CastleMoore News

Buy, Hold... *and* Know When to Sell™

VALUE INVESTING

By Ken Norquay, CMT, Partner

Many investment advisors claim to be value investors. They use statistics such as earnings per share and book value per share, to judge the so-called value of a company. If the price of the stock is below their calculated value, it's a bargain. If the stock is trading higher than their calculation, it's selling at a premium.

I sometimes wonder if investments have value that's not accurately accounted for in their bookkeeping. Accountants call it goodwill. A good example would be Tim Horton's stock. Some people buy their coffee just because they like the Tim Horton's brand. That Tim Horton's brand is a great example of goodwill. What's the brand really worth? How do you put a value on something like that? Between the accountants and the stockbrokers, they have figured out how to value goodwill. But is it really value? Or is it just something they made up?

At CastleMoore we think differently. We like to talk about the value of your portfolio. We are less inclined to value Tim Horton's or Starbucks: for us, it's important that they add value to your portfolio. It's important to us that the price is going up over time. And we think it's important to you too.

A case in point would be the wonderful financial story of Apple and Research in Motion stocks. Apple's stock has been going up forever, it seems. RIM has been going down for what, to its shareholders, might seem like forever. Apple's new products seem wonderful to securities analysts and Research in Motion's seem less than wonderful. If we measure value in traditional accountants' ways, using earnings and book value, Apple seems overpriced and Research in Motion seems a bargain. But Apple keeps going up and RIM keeps going down. The way traditional analysts approach it, value investing is tricky business. For CastleMoore, life is simpler. We'd like to own lots of stocks like Apple and none like RIM. Investments in up trends add value to your portfolio. Investments in down trends are disasters for your portfolio. CastleMoore's investment techniques involve adding investments that go up in price and weeding out investments that go down in price. That's our value. It's easy to say, but not so easy to do.

Investment professionals and accountants have a narrow view of what value really is. In this area, it's investors, ordinary people who are the experts on values. What really matters in our lives? Yes, making money is important, but what really matters?

Last week I sat with my mother in the last hours of her life. As I sat I pondered, what has been important to her. What was valuable to her? The value of her portfolio was way down on her list. Earnings and book value were not even on her list. She left those boring topics for investment professionals like me. In her world, it was me who was valuable. And in my world, it was she...

In the investment world, human relationships are valuable too. And every good securities salesman knows it. A good financial planner/salesman knows that ordinary people value relationships, not accounting terms. So they are nice people.

Which is more valuable, your portfolio or your relationship with your advisor?

My mother tried to strike a balance between being an artist, and putting dinner on the table. Her advice to investors would reflect that balance. She would advise you to keep one eye on the value of your portfolio and one eye on your relationship with your advisor. And leave the accounting to the accountants.

ken@castlemoore.com
1.905.847.8511 or toll free: 1.877.289.5673 www.castlemoore.com

6 OR 7 OUT OF 10 IS GOOD

By Robert 'Hap' Sneddon, FCSI, President

First published in 2009 and worth the reprint.

Good portfolio management, like many things in life, is about managing your mistakes, about managing your investment misses. Another way of looking at it is through the process of risk management. Risk management considers the inherent danger to capital or income from investing and lays out an investment plan, or more specifically, creates portfolio attributes that attempts to deal with that danger. Of course, before one invests a degree of risk is necessary; without it there is little potential for wealth creation.

In the year 2000, the process of managing risk changed. Selling is the best way to reduce investment risk for the world we live in today and for a long time into the future. When investors adopt a sell discipline they can expect a different portfolio management experience from the one that they are currently familiar with.

For many years conventional thinking by the investment community held that risk was simply controlled through diversification. In 1952 Harry Markowitz, brought the industry modern portfolio theory in his article "Security Selection", published in the Journal of Finance. Markowitz's theory advanced that portfolios were protected through the grouping of uncorrelated assets1. This meant investment advisors or financial planners, based on a client's age, net worth and risk tolerance, managed portfolios only by allocating between cash, bonds and equities. For example, if you were a modestly conservative 60 year old investor you might have a portfolio of 50/50, 60/40 or 70/30 bonds to equities. The cash level would rarely get above 5% and so it's really inconsequential. This relationship would be adjusted back to the original allocation when prices changed. If stocks grew, a portion would be sold and reallocated back to bonds and vice versa. Diversification across asset classes and within the asset class themselves was supposed to provide the protection.

