ALSO IN THIS ISSUE:

NORTHWOOD STEPHENS
PRIVATE COUNSEL INC.

The Northwood Stephens PERSPECTIVE

Summer 2006

President's Message

Tom McCullough
President and CEO

Welcome to the inaugural issue of *The Northwood Stephens Perspective*, a newsletter geared towards the interests of our clients, friends and colleagues. We hope this publication will stimulate your thinking and offer valuable insights. Authors will include members of our highly qualified Northwood Stephens staff and, from time to time, professionals from some of the specialist firms we work with on behalf of our clients.

As one of the leading multi-family office firms in Canada, we practice our unique Net Worth Management™ approach for families, individuals and foundations. We provide:

- Goal setting and an integrated plan for each client
- Comprehensive tax planning and structuring of clients' assets and liabilities in concert with their existing professional advisors
- Access to top quality investment managers from around the world
- Consistent, coordinated implementation and ongoing monitoring of each client's strategy
- Customized advice and service

While the 'family office' concept has been around for years in the United States and is currently in a significant growth phase, the term 'family office' is relatively unknown in Canada. So we thought we would take the opportunity in this first issue to provide a history of the family office and some details as to what clients can expect from a family office firm like Northwood Stephens.

We hope you enjoy this newsletter, and future issues. I encourage you to contact me directly with any feedback you have, any questions you would like explored in these pages, or how Northwood Stephens can be of any assistance to you in general. As well, don't forget to visit our newly-redesigned website to learn more about us.

Our hope is that, through this medium, we have yet another means of providing our clients and colleagues with direction, perspective, and confidence.

Sincerely,

Tom

Tom McCullough
President and CEO

Photograph courtesy of Frances Juriansz Photography

What is a Family Office?

Tom McCullough, MBA, CIM, FCSI
President and Chief Executive Officer, Northwood Stephens Private Counsel Inc.

Family offices originated over 100 years ago when wealthy families, mostly in the United States, hired dedicated staff to manage and coordinate their diverse financial affairs. They were designed to look after investment management, tax planning, succession, insurance, philanthropy and a myriad of other needs particular to the family. Names like Rockefeller, Carnegie, and Pitcairn are among the best known. In Europe, private banks have been the main vehicle serving the wealthy, and have been doing so for over 300 years.

There were often several reasons that drove families to set up a family office.

- Assets had grown to a size where full-time professional management was required;
- The family members were frequently too busy or didn't feel qualified to handle the increasingly complex financial issues brought about by their wealth; or
- A liquidity event, such as the sale of a business, required a significant range of coordinated decisions.

A family office is a dedicated team of professionals, focused on overseeing and managing the complete financial (and oftentimes other) affairs of wealthy families.

From the 19th century through to the 1980s, the majority of family offices were set up to oversee the affairs of single families. While single family offices continue to operate, they tend to be used by families with assets of $250 million and above.

A relatively recent phenomenon is the *multi-family office*, which has arrived along with the proliferation of wealthy families in the past 20 years. While there may be thousands of single-family offices in the United States, Bloomberg Wealth Manager magazine counted only 69 US multi-family offices in 2005. In Canada, there is less than a handful.

Multi-family offices serve the needs of more than one family and the asset requirement is considerably less than that of single family offices, often starting at $5 million of net worth.

Whether operating as a single family office or a multi-family office, an important characteristic of the family office is the intimate knowledge of the families' values and generational issues, as well as 'institutional memory' of the families' affairs. This allows the family office principals to speak intelligently with third party experts (accountants, lawyers, etc.) and be a source of 'general advice and counsel' to the family on 'one-off' decisions as they arise.

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Northwood Stephens Private Counsel Inc. is a multi-family office providing comprehensive Net Worth Management™ to wealthy families and foundations.

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Family Office Model vs. Traditional Financial Services Institution Approach

The table below provides an overview of some of the key differences between traditional financial services institutions and a family office, according to the Capgemini and Merrill Lynch World Wealth Report 2005.

Traditional Financial Services Institution Approach	Family Office Model
Product-oriented	Product neutral
Investment management focused	Investments are managed in the context of the family 'balance sheet'
Centered on 'in-house' portfolios only	Advice reflects full view of client's assets
Little or no coordination/collaboration with third-party providers	Coordinated/collaborates with all providers to develop an integrated wealth strategy
Service oriented toward individual high-net-worth individuals	Service focuses on the high-net-worth family 'entity'
Transaction-based pricing now moving towards assets under management or 'by service' fee-based model	Historically assets under management-based pricing
Ad-hoc investment process	Investment process is often documented and standardized, according to agreed-upon investment policy
Portfolio reviews based on standard templates	Portfolio reviews are regularly scheduled and customized, according to client's needs and preferences

Source: Adapted from Capgemini/Merrill Lynch World Wealth Report 2005 and The Journal of Wealth Management, Fall 2001.

