NORTHWOOD
FAMILY OFFICE

ALSO IN THIS ISSUE:

- Using Emotional Intelligence to Benefit Family Conversations About Wealth 2
- Tax Rates Have Risen Substantially for Ontario Taxpayers 3
- What is a Reasonable Expected Return from Equities? 4

Chairman's Message

Tom McCullough

Happy new year! Many people say they are glad to be rid of 2016, but 2017 looks like it could be pretty eventful too, especially given the potential surprises from the new administration in the US and the political instability in Europe, not to mention issues with Russia, and China and market volatility!

Wealthholders face a world of unknowns that can play havoc with their plans and goals. Investment returns are unknown, tax laws and regulations change, black swans and global events are unpredictable, correlation among asset classes is a moving target, and surprises on the personal and family front are not uncommon. So how should families operate with this level of uncertainty? Should we expect to accurately predict the outcomes of the events that will affect our wealth?

In his now-classic book on risk, *Against the Gods*, Peter Bernstein says that the way to deal with this is to "maximize the areas where we have some control over the outcomes, while minimizing" ... and I would add 'conservatively estimating' ... "the areas where we have absolutely no control."

In the face of unpredictable world events and capital markets, there are actually quite a few areas where investors do have some control or forecasting ability. Here are some of them:

A goals-based, cash flow approach to investing - The financial well-being of investors is often better protected from external market shocks if their investment strategy is structured to match their cash flow-related goals, such that they only take on the minimum amount of risk required to meet their most important goals. A family might not know the return it will earn on its portfolio, but it can more easily forecast its cash needs by quantifying its most predictable goals, such as the amount it reasonably expects the family members to spend during their lifetimes.

Tax management – Every dollar saved in taxes goes into the pocket of the wealthholder; in that way tax savings are a 'certain' additional return with no added risk. There are a number of avenues to save taxes, including income splitting, trusts, deferral of taxable gains, and tax-effective investment decisions, among others.

Costs – Every dollar saved in costs also goes into the pocket of the wealthholder; it pays to minimize costs wherever it makes sense. They include investment management fees, trading, custodial and advisory costs, professional fees and transaction fees. In a low investment return environment, 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 expenses and distributions - Some expenses are completely optional, other expenses can be cut back as needed. Expense control is a risk management tool families can employ at their discretion.

Conservative assumptions - As mentioned above, wealthholders can make conservative assumptions on the non-controllable aspects of their lives. This factor will reduce the risk of negative surprises.

Diversification - A diversified portfolio is an important risk mitigation tool and is another factor a family can control.

Behavioral risk management disciplines - While investors cannot specifically control the returns their investments provide, they can exercise some control over the way they themselves respond. Tools such as a written wealth plan and an investment policy can provide much-needed self discipline that can help save the portfolio from the effects of rash and unwise reactions, particularly in difficult periods.

Years of work or timing of business sale - Families normally have some control over how long the principal breadwinner(s) work and bring in income or when they sell the family business. The timing of cash flows can be an important risk management tool for any family and can be controlled, at least to some extent.

Continued

ROTMAN FAMILY WEALTH MANAGEMENT PROGRAM – April 6-9, 2017

Click to see the 3 minute video about the course

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 April 6-9, 2017, 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

Leverage - Families can control the level of debt they take on. Debt can provide important leverage for growth but can also restrict options in difficult times when liquidity and flexibility are required.

Complexity and illiquidity - While complex and illiquid investments can sometimes provide additional returns, complexity also has costs. These include additional fees, extra due diligence, distraction, illiquidity and an inability to make high quality decisions when required under time pressure.

Families have control over all of these decisions, and handling them well can mitigate the big picture risks and uncontrollable factors that face us all. A family office can help ensure these safeguards are in place.

Using Emotional Intelligence to Benefit Family Conversations About Wealth

Evan Thompson

This is a guest article by Evan Thompson, founder of Evan Thompson and Associates. Evan is a communications expert with over 30 years of experience. His passion is helping professionals and organizations meet their goals though Emotional Intelligence development, in which powerful communication skills play a large part.