There are serious flaws with this model today, in these times.

First, as we have seen in 2008, and as I have mentioned ad nausea on national television and newspapers, all stocks and stock mutual funds revert to "1", a measure of perfect market correlation, during periods of violent declines. In other words, there really is no safe stock to hide in, common, preferred or otherwise when things break down.

Second, the diversification approach is predicated on the fact that advisors stay with the original portfolio allocation and do not tilt more towards stocks because stocks pay them more commission or because having more stocks taps into their self image and importance of what they think being a broker is about (Think of the movie, Wall Street, as an example). On this point consider Peter Bernstein's reference in his seminal book Against the Gods (1996 Wiley): "Professional managers, who by 1969 had pushed client portfolios as high as 70% in common stocks, felt like fools.

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Their clients took an even harsher view. In the fall of 1974, the maiden issue of The Journal of Portfolio Management carried a lead article by a senior officer of Wells Fargo Bank who admitted the bitter truth:

***Professional investment management and its practitioners are inconsistent, unpredictable and in trouble… Clients are afraid of us and what our methods might produce in the way of further loss as much or more than they are afraid of stocks… The business badly needs to replace its cottage industry operating methods*.**[2]

This was written 35 years ago during the last secular bear market, which, at the time those comments were made still had 8 years to go and much more damage to wrought. In addition to any ethical compromises by advisors, actions may be undertaken at just precisely the wrong time. Whether investors could have held a properly managed buy and hold strategy or simply one that masqueraded as such, it is obvious that since the late 70's, the memories of such mistakes have all but faded from industry and society's consciousness. Time has a way of lulling the masses into forgetting previous generations' self inflictions.

Last, because typical advisors are stock market centred many good "non-stock" positions are never considered. For example, a good bond or currency strategy can provide quite profitable returns while others are distracted, glued to their stock market quote screens. The same could be said of gold. And certainly, off the beaten path is of course doing nothing. One of the best investment strategies is often to do nothing (cash or safe money markets).

What the investment industry does not want to come to terms with is that investment risk is about odds. Because of the way the industry compensates its salespeople and is generally structured it cannot deal with this reality. Risk is the balance of weighing success against failure and determining how an investor should be rewarded for assuming the risk. While you must understand the relationship investments have to each other, each investment must stand on its own merit. This is the chink in the armour that purports investors are always protected by diversification.

Controlling risk through selling defines a maximum allowable risk prior to any security purchase. This risk has some relationship to the historical variance of the security in question, and more importantly, to the overall portfolio capital value. In other words, (a) you must establish a maximum allowable risk that accounts for a security's particular behaviour, and (b) you also set loss limits based on an acceptable absolute loss. At CastleMoore, whatever the security, we have a general rule that when an investment is down 10% we are on sell watch regardless of overall portfolio performance.

Such an approach acknowledges up front a certain amount of misses or errors. Our clients understand that decisions are made on their behalf based on the totality of all decisions made for them. A good benchmark is 65% profitable decisions or 6/7 out of 10. The 35% unprofitable decisions are very manageable; it is easy to live with small losses when large losses are mitigated. In addition, because success is determined by the totality of decisions both client and manager have more relaxed modus operandi. Every decision does not have to be right; bad decisions do not have to be glossed over, shoved under the rug or explained away with some babble.

We accept the premise from the start that errors will be made, securities may be bought only to have them sold due to a breach of the maximum allowable risk and then subsequently repurchased at a higher price once downside risk has been cleared. To conventional "buy and hold" investment managers, this method may appear illogical. But over the long term the point is to identify up trending securities and remain in them as long as the trend persists. In some instances it may take a transaction or two for an investment in a security to "catch". Similarly, positions can be undertaken that are never profitable yet serious loss is avoided. Loss avoidance is the most significant determinant to positive long term rates of return (see or request CM Newsletter JAN-FEB 07).

Buying, holding and knowing when to sell will produce superior returns over the coming years. The investment industry has grown too large, too inflexible and possibly dangerous; they wish for the old bull market days to return.

