NORTHWOOD FAMILY OFFICE

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Chairman's Message

Rich Experiences

Tom McCullough

Many years ago, one of my children asked me at the dinner table "Are we rich?". It led to a very interesting discussion about what it means to be rich. Most people focus on the financial aspect of wealth, but of course it is much more than that. This past month, I felt very rich. Rich with a wide array of experiences.

It started with a brief trip to Mexico City for the semi-annual Wigmore Association meeting (www.wigmoreassociation.com). Mexico is undergoing rapid growth, strong infrastructure building, massive positive structural reforms and has a very young population that portends strong consumer growth over the next several decades. It is intimately connected to the U.S., which has helped to fuel its growth and will continue to do so. While there are risks, as in any developing country, it is easy to see why the Mexicans are extremely positive about the future of their economy and society. And no one we talked to seemed too worried about Donald Trump's proposed wall! It is also always a great privilege to share ideas with our Wigmore partners (from eight different countries) about the global economy and markets, investment opportunities, and creative ideas for serving our clients.

I also had the opportunity to spend five days of vacation with my 26 year old daughter while in Mexico City. She speaks Spanish and is an experienced traveller in Latin America, so I was able to be the 'follower'. For those of you with emerging adult children, you'll know what a wonderful feeling it is to see them take the lead and the relationship change from 'parent-child' to 'friends and traveling companions'.

I then travelled to Africa for three weeks – ten days in Rwanda/ Congo in volunteer activities and ten dates in Kenya on a safari.

My wife, Karen, goes to Rwanda every year for 4-6 weeks (for seven years now) to work with a local NGO/school organization to help train teachers in new education methods (e.g. learner-centred vs. traditional rote teaching). This is a very high priority, both for this NGO and for the Rwandan government, as they see top-quality education as the key to the future success and sustainability of their country and their people.

This year, I accompanied Karen for a week and a half to work with an NGO in Rwanda and one in eastern Congo to provide training and mentoring to their leadership staff on strategic planning, governance, time management, people development, mentorship, and general management skills. It was a great experience for me and valuable, I believe, for the NGOs, as they are recognizing a need for increased skills in management, planning and governance.

The Congolese organization I worked with, for instance, runs 655 schools, 120 hospitals and health clinics, and multiple food security and social programs. They play a vital role in the region because the government is incapable of providing the services, corruption is rampant, and there are still many rebel groups in the surrounding areas. The Democratic Republic of Congo is still in a big mess and these high quality NGOs are critical for sustaining the life and health of the people in these regions.

Rwanda is a much more stable, safe, and orderly society, but is poor and is still recovering from the emotional and physical effects of the genocide 22 years ago. But hopes are high. The government is a positive and proactive force in the country and well-supported by the average person, corruption appears to be minimal, infrastructure is being rebuilt, they have an 'open for business' policy, and they are investing in education. These are crucial steps to building a strong society and ultimately attracting investment dollars. If they stay on that track, the future could be bright.

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WEALTH EDUCATION PROGRAM FOR FAMILIES – November 3-6, 2016

After two successful years, the University of Toronto's Rotman School of Management is once again pleased to offer the Family Wealth Management course. The 3-day intensive program for family members and family office staff will be held in Toronto on November 3-6, 2016, and will be taught by Tom McCullough and other key faculty members and wealth management leaders. For more information and to enroll please visit: http://tinyurl.com/od5kr7s

While I am far from an expert in this very complex and confounding field, I had several thoughts as I travelled.

Stability and the rule of law. We in the West have had relative stability for so long that, not surprisingly, we take it for granted. We assume contracts will be honoured (or a fair court system is available to resolve disputes), we assume the right to property ownership, we count on a good basic infrastructure (highways, phones, government services etc.), we expect a social safety net to support the most vulnerable among us, and we assume a certain degree of freedom and safety to pursue our daily activities. So many others around the world (most, in fact) have to live life without being able to count on any of these core components of stable life. Stability is highly desirable, vital for economic progress, and everybody wants it.

