The Francis Forum

Winter Edition 2016

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INSIDE THIS ISSUE

Welcome to 2016! I hope your Christmas holidays were enjoyable and the New Year brings you peace, health and happiness. Personally, from an investment perspective – I'm happy to see 2015 fade into history. Markets (equity and fixed income), and energy in particular, continued a downward trend. Whether due to lower energy prices, China's slowdown or pending higher US interest rates – the ripple effect has created challenges – especially at home. This has left investors wondering if the wonderful advances we had over the six years after the Global Financial Crisis are about to come crashing down.

Some of you have been asking if you are well-positioned for a market downturn, should one arise. Few have even asked if it would be a wise idea to liquidate the portfolio and sit in a large cash position until an inevitable crash occurs – at which point we could buy back in to the market at rock bottom prices.

A strategy like this seems simple enough to wonder why everyone else isn't doing it…

When would you like to sell your investments? And, when would you like to buy them back – hopefully at a lower price? That is one tough call! It's also called *speculating*. Consider that if Warren Buffett and other world renowned investors cannot see the future or time the markets – how can you? Factor in the transaction costs (bid/ask spreads and any commissions that could apply), potential tax implications and simple reinvestment risk…and it becomes increasingly clear that it is simply better to make first-rate investments in the first place.

In 1949, Benjamin Graham described in his book *The Intelligent Investor*, that there are two kinds of market participants – Investors and Speculators. Investors trim positions when equities reach levels of becoming overvalued so as to ensure their portfolio is put back into balance with the same investment mix they began with. They are greedy when others are fearful and understand that when they buy high-quality businesses, the declines are temporary.

This is because an investor is someone who carefully analyzes a company, decides exactly what it is worth, and then buys it when it is trading at a substantial discount to its intrinsic value. Investors recognize why they bought a business and they want to own it for the long-term unless the fundamentals change. A temporary decline allows them an opportunity to buy more at a discount and increase any yield they enjoy.

If you are buying high-quality companies domiciled in long-term growth industries with a history of good management, growing earnings and cash flow at prices that are temporarily lower than what you feel they are worth, you will certainly create and preserve wealth *over time – as opposed to timing.*

A speculator is someone who buys a company for any other reason than what I just described above.
In theory, Speculators are market timers and are sure to sell (or at least talk about selling) at this juncture and will re-enter the market when they feel we have reached a low point. This is often after the initial rebound (they need proof of recovery) and thus often at a higher price than that which they sold at. They believe they know what's going to happen tomorrow. In reality no one does.

You only get one shot at retirement. I've seen many try to time markets and the vast majority of the time it does not work – never repeatedly. There are many, many studies on this should you have interest.

We continue to approach investing in current markets with measured confidence. We value your trust in us and look forward to building your wealth over the long term.

As always, I'm always available to discuss the topics in my newsletter, or any other financial inquiries you may have.

Sincerely,

Duane

Behind the Scenes – Advisor Focus

This is a new section that we added to this quarterly newsletter in early 2015. It focuses on what advisors in this branch have done to go above and beyond the call of duty. Most of the time, our clients don't ever find out how far we'll go to ensure advocacy on their part.

By Michael Prittie CFP, CIM, FCSI, CPCA, CIWM
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Recent market volatility may have caused you some sleepless nights over the past few months as you checked your portfolio and watched it seesaw up and down. As someone who "eats his own cooking", I own (as you do) several positions that have done the same. As many of you have heard me state: I will not invest in anything within your accounts that I myself, my wife, my two sons or my father would not own.

Although we, as portfolio managers/advisors have a general sense of how markets will react over the long term, it is impossible to predict how the markets will fare over the short term. That said, the service you get from our team at Capital Wealth Architects does not stop when approaching a year-end. In fact, November and especially December are our busiest months!

