PERRON & PARTNERS
WEALTH MANAGEMENT

Interest Gained™

Our best insights and updates, every quarter.

Nov. 2015 **Issue No. 05**

Featured Articles

"We'll show you the sectors our research team is favouring, when to justify an active management fee, and – with the election behind us – how your wealth will shift with the political tides."

Changing Investment Climate

Gary Perron, CFA, Portfolio Manager, Founder

Welcome to our fifth newsletter, marking our 2nd anniversary.

Yes, it's been two years since the original four left the big bank and now we are a team of 11 professionals.

One advantage of independence is that we can change our asset management priorities without political or bureaucratic interference. Within one year, the political environment has changed in Alberta and Canada, where the high-net-worth households/individuals and corporations have become a target for the left political parties, making asset allocation more challenging. Top Alberta individual taxes will rise by **23%** in 2016 over 2015. In 2012, according to Stats Canada, the top 1% of income earners paid a staggering 20% of the total federal and provincial taxes. The top 10% paid 54% of all taxes, while the bottom 50% paid 4%.

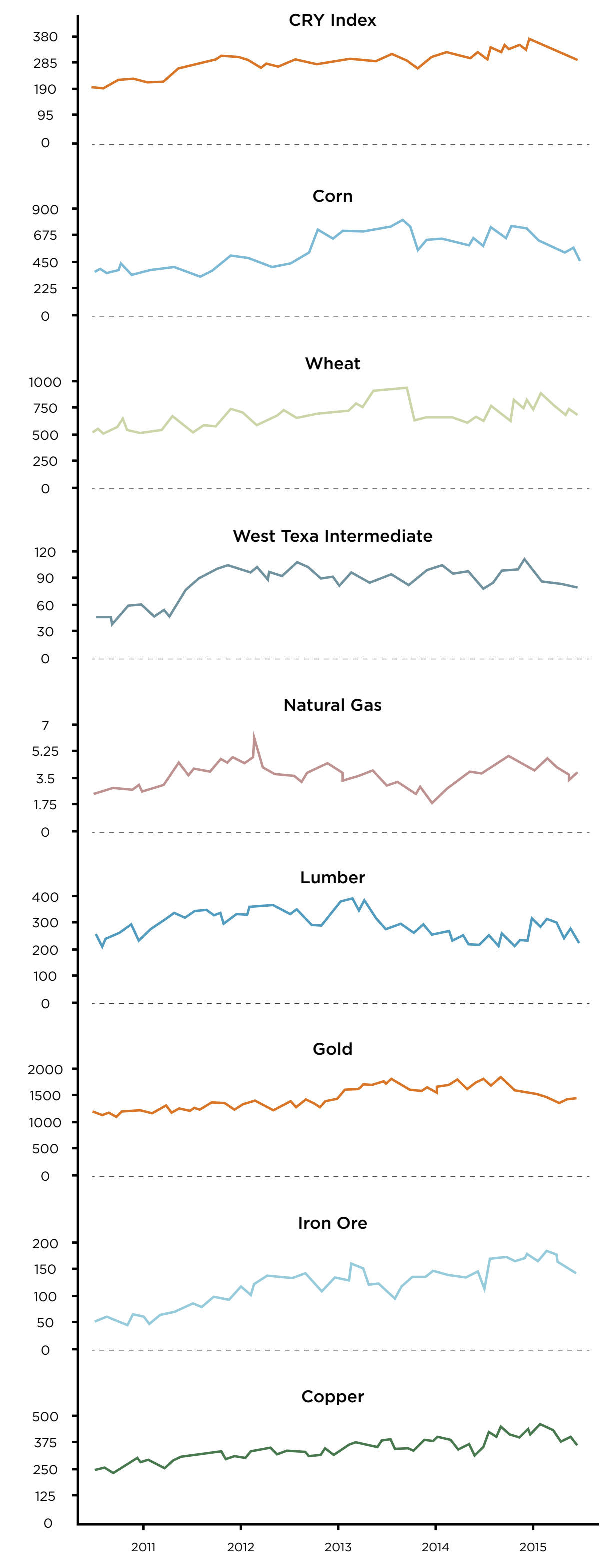
The new left politics are definitely going to disincentivize the productive to contribute as they have in the past and total tax revenues will decline. This has been proven again and again by various countries around the globe, most recently in the UK. These left governments will continue to spend more than the revenue they receive and will in-debt the country for the benefit of union employees and the unproductive, who receive more benefits from government programs than they pay in taxes. As Margaret Thatcher stated, "The problem with Socialism is that you eventually run out of other peoples' money." Unfortunately this could last for a decade in Canada.

