

THE ARTISAN

ISSUE: SUMMER 2019



THE MARKETS



UPDATE AND
OUTLOOK
Page 2

AN UNCERTAIN WORLD

We are now living in a period of financial uncertainty and it is reflected in the financial markets.

WHAT'S NEW



ORIGINS AND
UNDERSTANDING
Page 2

We Live In Interesting Times –
A Blessing Or A Curse?

BRUSH STROKES



A 25-YEAR TAILWIND
HAS BENEFITED
CORPORATE PROFIT
MARGIN EXPANSION –
CAN IT CONTINUE?
Page 6

It is unlikely that this pattern will
continue indefinitely.

PLANNING FILES



IT'S NOT JUST
ABOUT THE MATH
Page 6

...when you are making important
financial decisions, know the math,
but don't feel bad if you are making a
decision that deviates from the math...

Northland Wealth Management is proud to have won for the 2nd consecutive year **Advisor of the Year (Alternative Investments)** at the **Wealth Professional Canada Awards**; the leading awards event for the Canadian wealth management industry.

It is Northland Wealth's ability to access 'best in class' alternative asset managers from around the world which can help to protect and grow each family's wealth over generations to come. Our extensive and proprietary network is unmatched by the Canadian banks, investment dealers and advisors.



As we celebrate our 8th Anniversary we welcome you to this edition of The Artisan. Our lead story "Revisiting the Value of Value" was published in the Financial Post Magazine this past autumn. We then delve into the sometimes complex subject of financial planning in "It's Not Just About the Math". While the phrase "May You Live in Interesting Times" is sometimes construed as a curse, in this situation we highlight Northland's efforts and approach into understanding the global risks or potential 'black swan' events to better protect each family's wealth. We hope that you enjoy these insights along with our Quarterly Market Commentary and more.

Thank you to all of our client families for the privilege of being able to serve you.

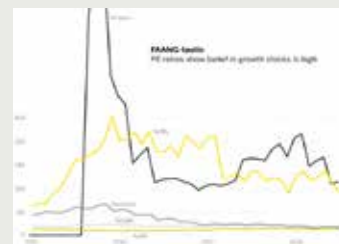
PERSPECTIVES



REVISITING THE VALUE OF VALUE From the Financial Post Magazine

Buying FAANG stocks makes
investing easy, perhaps too easy.

The recent outperformance of the Facebook, Apple, Amazon, Netflix and Google stocks, affectionately known as the FAANGs, has drawn many investors into these five names. Given their market superiority and growth over other stocks and sectors since the Great Financial Crisis 10 years ago, some weary investors might well be asking: Why not reduce my headaches and just own these five?



To best address this, we should first go back to the words of Benjamin Graham, mentor of Warren Buffett. Graham is considered by many to be the creator of modern day value investing, a concept detailed in his two classic investing books, *Security Analysis* and, later, *The Intelligent Investor*. Until these books were written, people bought what was going up and sold what was going down, which is akin to buying high and selling low.

(CONTINUED ON PAGE 4)



NORTHLAND
—WEALTH MANAGEMENT—



ORIGINS AND UNDERSTANDING



We Live In Interesting Times - A Blessing Or A Curse?

The expression “We live in interesting times” might sound like a blessing, yet it is often viewed as a curse. ‘Interesting times’ in historical terms usually refers to time periods that were compelling enough to appear in history books. These are often characterized by war, conflict, and disorder. The so-called non-interesting times are characterized by peace, abundance, and tranquility.

From a portfolio management perspective, time periods described as ‘interesting’ are also the most tormentous periods for investment returns.

From a portfolio management perspective, time periods described as ‘interesting’ are also the most tormentous periods for investment returns. It’s times like these that a family office with a team of experienced portfolio managers and analysts is worth its weight in gold. So, the question is: are we living in interesting times right now? Will future PhD history students concentrate on studying and writing about the next 50 years? In our view, the answer is an unequivocal yes.



Representatives from Northland Wealth Management’s investment committee attended an annual general meeting in Washington, DC for an alternative asset manager which we invest with on behalf of the families we serve. On the same trip, we visited other managers within close proximity of the White House.

The highly qualified speakers included former Director of the National Security Agency (NSA), General Keith Alexander, and former NATO Supreme Allied Commander, Wesley Clark, among other thought leaders noted below.