Families are faced with numerous distractions. Hectic schedules also conspire to make constructive conversations about wealth difficult to plan, let alone hold.

Research tells us that talking about money can be a difficult and even painful proposition. Growing up, money was never discussed in my household. My father's lament, "It's time to pay bills. I'm going upstairs" was about the only time the topic of money ever came up. My financial knowledge (such as it was as a young teenager) didn't go much further that realizing that getting a summer job could mean a new bike. Most of my friends shared my moment-to-moment approach when it came to thinking about money.

(It's no surprise that families who start early and talk freely about wealth can help themselves immensely in preserving their wealth for the next generation and beyond.)

Affluent families often face five challenges in launching "the money conversation".

1. The practice of family conversations is under siege, according to Sherry Turkle, author of "Reclaiming Conversation: The Power of Talk in the Digital Age". She writes, "Conversations are sacrificed for connections" and families resolve touchy issues on G-Chat versus through face-to-face conversations around the dining room table.

2. Business and travel schedules can make it hard to find the time to meet, let alone focus on a particular issue that also requires candour and thought you can't Google.

3. Just as their parents avoided the topic of sexuality, many also never talked about money with their children. The tradition of non-communication about money continues in many homes.

4. Families who, for whatever reason, don't spend much time together are less likely to have valuable conversations about wealth.

5. Parents may not see the need to broach the topic of wealth. Their children are good students, manage their own savings accounts and take part-time jobs to save for their education. (In fact, this scenario is the best foundation on which to begin the conversation about current and future wealth.)

EQ (Emotional Intelligence) can be instrumental in guiding parents and their children to worthwhile family conversations about wealth. They occur when all family members feel comfortable forming and sharing their aspirations about wealth freely with one another. The adage; "IQ (Intellectual Intelligence) gets us through school. EQ gets us through life" captures the essence of EQ. EQ helps us to navigate the tricky terrain that lies between strangers and trusted friends and family members of any generation.

EQ means much more than 'playing well with others." It is also about showing leadership as a parent, managing your emotions as well as understanding what family members are feeling and what drives them. Peter Salovey and John D. Mayer coined the term 'Emotional Intelligence' in 1990, describing it as "a form of social intelligence that involves the ability to monitor one's own and others' feelings and emotions, to discriminate among them, and to use this information to guide one's thinking and action".

Behavioural experts now see EQ as the leading indicator in predicting a person's leadership potential. It has eclipsed IQ as the fulcrum of personal happiness and business success.

Continued

Here are 10 ideas for harnessing your and your family's EQ to encourage open conversations about money. They involve all the EQ road markers, including active listening, showing empathy, avoiding mixed messages, being self-aware and sensitive to the feelings of others.

1. When planning a family conversation about wealth, consider the current family dynamics. Is yours a "tightly knit" family, or has time and distance taken away some of the openness you shared? The degree of closeness you feel may mean you need more time to get everyone comfortable before 'the conversation' and to re-establish trust among you.

2. Before having a family conversation, get focused on your and your partner's personal view of wealth and the role you want it to play in enhancing your children's (and grandchildren's) lives. For example, rather than giving them money to ensure their potential happiness and safety, would you rather give the something else— such as an opportunity to grow? Or both?

3. Try to ensure that your actions reflect the EQ premise about avoiding sending mixed messages. For example, solemnly stating that "money can't buy happiness," as you celebrate another major purchase may confuse children. They are looking for your actions to square with your beliefs. When your words and actions are aligned, children will be more encouraged to participate in the conversation.

4. When you let your children know it's time to discuss your wealth, remember that time and place is everything. The cottage or a family holiday in a new environment may be ideal. Talking over a family meal that each family member has helped to prepare can encourage closeness and a willingness to share ideas.

5. Consider the tone of the conversation: Wealth is an important topic, but keep your approach friendly and positive. Look forward, not backward, and avoid making judgments.

6. Hold conversations on a pre-arranged basis and avoid rescheduling wherever possible. Talking about wealth need not become an obsession, but giving it the respect it deserves is important in learning about family member goals and attitudes about wealth.

