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NORTHWOOD STEPHENS
PRIVATE COUNSEL INC.

Best Independent Family Office in Canada
EUROMONEY Private Banking Survey 2008

THE NORTHWOOD STEPHENS **PERSPECTIVE** SUMMER 2008

President's Message

Welcome to the summer edition of the Northwood Stephens Perspective. This has been a very difficult period for equity markets, sparked by the credit crunch and the U.S. housing slump.

It is now spilling into consumer markets causing a slowdown south of the border. Unfortunately, at the same time, the energy and commodity price spikes are pushing inflation up causing fears of a return of 'stagflation' that plagued the economy in the 1970s. And of course, when the U.S. 'sneezes' (central) Canada 'catches a cold'.

But from a stock market perspective, it looks a lot like 'A Tale of Two Cities'. To the end of the second quarter, the New York market has produced a -9.5% return and the Toronto market +6%. This is due to a heavy concentration of commodity and energy stocks in Canada, now almost 50% of the index – hardly well-diversified. In fact, the one year total return of the S&P TSX to June 30, 2008 was +6.7%. Almost all of that return (6.2%) is accounted for by three stocks – Potash, RIM and Encana. The rest of the Canadian market looks a lot more like the U.S. market!

These are the kinds of markets where alternative investments can contribute to the stability of portfolios. Hedge funds in particular, properly chosen and monitored, can be a helpful addition and can bolster portfolio returns and reduce risk. Private equity and real estate tend to have different patterns than public equities and can also reduce volatility, as can the use of insurance as an investment.

And if rates of return to investors do decline in the years ahead, as Warren Buffet and other experts suggest (see excerpt from his annual report on page 4), factors like tax savings, cost savings and spending management will also become more significant contributors to 'portfolio returns' in a broader sense. So too will a very clear understanding of your goals and the discipline to make sure you meet them.

We hope you enjoy this issue. We try to bring you interesting perspectives on managing wealth. We do this in several ways. We read voraciously, we attend conferences (see the two articles – A Window on U.S. Wealth Management, and Insights from Charlie Ellis), and we associate with smart people, like all of you who read this newsletter! As an example, see the article by guest columnist Jennifer East 'Engaging the Next Generation'.

Tom McCullough
President and CEO

Photograph courtesy of Frances Juriansz Photography

Do you understand your Will?

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

In a previous newsletter, we highlighted the importance of reviewing and updating your will on a regular basis. Just as important to the estate planning process as a timely review, is to have a clear understanding of how the terms of your will translate into dollar values; such as, how much each beneficiary will receive. Like many Canadians, you could probably describe the basic terms of your will, such as, if my spouse and I were to die today, our children would receive our entire estate when they reach the age of 25. However, if you are like most Canadians, you do not know how these terms translate into dollars and cents, i.e. how much will my children receive at the age of 25?

In most cases, we find that clients underestimate the amount their beneficiaries will receive under the terms of their will and that can be of particular importance when the beneficiaries are your children. Many of our clients and people we speak to are becoming increasingly concerned about *how much money* they will leave to their children and *when* the children will receive it, so as not to 'de-motivate them from succeeding on their own'. As such, it is vital that the process by which you draft and review your will produces a document that is structured to meet your estate objectives.

When drafting or reviewing your will, it is tempting to 'jump right in' and start to name beneficiaries, determine trustees and make specific allocations. However the starting point, and the most overlooked step, is to first obtain a clear understanding of the value of your total estate as it stands today. With this understanding, you will have a better picture of how much your children stand to inherit. The four main asset categories that may be included in your estate value include:

- Registered and non-Registered Investments
- Properties
- Shares of a business
- Life insurance proceeds

In addition, families with younger children will often leave their estate in trust until the children have reached a pre-determined age. The estate then stands to increase substantially in value if the funds are to remain in trust for a long period of time (i.e. if you die when your children are very young) and/or the performance of the underlying investments is strong. Therefore it is very important that you review your wills regularly as your younger beneficiaries may stand to inherit a far greater amount than you originally intended.

One of the easiest ways to review your current will is through the use of what we call a "will flow". We simply create a flowchart that maps out the terms of your will from the event of your death right through to specific beneficiary allocations. Once this is completed, you should have a helpful visual of the terms of your will. The next step is then to take your current estate value and overlay this onto the flowchart. The end result is specific dollar allocations to each beneficiary, assuming you passed away today. This will allow you to determine if your estate planning intentions have been accurately reflected in your will. You may be surprised by the results.