You see, behind the scenes, we are diligently looking for opportunities to make the most out of the selections that did not fare so well over the short term (ie this 2015 tax year). As I'm sure you can imagine, with the recovery mid-2009 through mid-2015 yielding such wonderful investment returns, there was little to no opportunity to perform **tax-loss harvesting** – an end-of-year process we as portfolio managers undergo to ensure our clients have the opportunity to take advantage of every measure to increase and preserve their wealth.

In fact, most of you had enormous growth over the past six or so years. The result was an increase in capital gains either due to rebalancing or outright sells/redemptions etc. These are all accounted for each year and end up on Schedule 3 of your tax return in April, resulting in additional taxes owing (a nice problem to have, I guess).

If you're one of those who have seen certain stocks or mutual funds you own drop in value in 2015, we are doing whatever we can to take advantage of the situation. This strategy, of course, is only applicable if you hold your investments in a cash account (*non-registered account)*, rather than, say, an RRSP, RRIF or TFSA. Registered accounts are not taxed in the first place so these do not apply here. This past tax year's decline predominately affected energy and some fixed-income positions. In 2008 it was financials... In 2000 it was technology...

Tax-loss harvesting is generally not discussed until year-end, but theoretically, it can be done at any time during the year. It would generally only be applicable if you bought your stock or mutual fund more recently, as chances are, if you've held the position for a couple of years or more, you likely still have an accrued gain from the growth in 2013-2014, despite suffering a recent setback.

Under the tax rules, capital losses may only be applied against capital gains. If you have no realized capital gains in the current year, the realized capital loss may be carried back and applied against any capital gains in the prior three years or may be carried forward indefinitely to offset any future gains.

Now we want to make certain that we don't think of selling an investment at a loss and then try to immediately buy it back again – we would fall afoul with the *superficial loss rule*. A superficial loss occurs if you dispose of an investment at a loss and the investment is then re-acquired either by you or an affiliated person within 30 days. The tax law defines an affiliated person to include, among others, your spouse or common-law partner as well as a corporation controlled by either of you or even your RRSP or TFSA.

The consequence of having a capital loss deemed superficial means that the loss cannot be used immediately, but rather must be added to the adjusted cost base of the investment, only to be recognized upon its ultimate disposition.

If we sell the investment at a loss we can however purchase a similar position in the same industry. If we/you have endured the pain of the downside, you can bet we want to be invested to capture the upside! That is why if we sell a preferred share from one bank – we will buy back a similar high quality preferred share issued by another.

Another example is energy. If we sold your iShares Equal-Weighted Oil/Gas ETF at a loss, we have bought BMO Equal Weighted Oil/Gas ETF for the recovery. This allows us to "crystallize" or "harvest" any current loss and offset any gains incurred in the present or as stated above, and repatriate tax previously paid by you. The result is immediate tax savings without losing any recovery potential.

A harvested loss is certainly something worth having. We have spent a lot of time this fall reviewing account history, previous tax returns, and fund distributions over the past several years.

In a perfect world there would be no losses to harvest, but we can't predict how markets will fluctuate over the short term. Market pullbacks (aka corrections) happen – that is a fact. They are unpredictable and the causes vary. *However, this time is no different - recovery will follow*. It's how you manage through them and capitalize on them that count. Know that if there is anything we can do, we are doing it – behind the scenes.

We maintain a long-term approach to our philosophy, so any edge we can get in future tax savings gives us all a wonderful opportunity to continue to create and maintain wealth in the most tax-efficient manner.

The Francis Forum

Create Wealth, Achieve Freedom — *Winter Edition 2016*

***As a Mandeville Private Client, you have already had the benefit of being able to invest like the wealthy and as such, have been well ahead of the curve. This article outlines changes to exempt market participants to private equity investors, which will begin in 2016.*

Invest like the Rich!

Don't just invest – Co-Invest! If you have interest in alternatives (LP's) and private investment markets and been denied, your options might be about to open up. Michael and Duane are registered Portfolio Managers and as such can already act as "the accredited entity" for any managed clients. However for the handful of non-managed clients, you will be interested in what follows as will out of province clients.