7. Invite family members to bring their ideas and concerns to the conversation without hesitation or fear of being judged. Appoint a different family member to keep minutes of each conversation, to the best of their ability and thank them in front of other family members.

8. Encourage a different family member to lead the conversation at each gathering and help them prepare an agenda in advance. Younger family members can gain confidence and learn how to speak in front of others by leading a family meeting.

9. If a financial issue arises with a family member that needs to be discussed between meetings, do your best to have the conversation in the moment and don't put it off until the scheduled meeting.

10. An advisor can help you structure your family meeting while offering practical insights to make it a success. Invite him or her to attend one or several meetings to act as an impartial resource to explain certain concepts, and to learn more about each family member as an individual.

Tax Rates Have Risen Substantially for Ontario Taxpayers

Cameron Scott, CPA, CA, CFA

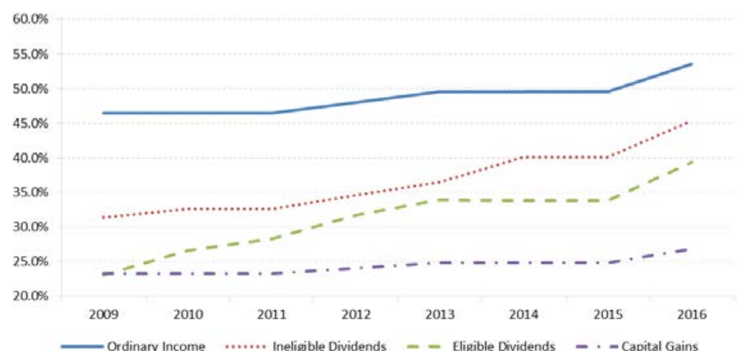
Widely publicized as part of the federal Liberal government's election platform and 2016 budget, the federal government added a new personal income tax bracket, which raised the top federal tax rate from 29% to 33%. When viewed in conjunction with Ontario provincial tax rates, the top combined marginal tax rate on ordinary income increased to 53.5%.

While current personal tax rates are well known to many, this article provides insight into several less familiar but related topics, including:

1. How Ontario's top combined rates have changed over time
2. How Ontario's top combined rates compare to other jurisdictions, both within Canada and globally

2009-2016 Ontario Combined Tax Rates

In Ontario, combined top marginal tax rates have been trending upwards since 2009. This trend is reflected Canada-wide, with combined top personal income tax rates increasing in every province since 2009. The chart below illustrates Ontario's combined top marginal tax rates over the 2009-2016 period by income type:



The above chart illustrates several interesting points:

Continued

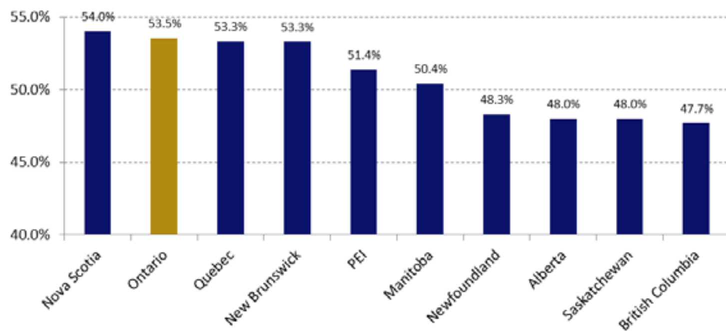
- Top combined marginal tax rates on ordinary income (e.g. employment, rental, and interest income) have increased by 7.1 percentage points or 15.3% over the 2009-2016 period.
- Perhaps more shockingly, top combined marginal rates on eligible dividends (i.e. generally, dividends paid from Canadian public companies) have increased by 16.3 percentage points, or an astonishing 70.6% over the same period.
- Increases in capital gains tax rates have been relatively muted compared to all other types of income, rising only 3.6 percentage points or 15.3%. As a result, there has been widespread speculation that the Liberal government will increase the capital gains inclusion rate from the current 50% to as high as 75%, which would bring the effective capital gains tax rate in line with that of dividend income.

