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The Northwood PERSPECTIVE

Chairman's Message

Tom McCullough



Welcome to the Summer 2013 edition of the Northwood *Perspective*. This is a special year for us since we are celebrating the 10th anniversary of Northwood Family Office. It has been a remarkably challenging ten years for investors and wealth holders, given the upheaval in the global economic environment and the extreme volatility in capital markets, not to mention the unique issues people have faced within their own families.

The importance of a well-managed, disciplined, integrated approach, firmly grounded in each family's individual goals and objectives has never been greater. Families who have followed this course have not only survived but prospered throughout this period.

And the challenges for wealthy families remain. In my remarks at a recent celebration of our 10th anniversary, I outlined two of the most significant trends facing wealth owning families and how a family office can work with them to mitigate these risks. An article in this newsletter entitled '*Two Trends that will Impact Wealthy Families*' summarizes the key points of the talk.

There continue to be many interesting activities on Northwood's agenda. This spring we once again co-chaired the Canadian Family Office Forum in Cambridge, a private discussion forum for an exclusive group of Ultra High Net Worth families and family offices from across Canada. We also chaired the Canadian Private Family Office Summit in Banff, the 8th annual conference of leading practitioners in the family office/ private wealth space in Canada and around the world. In this issue of the Northwood *Perspective*, we are pleased to continue our annual tradition of summer reading ideas, collected from the speakers at the Banff conference.

The next meeting of the Wigmore Association will be in Rio de Janeiro, Brazil this September. Regular readers of this newsletter will know that the Wigmore Association is a group of seven family offices from around the world (US, UK, Germany, Australia, Brazil and Canada) that meets twice a year to share investment views, asset mix forecasts, investment manager research, and other ideas that benefit our clients.

And finally, Northwood is pleased to announce the upcoming publication of a new book. It is entitled *Family Wealth Management: 7 Imperatives for Successful Investing in the New World Order*. It is co-authored by Mark Haynes Daniell (a five-time author on private wealth and family financial issues) and myself. It is published by J.W. Wiley & Sons and will be available in stores and on Amazon (and other online booksellers) in Autumn 2013.

Have a great summer.

This Time Economists *Really* Don't Know

Eric Weir, CFA, CFP



What to do when we don't know

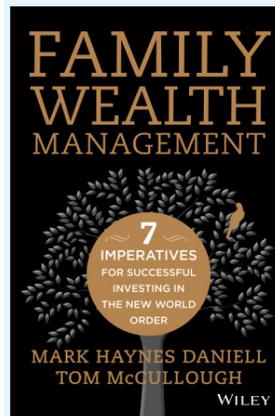
Over the last quarter, we've had the opportunity to attend some excellent conferences with top-notch speakers. We've listened to former finance ministers, bank economists, market strategists and even a few individuals who have the ear of European Central bankers. Typically, these sorts of individuals confidently make economic predictions, and stock market calls. However, recently, we've noticed a slight change in tone. We're in uncharted waters some might say, and many prognosticators seem to have lost some of their confidence. Instead of the usual conviction we are hearing a lot more 'could's', 'ifs' and 'maybes'.

It turns out that we are not alone in our observations. The following quote from *The Big Picture* colourfully illustrates what participants experienced at a recent large investment conference: "And after three straight days of very smart, well-groomed people regurgitating all of the clever, contradictory things they'd read in research reports and newsletters, I can only assume that the audience was utterly befuddled. So many articulate speakers, so many viewpoints, so many headwinds and risk factors and silver linings and unknowns and known unknowns....a complete overload, almost none of it particularly original or utilitarian. James Montier, as brilliant as anyone there, did an entire talk about why investors should do nothing right now – literally, he was lecturing on the virtues of inaction and quoting directly from the Tao of Pooh."

This new-found lack of confidence in economic predictions might indicate a more confusing landscape. Or it might just be indicative of the already poor record of forecasters. The chart on the next page shows the historical record of economists' predictions, which you will note has been a futile exercise over the past 40 years.