Update 2012

The investment world appears to make less sense than ever, especially when compared with 2009. Despite this we had a very positive and profitable investment year in 2011 and are expecting the same this year. Our unfair advantage at CastleMoore is that we don't need things to make sense as most other managers or investors do – it's a big advantage. As I've written about before, prices don't lie, risk management levels (selling) protect us from our investment ego and we understand clearly that thinking we know how the world will shake out is hubris of the first order.

robert@castlemoore.com
1.905.847.1125 or toll free: 1.877.289.5673 www.castlemoore.com

GUEST COLUMNIST

DOUBLE OR NOTHING: HOW WALL STREET IS DESTROYING ITSELF

by John Aziz

There's nothing controversial about the claim – reported on by Slate [12], Bloomberg [13] and Harvard Magazine [14] – that in the last 20 years Wall Street has moved away from an investment-led model, to a gambling-led model.

This was exemplified by the failure of LTCM which blew up unsuccessfully making huge interest rate bets for tiny profits, or "picking up nickels in front of a streamroller" [15], and by Jon Corzine's MF Global doing practically the same thing [16] with European debt (while at the same time stealing from clients).

As Nassim Taleb described in The Black Swan these kinds of trades – betting large amounts for small frequent profits – is extremely fragile because eventually (and probably sooner in the real world than in a model) losses will happen (and of course if you are betting big, losses will be big). If you are running your business on the basis of leverage, this is especially dangerous, because facing a margin call or a downgrade you may be left in a fire sale to raise collateral.

This fragile business model is in fact descended from the Martingale roulette betting system. Martingale is the perfect example of the failure of theory, because in theory, Martingale is a system of guaranteed profit, which I think is probably what makes these kinds of practices so attractive to the arbitrageurs of Wall Street (and of course Wall Street often selects for this by recruiting and promoting the most wild-eyed and risk-hungry). Martingale works by betting, and then doubling your bet until you win. This – in theory, and given enough capital – delivers a profit of your initial stake every time. Historically, the problem has been that bettors run out of capital eventually, simply because they don't have an infinite stock (of course, thanks to Ben Bernanke, that is no longer a problem). The key feature of this system– and the attribute which many institutions have copied – is that it delivers frequent small-to-moderate profits, and occasional huge losses (when the bettor runs out of money).

The key difference between modern business models, and the traditional roulette betting system is that today the focus is on betting multiple times on a single outcome. By this method (and given enough capital) it is in theory possible to win whichever way an event goes. If things are going your way, it is possible to insure your position by betting against your initial bet, and so produce a position that profits no matter what the eventual outcome. If things are not going your way, it is possible to throw larger and larger chunks of capital into a position or counter-position again and again and again –mirroring the Martingale strategy – to try to compensate for earlier bets that have gone awry (this, of course, is so often the downfall of rogue traders like Nick Leeson and Kweku Adoboli).

This brings up a key issue: there is a second problem with the Martingale strategy in the real world beyond the obvious problem of running out of capital. You can have all the capital in the world (and thanks to the Fed, the TBTF banks now have a printing-press backstop) but if you do not have a counter-party to take your bets (and as your bets and counter-bets get bigger and bigger it by definition becomes harder and harder to find suitable counter-parties) then you are Corzined, and you will be left sitting on top of a very large load of pain (sound familiar, Bruno Iksil?)

The obvious real world example takes us back to the casino table – if you are trying to execute a Martingale strategy starting at $100, and have lost 10 times in a row, your 11th bet would have to be for $204,800 to win back your initial stake of $100. That might well exceed the casino table limits – in other words you have lost your counter-party, and are left facing a loss far huger than any expected gains.

Similarly (as Jamie Dimon and Bruno Iksil have now learned to their discredit) if you have built up a whale-sized market-dominating gross position of bets and counter-bets on the CDX IG9 index (or any such market) which turns heavily negative, it is exceedingly difficult to find a counter-party to continue increasing your bets against, and your Martingale game will probably be over, and you will be forced to face up to the (now exceedingly huge) loss. (And this recklessness, is what Dimon refers to as "hedging portfolio risk"? [17])

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The really sickening thing is that I know that these kinds of activities are going on far more than is widely recognised; every time a Wall Street bank announces a perfect trading quarter [18] it sets off an alarm bell ringing in my head, because it means that the arbitrageurs are chasing losses and picking up nickels in front of streamrollers again, and emboldened by confidence will eventually get crushed under the wheel, and our hyper-connected hyper-leveraged system will be thrown into shock once again by downgrades, margin calls and fire sales.