Our challenge at Perron & Partners is finding businesses in which we wish to invest. One of the variables is the effective corporate tax rate of the business. The lower the effective corporate tax rate, the more the company has to reinvest into the business for growth, to increase dividends or to buy back stock in their company. Canadian governments continue to raise corporate taxes, which is confiscation from shareholders, and this affects the underlying valuation of the business. This makes Canadian companies less attractive for investment relative to US or Global companies.

Case in point, one of our most recent screens was finding public companies over the last 3 years that had (top line) revenue growth of at least 3%, dividend growth of 7% and common shares outstanding decline by 2%.

We ran our screen on the companies within the S&P/TSX Composite, and there were only three companies that met these variables. In the S&P 500, there were over 44 companies that met these variables, of which we own eight in our accounts and pools today.

Canada's economic growth and success greatly depends on commodity prices. HSBC Canada's Chief Economist David Watt stated, "Until Canada overcomes its productivity and competitiveness hurdles, it will continue to feature cyclical behaviours similar to those of emerging market economies." For equity investors, Watt's comparison will come as no surprise. The S&P/TSX Composite index has tracked the movements of the MSCI Emerging Markets index closely over the last 10 years. To the left, we have charted the commodity index (CRY Index) and some of the particular components that will affect Canada's economic growth. Our job of finding Canadian businesses in which to invest will be challenging until we have a price recovery in commodities.



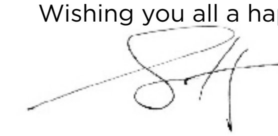
Source: Bloomberg

All commodity charts have indicated a reasonable decline in price in the last five years. Commodities are called cyclicals for a reason. There will be a price recovery, but the toughest judgement to make is on the timing. It could be three months or five years, and for each commodity it will be different. Our portfolios currently have a large non-cyclical component (financials, staples, discretionary, etc.) and the cyclical companies remain a minority allocation. The challenge is knowing when to enter back into the cyclical space and increase our exposure. Today, we are underweight cyclicals and will watch the commodity fundamentals to improve before we increase our portfolio weights.

In summary, we continue to focus our efforts on identifying the best businesses that meet our investable metrics and the majority of our new investable companies are outside of Canada. Our managed accounts continue to focus on owning non-Canadian companies and we are constantly looking to expand our resources toward a global effort.

This newsletter addresses: active share in our portfolios and pools, personal tax increases and how they will affect our investments, structural issues between US and Canadian investments, sector strategies, a balanced portfolio mandate and a discussion around family financial planning and values.

Wishing you all a happy fall!



Gary Perron, CFA
Portfolio Manager, Founder

Active Share, Tracking Error and Your Portfolio Manager

Jason Isaac, CFA, CAIA, Portfolio Manager,
Kipling North American Enhanced Dividend Private Pool

Investors and portfolio managers often ponder the best way to evaluate performance of a particular fund or investment strategy.

It is becoming increasingly common to examine a specific strategy in terms of how ‘active’ it is and what are the additional risks assumed in how it is managed. In other words, what is the value add and what does active management actually mean?

At the most basic level, an active manger adds value by deviating from the benchmark in one of two ways: stock selection and/or sector and regional weightings (factors). There are numerous studies that show, after fees, the average mutual fund manager underperforms their comparable benchmark. This has been attributed to the cost of active management; however, this is not the whole story.

Fortunately, there are tools that can help the investor understand what exactly the active manager is doing and how well they are doing it. Along with the traditional tool of measuring *Tracking Error*, researchers Cremers and Petajisto of the Yale School of Management, recently introduced a new risk measurement tool called *Active Share*. This tool complements and, in some cases, can be a substitute for *Tracking Error*. To get a complete picture of what active management means, it is critical to consider both measures.

