NORTHWOOD FAMILY OFFICE

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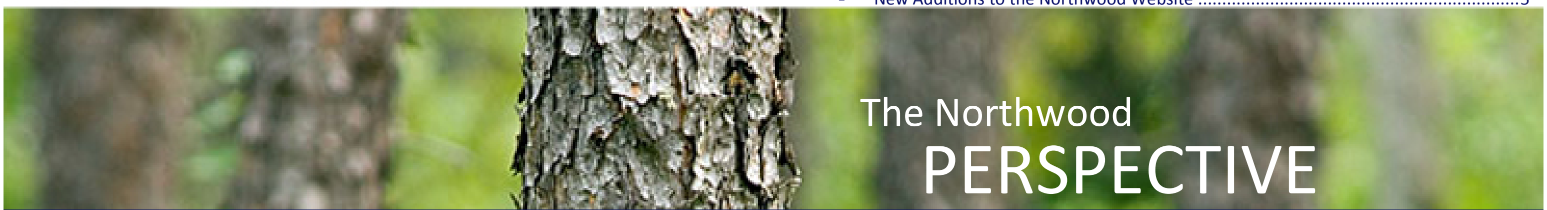


Chairman's Message

Tom McCullough

The past year was a terrific one for most stock market investors. The S&P was up 32.4% and the MSCI rose 27.4%, in local currency. (The TSX, full of gold and base metals, was one of the exceptions at only +13.0%.)

My contrarian (some would say 'contrary') nature has me looking for the clouds in this silver lining. And you don't have to look far to find them. Government and personal debts around the world are still very high and must certainly be unsustainable. Much of the rise in equity markets over the past several years has been fuelled by the ultra-low interest rate policy pursued by the US Fed. This too would seem to be unsustainable. And stocks, having almost tripled from their crisis lows of March 2009, are now trading at or above historical price/ earnings multiples, depending on the measure you choose. With corporate profit margins at all-time highs, further substantial earnings gains seem unlikely to carry the market multiples. (See the accompanying article.)

On the other side of the equation, bonds, the traditional alternative to equities are trading at unattractively low yields and it seems reasonable that market yields will ultimately rise, pushing bond prices down. This can make stocks still seem appealing, on a relative basis. And it is also true that most equity bull markets end in an overvalued fever, with retail investors piling in en masse. This has not happened yet, which means that this bull market could still have some legs left.

But we are clearly closer to the end of the good news than the beginning. How should investors think about structuring their wealth for this kind of environment? The first step is to clearly understand and quantify your lifetime and legacy goals, and then determine the rate of return you require to meet all of those goals. That target rate of return (not this year's market return) is your benchmark.

Because no one can predict the market movements with any consistency (despite what others may tell you), investors should hold a diversified mix of assets that is likely to meet the target return. You should also hold enough 'safe assets' to cover short-term and/or very high priority family objectives and to withstand (and take advantage of) the large market downdrafts that will inevitably occur. You should also hold enough growth assets to counteract the long term negative effects of inflation. This balance can be adjusted as market and family conditions change.

As market prices become stretched, this is also a good time to redouble efforts to ensure a high quality portfolio (managed by top notch, risk-aware managers), despite the temptation to reach for higher yield or promised gains as investor confidence rises alongside prices. Successful investing families understand that their goal is not simply the highest possible value on the portfolio today, but rather the effective funding of all of their goals over their lifetime. As the successful mountaineer once said "When you reach the summit of the mountain, you are only half-way there. **You still have to get back**."

Tom

Both Sides of the US Equity Story

Dan Solomon, MBA, CFA

2013 saw US equity markets surge to all time highs, while most international indices followed close behind. The Canadian market, although not faring as well due to its large resource sector weighting, still managed respectable double digit returns for the period. On the heels of such a banner year for US equities, there is widespread debate over the course the US equity market will take in 2014. All strategists and economists agree that this rally cannot continue in perpetuity, however, they have differing views on what we can expect in the near-term and are divided on whether or not US equities are capable of building on last year's gains.

