WINTER 2013

NORTHWOOD FAMILY OFFICE

ALSO IN THIS ISSUE:

The Northwood PERSPECTIVE

Chairman's Message

Tom McCullough

Happy New Year to everyone. Once again we have emerged from a difficult year, featuring civil wars, regime changes, mega storms, doping charges, mass shootings, currency crises and fiscal cliffs. Stock markets climbed the proverbial 'wall of worry', rising solidly in 2012, particularly in the U.S.

In this edition of the Chairman's Message, however, I'd like to shift from the big picture to the more mundane and talk about statements -- account statements. Have you ever thought of how many statements you receive in a year and how many pieces of paper that means? The Sullivans are a typical affluent family.

Banking - They bank at a major Canadian bank and have 8 accounts there - Jim, Susan, 2 small RRSPs, an account for their holdco, a family trust account (US dollar and Canadian dollar), and a line of credit. They receive a statement of each account every month. That's 96 statements a year.

Brokerage - They have accounts at a brokerage firm – 2 cash accounts, 2 RRSPs, 2 Tax-free Savings Accounts, 3 Education savings accounts (for their grandchildren), and 1 LIRA from Jim's old company. That's 10 more accounts, with monthly statements. Another 120 statements a year.

Investment management - The Sullivans have investments with three money managers. They receive 2 custodial statements a month for each manager, due to the multiple pools they hold. That's 6 statements each month from the various custodians, plus a quarterly portfolio statement from each portfolio manager. That's another 84 statements a year.

That totals 300 statements per year. If the average statement is 3 pages, that means 900 pages of statements per year for one family – a stack over 6 inches high! And this does not include statements from their insurance policies, golf club membership, household utilities, and taxes.

Some families choose to receive their statements electronically, which helps with the paper flow. But whether statements come in hard copy or soft copy format, they still need to be dealt with (e.g. reviewed, analyzed, filed) and they take up a lot of 'mind space'.

One of the roles a family office plays for affluent families is making sense of their investment statements and cash flow management. Instead of having to sort through multiple brokerage and investment manager statements, we provide a consolidated quarterly statement that incorporates all aspects of a family's investments, cash flow and net worth. Most of our families find that is a big load off their minds and allows them to 'see the forest for the trees'. The new year is a good time to turn over a new leaf and get organized. Consolidated reporting is just one way a family office can help.

Tom

The Closest Thing to a Crystal Ball…

Eric Weir, CFA, CFP

The final tally on 2012 showed a very respectable year for most investors. Stock markets around the world saw advances well into the double digits, and the Canadian market managed to post a gain of just over 7%, despite weakness in the resources economy. We continued to see low interest rate policies and the intervention of central banks in bond markets, however, the financial position of most developed economies remained rocky at best, with most countries choosing to continue to 'kick the can' of government debt down the road, and finally, volatility in the equity markets remained surprisingly low with only a few mild bumps throughout the year.

While we haven't found anyone with a crystal ball yet, we did ask some of the investment managers we work closely with for their sense of the major economic and investment themes for 2013. We've summarized the top four in this article.

Volatility will make a return – We've started 2013 at the lowest level of S&P 500 volatility (as measured by the VIX index) in over five years. Many managers believe that this placid trend will not continue and that the fallout from the strategies to repair government overspending and balance sheets over the next few years will bring volatility back to financial markets as investors digest how this will impact corporate growth and profits.

Corporate growth will slow – Developed economies are not expected to post significant advances in GDP, if any at all, and as such, most large corporations will not be able to continue to post double digit sales and profit growth. The exception to this will be companies with significant operations in emerging markets that can continue to grow at a much more rapid pace. Overall, the general expectation is that corporate profit growth will be in the high single digits at best over the next few years.

BRIC economic growth will lead, but at a slower pace – Developing economies, such as the BRIC nations of Brazil, Russia, India and China, are expected to continue to grow, although at a slightly slower pace. Most managers don't foresee major corrections, but a general reduction in the rate of expansion is expected as the developing economies feel the impact of reduced demand growth in more advanced economies. Searching for companies with good exposure to these markets is important to maintaining growth in a portfolio.