- ***Active Share*** is the percentage of the actual holdings in the portfolio that differ from its passive benchmark. *Active share* is measured within the range of 0-100% in the case of long-only portfolios. Alternative strategies that allow for leverage or shorting capabilities can have an *Active Share* percentage greater than 100%. All things being equal, mutual funds marketed as actively managed, should have high *Active Share* ratios. A portfolio with an *Active Share* ratio less than 60% suggests it closely mirrors its comparable index, therefore not truly adding any value to the investor.

> “Fortunately, there are tools that can help the investor understand what exactly the active manager is doing and how well they are doing it.”

- ***Tracking Error*** measures the divergence between the price behaviour of a position or portfolio in comparison to its comparable benchmark. This measure tells the investor how different the risks of the portfolio is taking on relative to the common/structural risks associated with the benchmark. Therefore, the higher the *Tracking Error*, the more the strategy deviates from what the benchmark is doing. For example, a portfolio with a *Tracking Error* greater than 15% would be considered higher risk and a portfolio with 5% *Tracking Error* or less, would be considered lower risk. A high number indicates increased risks to the portfolio, that need to be accounted for and managed appropriately.

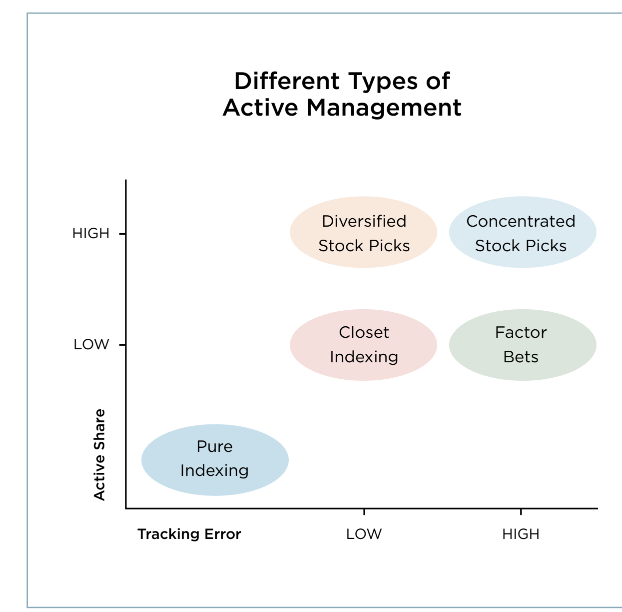
To summarize, *Active Share* and *Tracking Error* emphasize different aspects of active portfolio management. *Active Share* is a reasonable proxy for security selection (typically the higher the better) and *Tracking Error* measures the portfolio’s exposure to factors that do not affect the passive benchmark in the same manner (typically the lower the better).

> “A portfolio with an *Active Share* ratio less than 60% suggests it closely mirrors its comparable index, therefore not truly adding any value to the investor.”

Using these two portfolio management metrics, a separate research paper by Petajisto (2013 CFA Institute) looked at over 1300 actively-managed equity mutual funds in the US between the years of 1980 and 2009. He divided all of the funds into four broad categories in order to get a better understanding of what drives performance, the repeatability of those results, and the all-in costs for achieving them.

- **Diversified Stock Pickers** - these are active managers who hold individual security positions that are distinctly different than the benchmark, but also keep the portfolio well diversified, thus minimizing company and sector specific risks.
- **Factor Pickers** - these are active managers that focus more on factor bets, such as sector, industry or geographic weights, more than individual stock selection. An example would be an Index or ETF portfolio that is comprised of only a few sectors or regions. This usually entails larger risk/return discrepancies with respect to the benchmark and contains essentially zero ‘active’ positions.
- **Concentrated Stock Pickers** - these are active managers that combine large individual security decisions and have significantly less overall diversification. A portfolio that uses the S&P 500 as a benchmark, but holds 15-20 total stocks from only three or four specific sectors, would be an example of this management style.
- **Closet indexers** - these are managers that do not engage in any type of active management. A portfolio made up of a large number of stocks (80+) with weights that more or less match the benchmark.

Analyzing the results of *Active Share* and *Tracking Error* highlights some very important implications of which investors should be aware. Mostly importantly, how the type and degree of active management can impact the performance of the strategy.



Source: Cremers and Petajisto (2009).