With so much focus recently on tax brackets and who stands to benefit (or lose) based on their income, now is the time to compare.

Starting early next year, changes are coming to the investment industry and new options will be available to residents of Alberta, Saskatchewan, Ontario, Quebec, New Brunswick and Nova Scotia that were previously only open to high-net-worth investors.

Until now, only wealthy investors were able to make certain types of investments — ranging from private real estate limited partnerships to mortgage funds to solar panels to accounts receivable that were sold through the private (non-public) markets.

But, starting in 2016, these six provinces will join the rest of the country with plans to enact the offering memorandum prospectus exemption found in section 2.9 of National Instrument 45-106 – Prospectus Exemptions (the OM exemption). This means that small and medium-sized private businesses will be able to raise money more easily, while the restrictions that prevented smaller investors from investing in these companies will be loosened considerably.

Currently in Ontario, for example, companies looking to raise money would have to issue an expensive prospectus to potential investors, unless the investor met one of only four "accredited" exceptions:

- Investor has a net worth of over $5 million (including real estate)
- Investor has financial assets (net of debt) of over $1 million
- Investor has income over $200,000 in the past two years or $300,000 when combined with a spouse
- Investor invests a minimum of $150,000
- Invests with a registered Portfolio Manager (see 1st paragraph).

These existing rules seem to presume that accredited investors with higher incomes and more to invest are somehow more financially savvy than their lower income, lower net worth counterparts, is a poor generalization. The Wealthy are equally educated when it comes to investing, especially as the financial markets become more complex.

Private markets have grown considerably in recent years, despite the fact that only a small percentage of the population meets the accredited investor rules based on income or assets.

Some of this growth has come from non-accredited investors scraping together enough money to make the $150,000 minimum investment, even though this may have represented an irresponsibly high proportion of their assets being placed into a single investment. This has been happening all too frequently, according to the Ontario Securities Commission.

In a recent investigation of Ontario exempt market professionals who are licensed to sell private investments, the OSC found that nearly one in five was offering investments to people who did not qualify. Three quarters of them fell short on collecting and documenting important information about clients, including their risk tolerance.

On that basis, it may be that the six provinces making charges are simply making it OK to do what many exempt market professionals are doing already. Changes are slated to be implemented in Ontario as of January 13 and on April 30 in the other five provinces. These changes include:

- Any investor can invest up to $10,000 within any 12-month period without restriction into private market investments.
- Eligible investors* can invest up to $30,000 annually without suitability advice from a licensed investment professional (an exempt market professional).
- Eligible investors* can invest up to $100,000 annually with suitability advice from an exempt market professional. That advice may not cost the investor directly – it will appear free – but the dealer will receive a commission from the issuer that will otherwise reduce the investment's potential return.

(*In this context, "eligible investors" must have had a minimum of $75,000 of income personally in the past two years; income of $125,000 when combined with a spouse; or $400,000 of total net assets either alone or with a spouse.)

Instead of a prospectus, companies will need to issue investors an offering memorandum, which is a legal document that is not pre-cleared with the regulators as a prospectus would be. The memorandum does, however, need to contain standard disclosures, such as information about the management or promoters of a company raising money, the risks involved with investing and how exactly the company will use the money. As you can well imagine, these disclosures are more art than science.

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You cannot buy private market investment through your local bank. In Canada, only exempt market professionals working for a licensed firm can deal in private market investments. These investments do not trade on public markets like stocks or other securities. Whether you can invest directly or need to invest through an exempt market professional depends on the dollar limits indicated above, unless you meet the accredited investor criteria.

