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The Northwood
PERSPECTIVE

Chairman's Message: Northwood's 15th Anniversary – How It All Began

Tom McCullough

Northwood Family Office turns 15 this year! When we opened our doors in 2003, we had no clients, but we had a great idea and a lot of enthusiasm and passion to make it happen. And now in 2018, we have 60 wonderful client families and a terrific staff of 14 (heading to 18 by the end of the year)! We couldn't be more pleased with the results.

So for this anniversary year, each of my Chairman's Messages in *The Northwood Perspective* will address one theme associated with our first 15 years. This first one will step back in time and give you a behind-the-scenes look at how the idea for Northwood came about.

They say 'the best entrepreneurs are frustrated consumers.' And I was definitely a frustrated consumer. Back in 1999-2000, when I was an executive at an investment firm, I was looking for an advisor for our own family who was knowledgeable enough to take an integrated view of all aspects of our financial affairs, was objective and unbiased and put client interests first, and provided the highest level of customized service and access to whatever investments and products we might need. I also wanted someone who could take the load off me since I didn't have the time to manage it all myself. Unfortunately, I couldn't find anyone that offered all of that.

And I wasn't alone. From my conversations, I found that most clients simply had to cobble together a loose collection of tax, legal, insurance and investment advisors, and were not really happy with the result. (This is actually still the case for many families.)

As I turned this over and over in my mind, the frustration began to morph into a sense of opportunity. If *I* was looking for something better, maybe *other* families were too. Maybe there was a chance to create a solution for my family and other families too? A family office.

Perhaps not surprisingly, it took a lot longer to get it started than I thought. While doing some consulting in the interim, I reconnected with my colleague Scott Hayman and we worked together for an institutional client in Montreal. Scott had deep expertise in the integrated planning and investment services that a new family office could offer. So in the evenings (mostly at Reuben's Deli on St. Catherine Street in Montreal), we hashed out our ideas and built a business plan to create a family office.

> [W]e believed that a firm that offered the best of all three platforms would be an attractive offering to high net worth clients, especially if it could be delivered all in one place for the convenience of the family.

I recently came across that original business plan while cleaning out some files. Our idea was that wealthy families had no natural home in the financial services industry that could meet all of their needs. We thought we could create a firm that combined the best of the three main advisory channels – brokerage, investment counselling, and CAs/ financial planning – while avoiding the worst.

Brokers were particularly good at finding clients and offered the widest range of investment choice. On the other hand, they tended to focus on smaller-sized clients (so each advisor had to have many clients), didn't offer much planning, and had a sales-oriented/ commission-driven approach.

The *investment counseling* world dealt with higher-end clients, but they offered little choice, beyond their own investment funds, and very little in the way of planning services, so clients were forced to cobble together their own plan/strategy or turn to their disparate professionals (CAs, lawyers, insurance etc.) to do various parts of the plan.

The *fee-for-service planner/CA* community offered the best integrated planning and structuring services, but some didn't offer implementation and most did not deal with investments.

(Of course, many of these advisory channels have made improvements to their own offerings over the years as well.)

In any event, we believed that a firm that offered the best of all

three platforms would be an attractive offering to high net worth clients, especially if it could be delivered all in one place for the convenience of the family:

- A unique, customized level of service where clients can have someone 'looking after everything for them'.
- A planning-oriented approach where we would manage the whole client (including tax, estate, insurance, wills, charitable, family dynamics etc.)
- Top quality investment management for wealthy families' serious money (including top quality, independent managers)
- A high-integrity, client-first approach with an objective fee structure
- A partnership culture that would focus on attracting and retaining the highest quality professionals

One day in 2002, I got a call from a friend (- thank you!) whose advisory firm had just sold a multi-million dollar business for a family. He asked me for suggestions of investment managers they should consider. In conversation, it became obvious that the family needed more than just investment management and would benefit from the integrated approach we had been imagining. They signed on to work with us and are still clients to this day (-thank you!). Working with this first family, and soon others, allowed us to further hone our expertise and experience and build the firm.

We are grateful for the opportunity we have had over these 15 years to serve the needs of our client families. It is exciting to look back and see a dream become a reality. We are even more enthusiastic about our clients and our firm than when we started and we look forward to the next 15 years and beyond.