Active Share, Tracking Error and Your Portfolio Manager *Cont'd*

Implications

- **Closet Indexers** - *Active Share* is useful in identifying managers who claim to be active but whose portfolios are very similar to the benchmark portfolio. Typically defined as an *Active Share* ratio below 60%, closet indexing is of extreme importance to investors because, with any strategy, management fees can be a significant hurdle to overcome. For example, a fund that charges a 2.0% management fee and is 60-70% identical to its benchmark would need the 30-40% portion of the portfolio that is different to outperform by 6% just to cover the fees and ensure that the overall fund will match the benchmark's return.

- **Performance*** - research has shown that a high *Active Share* is a good indicator of positive performance, not only versus the benchmark but also from one period to the next, suggesting there is persistence of results. Not surprisingly, closet indexers generally underperform by more or less the amount of their management fee and do not exhibit much persistence. High *Tracking Error* tends to be an undesirable trait because managers that focus on large factor bets have, on average, underperformed. Concentrated managers who combine high active security selection with factor bets have also underperformed their benchmarks, therefore showing effectively no repeatability in their results.

- **Timing** - the *Active Share* trait is most beneficial during periods commonly known as a 'Stock Pickers Market.' In general, active management that focuses on stock picking, works particularly well in periods of decreasing liquidity, relatively stable/slow economic growth and in periods when valuation multiples are contracting. Empirically, this makes sense. During these periods, company-specific issues will influence returns much more than macro factors.

- **Risk** - Given a positive relationship between *Active Share* and *Tracking Error*, there is also a clear distinction as to what each of these measures implies. All things equal, *Active Share* is desirable for investors since there has been historically positive and persistent returns without assuming additional risks. *Tracking Error*, on the other hand, can introduce risks above and beyond the systematic exposures that affect the benchmark; although research has found that this type of active management does not typically yield better performance. Intuitively, this aligns with one of the foundations of modern portfolio theory; investors do not get rewarded for specific risks that could otherwise be avoided for free.

Conclusions

Active management adds value to portfolio management. It is critical to be aware of not only the 'activeness' of a fund, but also where that 'activeness' is coming from. Active management entails making decisions about what market factors to have in the portfolio and/or what securities should be held. Investors and asset allocators should focus on finding strategies that offer high *Active Share* (security selection) and low *Tracking Error* (low factor risks) to help optimize their returns.

*The benchmark-beating results of high Active Share noted above are an average of that group. It would be wrong for investors to interpret the results in a manner that leads them to conclude that all managers with high Active Share portfolios will beat their benchmarks. The data only indicates that the average performance of this group of managers has been better than the average performance of managers with low Active Share, concentrated bets or factor positioning.

Tax and Financial Matters:
Tax Increases and the Federal Election

Chris Woodward, CA, CPA, Vice President Finance

I joined Perron & Partners this past June. I qualified as a Chartered Accountant in London, England in 1978, shortly before emigrating to Calgary. After qualifying as a Canadian Chartered Accountant, I worked with personal and corporate tax, accounting and GST with several Calgary firms, culminating with a period as a partner with the Calgary office of MNP LLP.

I hope to be able to contribute both to the firm and to its clients as a resource for tax and financial matters, and to complement the wealth management services already provided. I will also prepare occasional commentaries on current tax and financial matters for general interest. If something in the following discussion piques your interest, I would be delighted to discuss it with you in greater depth.

In this particular article, I hope to address the concerns many are having with the current shift in the political landscape. With the federal election now behind us and the Alberta budget on its way, significant changes are coming to all levels of the tax system.

Personal Taxes

The Alberta NDP government has implemented an increase in individual tax rates, effective October 1, 2015 on a prospective basis. The current 10% flat tax rate will remain in place for Alberta individuals with income not exceeding $125,000.[1]

However, for those with higher income, new graduated rates will be introduced, resulting in significant increases in the marginal Alberta tax rates.

Without considering the tax increases within the new Liberal government's election platform, the top 2016 combined federal and Alberta marginal rates of tax will increase from approximately:

- 39%* to 44% in 2016 for interest and other income,
- 19.5%* to 22% for capital gains,
- 19%* to 26% for eligible dividends (generally public company dividends), and
- 29%* to 36% for ineligible dividends (generally private company dividends, unless designated as eligible).

The federal Liberal government's planned top marginal rate for individuals is expected to be 33% (an increase of 4%) on income in excess of $200,000[2]. This means that, combined with the Alberta increases, the top individual marginal rate of tax will increase to as much as 48% (interest and other income over $300,000), compared with the 39% rate at the beginning of 2015. Tax rates on capital gains and dividends will increase commensurately.