NORTHWOOD STEPHENS PRIVATE COUNSEL INC. IS A MULTI-FAMILY OFFICE PROVIDING COMPREHENSIVE NET WORTH MANAGEMENT™ TO WEALTHY FAMILIES AND FOUNDATIONS.

Insights from Yale's Charlie Ellis

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

At the last two conferences I attended, I was fortunate enough to have heard Charlie Ellis, Chairman of the Investment Committee at Yale University, speak about recruiting the right asset manager.

Mr. Ellis is very quick to say that his experience as Yale would be very difficult to duplicate elsewhere for a number of reasons, not the least of which is that the Yale management team has worked together for 25 years. As well, their average manager relationship is 17 years and most managers they use are closed to new relationships.

Mr. Ellis also says that most people have a misunderstanding of what the Yale endowment does. What they actually do is focus on six major themes and use about 100 investment managers at any one time. The six areas they focus on are:

- Absolute Return
- Private Equity
- Real Estate
- Venture Capital
- International Markets
- Emerging Markets

He also believes that being a "preferred client" of managers not accepting new investments has added 1.5%-1.75% of annual return to their results, which is something that investors cannot duplicate.

Despite these limitations for most other investors, I believe there are several insights he spoke about that can be very helpful. Below is my summary of his four key conclusions and recommendations.

1. Find an investment manager who understands the client and their real interests

While he admits this is a "motherhood" statement, the best investment professionals spend a lot of time understanding clients and do more than just pay lip service.

- Determine a strategy to achieve goals — that is, in Yale's case, right for the fund, right for the committee and right for the long term
- Do no harm — this really means that you have to avoid losing money at all costs
- More is better — this relates to returns and therefore an equity dominance in your portfolio

2. Beware of large institutions

- Size is a burden — the larger the organization, the less flexible they are likely to be
- Staff turnover — large organizations tend to move people around to other jobs
- Business focus usually trumps professionalism — the bottom line is very important and a profession will suffer within this environment
- Lack of focus — because they are so big, large organizations offer many choices, which isn't always a good thing
- Misalignment of interests with investors—the more they charge, the more they make — fees are a big issues for investor returns.

This doesn't mean that you can't use large institutions for certain things but, Mr. Ellis wants investors to be sure to understand the service they are buying and if the above factors are positives or negatives for that service.

3. Find an investment manager that is a professional…..not a business that has investment professionals

He defined a professional and professional firms using the following parameters:

- They focus on client needs as their mission
- Service is valued more highly than profit
- They operate under a code of conduct
- They protect lay people
- They demonstrate commitment to continuous learning
- They express deep satisfaction and passion in their professional activities

His view on a business, on the other hand, is that it is primarily profit focused. He believes that for investors to be well served, professionals can and should be paid well, and are fully entitled to profits, but not at the expense of the above attributes. Mr. Ellis's primary question is, "Does the investment manager have character and integrity and do they take their role seriously?" Mr. Ellis believes that years ago, the investment management industry used to be a profession, but it is now primarily a business.

4. Have a clear game plan yourself, as an investor

At Yale, Mr. Ellis says they have what they call "True Blue" (Yale's colour) attributes that they follow religiously:

- Focus on defense—don't make mistakes
- Use a combination of academic and street resources
- It's all about people—great people
- Maintain long-term relationships
- Use rational innovation
- Have an equity dominance
- Be mission driven
- Everyone must have character
- Everyone must have integrity
- Develop manager relationships

While implementing all of his suggestions is, in his words, "impossible", there are a number of very important messages in his comments that can be adapted to individual investors. And we could all do a lot worse than having a mentor like Charlie Ellis.

Northwood adds TD Capital Private Equity as Private Equity Manager

Northwood has recently added a proven private equity fund of funds manager to our investment platform, increasing investment options and diversification for clients. With a strong management team and almost a 40 year track record in the private equity market, TD offers a unique way to access many of the world's premier private equity firms. In fact, the Canada Pension Plan (CPPIB) outsourced a portion of their private equity program to TD in 2005. Northwood is the only external private client firm with access to TD's world class offering.

Some of Northwood's clients have begun subscribing to TD's private equity fund of funds and will invest alongside some of the top institutional and high net worth investors from across Canada.

Guest Column: Engaging the Next Generation

Jennifer East, President
ONIDA Coaching + Consulting Inc

In today's competitive global marketplace, families wishing to sustain themselves over many generations must invest considerable time and energy into developing the next generation. Only the careful preparation of young leaders will prevent successful family enterprises and families of wealth from fulfilling the age-old prophecy of "shirtsleeves to shirtsleeves in three generations".