The obvious conclusion is that if the loss-chasing Martingale traders cannot resist blowing up even with the zero-interest rate policy and an unfettered fiat liquidity backstop, then perhaps this system is fundamentally weak. Alas, no. I think that the conclusion that the clueless schmucks at the Fed have reached is that poor Wall Street needs not only a lender-of-last-resort, but a counter-party-of-last-resort. If you broke your trading book doubling or quadrupling down on horseshit and are sitting on top of a colossal mark-to-market loss, why not have the Fed step in and take it off your hands at a price floor in exchange for newly "printed" digital currency? That's what the 2008 bailouts did.

Only one problem: eventually, this approach will destroy the currency. Would you want your wealth stored in dollars that Bernanke can just duplicate and pony up to the latest TBTF Martingale catastrophe artist? I thought not: that's one reason why Eurasian creditor nations are all quickly and purposefully going about ditching the dollar for bilateral trade [19].

The bottom line for Wall Street is that either the bailouts will stop and anyone practising this crazy behaviour will end up bust – ending the moral hazard of adrenaline junkie coke-and-hookers traders and 21-year-old PhD-wielding quants playing the Martingale game risk free thanks to the Fed – or the Fed will destroy the currency. I don't know how long that will take, but the fact that the dollar is effectively no longer the global reserve currency says everything I need to know about where we are going.

The bigger point here is whatever happened to banking as banking, instead of banking as a game of roulette? You know, where investment banks make the majority of their profits and spend the majority of their efforts lending to people who need to the money to create products and make ideas reality?

azizonomics@aol.com.uk, Azizonomics.com
Economics for the jilted generation…

GUEST COLUMNIST

INVESTING LIKE ODYSSEUS

by Makul Pal

Odysseus has traditionally been viewed in the Iliad as Achilles' antithesis. Unlike Achilles whose anger is self-destructive, Odysseus is renowned for his self-restraint and diplomatic skills.

While passing through the land of sirens, known for their luring fatal songs, he orders his men to stop their ears with beeswax and ties himself to the mast of the ship. Recognizing that in the future he may behave irrationally, Odysseus limits his future agency and binds himself to a commitment mechanism (i.e. the mast) to survive this perilous example of dynamic inconsistency.

In economics, dynamic inconsistency, or time inconsistency, describes a situation where a decision-maker's preferences change over time in such a way that what is preferred at one point in time is inconsistent with what is preferred at another point in time.

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A simple analogy to investing and time preference would be trading gains and losses. It has been observed that that the investing community is more eager to cut out gains faster than a similar amount of loss.

This can be explained from a temporal perspective also. When choosing between $100 or $110 a day later, individuals may want to wait a day for an extra $10. Yet after a month passes, many of these people will reverse their preferences and now choose the immediate $100 rather than wait a day for an additional $10.

The eagerness to consume, or instant gratification compared to deferred gratification is what differentiates the investing majority from the Odysseus minority. Investing is a lot about self restraint. Humans give more importance to today compared to tomorrow, the idea of "now" is more important than to the idea of some distant time in the future.

Temporal discounting refers to the tendency of people to discount rewards as they approach a temporal horizon in the future or the past. To put it another way, it is a tendency to give greater value to rewards as they move towards the "now". For instance, a nicotine deprived smoker may highly value a cigarette available any time in the next 6 hours but assign little or no value to a cigarette available in 6 months. Hyperbolic discounting refers to this preferential bias towards "today" compared to tomorrow.

This bias creates a systematic tendency for humans to switch towards "vices" (products or activities which are pleasant in the short term) from "virtues" (products or activities which are seen as valuable in the long term) as the moment of consumption approaches, even if this involves changing decisions which were rationally made in advance. This bias towards now predisposes humans towards instant gratification, towards impatience, towards poor self control, towards impulsiveness and irrationality. Human preference is time inconsistent.

The Stanford marshmallow experiment was a study on deferred gratification conducted in 1972 by psychologist Walter Mischel of Stanford University. A marshmallow was offered to each child. If the child could resist eating the marshmallow, he was promised two instead of one. The scientists analyzed how long each child resisted the temptation of eating the marshmallow, and whether or not doing so had an effect on their future success. The results confirmed.

Though time influences decision making, humans are prone to poor will power, vices and resulting poor investment habits. This is why masses prefer consumption to saving, there are more day traders compared to investors and even fewer contrarians looking at worst performers. This is why foreseeing a personal irrationality, manipulating will power and tying oneself to a commitment (mast) is a rare feat.

mukul@orpheus.asia, Orpheus Capitals
Orpheus Capitals' vision is to revolutionize the world's understanding of TIME and build research analytics around it.