*rate January 1, 2015. The top personal tax rate for interest and other income 2015 will be 40.25% as a result of averaging in the current 39% rate with the proposed new rates effective on October 1, 2015.

[1] Alberta budget, October 27, 2015

[2] Liberal Fiscal Plan – Growth for the Middle Class

Tax and Financial Matters *Cont'd*

Corporate Taxes

Alberta corporate tax rates increased by 2% on July 1, 2015, though this excludes corporations paying the small business rate for Canadian-controlled private corporations (CCPCs), which remains unchanged.

According to their election platform, the Liberals propose a 2% reduction of the small business rate, combined with a warning that there will be measures to ensure that CCPC status is "not used to reduce personal income tax obligations for high-income earners rather than supporting small businesses."[1]

"The Liberals have stated that their tax proposals will be their number one priority once they take office."

Other Initiatives and Targets

Other tax initiatives proposed by the new Liberal government, noted in their election platform, include[1]:

- A review of tax expenditure items, especially those that "unfairly help those with individual incomes in excess of $200,000"
- A reduction in the employee stock option deduction (a cap of $100,000 is proposed)
- Increased CRA enforcement against tax evasion

What Can Be Done to Mitigate the Damage?

Taking appropriate professional advice, individuals can weigh the pros and cons of triggering income earlier than they had planned, in order to take advantage of current (lower) rates. For example, (before accounting for proposed federal increases):

- small business owners can bring forward the payment of dividends (an effective tax rate of approximately 31% in 2015 vs. 36% in 2016);
- investors can crystallize capital gains in 2015 (tax rate of approximately 20%) rather than in 2016 (tax rate of 22%);
- investors can exercise vested stock options held while it is still possible to access the preferential tax rate (equivalent to capital gains rate).

Individuals would have to balance carefully the cost of early tax payment (in terms of the cost of funds), with the amount saved by taking advantage of current lower tax rates. Other strategies may be available.

The tax rate mechanism in Canada is not straightforward. If you are unsure how these tax changes will affect your income, call us.

What's Next?

The new Liberal government promising to go after the "top 1%" is a strategy of redistribution of wealth: "We will increase the marginal tax rate on Canada's top one percent so that we can cut taxes for the middle class"[1]. This reminds me of the 1970s pledge by Dennis Healey, Labour Chancellor in the UK, to "squeeze the rich until the pips squeak." The Liberals have stated that their tax proposals will be their number one priority once they take office.

The recent Alberta budget confirmed earlier announced income tax changes. As well, the usual "sin" taxes were increased – liquor, tobacco and gasoline.

What We Can Do for You

Our firm is ready to help you find tax, advisory and planning services most appropriate for your situation, through our extensive network of accounting and legal professionals.

For example, we can source expert advice for:

- income tax planning and analysis for your investments (e.g. flow-through shares)
- estate planning
- insurance (life and disability)
- financial and retirement planning
- philanthropy

We can also provide general guidance on a range of financial issues. I would be happy to meet with you to discuss your needs.

[1] Liberal Fiscal Plan – Growth for the Middle Class

Structural Differences between US and Canadian Equity Investing

Darrin Erickson, MBA, CFA, Portfolio Manager, Kipling US Dividend Private Pool

For most Canadians, investing in the Canadian stock market is only natural. Most are comfortable holding shares in companies like Royal Bank, BCE, Sunlife, Canadian National Railway and Sobey's.

Unfortunately, Canada's stock market represents less than 3% of the world total. Opportunities for reducing risk and improving long-term returns abound outside of Canada, but venturing beyond the Great White North can be intimidating, meaning opportunities are often missed.

The most immediate (and potentially the most advantageous) option for international investing is the United States. As we have discussed previously, the US is the largest and most liquid equity market in the world, representing roughly 35% of the world's total market capitalization (the number of shares outstanding multiplied by the current market price of the stock).

What's more, many companies in this market generate a significant portion of their revenue from all corners of the globe, providing investors with exposure to numerous economies and currencies. This in turn benefits the investor by maintaining his or her purchasing power, increasing portfolio diversification and reducing risk. Investors can also benefit from a level of transparency, as companies in the US apply strict accounting standards — something that exists in few other countries.