Rotman Family Wealth Management Program – April 12-15, 2018

For the fourth consecutive year, the University of Toronto's Rotman School of Management is once again pleased to offer the Rotman Family Wealth Management course. This 4-day intensive program for family members and family office staff will be held in Toronto from April 12th to 15th, 2018, and will be taught by Tom McCullough and other key faculty members and wealth management leaders. For more details on the course (including registration information) please visit:

http://tinyurl.com/od5kr7s

Click here to see a three-minute video discussing the main topics that are covered in the Rotman Family Wealth Management Course

Northwood Volunteers at Yonge Street Mission

On Friday December 15, Northwood headed to Yonge Street Mission for a day of volunteering. The day started with unloading a truck filled with frozen meats and canned goods, progressed to sorting and organizing these supplies, and culminated in handing out holiday provision packs to families in the community. The experience was humbling, but also rewarding, and it gave all of us a chance to reflect on how tough it can be for some families to afford food in Toronto. The picture to the right shows all of us holding some of the supplies we handed out that day.

The Yonge Street Mission has been helping Torontonians from every walk of life to rise out of poverty since 1896. For more information on the work that they do there, you can visit their website at (www.ysm.ca).

When Do You Need a Family Office?

Scott Hayman, CPA, CA, CFP, TEP

2017 was a year of continued growth for us at Northwood Family Office, with the addition of a number of new families who chose Northwood to manage their integrated financial affairs. This got me thinking about what things typically lead a family to search for a family office and eventually end up knocking on our door. As I look back over the different reasons new clients have joined us, most of them fall into one or more of the following three categories:

1. **New-found liquidity**
2. **New stage of life**
3. **New awareness of family offices**

Let's look briefly at each of these categories:

New-found Liquidity

The number one reason why people end up in our offices is new-found liquidity. This might be from the sale of a family business, an inheritance, or even a significant lottery jackpot. The most common of these is a business sale. Many of these families have had years of experience in managing a complex family business, but have little to no experience in managing liquid family wealth. The CEO of a family business has a diverse set of skills, but they may not necessarily be relevant to the job of 'CEO' of the family's new-found liquid wealth. Whereas before the CEO had to manage the Finance, Sales, and Manufacturing departments, now they have to think about investments, tax planning, and philanthropic endeavours. This new level of liquid wealth and the effective management of it can be daunting and often leads people to seek out a family office.

New Stage of Life

Another change that brings people to Northwood (and to multi-family offices in general) is entering a new life stage. Maybe they have decided they want to stop spending so much time looking after their financial affairs and focus on what's really important to them. Or, their children may be reaching early-adulthood and the need for family education, financial literacy and succession planning may be at hand. Or, they may be thinking about their own mortality and what will happen to their family in the event of their sudden death or disability. All of these things can cause people to start thinking about the big picture and how they can set themselves and their family up for success in the long run. Working with a family office can provide people entering a new stage of life with peace of mind, and can help save them time, money and headaches, now and in the future.

Many of our clients have managed their own financial affairs for decades, but at a certain point realized that all of the important information was in their heads and had not been shared with anyone else. They engaged us as their family office to help bring their spouse and adult children up to speed, and to ensure that their affairs are in order.

New Awareness of Family Offices

In Canada, multi-family offices remain an enigma to much of the country and even to many wealthy families. The dominance of the big six Canadian banks over the past half century, has left many people unaware of independent partner-owned companies like Northwood. In the US, the banking industry is much less concentrated and the multi-family office industry has been around for decades in most major cities. In Canada, Northwood is the most well-known multifamily office and we have only been around since 2003. To this day, we meet with prospective clients who confess to us that before their friends recommended Northwood to them, they had never heard of a family office.

In the last few years, we have noticed that this situation is slowly changing. It is increasingly common for prospective clients to find us on-line from a Google search and contact us directly. On top of this, our now 15-year track record (and the work we have done with our long-time clients) is making a larger group of people aware of what Northwood offers. These clients and their related advisors know us and have confidence in the work we do, and they are increasingly making referrals to new families who could benefit from the services of a family office.

Criteria

So the next question is; what type of families are candidates for family office services? Although each family is different, we believe that the services of a multi-family office really only begin to make sense at a net worth of $10M or more. A second common criterion is the level of complexity of the family's affairs. Complexity can be driven by a number of factors including the size of the family, how many generations there are, the citizenships of the family and the family's goals. Complexity usually also increases as a family's wealth grows over time, but a family office can simplify the management of it significantly. Finally, the more liquid assets a family has (as a percent of their net worth), the more a family office can do for them based on its expertise and objectivity in planning, investing and risk management. For instance, if 90% of the family wealth is tied up in an illiquid business which the family is running themselves, a family office may make less sense – until they begin to build up liquidity from earnings or decide to sell the business.