Another benefit unique to multi-family offices is the resulting purchasing power, giving participating families access to the widest range of investment opportunities and the top tier of advisory services at a *much lower cost* than if each single individual or family were to contract those services on their own.

When all is said and done, the real value of a family office is having a trusted team of advisors to coordinate all the diverse aspects of clients' financial lives. Northwood Stephens is one of the few true multi-family offices in Canada.

Can you Achieve Perpetual, Guaranteed, Risk-Free Return?

Scott Hayman, CA, CFP
Executive Vice President and Head of Client Service, Northwood Stephens Private Counsel Inc.

At Northwood Stephens, we place great emphasis on determining and implementing 'asset structuring' strategies long before investment decisions are even considered. These strategies can often save our clients thousands of dollars in taxes, which we like to describe as a 'perpetual, guaranteed, risk-free return'.

Why do we do this? In one sense, the tax savings reduce the required investment return our clients *need* to meet their families' goals and objectives. Even if you do not want to look at it in that way, we think you will agree that the less money we send to Canada Revenue Agency (CRA), the better!

To illustrate one of the asset structuring strategies we use, I thought I'd describe a simple concept that can result in the equivalent of the 'perpetual, guaranteed, risk-free return' mentioned above.

When reviewing a new client's financial situation, we sometimes find both a large bank balance (or investment portfolio) and a large mortgage in place. CRA does not permit the deduction of interest paid unless it is explicitly used to generate income (such as rental income or income from investing). In these situations, we try to 'restructure' *non-deductible* debt used to consume (e.g., buy a house) into *deductible* debt used for investment purposes.

The interest savings can be quite compelling. For example, when reviewing a recent new client's situation, in addition to a good-sized investment portfolio, we found that she also had a $1 million mortgage on her house at 5% per annum, resulting in non-deductible interest expense of approximately $50,000 per year. We 'restructured' the mortgage by selling investments and paying off the original mortgage debt. We then re-borrowed using an investment loan (with the same terms as the original mortgage) secured by her house, thus making the interest deductible. To do this, we worked with the client's bank and provided step-by-step instructions to her bankers, and clear explanations to her lawyers who were preparing the documentation.

By carrying out this transaction, our client will save approximately $23,000 per year (or alternatively, it will reduce her borrowing costs to an effective rate of 2.7%). Assuming she has $5 million of investable assets, she has just earned the equivalent of a 0.50% perpetual, guaranteed, risk-free return. That might not seem like a huge amount, but coupled with other more complex tax-planning and asset structuring strategies we implement, the ongoing tax savings can be quite meaningful. We believe that the opportunity to discover an added level of 'perpetual, guaranteed, risk free return' is one way that Northwood Stephens adds value to our clients' lives.

Long-Term Investing in a Short-Term World

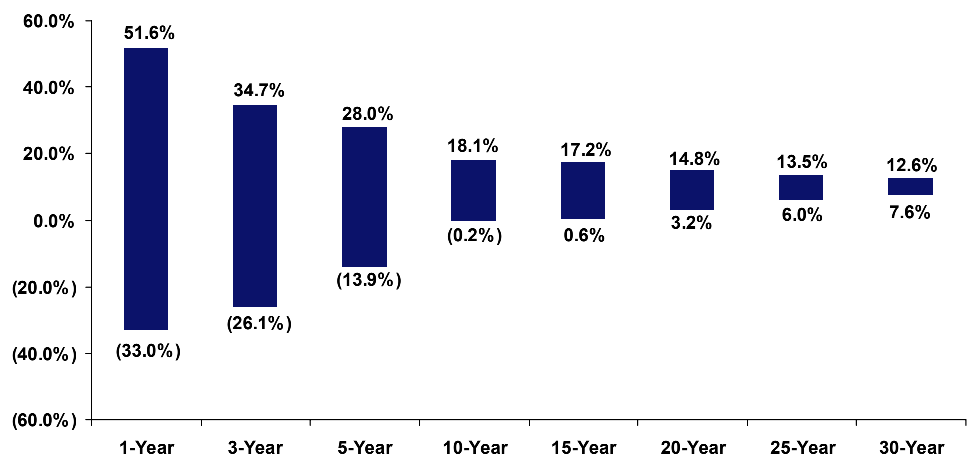
Ian Dalrymple, MA, FCIA, MAAA, FSA
Chairman and Chief Investment Officer, Northwood Stephens Private Counsel Inc.

We live in a time where information and ideas can be transformed into action in a matter of seconds. For long-term investors, it is important to separate what *can* be done from what *should* be done. While information is now received instantaneously and continuously, the important changes in the global economy move far more slowly and the compounding effect of increasing investment portfolio profits should be measured in years, if not decades. One of the most difficult yet rewarding disciplines of investing is to substitute *care* for the emotions of fear and greed.