The next generation in business and financial families must understand how to balance the responsibilities and opportunities of their family's legacy. Managing the complexity requires knowledge, skills and experience. Most importantly, the next generation must become engaged in planning for their own future in order to lead fulfilled, productive and happy lives. Responsible shareholders, inheritors, philanthropists and business leaders will each have a unique vision for their future. Empowering them to follow their dreams, design a plan to achieve them and learn how to work together with other members of their generation is an essential starting point.

How do parents and family advisors begin such a journey with the next generation? Here are five tips to get started:

1. What are My Dreams?

Next generation family members in financial and business families must be encouraged to explore their own dreams and desires. Too often, young leaders are directed into the family enterprise at a young age, or become dependent on family wealth without a clear direction for their future. The greatest gift a parent can give their children is the opportunity to determine what unique contribution they will make to the world. This can be challenging for children raised by successful, prominent people. How will they measure up? What is their vision for themselves? Is there space for them to explore their dreams within the powerful culture of the family?

2. Where am I Today?

Children raised in families where wealth, position in society or a family business provides them with an automatic status often don't know where they stand. It can be difficult for them to have a clear understanding of their strengths and gaps, let alone what they need to learn in order to achieve their goals. This is especially true in family firms, where next generation leaders rarely get objective feedback about their performance. Empowering young leaders by increasing their level of self-awareness and providing them with objective feedback about their abilities gives the next generation a realistic picture of who they are and where they can grow and develop.

3. What is My Development Plan?

Once the next generation has identified their goals and developed a clear sense of what they must do to achieve them, the next step involves creating a learning development plan. What are their learning objectives? What learning activities and education will they pursue in order to meet those objectives? Investing time and energy into a clear strategy for learning and growth significantly improves the chances of success. It enables both generations to know where the next generation is headed, and how to measure progress along the way.

4. It's My Life

Next generation family members who have been empowered to set goals, learn about their strengths and gaps and develop a learning plan are much more likely to follow through with their development than those without a plan. More importantly, when the next generation is engaged in setting a course for their own life, rather than following a path set out by parents or advisors, they take ownership of their own development. This requires parents to provide true autonomy to their kids, to trust in the process, accept the path chosen by the next generation and support them throughout their development.

5. How Can I Stay on Track?

How will the next generation ensure they meet their learning objectives? What happens when circumstances change and they need to shift their focus? Who will support them and hold them accountable? Throughout the development process, it's important to have a structure in place to keep the process moving. This can be a peer group, parent, existing family advisor or someone dedicated to developing the next generation, like a coach or facilitator. This is especially important when there are several siblings or cousins who will become joint shareholders, inheritors or business leaders. Their development must be coordinated, and should focus on building a sense of team between members of the next generation.

Families who invest time, effort and money into the next generation are laying the groundwork for a sustainable future for generations to come. Next generation leaders who pursue a development process will have clearly defined life goals, plans to make them happen and are much more likely to become both independent and informed family members. In addition, individuals and next generation teams can better manage the risks and opportunities of their family's legacy. Most importantly, the next generation will build a shared vision for the contribution they wish to make, both as individuals and as the future leadership team of the family.

A Window on US Wealth Management

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

Last month, I was in Palm Springs, California for a conference on Private Wealth. The attendees and presenters of this particular conference were primarily Americans so it was an interesting window on what families of wealth are doing throughout the U.S.

Here is a summary of the main three observations and ideas:

1. Alternative investments are a large part of the portfolio

Alternatives comprise 30-40% of the typical wealthy American family's portfolio. By alternatives, I mean hedge funds, private equity, investment real estate, structured products and real assets/ commodities. That is a far cry from the Canadian experience where the average would struggle to get above 5%. Even Canadian institutions and endowments are well behind their peers in the U.S. on inclusion of alternatives in their portfolios. There are several reasons for this. Historically, the U.S. has tended to lead Canada in acceptance of new products by five or more years. Also, the performance of the U.S. traditional asset classes (stocks and bonds) have trailed Canada in the past half decade, driving U.S. investors to embrace alternative solutions. The other key reasons cited for the inclusion of alternatives in client portfolios are the benefits of diversification, since they are often uncorrelated with traditional asset classes, and the attractiveness of promised predictable, absolute, positive return (vs. relative performance) in declining markets.