The decision to engage a family office and the timing of this decision will depend on different factors for every family. I hope that this article has given you a better idea of some of the variables that can influence this important decision.

Northwood Staff Profile – Andrew Jeffery

Andrew Jeffery, CPA, CA, CFP, CLU, CIM

In this quarterly feature, we help our readers to get to know some of the people who work at Northwood Family Office. The 'Northwood Staff Profile' consists of an interview with a team member at Northwood. This quarter, Andrew Jeffery, who has been on the client service team at Northwood since 2015.

1. What do you do at Northwood Family Office?

At Northwood, I'm a member of the client service team. My role is to help our clients manage their day-to-day financial affairs and tackle a wide variety of projects. Given my background in tax and accounting, I tend to work mostly with families who have specific needs in these areas. However, I'm also experienced in financial planning, and one of the few team members with an expertise in life insurance, so I'm leaned upon as an internal resource in these areas as well.

2. What did you do before you joined Northwood?

My career started at a mid-sized CA accounting firm in Hamilton, Ontario, where I primarily focused on taxation. It was a great place to start my career, but I realized early on that a life in public accounting wasn't for me.

From there I joined a boutique wealth management firm in Burlington, Ontario. I really enjoyed my time there and gained a lot of valuable experience – but as I progressed, I found myself especially interested in the planning and softer issues facing our clients, which led me to look for a new opportunity. It wasn't until I joined Northwood and starting working with our clients, that I knew I had found my calling in the family office space.

3. What attracted you to the multi-family office industry?

I think it was two things. The first is the relationships I am able to form with the families I work with. By design, I only work with a limited number of families, which allows me to get to know them on a deep personal level, making the work extremely rewarding. Secondly, our clients are all different and have unique financial needs, which means no two days at the office are the same. One day I could be discussing an investment portfolio, while the next I'm helping draft wills or planning how best to use a private foundation. It's rare I go home at night without having learned something new that day.

> [O]ur clients are all different and have unique financial needs, which means no two days at the office are the same.

4. You have many letters after your name. Are you done with designations yet?

At this stage in my career, I'm not planning to complete any additional designations. It has been a lot of work to get the alphabet soup of letters behind my name, but I felt like it was important early in my career to get my knowledge base up to snuff in order to handle the complex needs of our clients. Reflecting back on my designations, the most beneficial to my career has been my CA (or CPA as it's called today). Not only did it provide me an education in accounting, tax, and business advisory - it taught me to be a problem solver, recognize patterns and trends, and to assess any problem from both a macro and micro level. My other designations, while all beneficial, have been much more targeted in their specific disciplines of financial planning, investment management, and estate planning.

5. We hear you're the best golfer in the office...any good golf stories?

Golf has been a life-long passion of mine and is still a huge part of my life. I was a scratch golfer for most of my life, but unfortunately, I have watched my handicap trend higher over the last few years. I can still knock it around pretty well, but I'm never confident which of my golf personalities (Jekyll or Hyde) is going to show up on any given day.

This last September I crossed a big 'to do' off my bucket list and travelled to Ireland with seven friends to play some of the most beautiful courses in the country. It was one of the best experiences of my life and I can't wait to go back. The *links* style of golf is completely different from what we typically play here at home, and it didn't take long for some glaring holes in my game to be exposed (ahem…putting). If any golf aficionados are reading this, I highly recommend this trip. Just don't forget to pack a quality rain jacket!

Market Returns are Rarely Average Returns

Scott Dickenson, CFA, MBA

As the new year begins, the question on many investors' minds (as always) is – what type of investment returns can I expect in 2018? Everyone knows that the good times cannot go on forever, but no one is sure what the catalyst will be to slow down or flip the market, or when it will hit. At Northwood, we are not in the business of predicting the timing of the next market downturn, but we do recognize the unusual length of this bull market. In 2018, we will continue to invest our client's wealth cautiously with an eye on the markets of today, but a focus on the long-term appreciation needed to meet each family's individual goals and aspirations.