What should you take away from your new perspective on Ontario's increasing top marginal tax rates? With tax rates rising, the tax-efficiency of your investments is becoming increasingly important. Appropriately planning what types of investments and where to hold them can increase your after-tax returns with no corresponding increase in risk.

Tax Rate Comparison: Ontario vs. Other Jurisdictions

Within Canada

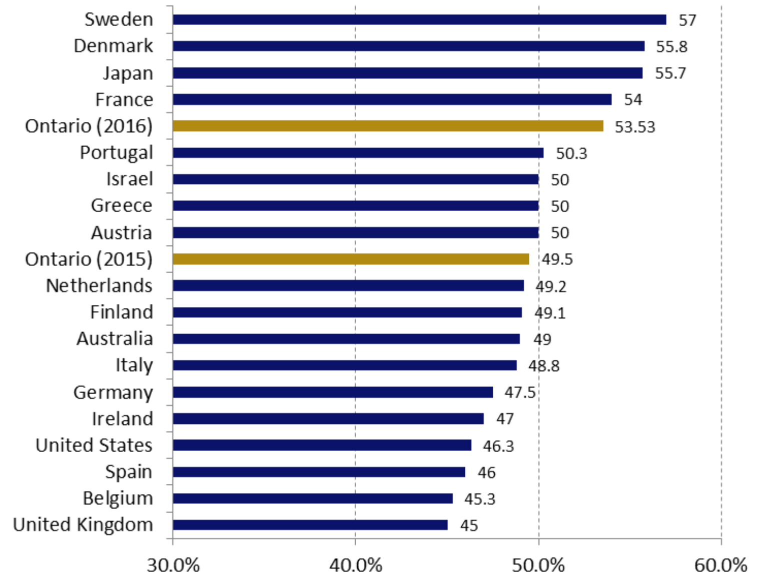
While top combined tax rates have been broadly increasing across Canada since 2009, there are still notable differences in provincial top combined tax rates. The following chart illustrates 2016 top combined rates on ordinary income by province:



In 2016, Nova Scotia has the highest combined tax rate in Canada at 54.0%, followed closely by Ontario at 53.5%. At the other end of the spectrum, British Columbia had the lowest combined rate of 47.7%, or 5.8 percentage points lower than Ontario's top rate.

Globally

With increasing numbers of transnational affluent families, another important perspective is how Ontario's combined rates compare to those of other industrialized nations. The following chart, compiled with data from the Fraser Institute, illustrates Ontario's top combined rates in 2015 and 2016 and other OECD countries' 2015 tax rates:



In 2015, Ontario had the 9th highest top tax rate at 49.5%, comparing unfavorably to the US (46.3%) and the UK (45%). With the federal government's increases in 2016, Ontario's tax rates became the 5th highest among OECD countries (compared to OECD's 2015 data), below only Sweden, Denmark, Japan, and France.

What is a Reasonable Expected Return from Equities?

Tom McCullough

This article is adapted from my book, Family Wealth Management – 7 Imperatives for Successful Investing, *available on Amazon (http://amzn.com/0470824298).*

What return should an investor assume equities will provide? In most studies, the long-term nominal returns from stocks in the United States have averaged around 9 to 10 percent. But that return varied dramatically depending on the decade and time frame selected. In the decades of the 1950s, 1980s, and 1990s, the annual average returns from U.S. stocks were above 17 percent. In the 1920s and 2000s, average returns were negative.

In trying to understand investment returns, industry veteran John Bogle builds on a helpful concept introduced by economist John Maynard Keynes. They suggest that stock returns are actually a combination of two factors – the *investment* return (the initial dividend yield and the subsequent annual rate of earnings growth) and the *speculative* return (the change in price investors are willing to pay for reach dollar of earnings, or the price-to-earnings [P/E] ratio).

