

ALSO IN THIS ISSUE:

- How will you Measure your Life? 2
- Maybe it's not so cold up here after all 3
- The Tip of the Iceberg 4

THE NORTHWOOD PERSPECTIVE

President's Message

Tom McCullough

"At a party given by a billionaire...over cocktail conversations, the late novelist Kurt Vonnegut advises his author pal Joseph Heller that their remarkable host, a hedge fund manager, earns more in one day than Heller ever made over the history of his wildly popular novel, *Catch-22*. Heller's response: 'Yes, but I have something he will never have ... *Enough*.'"

– From *Enough: True Measures of Money, Business and Life*, John Bogle, 2008

'Enough' is a fascinating concept, and perhaps more central to the world of investing and wealth management than we ever imagined.

In a world that tells you that 'you can have it all', that you're a chump if you miss out on the best returns, and that you have to maximize your portfolio, your kids' education and even your vacation experiences, every once in a while we hear a small voice that says 'enough' is ok.

Targeting 'enough' instead of 'more' can seem like giving up and leaving money on the table, unless you understand the reason for it.

The problem with maximization and pushing for more is that there is no end to it. When you ask someone to define 'what is wealthy?' the typical answer is 'just a little bit more!' And there is usually risk (i.e. adverse consequences) to overreaching. We see it all the time in the investing world. A family who needs a return of 6% per year to meet all their needs for their lifetime and for several future generations (i.e. enough to meet *all* their objectives) is enticed by the media and the investment industry to reach for the highest (potential) return and to try to 'beat the market'. Of course it seems like a good idea when things are going well, but not so wise when the investment fails or markets collapse.

Operating in a low return environment (low interest rates, low 10 year returns on stocks, etc.) adds a particular challenge to getting to 'enough'. It can push some wealth holders to reach for higher returns, with attendant higher risks. Or it can force families to reduce their lifestyle or legacy commitments.

The concept of 'enough' is a challenging idea because of its far-reaching consequences – from investment strategy to lifestyle choices. But it can also be freeing.

I hope you enjoy this issue and find it thought-provoking.




Sideways

A break from the storm

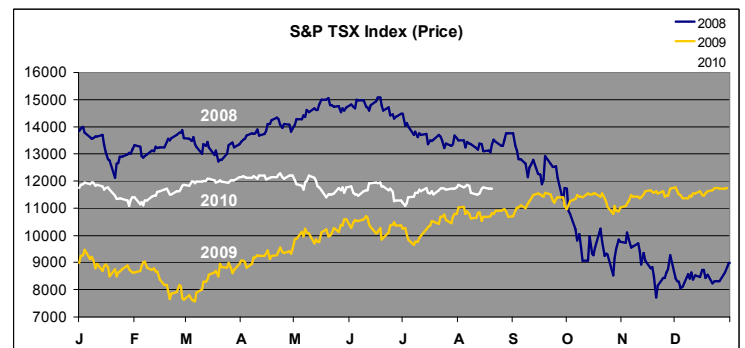
Eric Weir, CFA, CFP



Can you remember back to the first quarter of 2009? It seems like a distant memory now, but the following statistics will give you a quick reminder.

Right off the bat in 2009, the TSX continued the previous year's plunge, falling a further 15.8%, before finally hitting bottom at 7,566 on March 9, 2009, down 49.8% from the 2008 high of 15,073 (June 18, 2008). Volatility had everyone running for cover, and many investors took money out of the markets for fear of losing more. This, for many, turned out to be a bad decision, since by the end of the year, the stock markets had rallied over 50% from the low to 11,746, and we closed the books on what had been one of the most volatile and memorable years in investing history.

Thinking back to 2009, when moves of 2% (up and down) in a day were common, many investors wondered when things would return to 'normal'? Looking at 2010 so far, a year that can only be described as 'sideways', could it be that the stability investors longed for in those early days of 2009 is now coming true?



A quick recap of the TSX this year tells a much different story than last. As we prepare our newsletter this quarter, the TSX is trading at around 11,750 almost exactly where we started the year. Here are a few more facts on the TSX so far this year:

**Take our quiz to find out
if a Family Office might
be right for you.**

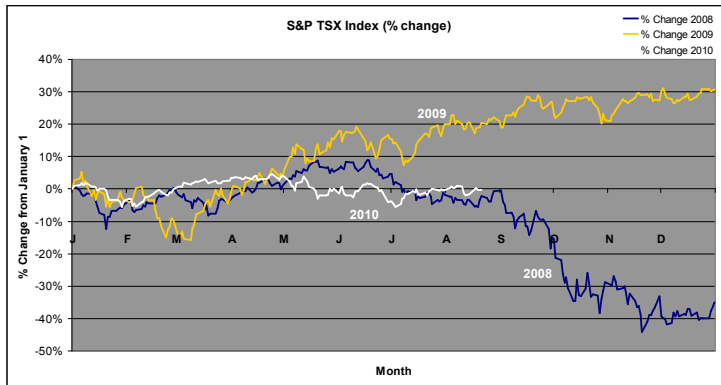
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CONTINUED ON PAGE TWO

CONTINUED FROM PAGE ONE... SIDEWAYS

- The TSX has traded in a 10% band of +4.5% on the upside and -5.5% on the downside;
- In about half of the trading days so far, the market closed above the 2010 opening level (and in the other half it closed below);
- Only about one third (35%) of the trading days so far this year have produced movements of 1% or more.