With that said, the topic I want to discuss today is the oft-misunderstood concept of long-term average market returns. For instance, over the past 30 years, the Toronto Stock Exchange (TSX) has produced an average annual total return (price return + dividends) of 9.5%. (The S&P 500, by comparison, has returned an average 12.0%, in USD terms). The question is how did investors get to their average annual return of ~9.5%? Did investors consistently earn 9.5% each year – or even within an 8-12% range? The following table helps illustrate the answer to that question:

Exhibit 1:
TSX Annual Return Data (1988-2017)

Annual Return	# of Occurences (1988-2017)
< -8%	6
-8% - 0%	3
0% - 8%	2
8% - 12%	5
> 12%	14

As we can see, the 'average' return range of 8-12% occurred in only five of the 30 years in the data. The two most common results were annual returns of <-8% (6 occurrences) and annual returns of >12% (14 occurrences). This helps to illustrate the limitations of calculating an *average* annual return, and the folly of expecting one.

In fact, in two thirds of the years studied, the annual return was not close to the overall average, but rather a large positive or negative return. These returns ranged from a low of -33.0% in 2008, to a high of 35.1%, one year later in 2009.

The lesson here is that if you remain invested over the long run, you may well continue to earn the average annual return. However, this does not mean that you should expect each year to deliver this type of consistent return.

This data was easy enough to find and the above analysis is rudimentary. This must mean that your average Bay Street or Wall Street strategist should be aware of this same phenomenon, right? Not so, according to a recent article by Matt Lundy in *The Globe and Mail*. In his article, Mr. Lundy looked at the differences between market predictions and market reality for the years 2008 to 2017. He did this by tabulating the historical predictions for the next year's returns made by strategists at top banks (Goldman Sachs, Credit Suisse, JPMorgan Chase, etc.) in December of each year. He then averaged the predictions of the ~15 strategists to get a consensus Wall Street view of what returns investors should expect in the following calendar year. So how did the highly-compensated strategists at the world's top banks fare at predicting the market outcome? The answer: Not too well.

So how did the highly-compensated strategists at the world's top banks fare at predicting the market outcome? The answer: Not too well.

In December 2016, the average estimate for 2017 S&P 500 returns amongst the 15 strategists was 5.25%. (Please note that these predictions are for S&P 500 price return, whereas the returns mentioned in the second paragraph of this article are total return numbers). The strategists' 2017 predictions ranged from a low of 3.0% to a high of 11.5%. Now that the year is over, we can see that even the most bullish strategist (11.5%) missed the mark as the S&P 500 returned 19.4% in 2017. As the below table from Mr. Lundy's article shows, the strategists have regularly been off the mark over the last five years, and most of them played it safe by forecasting returns that stayed pretty close to the historical averages.

Exhibit 2:
Strategists Consensus vs. Actual S&P 500 Price Returns (2013-2017)

Year-End Estimates	Average Estimate	Actual Change	% Point Difference
2013	7.35%	29.60%	22.25%
2014	5.28%	11.39%	6.11%
2015	8.07%	-0.73%	-8.79%
2016	8.42%	9.54%	1.12%
2017	5.25%	19.42%	14.65%

So what do we predict for 2018? There's a pretty good chance that returns won't be consistent with their long-term averages and you should take any market predictions you read with at least a couple of grains of salt. It is reasonable to estimate market returns over the long term, but in the short term, in the words of Bonnie Tyler, it's a fool's game.

Can't Get No Satisfaction – Update on Federal Tax Changes

Lorn Kutner, CPA, CA, MBA

In the last edition of the *Perspective*, I reported on the status of the Department of Finance proposals impacting private corporations and their shareholders. On December 13, 2017 the Department of Finance released its revised draft legislation in respect of its proposed changes to address income sprinkling using private corporations. Coincidently, that was the last sitting day in 2017 of the House of Commons which significantly curtailed any parliamentary discussion regarding the proposals.

Despite the lack of any parliamentary review and discussion, I can say with certainty that there were many accountants, lawyers and other advisors to small business owners who spent the following two weeks burning the midnight oil, and not because they were celebrating Hanukkah! Instead, they were trying to understand these proposals and determine whether any tax planning steps needed to be implemented before the end of 2017, as the new rules are set to be effective starting in 2018.

However, the legislative story does not end there. In light of the fact that the initial proposed changes to the taxation of private companies created significant concern for many Canadians, the Senate asked the Standing Senate Committee on National Finance (the 'Committee') to study them. So coincidently (yes again), on the same day that the revised draft legislation was released, the Committee released its 43-page report *Fair, Simple and Competitive Taxation: The Way Forward for Canada.*

The study considered witness testimony and written submissions, and in particular, focused on the impact of the proposed changes on incorporated small businesses and professionals, the country's economic growth and government finances, and on the fairness of the taxation of different types of income.