Self-sufficiency. I had interesting discussions with both local NGOs about the steps they are taking to improve the sustainability of their organizations so they, and so many others, will not have to rely so much on Western funding. The cycle of aid can be a destructive one, so the more they can build confidence, education, and a self-sustaining business base, the better the chances these countries have for real change. For some developing countries, this may actually be possible. For others, it still feels like a pipe dream.

Entrepreneurship. I met an interesting young entrepreneur while in Rwanda. She is starting a for-profit nursery school for the growing number of middle class Rwandans where both parents are working. She has a passion for entrepreneurship as the base for a strong, 'non-dependent' future for Rwanda. Another example is Butembo, a city in eastern Congo, which was recently featured in The Washington Post as an island of 'stability and prosperity' in the middle of a dysfunctional country (http://wapo.st/23yLq5S) based on its strong entrepreneurial economy. Several other people I spoke with in these African countries asked for advice on starting businesses so they can be self-sufficient and control their own destiny as well. These early rumblings of entrepreneurialism and self-sufficiency are encouraging.

Western contribution. We learned a lot about Asset-Based Community Development (ABCD) on this African trip. This methodology suggests development should start with the *assets* of a community (i.e. what they *do* have), not the *deficits* (i.e. what they *don't* have and ask for from the West). Development should harness those assets from within the community and according the community's own identified priorities. One of the areas where Western contribution is increasingly valuable, however, is helping local leaders build 'capacity' in their organizations. Not just giving money, but helping provide the skills for local community leaders to do it themselves. There are an increasing number of opportunities for Westerners (as well as locals) to come and bring their skills and expertise -- in education, management, administration, marketing and finance, among others -- to these countries that are just starting out. If you are interested in talking about this further, let me know.

Anything is possible. It is tempting to be pessimistic when you see the poverty, corruption and slow progress in some of these countries, but I was reminded by the (Korean-American) manager of a Rwandan micro-loan bank that less than 40 years ago, South Korea was one of the poorest countries in the world. Now it is approaching the GDP per capita levels of the most developed countries in the world. Mexico too has begun to make significant positive change and has made great strides over the past several decades. The situations – Korea, Mexico, Africa - are not the same, but it is a good reminder of how countries and regions can turn themselves around with the right leadership, commitment and a little bit of luck.

Finally, Karen and I concluded our time away with safaris in three Kenyan national parks. The landscape was spectacular, the wildlife amazing and the learning fascinating. I also found all of our people interactions particularly stimulating.

We had great conversations about life, dreams, and harsh realities with David, a young Samburu man in one of our camps, whose job it was scare the monkeys away with his slingshot to keep them from stealing our food while we were eating. We debated the U.S. political scene, governance of NGOs, and the price of Masai dowries with Joseph, our guide in the Masai Mara park. And, we talked about anti-poaching strategies, animal documentaries, and elephant preservation programs with Fran, a European living long-term in Africa, on a Twin Otter flight between Nairobi and Amboseli park.

So, what does it mean to be rich? Financial wealth is one measure. But so too are experiences of life, travel, family, friendships, learning, contributing to the lives of others, and receiving from them.

Tom

Control What You Can Control and Conservatively Estimate the Rest

Barrett Lyons, CPA, CA, CFP, CIM

Investors face a world full of unknowns, which can play havoc with our plans and aspirations. Investment returns are unknown, future trends in inflation are uncertain, correlation among asset classes is a moving target, and the level of market volatility is, well, volatile. Interestingly enough, the investment industry spends most of its time focused on forecasting the above economic factors, despite substantial evidence that it is almost impossible to do so accurately or consistently.

"Investors are hopeless at forecasting, yet it may be at the heart of their investment process." James Montier, Grantham Mayer Otterloo

Obviously some investments can be forecasted more accurately. A five year bond portfolio is more predictable than a basket of equities, and dividends are more predictable than the associated capital gains. It doesn't mean that investors should not have expectations for their investments. It's just that markets are notably fickle in terms of when and how the returns will be delivered. And if the timing of the returns doesn't match up with the timing of the family's spending needs, there may be a problem. We can look to the current market for a gauge on relative metrics and compare them to historical levels to give an indication of where we might be in the current market, but, as many know, past performance is not an indicator of future returns.