The main themes covered were: U.S. - China trade, increased scrutiny of tech firms, Washington’s dysfunction, and the future of democracy.

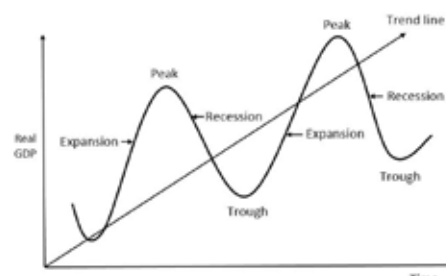


UPDATE AND OUTLOOK

AN UNCERTAIN WORLD

We are now living in a period of financial uncertainty and it is reflected in the financial markets. The bond market appeared to be at the end of a thirty year bull market, but now interest rates are falling rather than rising. Equity markets have had a major run for 10 years – it has not been a smooth run but they are up significantly. Since August of last year the Dow Jones Index has run into resistance above 26,000. The S&P 500 has just penetrated its old September 2018 high, while the NASDAQ is also just reaching old high territory. Are struggling equity markets trying to tell us that a recession with falling corporate earnings and equity market declines is coming soon?

Are struggling equity markets trying to tell us that a recession with falling corporate earnings and equity market declines is coming soon?



Historically, recessions have been a normal occurrence in free capitalistic economies. They serve as a cleansing mechanism as excesses build up in economies. In the past, excess production expansion has been the common cause of recession. However the nature of more recent recessions has been quite different from those after World War II. From the 1960s to 1980s, economies were dominated by manufacturing companies, such as the auto companies and General Electric. Recessions were caused by over expansion of production, which led to production cuts, which resulted in job losses and economic

ORIGINS AND UNDERSTANDING (CONTINUED FROM PAGE 2)

contractions until a stable demand and supply balance was reached. In more recent times, recessions have been set off by excess financial leverage. The 2001 contraction was largely the collapse of the dot.com craze (remember Nortel as a large percentage of the TSX). In 2008 it was the excessive U.S. housing expansion and the transfer of the risk to the mortgage derivative market that then collapsed. The fact that we have had an unprecedented long and relatively uninterrupted recovery requires some explanation.



Western economies in general are no longer goods-producing economies, where the curtailing of production means a major increase in unemployment and a further contraction. They are now service economies where a contraction has a much milder impact on unemployment. While these economics are less vulnerable to recession than in the past, this does not mean economic cycles are eliminated. At this current time, there has been an alarming increase in BBB rated corporate debt. This is debt that is one rating away from non-investment grade (aka 'junk'). Many bond covenants have also weakened to levels that would have been deemed unacceptable only a few years ago. As investors reach for yield in the low interest rate environment, we believe many have become too complacent. A new area of potential risk has appeared.

The other new risk element for world economies not faced for many years is the prospect of trade wars.

The other new risk element for world economies not faced for many years is the prospect of trade wars. In the Great Depression

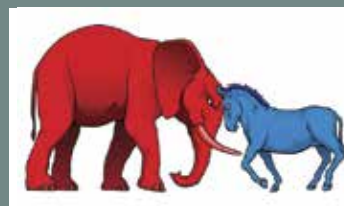
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There is a broad concern and skepticism toward the Chinese government, their ambitions, and motivations. The U.S. administration understands it can inflict economic pain, but may have underestimated the Chinese' ability to play the long-game. If anything, this makes the Chinese economy more resilient and underscores the need in their minds to forge a different path than reliance on the U.S. Other countries like Russia, Iran, and North Korea were also punished economically, but they still stand.

On U.S. tech firms, former U.S. Secretary of Treasury and former President at Harvard University, Dr. Lawrence Summers commented that "any strict regulation on Google, Facebook, etc., by the U.S. administration would be like shooting themselves in the foot. The sector has been a beacon of growth and pride - it shouldn't be constrained".

Chairman of the Senate Judiciary Committee, Senator Lindsey Graham (R-SC) was optimistic that a great bargain can be achieved on immigration. Both sides are willing to compromise as the topic is too important to ignore.

Former Mayor of Chicago, Rahm Emanuel, who was previously Barack Obama's Chief of Staff, argued that Trump is very smart, in tune with the populace, and shouldn't be taken lightly in 2020 - it's his election to lose. The key



to winning is to co-opt the suburbs and align their votes with the urban populace, which often votes for Democratic candidates.