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Central banks will continue to impact markets – During 2012, we continued to see the impact of the increased money supply and low interest rate polices from central banks around the world. Investors, fed up with the meager returns offered by fixed income investments, funneled money into other asset classes with good income characteristics, such as real estate, high yield debt, infrastructure and high dividend stocks. Investors in these asset classes saw significant gains during the year. This trend of low interest rates is not expected to reverse quickly. As such most managers tell us that the excess cash in the markets will continue to drive investors into riskier asset classes (and sub-classes such as high dividend stocks) as they reach for return.

Viewing these themes as a backdrop to investment decisions, we enter 2013 with the need to maintain a very balanced view of risk and return when considering portfolio allocation decisions. Expectations of higher risk due to the poor financial status of governments are very real and will add potential volatility to markets, but the need to achieve returns in excess of fixed income is important to most investors' long term plans. A well thought-out approach which takes appropriate amounts of risk relative to families' goals and objectives is our prescription for all situations, and this remains in force as we look at what the crystal ball portends for 2013.

A Lesson from Pension Funds for Private Clients

Tom McCullough, MBA, CIM, CSWP, CFBA

Most corporations and institutions use a balance sheet to assess their financial position and the achievement of their objectives. Leading thinkers in the private wealth management field suggest that individual investors can take a leaf from how pension plans think about their financial management. A family can benefit from using the same tools as part of a robust and effective wealth plan. In fact, it can be an essential tool to tell you whether your goals are achievable and realistic, how heavily you are relying on your assumptions, and what changes you need to make to your spending or investment plans.

On the left-hand side of a typical pension fund balance sheet (Figure 1) are the assets of the fund, both tangible assets (investments) and implied assets (contributions). Implied assets are not technically assets today, but are highly likely to be added to the asset base at some undetermined time in the future. On the right side are the liabilities of the fund or the commitments the fund has made to pay current and future pensioners.

If the assets are bigger than the liabilities, then there will be a surplus. If not, a deficit.

A family balance sheet might look like Figure 2.

Figure 1: Pension Fund Balance Sheet

Assets	Liabilities & Surplus
Traditional Assets	Accrued Pension Obligation (APO)
Alternative Assets	Projected Pension Obligation (PBO)
Expected Employer Contributions	Surplus
Expected Employee Contributions	

Figure 2: Family Balance Sheet

Assets	Liabilities & Surplus
Financial Assets	Mortgages
Tangible Personal Assets	Lifestyle Maintenance
Human Capital	Dynastic Goals
Family Business/Stock Options	Other high-priority goals
Deferred Compensation	Discretionary Wealth (Surplus)
Expected Inheritances	

Source: Stephen Horan, CFA Institute

On the left side of the balance sheet, the family lists their assets. Like the pension fund, a private wealth balance sheet includes tangible assets (investments, personal assets, family business) as well as implied assets (human capital, deferred compensation and expected inheritances). Human capital (sometimes called net employment capital) represents the present value of the expected earnings stream from employment as well as the skills the family has to manage and grow their wealth.

On the right hand side of the balance sheet are the current liabilities and future commitments. For most wealthy families, their liabilities are not actually debt. Rather, they are plans to fund the goals that the family has set, or in some cases commitments they have made. Implied liabilities typically include the following categories:

- *Lifetime spending* – This is simply the cumulative annual spending plans of the family over the lifetimes of the relevant family members. The appropriate amount of capital, assuming a reasonable discount rate on the future spending, should be notionally allocated to cover this planned spending.

- *Bequests and gifts to heirs* – The wealth owners may wish to identify a certain minimum (or target) amount of funds that will be allocated to their current and/or future heirs. The liability is the current amount of capital (based on reasonable growth assumptions that will need to be allocated to fund this liability. Some families will choose to identify only specific liabilities to fund and then will bequeath 'whatever is left' (i.e. the surplus of assets over implied liabilities).

- *Generational funding* – Some families want to fund many generations of future family members. The decision as to how many generations they would like to fund will have a significant impact on the liability side of the balance sheet. You can imagine the capital that would need to be allocated to funding ten generations vs. just your own children and grandchildren.

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• *Charitable donations and bequests* – Similarly, plans to fund philanthropic projects or a foundation either during the family members' lifetimes or upon their deaths must take into account and ultimately be funded. In some cases these are explicit commitments, such as a charitable bequest in a will, and in other cases are simply the implied liabilities of an intended donation.