Given this backdrop, what is an investor to do to help manage the elements of a wealth plan? Find the items that are *controllable* and manage them well. So, what things can be predicted or controlled?

Taxes – Every dollar saved in taxes goes into the pocket of the investor. In that way it is a 'certain' additional return with no added risk. There are a number of ways to save taxes depending on the family's jurisdiction and tax regime, including income splitting, trust and other tax structuring, deferral of taxable gains, and tax-effective investment products.

Investment costs – Similar to taxes, every dollar saved in costs also goes into the pocket of the investor. It pays to minimize these investment costs wherever it makes sense. Costs can include investment management fees, trading, custodial and advisory costs and transaction fees.

In a low return environment, the current fixed income market for instance, exercising control of these two factors in particular – taxes and costs – can have a significant impact on the net investment return available to the family.

Personal expense control – While not always easy, some components of family expenses can in fact be controlled. Some expenses are discretionary and other expenses can be cut back. In some cases, assets (like homes or other personal use assets) that require ongoing spending can be sold.

Personal budgeting - At the very least, future family expenses can be predicted. Having a reasonable idea of what those expenses are likely to be and how much investment return will be required to fund them is one of the most important factors in planning and portfolio management. It allows the investor to target a return (and the attendant risk) that is reasonable and appropriate to meet their needs, and can prevent investors from 'reaching for extra' return at the worst possible time.

"More money has been lost reaching for yield than at the point of a gun." - Raymond DeVoe, Jr.

Personal decisions - When you think about it, there are actually quite a few other things you can control. You can decide how much longer you will work (and receive income), which can be very significant for large income earners. You can decide when you sell (or don't sell) the family business. You can decide to take money off the table in good times to cover the inevitable bad periods. And you can decide how much future flexibility you want to gain by reducing debt.

Investment strategies - There are also investment decisions you can control that will affect the outcome in your portfolio. You can decide to buy investments at a discount to their true value to provide you with a certain margin of safety when markets decline. You can decide to reinvest your dividends or allow your interest to compound (i.e. not withdrawing the funds). And you can rebalance your portfolio by buying more of an asset class when it declines. In addition, if you have the financial capacity and ability to withstand volatility, you can buy less-liquid or higher-risk assets that normally have to pay investors a premium to own them.

Build a comprehensive plan – Knowing and documenting what your family's goals are and establishing a long-term plan to achieve them that considers the impact of each of the items discussed, and also considers worst case investment scenarios, can help investors exercise control over their emotions and provide comfort in turbulent markets. An investment policy statement can also provide much-needed self-discipline to help save the portfolio from the effects of rash and unwise reactions.

As for the things you can't control, like investments returns, the wise risk management route is to use conservative estimates in your planning models. Positive surprises are rarely a problem, whereas negative surprises can play havoc with family plans.

The investment industry spends a lot of time trying to forecast things that really can't be predicted. For investors looking for a more sensible and predictable financial life, it is wiser to focus on the elements you can predict or control, and use conservative estimates for the ones you can't.

Federal Budget Highlights

Andrew Jeffery, CPA, CA, CLU, CIM

On March 22nd 2016 Justin Trudeau's Liberals released their first federal budget since being elected into office last fall. The budget, titled *Growing the Middle Class*, aims to stimulate the economy, create new jobs, and strengthen the middle class.

The following are some of the key proposals from the budget that may be applicable to our clients and their professional advisors.

Personal Tax Changes

Canada Child Tax Benefit and Universal Child Care Benefit
The budget proposes to eliminate these two common child care benefits available to parents and replace them with a new single benefit called the Canada Child Benefit. This new benefit will provide an annual maximum of $6,400 per child under the age of 6 and $5,400 per child aged 6 to 17. The Canada Child Benefit will be income tested and start to decrease as household income increases over $30,000. In general, households with income over $150,000 will receive a lower benefit under the proposed regime than the current.