On democracy, there was a general sense that the polarized system we have now is unsustainable, and that at some point the nature of our governing system will have to adapt to autocratic rulers in China, Russia, and other parts of the world. There's a fear that in the 2020 election the U.S. could shift ideologically from the right, to the far left.

There are opportunities that present themselves when political and economic conditions gyrate.

There are opportunities that present themselves when political and economic conditions gyrate. These solutions in Washington DC focus on regulatory arbitrage, specifically as it relates to the financial sector.

At Northland Wealth, we have a philosophy of building portfolios that will be resilient to interesting times, but also attempt to take advantage when opportunities present themselves.

Victor Kuntzevitsky, CFA, CAIA
VP, Investment & Portfolio Strategy

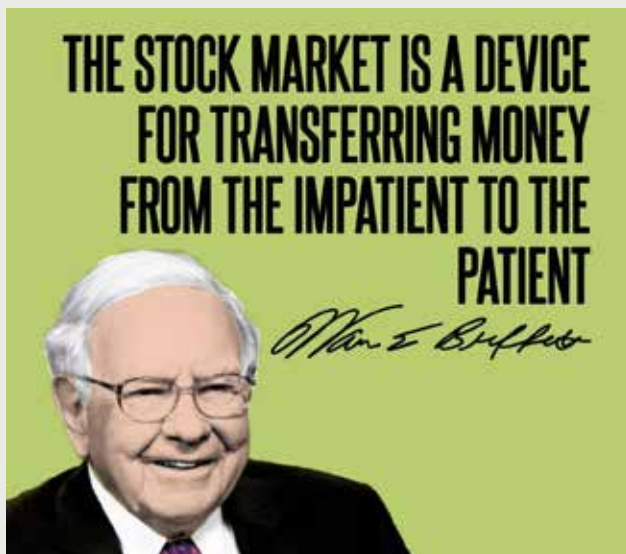




PERSPECTIVES: (CONTINUED FROM PAGE 1)

...buying when valuations are reasonable is easier said than done.

Graham was one of the first to recognize that the share of a stock represents an ownership interest in an operating business. By studying a company's financial statements, management, dividend policies, etc., it is possible to determine its fair value. All an investor has to do is wait for an opportunity to buy when a company's market price is at a discount in order to achieve a margin of safety over time. However, waiting is like watching paint dry and people often lose interest before an opportunity arises. It is also human nature to become excited when stock prices surge and to get depressed



when they collapse. Thus, buying when valuations are reasonable is easier said than done.

Most investors are not value investors, but prefer to operate as growth investors. There are two main reasons for this. First, investing in growth stocks is simple and fun. In general, people like investing in stocks that represent the future and that everyone is talking about. Also, it's much easier to invest when there is no need to read and understand complicated and boring financial statements. It's so much easier to buy a stock that everyone thinks is rapidly growing and the only direction is up. Secondly, to add fuel to the fire, when growth stocks are in favour, they can be in favour for years and turn anyone into an

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UPDATE AND OUTLOOK (CONTINUED FROM PAGE 3)

of the 1930s it was generally accepted that tariffs prolonged and deepened the economic decline. While service-dominated economies are less vulnerable to tariffs, a return of a trade war could prove disruptive.

Where is Canada right now? As is always the case, Canada's economic future is very dependent on what's happening to our southern neighbour. The US Federal Reserve has again stated its intentions to lower interest



rates. While the timing of its rate reduction is still an open question, some market predictions see a rate cut as early as July. There are signs that the US economy is already weakening, with forecasts of GDP growth reduced this year to 2.2% and next year to 1.2%. The ISM Manufacturing Index in May fell to a 31 month low reflecting weak global demand and supporting contention that world wide growth is declining. As of yet there are no indications the US economy is slipping into recession.

US importers are scrambling to switch to alternative suppliers rather than the Chinese.