The lure of the private markets is that higher, uncorrelated investment returns may be available. Large pension plans like CPP, OMERs and Ontario Teacher's Pension Plan all allocate funds to private market investments — a vote in favour of considering such an allocation in your own personal portfolio. But higher returns come with higher risk, including the risk of fraud that has taken down private market issuers in the past, like the First Leaside real estate limited partnership and New Solutions Group's receivables factoring business.

One benefit of removing the $150,000 minimum is that non-accredited investors who want to invest in the private markets can do so in a smaller, more reasonable, and more diversified way. Small companies will also have more access to capital than they have had up to this point, which is good for Canadian small businesses.

But just like any investment, buyers should beware. The benefit of more options may be offset by the drawback of more risk. Even though anyone can invest up to $10,000 a year without restriction or advice, and eligible investors will be able to invest up to $30,000, it might not be bad idea to solicit input from an exempt market professional or registered Portfolio Manager. At least that way you will have a little more insight into what you're getting yourself into.

Private is not perfect. Quality and experienced, trusted and proven management are key. Lastly, it must still meet your investment objectives, risk parameters and time horizon to be considered as suitable for your account. Mandeville offers ACCESS to the private equity landscape and only offers the highest quality opportunities.

http://business.financialpost.com/personal-finance/managing-wealth/soon-you-will-be-able-to-invest-like-the-very-rich-with-all-the-rewards-and-risks

Want to Destroy your Wealth? Here are 6 of the Best Ways to go about it

Impulse purchases. A Bank of Montreal study in 2013 found 21 per cent of men said they made impulsive decisions, compared to 13 per cent of women. If you weren't looking for it in the first place, do you need it?
Not having a budget. Lack of a financial plan can impact almost everything on the list. A recent LPSOS study found 29 per cent of Canadians have never created a budget. No budget means no examination of expenses and spending that could be eliminated.

Diversification. It comes back to haunt you when you've invested most of your wealth in one thing — and that includes the housing market. When markets turn, some Canadians always find themselves burned because they were overly exposed to one sector.

Counting on an inheritance. Another Bank of Montreal study found 40 per cent of Canadians expect an inheritance to bail them out. It's a useless plan. Even if you get it in writing, wills can be rewritten. Inheritance is a bonus, not a guarantee. Don't make them part of your financial plan.

Not making enough money. Sure it's not that simple, but a study by the Canadian Imperial Bank of Commerce in 2013 showed degrees, like engineering, pay 117 per cent more than a simple high school diploma. Fine arts grads earn 23 per cent more. Student debt is rising faster than inflation, making it all the more important to get bang for buck.

Not saving for retirement. The Canadian Payroll Association found in a September survey that 76 per cent of Canadians have put aside less than a quarter of what they will need in retirement. Statistics Canada said in 2013 that only about a third of the labour force has a registered pension plan — you need to create your own retirement plan.

Staying single. Study after study shows that married people are wealthier. An Ohio State University study in 2013 found married couples in long-term relationships are twice as wealthy as their single counterparts. Now, sometimes relationships don't work, but divorce is the No. 1 destroyer of wealth. Yet it still goes on. The last time Statistics Canada looked at the issue, in 2011, it found 43 per cent of marriages will end in divorce before 50 years.

http://business.financialpost.com/personal-finance/debt/want-to-destroy-your-wealth-here-are-10-of-the-best-ways-to-go-about-it

What are Negative Interest Rates and How do they Work?

The Bank of Canada said last month that it could push interest rates below zero if the nation faced an economic crisis. The central bank stressed that it was updating its economic toolbox and would only embark on negative interest rates in times of crisis.

What are negative interest rates and how do they work?

The central bank currently pays banks interest on the funds they park at the Bank of Canada. If rates are slashed below zero – known as negative interest rates – banks would be required to pay the central bank to hold their deposits.

For example, if rates were minus 0.5 per cent (the lowest level the Bank of Canada said they would go), a bank would have to pay the central bank $5,000 on a $1-million deposit. The European Central Bank cut rates below zero to reinvigorate the euro zone's economy. Switzerland also chopped rates below zero to slow the ascent of its currency and discourage investors from parking their funds in the European country.