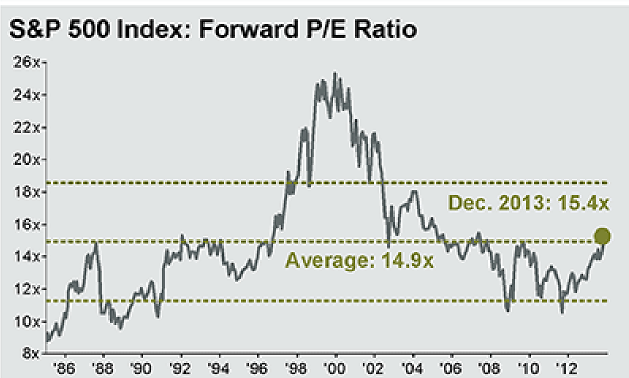
Index	2013 Total Return (C$)
S&P 500	41.53%
MSCI World	36.16%
MSCI EAFE	31.81%
S&P/TSX	12.99%

Even those calling for a continuation of the rally are mostly reserved in their predictions, suggesting that US stocks still have room to move higher but not at the incredible pace they did in 2013. They point to the following in support of their expectations:

- The outlook for a recovering US economy could lead to continued strong performance for stocks, and those conditions appear to be improving with the latest US GDP stats recently revised upward from an already impressive 3.6% for Q3/13 to 4.1%.
- US consumer sentiment was in strong form to end 2013, which could bode well for equities, as consumer spending accounts for the bulk of the nation's GDP.

Continued

- Although the US Federal Reserve began the tapering of its bond program in December in light of positive economic prospects, it simultaneously pledged its continuing support for the economy with a prolonged policy of low interest rates. This helped to ease the concerns of market participants that had feared the fallout from a rapid withdrawal of stimulus.
- The price-to-earnings (P/E) ratio is a measure of the amount investors are willing to pay for each dollar of company earnings, and is also one of the most commonly used gauges of market valuation. Nearing the end of 2013, the forward P/E ratio for the S&P 500, based on expected earnings, was essentially in line with its long-term average, indicating that even at these levels valuations are not extreme.

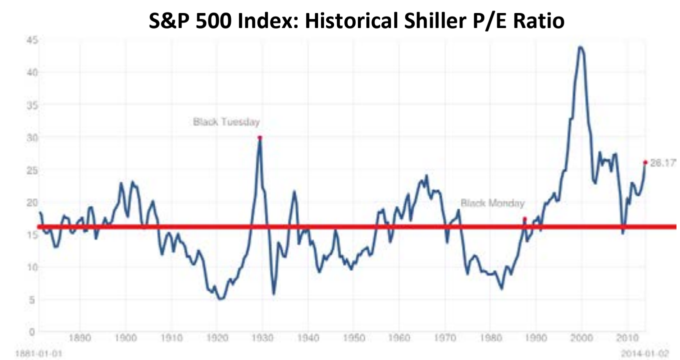


Source: J.P. Morgan Funds

- International economies dependent on the prosperity of the US for growth should begin to benefit from a strengthening US economy, in turn contributing to better results for the many US companies with multi-national operations.
- An environment of historically low fixed income yields seems likely to persist in 2014, leaving equity markets as the most liquid source of potential superior returns for most investors.

As usual, there are also those who paint a less rosy picture, worrying about an immediate risk to US equity market performance in 2014. They stress that the wind could be taken out of the sails of the rally faster than some might anticipate, highlighting the factors below as evidence:

- A closer look at US corporate earnings results shows that much of the latest improvement in earnings has been driven by rising profit margins. Because there is a limit to the amount of earnings growth that can be garnered from expense reduction, it is top-line expansion (i.e. rising revenues and prices) that will have to fuel the majority of growth going forward. However, the recent spate of corporate earnings warnings and negative analyst revisions indicates that it may be unrealistic to expect top line results to pick up this slack any time soon, which could hurt stocks.
- According to one well-known fund manager, corporate earnings as a proportion of US GDP is 70% above the long-term average, and a reversion to the mean for this metric would not be promising for stock prices.
- US quantitative easing measures likely contributed significantly to last year's rally, but just how much no one can peg with precision. Now that the US Fed has begun to taper its bond purchase program, markets are faced with the task of learning how to stand on their own two feet again, a reality that some believe could weigh heavily on equities, even as interest rates remain low.
- Professor Robert Shiller's cyclically adjusted P/E ratio tells a different story than the aforementioned traditional forward P/E ratio. To smooth results for cyclicality, the earnings component of the Shiller ratio is a calculation of average earnings over the past 10 years. Contrary to the traditional measure, the Shiller P/E is currently sitting well above its long-term average, suggesting that stocks are historically expensive.