• *Large investments or purchases* – Any anticipated large cash outflow must be planned for and ultimately funded by assets. This could include plans to start a business, buy a recreational property or fund a family bank.

It is important for each family to determine the relative importance and priority of their goals/ commitments and notionally (or, in some cases, explicitly) assign investment capital to fund these amounts. Lifetime spending is normally viewed as a non-negotiable and so will require the first notional assignment of capital. The relative importance of other goals will depend on each family's own preferences and priorities. The more goals a family puts in the 'high priority' category, the more 'liabilities' they will have and the less 'discretionary wealth' they will have. This may reduce the amount of risk the family will be able to withstand in their overall portfolio.

The use of a family balance sheet is a helpful tool by which to determine investor goals and then build an asset mix that is most likely to meet the family goals, depending on their relative priority.

The Critical Importance of a Disciplined Investment Process

Scott Hayman, CA, CFP, TEP

Investment management of private wealth is not for the novice, faint of heart, nor the uninitiated.

Many investment ships have foundered on the shoals of poor investment implementation or succumbed to the dangerous call of the sirens offering an easy path to an easy and prosperous future. In investment management, like many pursuits in life, the devil is in the details.

'Planning' is the process of thinking about and organizing the activities required to achieve a desired goal. It encompasses looking at how to identify the family's goals and how achievable those goals might be given the family's current balance sheet and a sense of how things might develop in the future. There are four important aspects of a wealth management plan that will help ensure its success – clear goals, a sound framework, an integrated approach and a resilient, adaptable model.

Start with the end in mind

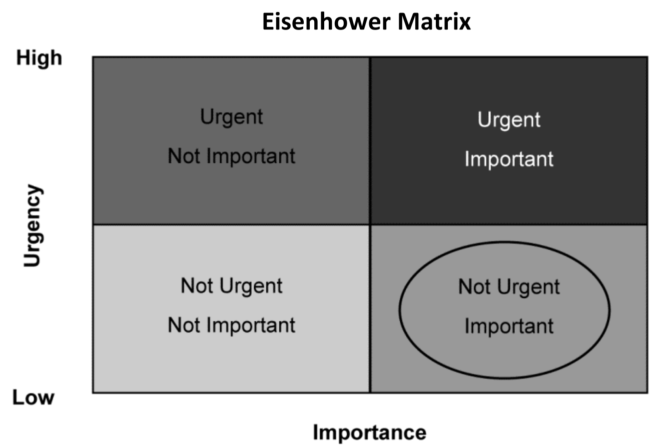
An effective family wealth plan starts with the end in mind. It clearly states the objectives of the family and sets out to achieve those goals with the highest possible probability of success and the least amount of risk. This may sound blindingly obvious, but it is not. Most investors, prodded by the media and financial industry, still focus on the elusive search for the highest return or try to beat a particular benchmark over the short term.

The mistake most investors make is focusing solely on the asset side of the family balance sheet when their focus should be on the whole balance sheet – with particular attention to the liabilities or the goals they want to accomplish. In fact, from a family wealth perspective, the assets should simply be 'in service of the liabilities'.

The tyranny of the urgent

Why is it so hard for many people to move forward on a strategic wealth plan even when they realize that it is crucial to the success of their family? The now ubiquitous 'Eisenhower Matrix' highlights the dilemma that wealthy families face every day.

The matrix is thought to be based on U.S. President Dwight D. Eisenhower's quote, "What is important is seldom urgent and what is urgent is seldom important." This is apparently how Eisenhower organized his tasks.



The upper right-hand quadrant represents the tasks that are both Urgent and Important (e.g. responding to a call from a client). Most busy people can get to those tasks right away.

The two quadrants on the left-hand side represent activities that are Not Important (-- whether Urgent or Not Urgent) and can be significant timewasters. Those activities should be efficiently managed, minimized or, where possible, eliminated.

The problem seems to be the activities in the bottom right-hand quadrant entitled Not Urgent, but Important. While we know tasks like these are important, they somehow 'never make it to the top of our in-basket' because they don't seem urgent.

Getting a coordinated plan in place for a family's financial affairs with the right kind of advice and a regular review process clearly runs the risk of falling into this quadrant. It can be hard to move forward on these kinds of projects, but the positive impact can be enormous. The first step to forward momentum in developing a wealth strategy can be the selection of an integrated advisor who can lead a family leadership team through the process and provide the discipline and framework to help work through all the steps.