While not exciting, investors may be enjoying the break from the volatility of the two previous years. In fact, the outcome of this flat market may seem like a welcome relief: modest volatility, consistent dividends, and the potential for long term capital appreciation.

Why are we moving sideways? Economic recoveries are never easy to forecast, and economists are famous for having differing views on where we are heading. The key question now seems to be whether we have emerged from the Great Recession or whether the economy will falter and we will experience a 'double dip'.

When analyzing the U.S. economy, most economists focus on two main factors: unemployment and debt. Essentially, the U.S. must somehow get their population employed, at the same time as they figure out how to deal with the massive consumer and public debt that has been amassed in the past few decades. This is a monumental task and the markets aren't yet certain whether or not we are out of the woods yet. Until there is more clarity, it looks like we're still heading sideways.

As we look to the final stretch of 2010, it's important to ensure that the valuable lessons we learned from the volatile 2008/ 2009 period are not forgotten. 🌲

How will you Measure your Life?

Clay Christensen talks to Harvard grads about 'Finding their Purpose'!

Tom McCullough, MBA, CIM, Ch.P.



When the members of the Harvard Business School 'Class of 2010' entered business school (in September 2008), the economy was strong and their post-graduation ambitions seemed limitless. Just a few weeks later, the economy and markets went into a tailspin.

They've spent the past two years recalibrating their worldview and their definition of success. The students seem highly aware of how the world has changed (as the sampling of views at the end of the linked article shows). In the spring of 2010, the graduating class asked well-known professor and author (of *The Innovator's Dilemma*, among others) Clay Christensen to address them—but not on how to apply his principles and thinking to their post-HBS careers. The students wanted to know how to apply them to their *personal* lives.

He shared with them a set of guidelines that have helped him find meaning, purpose and direction in his own life. Christensen says: "I promise my students that if they take the time to figure out their life purpose, they'll look back on it as the most important thing they discovered at HBS. If they don't figure it out, they will just sail off without a rudder and get buffeted in the very rough seas of life. Clarity about their purpose will trump knowledge of [a long list of business skills]."

Though Christensen's thinking comes from his deep religious faith, Harvard Business Review magazine thought that these would be strategies anyone could use and so asked him to share them with their readers.

While it is a great message for everyone, it is especially relevant for students, new graduates and young adults in your family. In fact Christensen says: "It's quite startling that a significant fraction of the 900 students that HBS draws each year from the world's best have given little thought to the purpose of their lives. I tell the students that [university] might be one of their last chances to reflect deeply on that question. If they think that they'll have more time and energy to reflect later, they're nuts, because life only gets more demanding: You take on a mortgage; you're working 70 hours a week; you have a spouse and children."

The article is available free of charge on the HBR website and is worth a read:

<http://hbr.org/2010/07/how-will-you-measure-your-life/ar/1> 🌲

Maybe it's not so cold up here after all

Pending changes in the U.S. tax structure makes Canada more attractive

Barrett Lyons, CA



It is a common perception that the U.S. is a better place to live than Canada when it comes to taxes and weather. One of these perceptions may soon be shattered. With likely increases in American income and estate taxes on the way, along with the U.S. debt crisis, the winter here in Canada this year might not seem so cold.

In 2001 and 2003, the Bush administration passed legislation to reduce estate and income taxes over the course of the decade. This made the U.S. a more attractive tax regime. However this tax reform will expire on January 1, 2011 unless Congress passes new legislation. High net worth families in the U.S. are anxiously awaiting the resolution of this issue in Washington.



Estate Tax

In 2001, the U.S. Congress enacted legislation to gradually minimize the estate tax and ultimately see it repealed in 2010. If Congress fails to act, and this legislation expires, the tax rates will revert back to the 2001 levels, which feature a \$1 million estate tax exemption and a top marginal estate tax rate of 55%. These changes can have a significant impact on a family's estate.

For example, consider a couple who are both U.S. citizens and who own a home worth \$1 million, have retirement assets of \$1 million, and each have a \$1 million insurance policy on the other's life. If the 2001 rates come back into force, this couple's estate would have a tax liability of approximately \$1.3 million, as compared to nil in 2009 and 2010.

Compare the above results to the income tax consequences of the estate settlement for two *Canadian* residents. Although Canada has no estate tax, all assets are deemed to have been disposed of on the settlement of the estate and accrued gains may be taxed. In this example, the insurance policies would pass to the beneficiaries tax free, the gain on their home would be tax free due to the principal residence exemption and the retirement assets would be deemed to have been disposed of, with only half taxable as a capital gain. The resulting income tax liability would depend on the cost base of the retirement assets, but assuming a cost base equal to half the market value of the assets, the resulting federal tax liability would be approximately \$61,000. That is approximately a \$1.24 million difference in taxes on the family's estate between the U.S. and Canadian cases.