Source: multpl.com

- The ongoing budget standoff between Congress and the White House is expected to continue in 2014, potentially adding a negative tone to the equity market.
- Finally, some key indicators are also exhibiting worrying signals:
  - The VIX, a widely used measure for market volatility, is very low, potentially signaling the sort of overconfidence often prevalent prior to a market crash.
  - Markets are reaching record highs on relatively low trading volume. This may mean that there will be little buying support in the event of a sell-off.
  - Investors should be aware of the abundance of cash funneling back into equity mutual funds as cash flows into equity funds tend to follow performance, acting as a contrarian indicator in helping to approximate the timing of market peaks and troughs.

As usual, there are valid arguments to both sides of the debate. It is probably fair to say that there is a better than average chance that the returns next year will be less than the stellar 2013. But the truth is, no one can really predict what markets will do in a 12 month period and it is probably not worth the effort.

Investor strategies should look well beyond what is expected to transpire in the coming year, and be constructed to focus on achieving the returns required to meet both their lifetime and legacy goals. Implementing and adhering to a long term strategy will help guide the investment decision making process through even the murkiest of times.

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Along the way, the following five rules of thumb will help keep investors on track and out of trouble.

1. **Setting realistic goals.** Investors who know their specific financial objectives are less inclined to overreach beyond their risk capacity and more inclined to protect capital, which is the most important factor in meeting investment objectives. And using conservative estimates of asset class returns is likely to lead to fewer negative surprises. A written plan, which captures these objectives and expectations, will also improve the chances of success.
2. **Matching assets to liabilities.** If you match your 'must-have' objectives with low-risk assets, and longer-term 'wish-list' objectives with higher-return (higher-risk) assets, you increase your odds of successfully meeting all your objectives.
3. **Holding a diversified portfolio.** Holding a mix of high quality stocks and bonds (and other asset classes) and ensuring that they are diversified by geography, sector and manager style is likely to help protect capital. As one asset class rises, all other things being equal, you should consider shifting some portion to the other asset classes.
4. **Compounding and dividend reinvestment.** Albert Einstein famously posited that "the most powerful force in the universe is compound interest". This simple technique, along with its cousin 'dividend reinvestment', is a powerful and fully-controllable way wealth holders can boost the probability of growing their wealth over the long term.
5. **Tax and expense management.** A tax dollar saved is a dollar in your pocket. Prudent tax management, including income splitting and tax-aware investing, can create additional 'return' in a portfolio, with no additional risk. This can make a big difference. Just like tax savings, expense savings also drop right to your bottom line. Finding ways to reduce your investment management costs, through pooled purchasing power and segregated management (vs. most funds), can also provide tangible benefits.

Wigmore in Rio

Tom McCullough, MBA, CIM, CSWP, CFBA

As regular readers of this newsletter will know, Northwood Family Office is a founding member of the Wigmore Association (www.wigmoreassociation.com), a global collaboration of chief investment officers from seven leading family offices from around the world -- HQ Trust (Germany), The Myer Family Company (Australia), Pitcairn (US), Progeny 3 (US), SandAire (UK), Turim Family Office (Brazil), and Northwood Family Office (Canada).

Its goal is to further the group's understanding of issues of importance to the families we serve. The Wigmore Association meets twice a year in key cities around the world, most recently in Rio de Janeiro, Brazil in September 2013.

In Rio, the CIOs discussed investment strategy, global economic developments, and investment products and strategies designed to improve the return and risk profile of our client families. We also held private meetings with a number of experts who brought further insight to the issues at hand and the potential investment solutions.