Consumer confidence remains high and labour markets are still strong with unemployment holding at 4%. Inflation remains well under control and investment markets have been encouraged by the Federal Reserve's dovish stance. However, the prospect of an escalation of the trade dispute with China is a significant cause for concern in corporate America. US importers are scrambling to switch to alternative suppliers rather than the Chinese. South Korea, Taiwan and Vietnam have seen shipments to the U.S. rise sharply. As major U.S. corporations announce plans to shift production out of existing Chinese sources elsewhere, such actions are likely to add to costs and affect the economies' future corporate strategies for the worse. Further escalation of the trade dispute with China with the imposition of a full 25% tariff on all Chinese imports would potentially reduce the U.S. GDP by 0.7%

In Canada, GDP growth continues to exceed forecasts with estimates for the second quarter now at 2.5% annualized. The Bank of Canada (BOC) held the bank rate steady despite the strong indications of a looming Federal Reserve rate cut. But the BOC has seen the inflation rate edging over 2%. By holding the bank rate steady, the BOC faces the uncomfortable risk of a higher Loonie, which may hurt Canadian exporters, but this would be deflationary - something the BOC would welcome.

Again, US politics will be a major factor in Canada's economic outlook.

While the Federal Liberal Government has approved the much needed Trans Mountain Pipeline Project, it is yet to be seen if it will proceed. Canada is also waiting for the US to approve the new NAFTA agreement with the US and Mexico. Again, US politics will be a major factor in Canada's economic outlook. Added to



this, the Chinese blockage of Canadian farm products is a further future complication. The upcoming Canadian Federal election campaign may produce some negative commentary on Canada's prospects.

Given the foregoing, it is hard to see anything but a clouded and negative psychological atmosphere for financial markets in the next few quarters. Markets failed to see the 2008 crash coming so why should this time be different? With that said, given the trade concerns are self inflicted, it is conceivable that the Trump administration can roll back tensions if it hurts their prospects in the 2020 election.

Our strategy in the fixed income asset class continues to avoid exposure to long-term fixed income investments while favouring opportunities that focus on the "real economy" rather than the "financial economy". The areas where we see the greatest return vs. risk is in the area of supplying growth capital for companies (private debt), hard asset lending (private mortgages) along with critical infrastructure.

In the equity portion of portfolios we favour the utilization of ETFs to gain a low-cost and diversified global exposure, which utilizes a combination of indexing along with low-volatility factor based strategies. For investors with long-term horizons and a reduced need for liquidity, private equity (both in the growth equity and secondary sectors) has the potential to create value in excess of the public markets over time.

As a compliment to fixed income and equity asset classes, we continue to view multi-family real estate as having good potential as strong rent growth should compensate for higher interest rates.

David Cockfield, MBA, CFA
Managing Director & Portfolio Manager



Arthur C. Salzer, CIM, CFA
CEO & Chief Investment Officer



PERSPECTIVES: (CONTINUED FROM PAGE 4)



investment genius. Why would an investor hire a money manager or hold a diversified portfolio when it's so easy to make money?

Growth stocks today have outperformed value stocks by more than 130% over the past decade. The last time growth outperformed value by such a large margin was in the 1990s. Even the legendary Warren Buffett could not keep pace with growth stocks back then: for instance, the Nasdaq in 1999 was up 86%, while Berkshire Hathaway Inc. was down 20%. To the investing public, value was dead on arrival — along with prudence and diversification. For those too young to remember, there was a cataclysmic change from growth to value stocks in the early 2000s, corresponding to the dotcom crash, which led to decline of 75% in the tech-heavy Nasdaq over a period of 18 months. Offsetting these losses, value stocks, such as Berkshire Hathaway, generated positive returns of more than 30% during this tumultuous time.

**...the market over time always
reverts to the mean and, by
extension, common sense
valuations.**

Fast forward to today: the PE multiple of Amazon.com Inc. is 150x, Netflix Inc. is 163x, while Apple Inc. is a relative value at only 19x. We are not suggesting an imminent crash in these stocks is in the cards, but we are also well aware that there is better value and, therefore, a margin of safety in other names and sectors of the public equity markets. Will the stock run of the FAANGs go on for the foreseeable future? We don't think so. Remember, the market over time always reverts to the mean and, by extension, common sense valuations. It may be time to harvest the gains from the FAANGs and look for better value in other sectors.