The Bank of Canada already cut interest rates twice this year to 0.5 per cent, in a bid to stimulate the economy. Canada has never operated in a sub-zero interest rate environment.

What do they mean for banks?

If banks have to pay to park their money with the Bank of Canada, this could eat away at their profits. According to a Bank of Canada discussion paper, banks with a larger retail business would be hit harder than those focused on corporate banking, as it may be easier to "pass negative rates through to corporate clients than to retail clients."

"Banks could mitigate a decline in profitability by increasing charges on accounts, raising fee-based revenue or reducing deposits, but these efforts may not be fully offsetting," the discussion paper said.

What do they mean for the economy?

Think of it as an added incentive to get banks to do something with their money – that is, to lend or invest. Negative interest rates punish banks for parking their excess funds at the Bank of Canada by making it more expensive for banks to hoard cash. The deposit costs are supposed to encourage the banks to lend or invest.

Assuming banks will have no appetite to lend during an economic crisis and consumers will be unwilling to borrow, the negative interest rate is supposed to encourage lending and borrowing.

So, if the Bank of Canada slashes rates to minus 0.5 percent, that would theoretically mean that the banks would lower their prime lending rates to between 1 and 1.15 per cent. However, this would be an act of desperation. When we get down to these levels, each additional cut tends to have less and less impact.

What does this mean for consumers?

So, the bank isn't going to pay you to borrow funds, but you will essentially get to borrow money for free.

The cost of borrowing will be close to 0 per cent. If you have a job and you are secure and you are doing great in this kind of crisis, you are laughing because you can borrow at zero.

At the same time, banks may decide to pass on the extra costs to their customers and charge them to safeguard their cash.
So what is a depositor supposed to do? You can take your money out of the bank and invest it in an asset, such as a bond, or you can bring it home and store your cash in your mattress.

Are you going to be comfortable every time you leave the house if you have thousands of dollars there? You would definitely have to invest in a good alarm company…

http://www.theglobeandmail.com/report-on-business/economy/what-are-negative-interest-rates-and-how-do-they-work/article27669897/

The Francis Forum

Create Wealth, Achieve Freedom

Winter Edition 2016

Health and Wellness: Carpe Diem

While everyone knows we are living a lot longer than we did half a century ago, we are not living much healthier. By some measures, we might even be losing ground. A healthy 50-year-old male has roughly a chance in 2 of not making it to 70 without dying or incurring one of the following 14 critical illnesses:

- Life-threatening cancer
- Benign brain tumour
- Early stage malignant melanoma
- Early stage prostate cancer
- Acute myocardial infarction
- Coronary artery bypass graft
- Coronary angioplasty
- Heart valve replacement
- Aorta surgery
- Stroke
- Kidney failure
- Alzheimer's disease
- Parkinson's disease
- Loss of independent existence

The accompanying table shows the percentage of healthy people who will experience one of these critical illnesses (or die) in each 10-year span starting at age 50. While it should come as no surprise that the risk of death or critical illness rises with age, the steepness of the rise is shocking.

The table shows, for instance, that out of 100 healthy 60-year-old men, 36 will either suffer a critical illness or die before they turn 70. After age 70, the incidence of disease or death climbs exponentially. The numbers are better for women, but ultimately no one is unscathed.

A 50-year-old man today can expect to live to about 87. For women, life expectancy is even longer. That might give the impression you have a lot of time in retirement to do the things you have always yearned to do, but life expectancy does not tell you how many healthy years of life you have remaining. What is more important as you plan your retirement is to know your disability-free life expectancy (DFLE).

While hard statistics are not kept on DFLE, it can be approximated by applying the critical illness tables. Measured from age 50, the disability-free life expectancy of a Canadian male is very close to 70, a figure that is consistent with European statistics. This comes as sobering news if you plan to retire at 65!