The general discussion had a marginally less bullish tone this time than last March as the market moved ever higher. Members still feel 'forced' into equities to some extent because fixed income yields are so low. Private investments seem to be the release valve – both fixed income and equity – and investors seem willing to give up liquidity for return.

We were also able to broaden our perspective on the Brazilian and Latin American markets. These two graphics capture the recent history of Brazil well. In November 2009, with the BOVESPA index almost back to the 2008 pre-crash highs and the country poised to become the world's 5th largest economy, *The Economist* featured Brazil on its cover under the banner "Brazil takes off". Just four years later, with the market index down 25%, the cover sported the headline "Has Brazil blown it?"

At our meetings in Rio, we heard from several current and ex-central bankers and investment managers. All were quite realistic about Brazil. Investors have become concerned that the country's stellar growth has slowed. China's deceleration has impacted the economy somewhat (due to Brazil's large trading relationship with China), as has the global commodities slump. Also unit labour costs have gone up a lot.

But if there was one single theme, it is this. The biggest problem Brazil faces is lack of infrastructure. The demand side of the economy is not the problem, but the roads, ports, rail and airports can't handle it. Brazil ranks near the bottom of the list on 'infrastructure stock as a percent of GDP' (16% vs. 71% global average in 2012) and, despite that, the country still continues to commit an extremely small percentage of GDP (2.1% in 2011) to infrastructure building. Despite a growing population and domestic and international demand for Brazilian products, it is slow and costly to move them.

Many local investors also think Brazilian equity markets are still not cheap. They carry the perennial worry of renewed inflation (not a huge risk) and government mismanagement (always a concern).

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On the positive front, the country has a large, hard-working population, solid economic growth, lots of commodities, democratic traditions, good institutions, a free press, and low debt to GDP.

Some believe that the real opportunities in Latin America are outside of Brazil, particularly Mexico (even though it is already 35% above the 2008 highs) with its positive economic reforms, strong government leadership, and low labour costs. The likes of Colombia, Peru, and Chile are also coming on strong.

The Wigmore Association will meet in the US Pacific Northwest in February 2014, and in Singapore in September 2014.

Three Steps to Foster Financial Responsibility in Kids

Barrett Lyons, CPA, CA, CFP

Despite an increasing willingness in our society to talk about pretty much anything, adults often struggle to decide when—or even if—they should have a conversation with their kids (and grandkids) about wealth and exactly what they should say.

But talking about family wealth is a must—and not just once, but regularly. Those conversations will help your kids develop the skills, experience and maturity to handle whatever money they ultimately receive, whether it's a salary, a bonus or an inheritance.

1. Communicate values.

Many parents believe their children will pick up the family's values about money by osmosis, but competing messages, particularly from the media and friends, can send confusing signals. "Television is already teaching kids that the purpose of this life is to be a consumer," says Jon J. Gallo, co-author of Silver Spoon Kids: How to Raise a Responsible Child in an Age of Affluence, "and this may not be the message you want to communicate."

Consider writing down the values you want to establish about money, such as, "Don't spend more than you earn" or "Be sure to set aside a portion of your money for the less fortunate." Remember, however, that children are observant and will pick-up on your habits. If you practice what you preach there is a greater chance they will follow your lead.

Consider taking your family on a trip to the developing world. One family did this with their children when they were younger, to share their passion for helping the poor. Now their 21 year old daughter says these experiences made her more conscious of the needs of other people and positively shaped her world view.

Vanguard Mutual Funds founder and well known investor Jack Bogle suggests: "You have to find the right way to communicate with each child, depending on his or her level of interest, and find a way that feels comfortable for you." The process that he follows for talking to his grandchildren is simply to have a 'brief sit down' at year-end and review the performance of their investment account.

2. Establish financial literacy.

If you plan to leave money to your children, it's important to set them up for success, not failure. They need good financial management skills, so they will be prepared to handle the complexities—both practical and emotional—of wealth. Unfortunately, these skills aren't taught in school, so give them some instruction at home.

For instance, when children receive their allowance or gifts of money, encourage them to divide the funds into three boxes—one for spending, one for saving and one for giving—so they can learn about planning, the value of a dollar and delayed gratification.