There has been a continuous debate in Washington on various drafted estate tax bills, without any having been passed by Congress. The

result is a political divide, with Republicans wanting higher exemptions and lower rates (\$5 million exemption or more and a 35% top rate), and Democrats wanting to restore the 2009 levels (\$3.5 million exemption and 45% top rate)¹. Regardless of the final outcome of the ultimate compromise achieved, it is clear that there will be some form of estate tax enacted. Interestingly, the U.S. has already lost an estimated \$253 billion in revenues from the Bush-era estate legislation¹. Given the colossal debt and deficits the U.S. government is running, these tax revenues have been sorely missed.

Income Tax

Similar to the estate tax, the income tax relief passed by the Bush administration in 2001 and 2003 is set to expire at the end of 2010. The current debate indicates that there are three possible outcomes in play. First, if new legislation is not passed, income tax rates will revert back to 'pre-Bush' rates; second, new legislation could be passed to extend the existing rates; and, finally, President Obama's proposed 2011 budget could be enacted. This legislation would impact numerous categories of income tax provisions, particularly ordinary income (i.e. employment and interest), dividend income, and capital gains¹.

The tax rates from these three scenarios have been summarized in the table below. When adding state income taxes to the federal rates, the total rates can exceed the top combined provincial and Canadian income tax rates. For example, in California, the top marginal income tax rate on employment earnings is 50.2% (state tax of 10.6% on top of the federal rate) vs. 46.4% in Ontario.

	Top Federal Tax Rate		
	Ordinary Income	Long-Term Capital Gains	Eligible Dividend
Pre-Bush Rate	39.6%	20.0%	39.6%
2010 Rate	35.0%	15.0%	15.0%
Obama 2011 Budget Rate	39.6%	20.0%	20.0%

Looking Forward

These tax issues have been overshadowed in the media recently by the other political concerns the U.S. is dealing with (i.e. the Gulf oil leak, healthcare, Afghanistan, faltering economy, etc.), however this topic will be interesting to follow leading up to the fall mid-term elections.

It has recently been reported that the White House budget deficit will be \$1.5 trillion for 2010² and the U.S. federal government is now borrowing 41 cents on every dollar it spends³. It is hard to imagine how the U.S. will be able to manage its debt levels without tax increases across the board, now and in the future. Against this backdrop, and despite problems of our own, Canadian wealth holders might want to count their blessings. 🌲

¹ Hodgson Russ LLP – August 2010 Newsletter.

² Roger Runningen. "Obama raises 2010 deficit estimate to \$1.5 trillion." Bloomberg. August 25, 2009.

³ James Politi and Robin Harding. "US stimulus boosted growth by up to 4.5%." Financial Times. August 24, 2010.

The Tip of the Iceberg

The work that goes on behind the scenes of a family office

Scott Hayman, CA, CFP



As you might imagine, there is a lot of work that goes on behind the scenes in a family office. Of course, we meet with clients, prepare analysis and reports, and implement strategies for them. There is also a lot of activity and research that most people never see or even hear about. In fact, the 'up-front work' is just the tip of the iceberg.

I thought it might be interesting to give you a glimpse of the kind of background activity that goes on at Northwood Family Office in preparation for the more visible work we do with clients. Below are just two examples:

Topical reading, research and review

We read mountains of documents and reports on an ongoing basis to ensure we are staying current in a myriad of fields, including investment strategy, mandates and funds, taxation strategies and rulings, estate planning and insurance developments, new service offerings, alternative reporting formats and programs, cost saving opportunities and potential risks.

To accomplish this, we read multiple magazines, journals and publications, attend conferences, review court rulings, and consult with industry experts, just to mention a few. Some of the reading and research results in a specific action step or recommendation, but most just goes into the general body of knowledge we develop that will ultimately be called upon to solve a problem, take advantage of an opportunity when it arises, or otherwise serve a client family.

While it takes a lot of time to separate the proverbial 'wheat from the chaff', staying current is an important responsibility we undertake on behalf of our client families and it allows us to develop important perspectives and points of view that help guide our decision making.

Advisor Research

Working with other advisors and specialists is another important role we play in the lives of busy wealthy families. We both seek out and are approached by literally hundreds of advisors and managers on an annual basis who are all looking to offer a product or service to our clients. This can include insurance advisors (both home and auto, and life agents), chartered accountants, lawyers, family business advisors and investment managers. As an example, we receive about 30 calls and emails a week from investment companies (traditional, hedge, real estate, private equity and everything else you can think of) from all over the world, each of whom believes that their offering is one of the very best and is perfectly suited to our clients. As you might imagine, it takes a significant amount of time to triage this communication and then to decide which ones should receive preliminary (and possibly follow-on) interviews and consideration, and which ones should be set aside.



A family office's role has been defined as a 'sword and a shield' for its client families. The 'sword' is used to get things done and the 'shield' is used to protect the family from harm. But to wield either the sword or shield, a family office advisor requires substantial experience, knowledge, and awareness of the opportunities and dangers in the world and in the family itself. There is no shortcut for this kind of preparation. 🌲



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