RECENT MEDIA

BNN Appearances **http://www.castlemoore.com/businessnewsnetwork.php**

THE CHART PAGES

GOLD BULLION

We now own gold. After avoiding gold bullion since we sold it last August the metal has fallen over 18%, though we always remained long term bulls. Sentiment has become very bearish as have many indicators, including the three shown in the lower panels above. We are intending to complete our purchase in three tranches, with the first executed a couple weeks back, and the rest based on certain conditions being met.

CANADIAN BONDS

After holding 40% of most portfolio types in long bonds we sold half of that or 20% in November this past fall, and preferred to keep the remaining allocation for the time being. Recent action has seen most bonds make new highs, but just barely. Our commitment to bonds has been very profitable despite the talk from pundits and the financial media about inflation, et al. There will be a time to sell, and we'll let our models tell us when. Bonds remain in the longest bull market to date at +35 years.

LOONIE

The Loonie has seen some significant weakness over the last few months. The typical investment pattern at this time of year, beginning in late winter, usually ushers in resource plays stemming from seasonal strength in metals & mining and energy. This year concerns over a slowing global economy have not only weighed on these two sectors but also the C$. We own no equities in these sectors at the moment, and have reduced (or profited) client portfolio impact from a weak Loonie.

US DOLLAR

Unlike the C$, which appears to be solely a "risk-on" trade for the time being, the US greenback has performed quite well. With the Euro tanking, the Swiss capping upside strength in the Franc currency peg, the Yen under constant weakening efforts from Japanese authorities (read they need to raise exports), and the Loonie in a resource-led malaise, the U.S. dollar is strong. Most portfolio types have a 10% pure dollar bull allocation.

THE CHART PAGES

CANADIAN EQUITIES

Clients will be well aware of the performance of the overall Canadian market through our client-only, monthly missive, The Current Investment Themes. Each month we review the box scores – like the sports page run down in brief – in the top right corner. Since February, the TSX index is down over -9%, but our Canadian equity holdings of the income trust sector, corporate and government bonds, consumer staples, pipelines, and telecom are up! We do own one investment that is down in the utilities sector.

US EQUITIES

The US stock market represented here by the S&P 500 has fared much better than the resource-based ones such as the TSX or Australian All Ords, or of course European markets. Much of the strength in corporate profits (and index upside) were assisted by earnings repatriations. A weak US dollar over the winter and into the early spring made international US companies' earnings increase. A look at the chart shows a bottoming or correction process occurring in the S&P. Though we have longer term concerns about stocks in general (2013, 2014) our models are indicating another potential rally before then. Of course, we don't rely solely on stock markets, unlike most other managers, to provide investment returns. There are many markets to seek profits.

WHAT MAKES CASTLEMOORE UNIQUE AND VALUABLE?

- Management of Client Life Savings
- Not Stock Brokers or Mutual Fund Salesman
- Discretionary Asset Management
- Methodical and Disciplined
- Unemotional, Unbiased Decision-making
- Low Loss Tolerance
- All-Inclusive Fee Pricing
- Focused Approach – No "Super-Market of Services"
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- Effective Portfolio Management – Plain & Simple
- Broad & Deep Industry Experience
- Managed Asset Classes – cash, maturities, ETFs/stocks, precious metals

Head Office
12 – 2441 Lakeshore Road
Oakville, ON L6L 1H6

Phone 1.905.847.1400
Fax 1.416.352.0190

Toll Free 1.877.289.5673
Email info@castlemoore.com

www.castlemoore.com

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FROM THE KITCHEN TABLE…NEW & IMPROVED FINANCIAL PRODUCTS

By Thomas Kleinschmidt

Typically, financial advisors meet prospective clients at their kitchen table. Perfect place…that's where most of the important family decisions take place, so it is from that perspective which I write.

I have spoken with a number of clients of ours recently and the common theme was the observation of how all asset classes performed poorly. Cash was sideways with the Canadian Dollar and US Dollar at par. Bonds were sideways as 10 year rates are trying to figure if this is indeed the end of the bond market bull run or if they will finish a full 30 year uptrend. US equities out performed Canadian ones but that was a sector issue more than anything but now equities on both sides of the border are looking weak.