Arthur C. Salzer, CIM, CFA
CEO & Chief Investment Officer



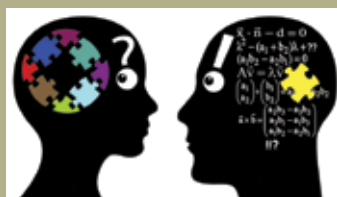
IT'S NOT JUST ABOUT THE MATH

Math is important and certainly a big part of financial literacy, but many focus solely on the math and often do not place the appropriate value on the non-math factors when it comes to decision making. If all decisions were based purely on the math, then one could make perfect decisions if all factors are considered. However, in life that is just not the case. The reality is we need to consider the "Human Capital" that we have referred to in the past.

I subscribe to the belief that personal finance is a science and that successful planning actually happens with elements like logic, research, process and discipline as opposed to things like luck and intuition. That being said, I also believe that emotions also play a very important role in your financial decisions.

PSYCHOLOGY VERSUS MATH IN PERSONAL FINANCE

Many personal finance questions boil down to a decision between psychology and math. When deciding between two options, you can run the numbers and know which option makes more sense financially. However, even while knowing the math, some people choose to ignore the numbers, and make decisions that don't maximize their net



worth. Are these bad decisions? Not necessarily, because in many cases psychology is more important than math.

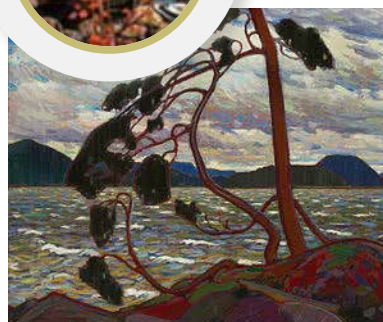
Is math or psychology more important?

For some people math = psychology. Knowing that you are maximizing your accounts and your net worth may be what's most important to you - leaving money on the table bothers you. This is when math and psychology become one and the same.

But for most people psychology trumps the math. Many people derive non-monetary benefits from their decisions. Living in a home that they own is

(CONTINUED ON PAGE 7)

A 25-YEAR TAILWIND HAS BENEFITED CORPORATE PROFIT MARGIN EXPANSION – CAN IT CONTINUE?



The past 25 years have seen many positive forces contribute to corporate profit margin expansion globally, which in turn has propelled stocks ever higher on all major exchanges. It is unlikely that this pattern will continue indefinitely.

Decline in Organized Labour

A reduction in labour's bargaining power due to the decline of organized labour and unions has been a significant contributor to profit-margin expansion. There are many factors driving this trend, with the primary contributors being access to cheaper foreign labour and an increase in the use of automation in manufacturing. Real wages have lagged productivity gains in the major developed world economies since the 1990s, allowing corporations to garner an increasingly larger share of the overall output.

Increased Globalization

Globalization (how countries are coming together as one global economy, making international trade easier) has grown dramatically since the 1990s. Technology has helped the world become more integrated (socially, politically and economically) and encouraged pools of capital and labour to come together more efficiently than was possible in the past. Businesses have used this as an opportunity to shift operations abroad and outsource a range of activities that can be accomplished at a reduced cost in developing nations. These changes have lowered labour costs for producing goods and in turn exerted a downward pressure on wages in developed countries. Globalization has also provided opportunities for businesses in developing nations to tap into new, faster-growing markets, thus benefiting sales growth.



Corporate Consolidation

The past 25 years have seen high levels of merger and acquisition activities in all developed markets. Companies buy other businesses in order to grow revenue and earnings - by adding new product lines and expanding into new markets - and to cut costs. An example that is close to home is Canadian Tire. Over the years their acquisitions have included Mark's Work Warehouse (now branded as Mark's), Sport Chek and Sports Experts. This rising concentration within a sector generally leads to expanding margins, suggesting that greater pricing power comes from having more economies of scale, less head-to-head competition within a market and a stronger bargaining position against labour.

Falling Taxes and Interest Rates

Corporate tax rates have generally favored businesses over the last few decades. Globally, corporate tax rates are currently at all-time lows. The recent US tax reduction is the largest and most recent cut.

We have also seen borrowing costs falling for corporations globally. The sustained reduction in interest rates has been a meaningful support to corporate margins, as companies have been able to fund investment at a much lower cost, thus keeping their debt service expenses at historically low levels.

Looking Forward – Can it Continue?

