decisions faster than before, without necessarily taking the time to adequately measure the possible effects these actions will have on others and in the long run.
6. *Uncertainty, if not ignorance.* A lot of research has been devoted in the past decades to decisions under uncertainty, and the preceding features create an unprecedented environment in which assessing risks becomes more difficult. We were trained to solve problems with clear questions and clear scientific knowledge. Knowing the risk profile, we made investment decisions. But historic data does not shape the future any more, given how rapidly the world is changing. We move from risk to uncertainty or even pure ignorance. This is, of course, a major challenge.

The general surprise that came with the series of catastrophes and crises that have unfolded one after another over the past few years – including the GFC – reminded me of excerpts of *The Plague*, the famous novel written some 60 years ago by French author, journalist, and Nobel laureate Albert Camus: "There have been as many plagues as wars in history, yet always plagues and wars take people equally by surprise."

Welcome to Risk Management 2.0.

Dr. Erwann O. Michel-Kerjan is the managing director of the Wharton Risk Management and Decisions Processes Center at the University of Pennsylvania, and he teaches Value Creation in the Wharton MBA program in Philadelphia, Pennsylvania. He is an authority on managing the risks, financial impact, and public policy challenges associated with catastrophic events. 🌲🌲

Selecting Your Personal Representative

Barrett Lyons, CPA, CA, CFP, CIM



If it has been 3-5 years since you last updated your wills and powers of attorney, 2015 may be the year that you or your advisors dust them off to ensure they are still in line with your wishes and that the personal representatives you have appointed in these documents still make sense.

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

These are the individuals you appoint to carry out your estate wishes documented in your will(s). Depending on the estate size and your specific wishes, the role can be quite an onerous one that is carried on for many years and may require successive appointments.

When selecting a personal representative you will obviously want to appoint someone that has the ability and integrity, has the time, is trustworthy, and has your best interests at heart. However, for

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some individuals this choice can be a difficult one, due to family circumstances/relationships or lack of professionals or trusted advisors to select from. In this case an independent third party may be the best selection.

In considering appointments for an estate trustee or executor, below are a few topics to consider:

- *Number of decision makers* – You should generally have an odd number of trustees to eliminate stalemates in any decision making and provide in your will that decisions are made by majority rule. Otherwise decisions will have to be made unanimously, which is not realistic. 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. If you prefer two trustees, consider the appointment of a third party for tie breaking purposes.
- *Blended families* – If you settle a spousal trust upon your death in the case of a second marriage, be careful of your choice of trustee. If the spouse is appointed trustee, they may 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.

- *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.
- *Specific assets* – If your estate includes an asset that requires specialized knowledge (i.e. an art collection or business) consider appointing an expert as a representative for that asset only, while another representative manages the remainder of the estate. Alternatively, provide guidance to the trustees in a memo accompanying the will for the specified asset. The representative might otherwise overlook details in dealing with that specific asset that may be detrimental to the estate.

Above all else, when dealing with estate planning, communication is key. Having dialogue with your family, representatives, and business partners with respect to your estate wishes goes a long way in limiting conflict or confusion once you are gone. If possible, speak to your children about the decision of why you are selecting specific advisors or family members to be your personal representative as the explanation can provide clarity and reassure them after your death. 🌲

New Additions to our Website

There is already a wealth of resources for families on our website (www.northwoodfamilyoffice.com) and we are always looking for new ways to share ideas.

Be sure to visit our **new blog page** ([click here](#)) where we share our own perspectives on areas of interest that relate to managing family wealth as well as some excellent third party content that we come across in our daily reading. Check in often as we will be updating the material regularly.

Also, our **new video series** ([click here](#)) features the authors of *Family Wealth Management*, Tom McCullough and Mark Daniell, discussing a range of topics on family wealth that are covered in detail throughout the book.

As previously mentioned, we are excited to have added a page dedicated to **testimonials from our clients**, which can be found by [clicking here](#). 🌲



For more information, please call Tom McCullough or Scott Hayman at

Main: (416) 502-1245

www.northwoodfamilyoffice.com

Email: tmccullough@northwoodfamilyoffice.com

shayman@northwoodfamilyoffice.com

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