Family Tax Cut (Income Splitting)
The budget proposes to eliminate this tax credit which enables families with a child under the age of 18 to split up to $50,000 of income with their spouse or common law partner to reduce their joint tax liability by as much as $2,000 annually.

Education and Textbook Credits
The budget proposes to eliminate these two tax credits available to students attending post secondary education. Combined, these credits provided potential tax savings of $69.75 for each full time month of post secondary education attended and $21 for each part time month. The budget does not propose to change the tuition tax credit, which equals 15% of amounts paid as eligible tuition costs.

Children's Fitness and Arts Tax Credits
The budget proposes to eliminate these two credits which, combined, provide potential tax savings of $225 per child if $1,000 and $500 is spent towards physical activity and artistic programs, respectively. This credit will be reduced by 50% in 2016 and phased out completely in 2017.

Corporate Class Mutual Funds
Corporate class mutual funds are a unique type of mutual fund structured as a corporation opposed to the typical trust structure. One of the major benefits of this structure is that it allows individuals to switch between funds without triggering a taxable disposition. The budget proposes to eliminate this benefit and deem a gain or loss to be realized when a fund switch occurs.

Returning Old Age Security (OAS) Age of Eligibility to 65
The budget proposes to cancel the scheduled increase in the age of OAS eligibility to 67 and maintain the eligible age at 65.

Corporate Tax Changes

Small Business Rate Reduction
Canadian small businesses benefit from a preferred federal tax rate of 10.5% on the first $500,000 of active income they earn (total tax rate is 15% in Ontario). This preferred tax rate is scheduled to decrease to 9% by 2019, but the budget proposes to freeze the rate at 10.5% for 2016 and beyond.

Manipulation of the Tax Act to Achieve Multiple Small Business Deductions
As mentioned above, Canadian small businesses are eligible for a preferential tax rate on the first $500,000 of active business income they earn. There are rules in place that require associated companies to share the $500,000 small business deduction, however complex structures have been created that enable business owners to gain access to multiple small business deductions. The budget proposes to restrict this type of planning.

Life Insurance – Strategy to Maximize the Capital Dividend Account Credit in a Corporation
When a corporation receives proceeds from a life insurance policy, a capital dividend account (CDA) credit is created if the proceeds are greater than the adjusted cost basis (ACB) of the policy. If a CDA credit is created, a tax free dividend equal to the amount of the credit can be paid to the shareholders of the corporation.

To maximize the CDA credit created on receipt of life insurance proceeds, some individuals have structured their affairs to have one corporation own the policy and another as the beneficiary. The result of this structure is that the CDA credit is not reduced by the ACB of the policy and is equal to the full proceeds received. The budget proposes to eliminate the benefit this strategy by ensuring

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the CDA credit is reduced by the insurance policy's ACB, regardless of the structure used.

Life Insurance – Transferring Policies to a Corporation

When an individual transfers a life insurance policy to a non-arm's length corporation, they are able to extract corporate funds equal to the fair market value of the policy. This is deemed a taxable transaction to the extent that the fair market value of the policy exceeds the adjusted cost base, however, there is a discrepancy on how fair market value is determined in this situation that often allows individuals to extract significant corporate funds without incurring any tax. The budget proposes to eliminate this discrepancy by deeming the fair market value for tax purposes to be equal to any consideration received from the corporation.

In addition, if individuals have utilized this planning in the past, the budget proposes to reduce the CDA credit that will eventually be generated within the corporation by an amount equal to the benefit they previously received when they transferred their policy.

It is important to note that the changes discussed above are not yet law and should not be acted on without consulting your applicable professional advisors. If you think you may be impacted by one of the proposed changes, or have any questions, please feel free to contact a member of the Northwood team.

The Family Balance Sheet

An Important First Step in Determining Asset Allocation

Scott Hayman, CPA, CA, CFP, TEP

Most corporations and institutions use a balance sheet to assess their current financial position and test the likelihood of the achievement of their future objectives. A family can benefit from using the same analytical and assessment tools, adapted to the family context, as part of a robust and effective wealth plan. For the family, assets are relatively straightforward. Liabilities less so.