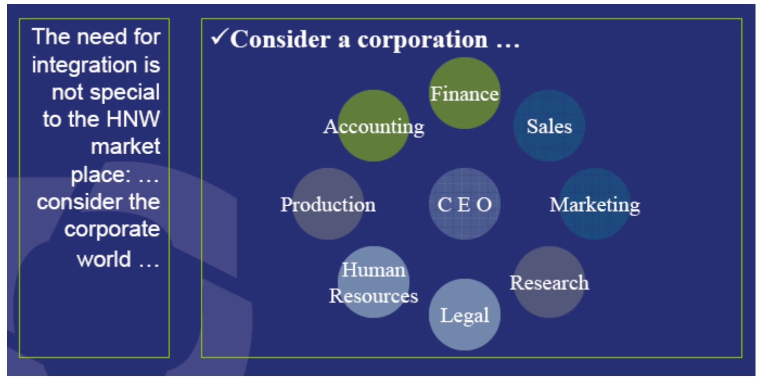
2. Inflation is again one of the biggest fears

Inflation is the most worrisome indicator U.S. wealth advisors and economists are seeing on the horizon. The twin concerns of higher commodity prices and higher oil prices are driving core inflation numbers to the highest levels in the years. Even the weakened consumer spending, as a result of the 2007 credit crisis, is not enough to offset the upward creep of inflationary pressures. That tends to push investors out of traditional bonds into other options such as inflation-indexed bonds, stocks and commodities.

3. "Integrated Wealth Management" is beginning to take hold

The integrated approach to managing high net worth families (which we have practiced for years at Northwood) is just beginning to emerge among some firms in the U.S. By this I mean an approach that starts with client objectives rather than public securities markets as the centre. This approach then integrates all the factors in a client's life (including investments, tax planning, estate and succession issues, philanthropic objectives and unique family characteristics) into a single inter-connected plan. While to many this may seem obvious, a substantial majority of professional advisors today operate as silos, and assume that it is the client's job to integrate the other silos, as required. It was encouraging to see a few firms beginning to embrace this philosophy.

Jean Brunel, one of the fathers of the integrated wealth management methodology, was the keynote speaker at this event. He likened the need for an integrated approach in family wealth management to the integration of the functions of a corporation, as can be seen in the diagrams to the right. Just as a CEO must rely on a strategy that takes into account not just one department, families should ensure that their approach integrates all factors and disciplines, not just one or two.



- Jean Brunel, Presentation, June 2008

An excerpt from the 2007 Berkshire Hathaway annual letter

The often quoted Warren Buffet weighed in on the unrealistic return expectations that many corporations use in their pension plan assumptions in his annual newsletter to shareholders this year. We've reproduced a portion of the letter you may find most interesting below:

"The average holdings of bonds and cash for all pension funds are about 28%, and on these assets returns can be expected to be no more than 5%. Higher yields, of course, are obtainable but they carry with them a risk of commensurate (or greater) loss. This means that the remaining 72% of assets – which are mostly in equities, either held directly or through vehicles such as hedge funds or private-equity investments – must earn 9.2% in order for the fund overall to achieve the postulated 8%. And that return must be delivered after all fees, which are now far higher than they have ever been.

How realistic is this expectation? Let's revisit some data I mentioned two years ago: During the 20th Century, the Dow advanced from 66 to 11,497. This gain, though it appears huge, shrinks to 5.3% when compounded annually. An investor who owned the Dow throughout the century would also have received generous dividends for much of the period, but only about 2% or so in the final years. It was a wonderful century.

Think now about this century. For investors to merely match that 5.3% market-value gain, the Dow – recently below 13,000 – would need to close at about 2,000,000 on December 31, 2099. We are now eight years into this century, and we have racked up less than 2,000 of the 1,988,000 Dow points the market needed to travel in this hundred years to equal the 5.3% of the last.

It's amusing that commentators regularly hyperventilate at the prospect of the Dow crossing an even number of thousands, such as 14,000 or 15,000. If they keep reacting that way, a 5.3% annual gain for the century will mean they experience at least 1,986 seizures during the next 92 years. While anything is possible, does anyone really believe this is the most likely outcome?

Dividends continue to run about 2%. Even if stocks were to average the 5.3% annual appreciation of the 1900s, the equity portion of plan assets – allowing for expenses of .5% – would produce no more than 7% or so."

NORTHWOOD STEPHENS PRIVATE COUNSEL INC.

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