As they get older, help them work out a budget or financial plan. It's helpful to give each child an amount of money to manage themselves, so they can learn about investing first-hand. Start investment accounts to save for their college expenses or a home purchase, so they can see the value of putting funds away early and seeing them grow over time. This is a role grandparents can offer to help with.

3. Develop their independence.

While wealth can have a positive impact in a child's life, it can also unnecessarily protect them from hardship and the associated valuable life lessons that challenges bring.

If you give your teenager a monthly allowance and she runs out by the middle of the month, let her feel the pinch for the rest of the month, instead of topping up her fund. Helping kids learn they can't necessarily have their cake and eat it too, is an invaluable life lesson.

Or if your son drops out of university after an unsuccessful first semester, teach him that money doesn't always come easily in life, and insist he pay his own tuition for the first year if he goes back. You can reimburse him the money after he completes the year successfully, if you so choose.

The earlier you start these steps the better. Financial knowledge is one of the best gifts you can give your children.

What's in a Name?

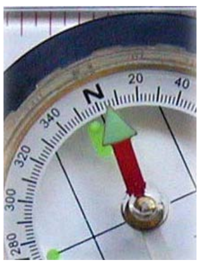
How a name can say a lot about you

Scott Hayman, CPA, CA, CFP, TEP

I find it interesting to know the origin of company names. While it's true they are sometimes just made-up words (like Häagen-Dazs), oftentimes they actually tell you something about the vision of the company (Nike is the name of the Greek goddess of victory), its product and services (Coca-Cola is made from coca leaves and kola nuts), or its key people (Adidas derives from the name of its founder Adolph 'Adi' Dassler).

The name Northwood actually has an interesting origin as well. It is based on the three benefits we want to add to the lives and financial affairs of our client families – direction, perspective and confidence.

Direction. The first part of our name – 'North' – evokes a picture of a compass, with the needle pointing north. Our experience is that if a person knows their 'north point' – in other words, if they have thought through what is most important to them and their family, their principles, their goals, and what they really believe in – they are less likely to get lost on their way there. All other decisions become easier and make more sense when you have truly understood what is 'north' for you. We help our clients do this, and thereby, get *Direction*.



Perspective. The second part of our name evokes a picture of a 'wood' or a forest. Most people's financial lives are made up of a collection of standalone advisors and products, such as tax, investment, insurance, philanthropy, and legal structures, among others. Because these areas are often kept separate, like individual trees in a forest, the clients are often faced with making 'one-off' decisions that don't necessarily fit in with the whole picture. We help our clients avoid missing the proverbial 'forest for the trees', and thereby, gain *Perspective*.

Confidence. A clear understanding of your *Direction* (knowing what 'north' is for you) and a good sense of *Perspective* (not missing the 'forest for the trees'), leads to a sense of *Confidence* – the confidence that you have a sensible plan, you have made the best decisions you can, and things are well looked after.

This is our name and our promise!

New Additions to the Northwood Website

We have made some significant additions to our website. You will be able find the new content under the *Resources* tab at www.northwoodfamilyoffice.com.

Articles of Interest. We have added links to two dozen iconic articles by global experts that will be of interest to wealthy families. Topics include next generation planning, wealth transition, portfolio implementation, manager selection, investment policy, risk management, goals-based investing, succession planning, and family businesses.

***Family Wealth Management* Book.** We now have a link to our new book, *Family Wealth Management: Seven Imperatives for Successful Investing in the New World Order*. You can read the table of contents and a free e-version of the first chapter. There is also a Q&A with the authors and reviews from global wealth management leaders.

NEW VIDEO SERIES

New Videos. We also have a series of videos covering key issues in the *Family Wealth Management* book and the work we do for client families. All videos are 3 minutes or less and cover such topics as: *What Are The Seven Imperatives?*, *Putting The Family Back At The Centre*, *What Is Your Money For?*, *How Should Families Think About Risk?*, *The Role Of An Integrated Advisor*, and *Correcting Lop-sided Perspectives*. If you aren't sure where to start, try this one [*The Role Of An Integrated Advisor*].

We update the website regularly so check back frequently.

NORTHWOOD FAMILY OFFICE

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