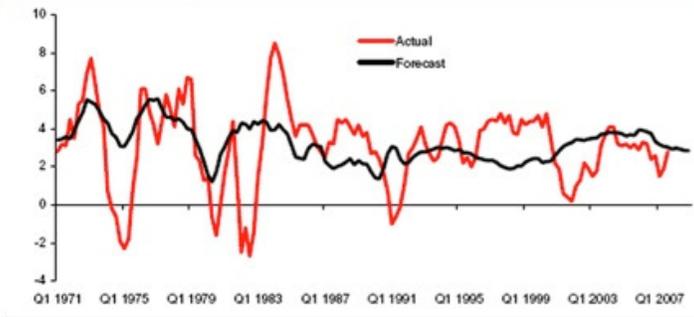
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Coming Autumn 2013



"The successful management of family wealth has always been a challenge, even in the best of times. And it has become even more difficult in this new world order where income and capital growth are hard to generate, where the old rules of the game no longer provide reliable guidelines, and the careful balance of both family and financial considerations is more important than ever. Authors Mark Haynes Daniell and Tom McCullough bring to life their many years of experience in advising wealthy private families in this new book, to be published by J.W. Wiley & Sons in Autumn 2013."

Economists have never predicted recessions (US GDP YoY %)



Source: SG Equity Research

Source: Mauldin Economics

Economists are excellent at telling us what happened and why after the fact, but gazing into their crystal ball has, in general, been a pointless exercise. But we do wonder if there is something we can glean from their change to a less confident tone? Should we be taking notice? We think yes. Economists of this century are finding themselves at a loss to explain where we will head using their typical methods of analyzing the variables in an economy. A few of the major forecasting issues economists need to contend with are in uncharted territory:

- The world economy has become integrated to a degree we've never seen before.
- Since the gold standard was eliminated, total credit in the economy has expanded dramatically and we now live with total levels of credit never seen before in modern economic history.
- Financial engineering through derivatives markets has created a secondary investment market that by many measures is staggeringly large.
- We are in the middle of a technology and digital revolution, the long term impacts of which remain to be seen.
- Aging populations will continue to grow and the impacts will have ripples through all aspects of the economy. Japan has been one of the first countries to experience this.

When we look through these variables, we see some challenges and some opportunities but overall it remains very difficult to predict where the economy will be in the future, and the path it will take to get there. The one

thing we do recognize is that overall there is more potential for significant risk in economies based on many of the changes that have occurred.

What do we know?

Although we put very little confidence in economic predictions, there are some general themes in the markets that we believe investors should be mindful of when making allocation decisions. A few examples that we see today:

- Opportunities to invest in corporations via debt or equity are much more attractive on a relative basis when compared to government debt. There is an imbalance between corporations and governments in the developed world. Many governments are struggling under massive debt levels while corporations post record profits and dividends grow.
- The foregone premium for reducing risk and maintaining liquidity is extremely high. For many investors, managing an investment portfolio has moved from the management of return, to the management of risks. Many investors have shifted their focus simply to Return of Capital vs. Return on Capital.
- While bonds have traditionally been a place of safety, long interest rates are at historical lows, and potential for capital losses is significant if rates begin to rise significantly. In some portfolios, bonds can be regarded as 'risky' assets.
- Investors must broaden their approach to look beyond the traditional markets for efficient ways to access a source of growth. Although still called 'emerging', many emerging market countries have surpassed developed markets in the opportunities for investing, particularly as market values have declined.
- The traditional asset classes of stocks and bonds have had to make room for new options for investors to take advantage of such as real estate, infrastructure, and private equity.

In our view, the future remains impossible to predict but a well balanced strategy that takes advantage of the major themes at play is the best solution for private investors. We continue to be conscious of the risk levels in our modern economy, but we remain focused on family goals and building long term investment strategies built on the investment themes laid out above. 🌲

2013 STEP Conference Update

Barrett Lyons, CPA, CA, CFP

On June 10th and 11th, Northwood attended the 15th annual Society of Estate and Trust Practitioner ('STEP') Canada National Conference. This annual event is attended by lawyers, accountants, planners, and advisors from across the country to share and discuss ideas, trends, updates, and current issues in the estate and trust fields. There were numerous sessions and topics covered at the conference. Below we have highlighted a couple of the key trends and technical updates:

Key Trends:

- Governments around the world are focusing on raising tax revenues given the current debt environment. Loopholes are closing, tax rates are increasing, and the lines between tax evasion, avoidance, and minimization (e.g. corporate offshore taxation) are being blurred. The need for increased revenues is driving greater information exchange between countries and amnesty programs are becoming less generous.

- Bank secrecy is waning due to the US FATCA provisions and citizens are being 'bludgeoned' into conformity. Other governments are starting their own FATCA style programs to drive tax revenues. The resulting impact to traditional financial centres in the world such as Switzerland, Luxembourg, and the Caribbean remains to be seen.