While every family is different and will develop its own unique investment strategy, there is no substitute for a thoughtful, well-conceived plan and well-executed plan.

Philanthropy for the Ultra Wealthy – The Giving Pledge

Barrett Lyons, CA, CFP

The Giving Pledge was an idea conceived by Bill and Melinda Gates and Warren Buffet to encourage other billionaires to publicly pledge to give away more than half their wealth to philanthropy during their lifetime or at death. The purpose of the pledge is to inspire others to give back and make a substantial difference in our world, and share ideas on how to do so.

To date, the Giving Pledge group includes 92 billionaire households with a combined net worth of approximately $433 billion, meaning they have committed $216 billion or more to charity. The list of names, ranging in age from 28 to 97, are primarily from the U.S., but includes a handful of Canadians, and the group is trying to grow globally. Their individual causes are broad and diverse, and in some cases, as unconventional as the individual (e.g. progression of marijuana laws). Each member writes a pledge letter that is posted online at givingpledge.org, where they describe their inspirations and why they made the pledge, as well as their perspectives on philanthropy. Some of the letters are quite interesting. If you are interested in philanthropy, I highly recommend you visit the website simply to glean the perspectives of others attempting to make an impact. Below are a handful of excerpts from letters that might stimulate your interest:

"I've long stated that I enjoy making money, and I enjoy giving it away. I like making money more, but giving it away is a close second….. I'm not a big fan of inherited wealth. It generally does more harm than good."

– *T. Boone Pickens*

" Philanthropy is an unnatural act that must be learned and practiced."

– *Peter B. Lewis*

"While my motivations for giving are not driven by a profit motive, I am quite sure that I have earned financial returns from giving money away. Not directly by any means, but rather as a result of the people I have met, the ideas I have been exposed to, and the experiences I have had as a result of giving money away. A number of my closest friends, partners, and advisors I met through charitable giving. Their advice, judgment, and partnership have been invaluable in my business and in my life. Life becomes richer, the more one gives away."

– *Bill Ackman*

"Harriet and I never expected to become members of the giving pledge group but since our wealth – like all fortunes – rests so heavily on the intelligence, work and contributions of others it seems only right that we voluntarily give most of it to causes that help improve the lives of people we do not know."

– *Michael Moritz and Harriet Heyman*

"Philanthropists, at their best, try to address serious societal problems and occasionally come up with innovations that lead to enduring change. In the end, success requires much more than financial resources, although money is, of course, essential. Good ideas are just as important; otherwise one risks wasting both the funds and the opportunity. Effective philanthropy also requires patience - patience to deal with unexpected obstacles; patience to wait for the first, slight stirrings of change; and patience to listen to the insights and ideas of others."

– *David Rockefeller*

"…watching the product of one's giving is one of life's greatest pleasures, and those with the ability to do so should do what they can to experience that pleasure when they are around to see the benefits. They will never regret doing so."

– *David Rubenstein*

"I have never seen a hearse pulling a U-Haul trailer. You can't take it with you….Pick your passion and make a difference!"

– *Albert Lee Ueltschi*

"….this pledge does not leave me contributing the most precious asset, which is time. Many people, including -- I'm proud to say -- my three children, give extensively of their own time and talents to help others. Gifts of this kind often prove far more valuable than money. A struggling child, befriended and nurtured by a caring mentor, receives a gift whose value far exceeds what can be bestowed by a check."

– *Warren Buffet*

Giving over half your wealth away might not fit well into all estate plans, however, the ideas and perspectives the ultra-wealthy provide an interesting perspective. Our society often focuses on a 'more is better' philosophy when it comes to wealth and this mantra was often passed on to the next generation. However, Wealth Pledge group of ultra-wealthy individuals have taken a different approach. They want to leave a charitable legacy versus simply concentrated wealth in the hands of their heirs.

Although we don't work with Bill Gates or Warren Buffet, we do help clients with very sizable estates develop their legacy plans. In our work, we continue to see estates trending to give beneficiaries access to money later in life, and we have also begun to see a greater role for charity in large estates. The structure and governance of these estates can be complex, and we've enjoyed helping our clients customize their legacy based on the goals and values of their families.

Sources: givingpledge.org, glasspockets.org

NORTHWOOD FAMILY OFFICE

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