Global labour costs have moved closer to an equilibrium. Unemployment is at generational lows and there are currently 8 million job openings in the United States - it is inevitable that we will see wage price inflation. Government budget deficits and accumulated debt are at historic highs. It seems probable that over time there will not be upward pressure on corporate tax rates. Interest rates are at historic lows – leading one to suspect that over time there will likely be a reversion to the mean, thus requiring businesses to fund at higher levels.

While we are still constructive on the public equity markets the forces outlined above encourage us to continue to search out high quality alternative investment solutions for our clients that are not correlated with the public markets.

Gregory Lawrence, CPA, CMA, CFA
Vice President, Wealth Management



something that some people value immensely. Even when it doesn't necessarily make sense for them financially, they feel the need to buy a home and be earning equity instead of just paying rent to someone else. They potentially are paying a price to feel like they have achieved something.

Most people would rather maximize happiness instead of maximizing money. In general more money is correlated with more happiness, but the marginal benefit of each additional dollar actually declines after a certain point. So, if you derive a lot of non-financial benefits

from a sub-optimal financial decision, then you may be happier to let psychology trump the math.



MAKING THE BIG DECISIONS

In medicine there is a principle called informed consent. Doctors inform patients of the risks, benefits, side effects, and alternatives associated with a prescribed treatment. With informed consent patients can then make the medical decisions that they believe are best for them. You can do the same thing with your personal financial decisions. Be an informed financial decision-maker:

1. Keep your company pension in place, or take the commuted value at retirement.

One solution provides consistent retirement income and the other potentially leaves a larger estate to your family.

2. Topping up unfunded years in your company pension, or keeping additional funds in an RSP..

Some prefer to have access to additional funds versus being on a fixed income.

3. Establishing a trust in your estate to protect a spend thrift child.

This will protect your hard-earned money from frivolous spending, but it also has the potential to be taxed at a higher rate.

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West Wind by Tom Thomson

(photo on page 6)

Painted in the winter of 1916–17, this lone pine tree demonstrates that Thomson's formation as an artist was both erratic and original. The image, based on a landscape he

knew well, contains imaginary elements too. Thomson places the pine tree alone on a point beside a lake. It stands in the middle of the canvas, lopped off at the top—a position that transforms a simple subject into one making a strong and provocative statement. The twisted trunk and branches show age and perseverance, and bravery against the elements.

The painting may also reflect Thomson's state of mind—a kind of mental or metaphorical self-portrait. He may have felt empathy with the tree, for the way it had grown and survived.



IT'S NOT JUST ABOUT THE MATH (CONTINUED FROM PAGE 7)

4. Wrapping up a holding company that no longer serves its purpose.

Taxes associated with the wind down of a company could be offset by annual reporting fees and the lack of simplicity of your financial picture.



5. When to take your government pensions.

The math indicates the longer you wait the higher the monthly amount, however many believe they are entitled to the money and should receive funds as soon as available. The "sleep factor" or consistent cash flow is often appealing.

6. Borrowing to invest.

In certain circumstances the math can work, with there being a net benefit after borrowing costs and taxation. However, many are just not comfortable with being in debt, even if there is still a net positive on the math side.

We often refer to actuarial calculations, however our date of death is not known so the calculation is only an estimate or assumption based on tables of data. The reality is there are pros and cons, consequences and benefits to each option.

So, when you are making important financial decisions, know the math, but don't feel bad if you are making a decision that deviates from the math. You are not a corporation trying to maximize shareholder value and profits. You are a human being making financial decisions that make the most sense for you.

At Northland Wealth, we are here to help our clients with both sides of the equation. It's important to understand the math and the psychology of your big personal financial decisions. If you know the math and you know the psychology of your personal financial decisions, then you can make the decisions that are right for you.

Jeff Sproul, Hon BBA, PFP, CIM
Vice President, Wealth Management
and Associate Portfolio Manager



The Pioneers: The Heroic Story of the Settlers Who Brought The American Ideal West

by David McCullough

An inspiring tale of little-known patriots and the big-time impact they had on America. Drawn in great part from a rare and all-but-unknown collection of diaries and letters by the key figures, *The Pioneers* is a uniquely American story of people whose ambition and courage led them to remarkable accomplishments.

The Silk Roads: A New History of the World

by Peter Frankopan

The trade routes which connected the East and the West also led to the spread of ideas, cultures and religions. In the midst of the budding trade war, perhaps some history on trade between China and the world might shed some light on current affairs.



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