So, what is an investor to do? How can higher rates be had with lower volatility and (ahem) lower risk?

We all know – even if we don't/won't/can't admit the fact – the buy and hold strategy of "long term investors" is not working out very well. Subtract inflation and most folks are in fact losing money every day with their "investments". Put on top of that fact how their portfolios are constructed and they could even be in for worse returns or even higher risks. Could the answer investors seek – high, safe returns – in a handful of new financial products? Let's take a look and discuss what you can do while the table is being set.

At least one large bank has recently introduced special "tactical" funds. These products aim to allow the investor or their advisor to construct a portfolio that MORE CLOSELY SHOULD return what the investor is suited for with respect to their needs vs risk tolerance and not be beholden to a 1-asset-only product. Finally, finally, finally!

The managers of the more interesting targeted return products aim to smooth out returns and minimize risk and volatility by having the flexibility to actually choose the ratio of the various asset classes in the product, including cash! Digging into the prospectus of one of these reads: "The portfolio adviser may dynamically shift between any asset classes and markets and may use defensive strategies such as derivatives to modify the return and risk profile of the fund." Said differently, the fund advisor will recommend to the fund manager what asset classes to invest in, at what weighting, and what specifically to put into the fund. Said clearly, this should result in significant shifts in the fund holdings when there are significant shifts in the performance and risks of the various asset classes. This is, in my opinion, the way to manage a portfolio. And despite the very high MERs the funds have very decent dividend returns inside of them.

So, be it rain, sleet, snow or slush these funds hold themselves out to bring to the investor solid, smoother returns!

Now, for those of you interested in such products I'll give you my sales pitch for OUR portfolio management services. First, we are not investment advisors…we are actual portfolio managers (not middlemen). We offer our services to folks with over $250,000 of investable assets who now can get the same discretionary portfolio management usually reserved for millionaires and pay no more than 2% for active management – and by active I mean DAILY. Second, we at CastleMoore built our portfolios from the ground up with complete and dynamic asset allocation built into the DNA of the firm and client portfolios. Third, for large accounts, we have a unique and simple menu of portfolio strategies that allow for complete customization of your overall holdings.

Our aim is to participate in bull markets and avoid bear markets. Our intent is to buy asset classes that are going up in price and sell non/negatively performing holdings towards absolute returns having removed ALL restrictions that fund products have, including those found in these new products. Give me a call to learn more.

That said, may you please pass the salt.

thomas@castlemoore.com 1.905.847.2713
or toll free: 1.877.289.5673 www.castlemoore.com

GUEST COLUMNIST

YOUR POWER OF ATTORNEY FOR PROPERTY

By Ed Arbuckle, CA, FCA, TEP

As financial advisors, we see no end of legal documents – trusts, wills, articles of incorporation and the like. The power of attorney (POA) can be as complex as any of these but its length is unusually short despite its awesome implications.

Powers of attorney are governed not only by the words of the document but also by statutory legislation and legal interpretations. You certainly don't see this in the POA itself but be assured it is there. The person signing the power of attorney is the grantor and the persons to whom authority is given are the attorneys.

Whenever I ask clients if they have a power of attorney the answer is usually a short yes – my lawyer did one for us. It never seems to me that clients really give enough thought about the vast powers they have given over to others by signing a POA. And lawyers advising clients share in this responsibility and if they do not follow some pretty strict procedures they can probably be sued. Litigation may only be a short way down the line once family members get involved in hand to hand combat, misunderstandings and substantially differing points of view.

There are two kinds of powers of attorney – the Continuing Power of Attorney for Property and the Power of Attorney for Personal Care. They are regulated by the Substitute Decisions Act (SDA) in Ontario although other laws will come into play. This article will be restricted to a discussion of the Continuing Power of Attorney for Property (CPA) and is based on Ontario law, so if you live elsewhere the rules could be different. Obviously we are not giving legal advice and you should seek professional guidance in all Power of Attorney matters.