The study provided three recommendations:

1. The Government of Canada should withdraw the proposed changes to the Income Tax Act respecting Canadian-controlled private corporations;

2. The Government should undertake an independent comprehensive review of Canada's tax system with the goal of reducing complexity, ensuring economic competitiveness, and enhancing overall fairness; and

3. Should the Government proceed with its proposals to amend the Income Tax Act respecting Canadian-controlled private corporations, then the implementation should be delayed until at least January 1, 2019.

In light of the ongoing criticism of this updated legislation from the professional community and the comments contained in the Senate report, it will be very interesting to follow the future of these proposals after the members of the House of Commons return in 2018 after their holiday break. In the interim, let's understand the impact of these proposals as they currently exist.

Despite the lack of any parliamentary review and discussion, I can say with certainty that there were many accountants, lawyers and other advisors to small business owners who spent the following two weeks burning the midnight oil, and not because they were celebrating Hanukkah!

The revised draft rules are intended to clarify when a family member has made a significant contribution to a business and is therefore not subject to the new rules. Family members who are now *excluded* from the income sprinkling rules are:

1. A business owner's spouse where the owner made a meaningful contribution to the business and is 65 years of age or older;

2. Adults aged 18 years of age and older who were engaged on a regular, continuous and substantial basis in the business' activities (generally worked on average at least 20 hours per week during the year, or any five previous years);

3. Adults aged 25 or older who own shares that have 10% or more of the votes and value of a corporation, provided that the corporation earns less than 90% of its income from providing services and the corporation is not a professional corporation; and

4. Individuals who realize capital gains from the disposition of qualified small business corporation shares or qualified farm or fishing property (except for the gains of a minor on a non-arm's length sale).

Individuals aged 25 or older that do not meet any of the exclusions above would be subject to a reasonableness test on non-salary income and gains. If the amount received is considered unreasonable, then the income would be taxed at the top tax rate. The Canada Revenue Agency (CRA) has released some guidance regarding factors it will consider in determining whether a payment is reasonable and has illustrated how it intends to apply the reasonableness tests through examples, although it does note that its approach will develop over time based on its experiences.

Individuals aged 18 and 24 who do not meet any of the exclusions above will be taxed at the top tax rate unless they have contributed to a family business with their own capital and are earning a reasonable return.

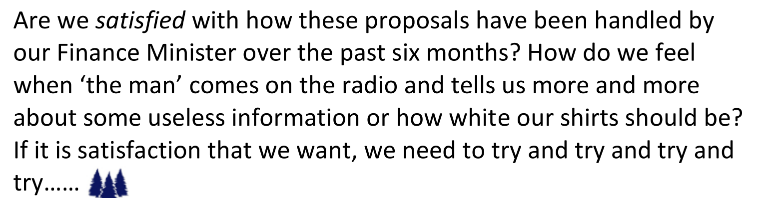
As mentioned above, these proposals will apply to 2018 and subsequent years. However, taxpayers have until the end of 2018 to meet the 10% share ownership exclusion test noted above.

The Department of Finance's December 13, 2017 release also confirms that the Government intends to move forward on measures to limit the tax deferral opportunities related to passive investments in a Canadian-controlled private corporation and details will be included in its 2018 Federal Budget (usually tabled in March or April).

So it's been almost six months since the Finance Minister first released his broad sweeping proposals impacting private corporations and their shareholders. Fortunately, over this period of time he has backed down on two of the three themes introduced in his July 2017 paper, he has significantly simplified the dividend sprinkling proposals and has yet to present his proposals to address the tax deferral achieved related to passive investments retained in a private corporation.

Canadians who are impacted by these proposals are buoyed by the scathing Senate report and look forward to a re-energized conversation when Parliament resumes. They are not content with where things currently lie and are hopeful that there will be yet another round of 'softening' of the dividend sprinkling rules and a further, (and hopefully) permanent delay to the introduction of the passive investment deferral rules.

Are we *satisfied* with how these proposals have been handled by our Finance Minister over the past six months? How do we feel when 'the man' comes on the radio and tells us more and more about some useless information or how white our shirts should be? If it is satisfaction that we want, we need to try and try and try and try……



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 $10M and above 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, visit our website or contact Tom McCullough for a confidential conversation.

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