However, there are some key structural differences, between Canadian and US equity markets, that warrant mentioning:

- Most importantly, the US market is much broader. In terms of market opportunity, the following table compares the number of listed companies in Canada and in the US, by market capitalization:

	< $1 B	> $1 B	> $2 B	> $10 B	> $50 B	> $100 B	> $200 B
CANADA	3175	230	154	43	5	1	0
USA	8156	2096	1457	466	86	42	13

**As of September 30, 2015*

Structural Differences between US and Canadian Equity Investing *Cont'd*

- There are significant differences in terms of diversification between the two markets. The following table shows the composition of each at the sector level:

SECTOR	S&P TSX Composite (%)	S&P 500 (%)
Consumer Discretionary	7.2	12.9
Consumer Staples	4.4	10.0
Energy	18.7	6.9
Financials	37.2	16.5
Healthcare	4.5	14.6
Industrials	8.3	10.1
Information Technology	2.8	20.2
Materials	9.1	2.8
Telecom	5.6	2.4
Utilities	2.3	3.1

**As of September 30, 2015*

- The composition of each sector often differs substantially. The Materials sector, for example, is made up predominantly of metals and mining companies in Canada, and chemical and packaging companies in the US. Canadian banks tend to be low beta and operate within an oligopoly, while US banks are more cyclical in nature and operate in a more competitive environment.

- Different factors drive performance in each market, meaning strategies that work well in Canada may not perform as well in the US market and vice versa. For example, the US charges the same rate of tax on capital gains and dividends, while in Canada, depending on the recipient's personal tax situation, tax paid on dividends can be lower than tax paid on capital gains. This explains why dividend strategies are more popular in Canada than they are in the US.

- Looking at the markets over the long term, the US has tended to outperform the Canadian stock market. The average annual return for the TSX Composite over the past 44 years (as far back as our data goes) has been 9.5% compared to 10.9% for the S&P 500, when both are converted into Canadian dollars.

"Different factors drive performance in each market, meaning strategies that work well in Canada may not perform as well in the US market and vice versa."

A rigorous set of principles guide investment decisions at Perron & Partners. Naturally, this restricts the number of companies that we would be willing to buy, especially in a smaller equity market like Canada. By adding exposure to outside economies like the US, Canadian investors are expanding their investment options and preserving their wealth at a global level.

Should Your Portfolio Be More Balanced?

Shawnalynn Perron, MBA, CIM, Portfolio Manager,
Co Portfolio Manager of Kipling Monthly Income Private Pool

One of the most popular investment strategies out there, judging by the number of funds within the asset class, is the 'balanced' strategy. Why is this? Because it combines the need for capital growth with the need for conservative income generation and preservation, and this comforts those investors with moderate risk tolerance.

How do you know if a balanced strategy is the right approach for your portfolio, or for a component of it? Lets start by clarifying what 'balanced' means.

The term 'balanced' refers to a combination of fixed income/money market and equities/ securities, usually between the ranges of 30-70% of the portfolio.

If the portfolio consists of more equity, it would be considered more moderate in risk, whereas if it consisted of mostly fixed income, it would be considered more conservative – this strategy is about reaching a healthy balance between the two.

This balance can be different for each investor, and it can depend on any number of factors. The first is the comfort level the client has with exposure to fixed income and equity, as it's essential to understand the related risks of owning both asset classes.

The other most important factor in determining an appropriate asset allocation is the investor's current life stage. For instance, if you are near the beginning or middle of your career, you are at a

"Essentially, the shorter the time horizon, the more risk averse an investor tends to be."

Should Your Portfolio Be More Balanced? *Cont'd*

stage in your life where your time horizon for your savings and your investments is much shorter than someone considering retiring in a couple years. Essentially, the shorter the time horizon, the more risk averse an investor tends to be.

Near-retirement investment goals typically shift from being primarily growth - oriented to using a more conservative strategy with an income focus – one that will help maintain purchasing power throughout their retirement years. Naturally, their investment needs have changed and this is the point where a more balanced asset mix often becomes more suitable.