The U.S. statistics are equally bleak and, moreover, they are trending in the wrong direction. The U.S. National Health Interview Survey that was conducted in 1998 showed that both men and women aged 65 could expect to live at least seven of their remaining years with some disease (this survey is based on self-reporting).

RISK OF ILLNESS OR DEATH

Percentage of healthy people who develop a critical illness or die

Ages	Men	Women
50 to 60	18%	
60 to 70	36%	22%
70 to 80	56%	
80 to 90	82%	69%
90 to 100	98.5%	

MORNEAU SHEPELL CALCULATIONS, DERIVED FROM 2008 CANCI TABLES

The same survey was conducted again 8 years later and while total life expectancy went up, the number of healthy years actually declined for both men and women — a 65-year-old man in 2006 could expect to spend more than half his remaining time with at least one disease.

While heredity is responsible for some of the illness, it does not explain why the number of unhealthy years is increasing. Much of the unhealthy trend reflects the lifestyle decisions we make, with the main culprits being obesity and smoking, even though the latter is on the wane.

HEALTH PROSPECTS AT AGE 65

AS MEASURED IN 1998

Number of years after age 65	Men	Women
Without disease	8.8 years	11.8 years
With at least one disease	7.2 years	7.4 years

AS MEASURED IN 2006

Number of years after age 65	Men	Women
Without disease	8.1 years	11.3 years
With at least one disease	8.9 years	8.3 years

SOURCE: NATIONAL HEALTH INTERVIEW SURVEY — NATIONAL POST

What does one do with this information? First and foremost, you should take control of your own life by making lifestyle changes. If you eat better, exercise regularly and stop smoking, it will not only increase your life expectancy, it can increase your disability-free life expectancy even more.

The second action to consider is to re-evaluate your retirement plans on the basis of your disability-free life expectancy rather than your total life expectancy. Based on your DFLE, you might decide to retire sooner, spend more money in your 60s and reconfigure how you spend your time while you still have your health. The words carpe diem apply at any age, but never more so than when you turn 60.

http://business.financialpost.com/personal-finance/family-finance/once-you-hit-60-its-time-to-take-carpe-diem-seriously

Winter Activities

Taste in the Glebe
January 21st, 2016
http://www.gnag.ca/

Winterlude
January 29th – February 15th, s016
http://www.canada.pch.gc.ca/eng/1416239267950/1416239373076

The Polar Hero Race
January 30th, 2016
http://www.polarherorace.com/#!home-en/c1co3

Winterlude Stew Cook-Off
February 5th, 2016
http://www.byward-market.com/

The Tim Horton's Brier – Curling Championship
March 5th – 13th, 2016
http://www.curling.ca/2016brier/

Upcoming Events:

Client Seminar: How to Select Investments
TBD
1525 Carling Avenue in the Lower Boardroom

Client Seminar: Seasonal Gardening
TBD
1525 Carling Avenue in the Lower Boardroom

Client Seminar: Nutrition Tips for 2016
TBD
1525 Carling Avenue in the Lower Boardroom

Client Seminar: Tips for Selling Your Home
TBD
1525 Carling Avenue in the Lower Boardroom

Hockey Day in Ottawa 2016

On Saturday, February 6th, lace up your skates and take to one of the City's outdoor rinks for a sunny Saturday afternoon of fun. Enjoy a game of pick-up hockey or skating while showing support for your community volunteers who work hard all winter to maintain your local rinks.

Date: Saturday, February 6, 2016
Time: 1 to 3 pm
Location: Your local City of Ottawa outdoor rink

The City would like to remind residents to dress appropriately for the weather and recommends the use of helmets and safety equipment.

Wear your favourite team's colours and share your photos from your local rink at seasonalrecreation@ottawa.ca
Come on Ottawa, let's show the rest of Canada what a city that lives and breathes hockey really looks like! Support your local community-based rink operators!