On the left side of the balance sheet, the family lists their assets. A private wealth balance sheet includes tangible assets (investments, personal asset, and family business) as well as intangible or "soft" assets (human capital, deferred compensation, and expected inheritances). Human capital represents the present value of the expected earnings stream and capital creation from employment or entrepreneurial activity, as well as the skills the family has to manage and grow their wealth.

The Family Balance sheet

On the right side of the balance sheet are the current liabilities and future commitments. For most wealthy families, their liabilities are not actually debt. Rather, they are funding plans for goals the family has set or, in some cases, financial commitments they have made. These commitments are normally self-imposed, but must be funded by income or assets nonetheless.

These 'implied liabilities' typically include the following categories:

Lifetime spending. This is simply the cumulative annual spending plans of the family over the lifetimes of the relevant family members. An appropriate amount of capital, assuming a reasonable discount rate on the future spending and consideration for inflation, should be notionally allocated to cover this planned spending.

Bequests and gifts to heirs. The wealth owners may wish to identify a certain minimum or target amount of funds that will be allocated to their current and/ or future heirs. The liability is the current amount of capital (based on reasonable growth assumptions) that will need to be allocated to fund this liability. Some families will choose to identify only specific liabilities to fund and then will bequeath "whatever is left" (i.e., the surplus of assets over implied liabilities).

Generational funding. Some families want to fund many generations of family members for a certain lifestyle or level of wealth. The decision as to how many generations they want to fund and how much each beneficiary will receive will have a significant impact on the liability they need to fund. The capital that would be needed to fund ten generations as

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opposed to one single generation would be enormously different in obligation and required capital commitment.

Charitable donations and bequests. Similarly, plans to fund philanthropic projects or a foundation, either during the family members' lifetimes or upon their deaths, must be taken into account and funded. In some cases, these are explicit commitments (such as a charitable bequest in a will) and in other cases they are simply the implied liabilities of an intended donation.

Large investments or purchases. Any anticipated large purchase or investment must also be planned for and ultimately funded by assets. This could include plans to fund a business, buy a recreational property, or fund a family bank.

It is important for each family to determine the relative importance and priority of its goals and commitments and notionally (or in some cases, explicitly) assign existing investment capital to fund these amounts.

Lifetime spending is normally viewed as nonnegotiable and so will require the first assignment of capital. The relative importance of other goals will depend on each family's own preferences and priorities. The more goals a family puts in the "high-priority" category, the more "liabilities" they will have and the less discretionary wealth they will have for other purposes. This may reduce the amount of risk the family will be able to withstand in their overall portfolio.

Key Questions for Family Investors

Following are some of the questions family members will want to ask themselves as they create their family balance sheet:

- What are the family goals? Can they be afforded given current and expected assets and liabilities? What cash flow funding will they require?
- How much certainty does the family want that those goals will be met? How far into the future will they need to be met?
- What are the family's assets? What cash flow can they generate? How likely are the assets to be able to fund plans and commitments when needed?
- Will there be sufficient cash flow to fund all of the objectives and aspirations?
- Is there a gap between liabilities and assets? How will the gap be addressed? Or will goals have to be prioritized or deferred?
- Does the family have surplus assets? What is the purpose of those surplus assets?
- How is the family balance sheet likely to change over time and over generations?

This balance sheet approach is a helpful method by which to determine investor goals and then build an asset mix that is most likely to meet these goals, depending on their relative priority.

Who is Northwood Family Office?
Northwood Family Office is an independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ to wealthy Canadian and global families. Northwood clients have significant family net worth, typically in the $10 - $500 million range. The firm acts as a Personal CFO or Chief Advisor to client families using a dedicated team of professionals who oversee and manage their integrated financial affairs. Northwood Family Office is Canada's leading independent multi-family office and has consistently been ranked the '#1 family office in Canada' in the *Euromoney* Global Private Banking survey. For more information, see our website at www.northwoodfamilyoffice.com or contact Tom McCullough for a confidential conversation at tm@northwoodfamilyoffice.com.

NORTHWOOD FAMILY OFFICE

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