With this in mind, our Kipling Monthly Income Private Pool was created to meet the needs of clients who are more risk averse and would like the degree of stability that the balanced approach has proven to provide. The pool focuses on the following:

- Having an asset mix ranging from 40-60% in either equities or fixed income (depending on which asset class our investment team favours), with the ability to invest in Canadian, US and potentially global markets.
- Having the flexibility to actively change its asset mix and geographic weightings based on our team's market forecasts and quantitative/qualitative analysis within the defined parameters.
- Actively differentiating ourselves against our peers in the same category on Global Neutral Balanced. This category allows the pool to own investments within North America and in global markets with less than 70% of total assets domiciled in Canada.
- Having more concentrated positions with the chosen amount of diversification, across sectors and geographies in both its fixed income and equity components.

> "The balanced objective helps to preserve the capital you have worked hard to save and to achieve better returns than inflation."

Overall, the balanced objective helps to preserve the capital you have worked hard to save and to achieve better returns than inflation, in an effort to ensure the purchasing power of your money today can withstand the next 20-30 years in retirement.

If you should have any questions about this mandate, please contact Chris Bolton or Shawna Perron, co-managers of the Kipling Monthly Income Private Pool at Perron & Partners.

Sector Strategy

Chris Bolton, CFA, Portfolio Manager,
Co Portfolio Manager of Kipling Monthly Income Private Pool

While individual security selection is a major part of our investment process at Perron & Partners, we also spend significant time analyzing and identifying broader sectors in which to invest.

The Global Industry Classification Standard (GICS) was developed by MSCI and Standard & Poor's in 1999 to categorize companies broadly. The GICS structure consists of 10 sectors: Energy, Materials, Industrials, Consumer Discretionary, Consumer Staples, Healthcare, Financials, Information Technology, Telecommunication Services and Utilities. Real Estate is currently part of the Financials category, but is scheduled to receive its own category in 2016.

Increasing exposure to sectors that outperform, and decreasing exposure to sectors that underperform, can have a significant impact

> "Sector allocation is increasingly important and country effects are less important in explaining variations in global stock returns."

on returns over time. In an August 2000 paper entitled "The Rise of Sector Effects in Major Equity Markets" the authors (Baca, Garbe and Weiss) argued that sector allocation is increasingly important and country effects are less important in explaining variations in global stock returns. The August 2008 issue of the CFA Digest contained an article entitled "Sector Rotation and Monetary Conditions." Here the authors "observe[d] that the annualized return of the sector rotation portfolio exceeds that of the benchmark and market portfolio by an average of 3.49 percent and 3.79 percent, respectively. The rotation sector strategy outperforms the other benchmarks on a statistically significant risk-adjusted basis."

When evaluating sectors, the Perron & Partners investment team considers many of the same factors as we do when evaluating an individual stock:

- We attempt to determine if the sector is growing revenue, cash flow and earnings, at a faster rate than it has in the past, and at a faster rate relative to other sectors.
- We evaluate historically, volatility in cash flow, revenue and earnings.
- We consider the sector's valuation, based on metrics such as price-to-earnings ratio, return on equity and free cash flow yield.
- We consider other factors, such as liquidity/balance sheet strength and technical analysis.

Sector Strategy *Cont'd*

- Finally, and probably most importantly, we consider what assumptions may be underlying our forecasts and what factors and risks are involved in these forecasts.

Sectors Perron & Partners currently favour:

- **Consumer Discretionary** (particularly in the US): US consumers are currently benefiting from low gasoline prices, rising disposable incomes and reasonable employment growth. The strong US dollar is positive for companies that import goods from abroad and sell in the US. This sector has the second highest two-year cash-flow-growth per share, according to Bloomberg.
- **Information Technology:** This sector is generating higher organic growth than the S&P 500, yet it is trading at a discount (on metrics such as price-to-earnings). Despite a rising US dollar, the sector has generally been able to maintain margins by increasing prices. Increased use of information and technology is a long-term trend in almost all areas of our economy/lives.
- **Healthcare:** In our opinion, the Healthcare sector represents relative defensive growth. In the US, this sector has the highest forecast cash flow growth and the fourth highest forecast earnings growth over the next two years, while trading in line with the broader market (on a price-to-earnings ratio). Aging baby-boomers will continue to expand their need for healthcare services. In our opinion, the major risk is regulatory reform in the US, and we are monitoring the situation closely.

"The Consumer Discretionary sector has the second highest two year cash-flow-growth per share, according to Bloomberg."