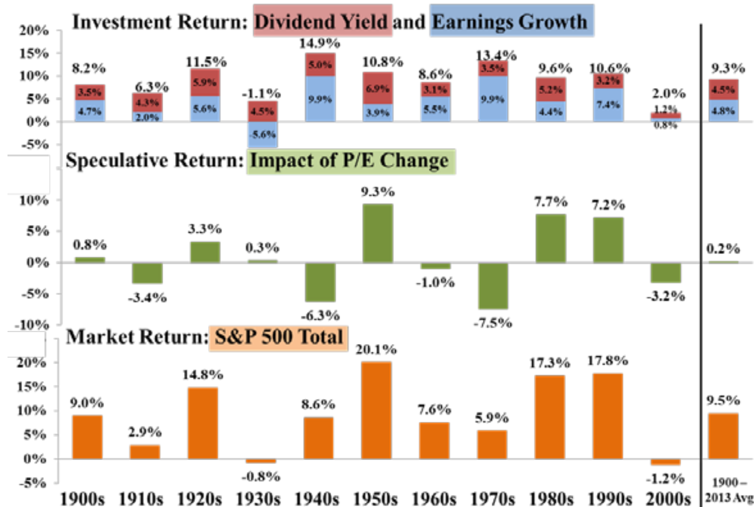
The following three part bar chart helps to explain this. The bottom graph shows the average annual returns of the overall U.S. stock

Continued

market for each decade between 1900-2013. You can see that it averaged +9.5% since 1900, but some decades averaged -1.2% and some +20.1%.

The top graph shows the average annual *investment* return (dividend yield and earnings growth). It has been remarkably stable over time, averaging +9.3%, with only two decades averaging less than +6%.

The middle graph shows the average annual *speculative* return. It has been very volatile with a wide range of average returns from +9.3% to -7.5%, and producing a net return of just above 0%.



The encouraging lesson is this: Despite the swings in the stock market, driven mostly by speculation, the actual returns from equities over the long run have been derived primarily from real economic factors that have produced real results. For families with very long-term orientations and good staying power, equities may have reasonably predictable returns. Unfortunately, shorter time periods are subject to much more variability in returns, and families need to take this into account in their planning.

In another analysis of the U.S. market using a slightly different time frame, equity returns are deconstructed as in the following list:

S&P Returns (1926-2009)

Earnings growth	4.1%
P/E increase (10.2-25.1)	1.3%
Dividend yield	4.3%
Nominal equity return	9.8%
Inflation	3.0%
Real equity return	6.8%

Using the same math today to forecast future equity returns would, not surprisingly, produce a lower outcome than historical averages. For the purpose of this example, we simply assumed roughly the same historical earnings growth rate, no P/E increase*, and the current dividend yield and inflation rate:

S&P Returns (Future?)

Earnings growth	4.0%
P/E increase	0.0%
Dividend yield	2.0%
Nominal equity return	6.0%
Inflation	2.0%
Real equity return	4.0%

It is important to do this analysis on a regular basis since the market environment can change rapidly, but these frameworks can be helpful in making a reasonable assessment of how much an investor should expect to achieve from asset classes over the long term. Sharp changes in equity price levels can provide opportunities to reassess valuations.

*Note that the cyclically-adjusted Shiller P/E ratio is currently near 28x earnings, well above the long term average of 16.7, which suggests we probably can't count on the multiple to expand much further.

Who is Northwood Family Office?
Northwood Family Office is an independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for 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.

For more information, please call Tom McCullough or Scott Hayman at
Main: (416) 502-1245 Email: tm@northwoodfamilyoffice.com
www.northwoodfamilyoffice.com sh@northwoodfamilyoffice.com

The Northwood Perspective is published by Northwood Family Office Ltd., a Portfolio Manager and Exempt Market Dealer registered in the provinces of British Columbia, Ontario, and Quebec. The articles and information in this newsletter are prepared as a general source of information and should not be relied upon as personal investment, legal, or tax planning advice, and, should not be construed as an offer to buy or sell securities. We have used our best efforts to ensure that all material contained in the newsletter is accurate at the time of publication; however, we cannot guarantee its accuracy or completeness. Any opinions expressed in this document are based on current analysis of market events and circumstances and are subject to change.