PUTTING YOUR ASSETS AT RISK

As discussed above, grantors are handing over significant powers to their attorney so they should totally understand the implications. Some important things they should consider before signing a POA are as follows:

- The CPA usually comes into effect immediately
- A CPA is valid providing the grantor is capable of giving it even if he or she is incapable of managing property
- The attorney can do anything that the grantor can do. Anything!
- Co-attorneys must act unanimously unless otherwise stated in the CPA (but infighting often results)

Once you sign a CPA you should realize that you have put your assets at risk should your attorney be dishonest, incompetent in financial matters or see things differently than you do. It's also not unusual for an attorney to have a different perspective than others in the family (or a co-attorney) and this is where major conflict and legal fights begin. So the attorney should consult but let it be known that under the golden rule, the one who has the gold (the attorney) rules.

GIVING A POWER OF ATTORNEY

In Ontario, a person is capable of giving a CPA if he or she knows a number of things which the lawyer should confirm including the following:

- The kind of property he or she is turning over and its approximate value
- Possible legal obligations to dependants
- The fact that the attorney will be able to do anything that the grantor could do
- The attorney will have to account for his dealings with respect to the property
- The grantor can revoke the power of attorney
- The possibility that attorneys may misuse their authority

An English court case stated this more forcefully saying that the attorney acquires complete power over the grantor's affairs, the attorney is able to do anything the grantor could have done and the attorney's powers continue even if the grantor loses capacity.

DRAFTING THE CPA

Responsibility for drafting the CPA starts with a lawyer who should carefully counsel his client. Some lawyers have checklists to review with clients which the client should sign off on. Most importantly, the lawyer must make sure that grantor is competent and not subject to undue influence of well intentioned (or not so well intentioned) family members, close relatives or friends – even if it seems to be an honest

continued on next page

attempt to be helpful. While it may seem draconian, lawyers should meet with their clients alone – without family present so the conversation can be open, frank and visceral.

ACCEPTING ATTORNEY RESPONSIBILITIES

Before accepting the responsibilities of attorney, you should understand the many legal responsibilities you are taking on. The attorney is there to take care of the wishes of the grantor first and make sure the grantor's needs get first priority. Yes, they deserve a good quality nursing home and not the bare minimum. Sometimes attorneys seem to be so concerned about their inheritances that the grantor's needs get short changed. Some of an attorney's important responsibilities are as follows:

- Understand the terms of the grantors will so its terms are not violated
- Make expenditures reasonably necessary for the grantor or the grantor's dependents
- Make application to the court for direction if necessary – especially in cases of conflict
- Beware of the possibility to formally pass accounts if required by the grantor or family members
- Keep a list of all assets acquired or disposed of with dates, amounts and relevant details
- Don't disclose information contained in the grantor's accounts except to the grantor
- Listen to relatives and friends and family before making final decisions
- Keep accounts and records until authority ceases under the CPA and then maintain them for possible later examination

In addition to the rules under the SDA, there are some general rules imposed on the attorney under common law:

- Use reasonable care
- Not obtain a secret profit
- Not allow personal interest to conflict with those of the grantor
- Not assign or delegate your attorney's authority to another person

DISPUTES

There can be many kinds of disputes under a CPA that could lead to litigation. An attorney is usually a lay person and may need professional advice to avoid such disputes. Areas of possible uncertainty are as follows:

- The date upon which the power of attorney became effective, the date of incapacity of the grantor and the extent of the attorneys involvement
- Disputes on whether it was the grantor or the attorney acting at any given stage
- Whether the attorney has made unauthorized, questionable or even speculative investment decisions
- Whether the attorney has taken into consideration the tax implications of an action
- Whether the attorney has acted in a timely fashion in attending financial matters which otherwise may contribute to unnecessary expenses or losses
- Whether the attorney sought professional advice when necessary
- Disputes between siblings regarding the capacity or incapacity of the grantor
- Attorney misappropriation of assets
- Disputes where one or more attorneys have acted without knowledge or approval of another attorney under a joint CPA

An attorney should know the provisions of the grantor's will because the attorney will ultimately be responsible to estate beneficiaries if they do something to frustrate a bequest. Recently, beneficiaries of estates are having more success in making attorneys accountable for their actions. For example, if as attorney you sell the cottage that nobody seemed to want and the cottage was a bequest to Mary under the grantor's will – you have a big problem.

If someone asks you to be their attorney, do it if you wish, but think carefully about your responsibilities and whether you have the capabilities and courage to take some tough decisions and get kicked around a bit – or a lot.