Sectors Perron & Partners currently does not favour:

- **Industrials:** This sector has the third lowest cash flow growth in the S&P 500, yet it is trading at only a modest discount to the index. Weakness in commodity prices, emerging markets, and a strong US dollar have a negative impact on the vast majority of companies in these sectors. Also, this sector has lower pricing power than one such as Information Technology, as evidenced by its lower margins.
- **Telecommunication Services:** This sector has the lowest cash flow growth forecasts of any sector over the next two years. We expect that constant price deflation, a relatively saturated market, and the liftoff in U.S. interest rates will likely be a negative for this bond proxy and capital-intensive sector. It's nonetheless worth noting that historically this sector tends to outperform on a relative basis, in down equity markets.
- **Utilities:** Utilities are the most bond-like of all sectors, given their relatively stable fundamentals and high dividend payout ratio. They have the second lowest cash flow growth forecasts according to Bloomberg, yet they are paying a premium to the market (being the second most expensive sector on a price-to-earnings basis in Canada). Utilities do tend to outperform in a declining interest rate environment.

We are currently neutral on Financials, Materials, Energy and Consumer Staples. We remind our clients that Financials comprise 36.8% of the S&P/TSX Composite Index and therefore we expect they will remain a significant holding for most of our clients. Canadian Financials generally remain a solid source of dividends, as they are growing and most will benefit from higher interest rates.

In conclusion, we still believe clients should be diversified on a sector basis. While we favour three sectors over the rest, we do not believe it prudent to allocate all of one's assets to only these three. Furthermore, there are still many companies within those sectors that do not meet our investment criteria, and at the same time, there are still select opportunities within Industrials (such as in Aerospace and Telecommunications) that do meet our criteria.

Family Values: Understanding the Power of a Value

Shawnalynn Perron, MBA, CIM, Portfolio Manager,
Co Portfolio Manager of Kipling Monthly Income Private Pool

More likely than not, you know what your individual and corporate values are, but do you know what your family values are? And if you do, have you clearly articulated them? Do all the family members define and understand them in the same way you do?

So, what is a family value?

The family value system provides the foundation for how you live your family life. Values can be social, recreational, professional or moral, and they are innately passed down to your children and then their children. This develops trust amongst family members, which helps to define appropriate behaviours, relationships, governance, communication and self-management. It also provides clarity and structure, enabling you to make better decisions as a family unit and to create harmony. Some examples might include: love, respect, health, education, integrity, and listening.

Defining your values may not be as easy as you think. A lot of times, we find that we have two or more competing values and we need to determine which has priority. This is an extremely important exercise when working with the next generation to prepare for inter-generational wealth or business transfer.

If the patriarch/matriarch has not clearly articulated his or her family values and, in particular, values around the topic of wealth management and money, this process can become challenging and result in conflict and misunderstanding. It is imperative to define first your individual values and then the family values. If your values are clearly defined and practiced, they will start to shape more powerful conversations within the family, in particular around the tougher topics of wealth management and/or business succession planning.

"The family value system provides the foundation for how you live your family life."

If this topic of discussion is of interest to you, we would love to learn about your interests and family needs so that we can provide you with the information and answers you need.

> "Our services reward families who expect wealth management that is both custom and independent."
>
> **Gary Perron,** CFA
> Portfolio Manager, Founder

- **Truly Independent:** As an independent practice, we have no restrictions, directives or corporate incentives. We are in this business with one agenda: to preserve and enhance our clients' wealth.
- **Flexibility and Tailored Service:** With an open architecture, we have the flexibility to find the lowest costs, best platforms, and latest innovative ideas to meet your specific needs for risk, preservation and growth.
- **100+ Years:** Our core team is guided by over 100 years of combined industry experience.
- **Superior Due Diligence:** Our independence provides us the freedom to explore a variety of resources before selecting the appropriate investments and strategies for you.
- **Risk-Adjusted Investing:** We are experts in generating risk-adjusted returns. We also work to maximize results by controlling tax and identifying low-cost investment options.
- **Business Expertise:** We work with business owners to develop succession strategies, identify taxation opportunities and implement complex investment plans.
- **Family Wealth Guidance:** Through simplified guidance and a personalized approach, we work with families to grow, preserve, plan and transfer wealth.

IIROC Investment Industry Regulatory Organization of Canada

CIPF Canadian Investor Protection Fund MEMBER

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