Fear and greed seem to dominate investing because, as social animals, we are aware of those who appear to be winning and those who appear to be losing – today. These very human traits can lead to herding behaviour in the stock market as well as in other areas of society. Most have heard about the Great Tulip Mania of the 17th century where great fortunes were lost speculating that the price of tulips would reach ever-higher levels. Three centuries later the same phenomenon has been experienced with gold in the 70s, biotech stocks in the 80s and dotcom stocks in the late 90s. It remains to be seen what, if any, category of stocks will be referenced for the early 2000s. Perhaps energy and commodities?

Canadian Market (S&P/TSX) Minimum and Maximum Returns over Rolling Periods (1924-2004)

The table below highlights the well-known fact that short term investors will have to contend with wide variations of returns, while long-term investors can typically expect more predictable and positive returns.



Source: Report on Canadian Economic Statistics 1924-2004, Canadian Institute of Actuaries. Includes reinvested dividends.

But while we can all see the problems very clearly, the solution is more subtle and it, in many ways, requires a leap of faith in the future. First, the goal is not to 'win' in the bond or stock markets every day (or to avoid loss) but to ensure that your investments are there when you need them. To determine whether the growth of an asset is reasonable requires careful study of both long-term trends and other potential investments on a risk-adjusted basis.

There are several powerful trends at play in today's global economy many of which are very positive. The arithmetic of long-term growth has always been the same, only the methods of achieving that growth have changed. An increasing population, increasing productivity and increasing money supply fuels economic growth, while inflation, mostly caused by a shortage of productive capacity, erodes wealth. Factors that influence these trends include technological change, demographic trends, government intervention, taxes, global trade, war, and the level of cooperation between governments and corporations.

Fortunately for investors, many of these latter trends are positive now and should remain so throughout a relevant investment horizon. This does not mean that there will not be recessions, bear markets and companies that fail to live up to expectations. Indeed, 2006 is proving to be a challenging environment. But riding out these vicissitudes should prove rewarding over the long term for prudent, balanced investors.

A Charitable Federal Budget

Bryan O'Neill, CA, MMPA
Associate, Northwood Stephens Private Counsel Inc.

On May 2, 2006, in his Federal budget, Minister of Finance Jim Flaherty reduced the capital gains inclusion rate on donations of publicly listed securities to charitable organizations and public foundations from 25% to 0%.

The 2006 budget materials also indicate that the government will begin consultations to see if these measures can be extended to donations of publicly traded securities to private foundations.

This presents some unique charitable giving and tax planning opportunities for those generous individuals who have also experienced generous capital gains on their investments.

On March 27, 2006, Northwood Stephens had the pleasure of hosting Jim Hemerling, head of Greater China for the Boston Consulting Group, as he spoke with a number of our colleagues and clients on the current state of China's development and its implications for the future and for investors:

Report on China

Brian Ginsler, MBA, CFA
Vice President, Northwood Stephens Private Counsel Inc.

Over the next 10 years, 40% of global GDP growth will come from the world's rapidly developing economies, with a huge proportion of that coming from the BRICs (Brazil, Russia, India and China). China itself is currently a $2 trillion economy and is growing at 8% to 10% per year.

What is driving China's incredible growth? The engines of the economy are threefold:

1. The Chinese consumer, which is a powerhouse based on sheer numbers,
2. Imports and exports, which were initially based on low-value goods but are quickly moving to sophisticated products in the telecom equipment and consumer electronic areas, and
3. Massive infrastructure investments of approximately $800 billion per year (37% of the economy) and growing at twice the rate of GDP growth per year. These include investments in roads, telecommunication, water and waste infrastructure, and buildings, to name but a few.

The economy and market are much more robust and stable as a result of the above three drivers.

"China is on its way to becoming…the largest economy in the world." As an investor, how does one take advantage of China's growth? Jim warns against blindly investing in Chinese companies, as the Chinese capital markets are a long way from being fair and efficient. He suggests, rather, that investors invest in global companies that are in China or global industrial products companies and countries that supply China (for example, raw material providers from Canada and Australia).

Jim pointed out, however, that there are huge risks to the rosy picture he painted above. These include the risk of social unrest (last year alone the Chinese government tracked over 100,000 incidents of uprisings), the risk Taiwan poses should it become more nationalistic (which could result in military actions), the energy supply, China's banking systems (which are still fairly rudimentary), human rights issues (which includes expropriation of land) and pollution/environmental problems.

While China's future looks incredibly bright, it will face many bumps on the road to success.

China Facts:

- Over the next 20-30 years, China will become the biggest economy in the world.
- China is the largest market worldwide for mobile phones, beer, appliances and consumer electronics.
- There are 300 million mobile phone users in China.
- The typical wage outside China is $20-$30/hour. In China it is $0.65/hour.
- Chinese manufacturing represents $1 trillion out of total annual world manufacturing of $6 trillion.
- China has a huge research and development 'offshoring' market with currently 500-700 research centres in Shanghai and Beijing.

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