COMPENSATION

An attorney is entitled to compensation. If the CPA is silent on compensation, the SDA prescribes a fee of 3% of capital and income receipts, 3% of capital and income disbursements plus 3/5 of 1% of the average annual assets under the attorney's power. The best plan is to spell out the compensation in the CPA so everyone knows the grantor's wishes up front and court approval is unnecessary. Compensation is taxable, but CRA is unlikely to allow a deduction for attorney fees paid.

THE ATTORNEY MUST KEEP AN ACCOUNTING

An attorney is required to keep accounts but is not required to pass them by a court unless ordered to do so. However, an attorney should keep complete accounting records and all related documents, invoices, correspondence and supporting evidence on which decisions were made. Minutes of meetings are a good idea.

SUMMING UP

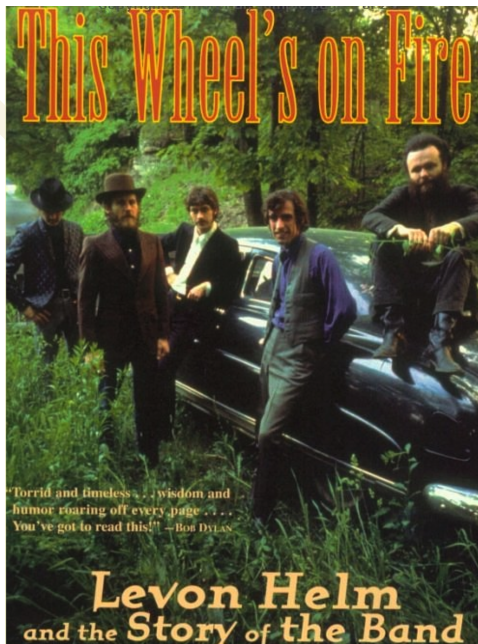
The responsibilities of an attorney are many. Because the outcomes of an attorney's many decisions can significantly affect the value of assets and ultimate beneficiaries' entitlements, an attorney should listen carefully to the quiet foot steps down the hall. Accept a power of attorney with care and expect the worst. But if you make good decisions, know and play by the rules and consult widely, hopefully all will work out.

Ed Arbuckle CA, FCA, TEP, Personal Wealth Strategies - Fee based family wealth planners, 205 – 30 Dupont St. E., Waterloo, Ontario
Phone: 519-884-7087 www.finplans.net

GUEST COLUMNIST

THIS WHEEL'S ON FIRE

By William Chin



…Thanks for the music Levon…

Levon Helm wrote this book to voice his discontent over Robbie Robertson's handling of the affairs of The Band. In the 17-wheel monster that is the Euro zone, there are many unhappy members and quite a few 'wheels are on fire' as well. Anti-austerity sentiment is heavy in the air. As new elections swept across Europe, another wave of uncertainty and challenges are just waiting around the corner. The latest will likely come from the newly elected French President, Francois Hollande.

France is the second-largest member of the Euro zone and a major player in European affairs. Franco-German conflicts and resolutions had penned the script of numerous episodes throughout the course of European history. Years ago, Chancellor Kohl summarised the essence of Franco German relationships in "every German chancellor must bow three times before the Tricoleur." Expect Hollande to exert tremendous pressure and influence on Merkel and the rest of the Euro zone.

BOARDS ON THE WINDOW, MAIL BY THE DOOR…

There is a growing awareness across Europe, (maybe minus Germany and a few northern members), that austerity does not work without currency devaluation (to improve competitiveness). Instead, austerity is driving several countries into deep recessions. In Ireland, Portugal and Spain, young people are leaving their countries in droves, for better employment opportunities elsewhere.

It should come as no surprise that anti-austerity is a very palatable alternative. The new pro-growth approach by the new French leader is not to be under-estimated because it clashes directly with the German model of imposing fiscal discipline through austerity programs. Hollande has already been successful in rallying those who suffered through imposed austerity around him. It is almost impossible now for Germany to push through its agenda alone. Merkel and the rest of her party will now face tremendous pressure to loosen up the tight grip Germany has over the rest of Europe.

Greece held its elections on May 6 as well. With no party having more than 20% of the votes in a deeply divided electorate, the Greeks are having trouble in forming a coalition government. The risk of Greece not able to function as a government and eventually leaving the Euro zone is rising, although we do not view it as a high probability outcome; but if it were to take place, it could be devastating.

The unfolding of this development deserves careful monitoring and analysis because Europe is the number one worry on most investors' minds.

William Chin is a portfolio manager with e3m
wchin@e3m.com 416.972.7472