Key Canadian Technical Updates:

- *Update on government review of exempt insurance policy test.* The government proposes to reduce the amount of accumulating tax-free income growth in a policy. Stakeholders are in consultation with the government and draft legislation is expected in 2016. It is expected that policies issued before then would be grandfathered.
- *Update on the government review of testamentary trust taxation.* The government proposes to eliminate the graduated rates available on the taxation of trusts resulting from wills and tax them at the top marginal rate. These measures would apply to existing and new arrangements for 2016 and beyond. 🌲

Two Trends That Will Impact Wealthy Families

Tom McCullough, MBA, CIM, CSWP, CFBA

The environment facing wealthy families is changing rapidly. It is important for families and their advisors to be aware of these key trends and their potential impact. While there are many important issues on the horizon, I will just focus on two.

1. Increasing Risk and Complexity

The degree of risk and complexity families face is unprecedented. It is becoming ever more difficult to sort through all the clutter, make good decisions and keep on top of changes.

The current global economic landscape (including government debt, market volatility and low returns on safe assets) can be a minefield for investors. On top of that, the world is now so interconnected and hyper-correlated that when something goes wrong, it seems like there is no longer anywhere to hide. Speaking at the annual meeting of the Davos World Economic Forum in 2007, former British PM Tony Blair said that ‘interdependency’ is the defining element of the 21st century.

While interdependency has many positive features, there are also significant risks, as *local* issues can quickly become *global* issues. Who could have imagined a volcano in Iceland that shuts down North Atlantic air travel, a debt crisis in southern Europe that rattles world markets, and a building collapse in Bangladesh that resonates to North American clothing retailers?

Risk and complexity are also evident in the dizzying range of investment choices available to families – 8,000 hedge funds, 5,000 ETFs and countless other investment managers and products. How is an investor to effectively sort their way through this jungle? One of the steps we have taken is the formation of a global alliance of seven family offices from US, UK, Germany, Australia, Brazil and Canada (called the Wigmore Association) to share and evaluate global investment manager research.

There is also a myriad of other related factors families face such as tax issues, legal issues, multi-jurisdictional differences, family relationship factors, and structure issues that must be taken into account. And, of course, all of these issues are also interconnected. For instance, the decisions families make about investments can affect taxes, decisions about estate planning can affect asset allocation, and marriage choices can impact family financial structures.

Then there is the job of keeping track of all this. We have calculated that the average wealthy family with the normal level of advisory relationships (banks, brokers, money managers, insurance) and typical number of entities (husband, wife, children, trusts, holdcos, registered accounts, tax-free savings accounts, foundations) can easily receive over 300 statements, renewals and reports a year. At a conservative average of 3-4 pages each, that’s over 1,000 pieces of paper a year to keep on top of.

To help with the management of this tsunami of information, choice and convulsion, one of the key roles a family office plays is that of ‘complexity manager’. We believe that the need for this role will only increase in the future. A trusted family office will become even more crucial as complexity continues and time pressures on families mount.

2. The Interconnection of Family and Finance

The second key trend is the growing importance of the link between family and finance.

I believe that, over the years, the financial industry lost its way. It has become overly focused on selling a product and on its own bottom line, not the family and their needs. I am, however, hopeful that there is some improvement on the way. The rise of a ‘goals-based’ approach to investing over the past five years has started to have a positive impact and is putting families back in the centre of family wealth management where they have always belonged.

As many of you know, I am an adjunct professor at the Rotman School of Management at the University of Toronto where I teach an MBA course called the ‘*Management of Private Wealth*’. This involvement has helped us hone our skills, test our theories, and stay on the leading edge of (and contribute to) the most advanced thinking in the management of the investments and financial affairs of wealthy families and foundations, particularly in reconnecting investment management and family goals.

But there is something else very significant about to happen that will further connect family and finance. There is a massive wealth transition pending. Even though it has already begun with the transfer of businesses and wealth to Baby Boomers from their parents, it still hasn’t really started in earnest yet. The largest share of global wealth is held by Boomers who are now starting to turn 65 and are grudgingly willing to admit that they are not immortal. Businesses will finally have to be sold or transitioned and wealth will have to be distributed to children or charities and this will happen over the next 20 years.

This fact has spawned all sorts of family-related activities:

- Parents are rewriting wills
- They are wondering about what ages their children should receive assets
- They are worried about whether their children have the financial skills to manage significant wealth
- They are worried about the impact the money may have on their children’s motivation and choices
- They wonder if the money should skip a generation
- They want to know what other families are doing and what the best practices are

Family leaders are also starting to think about the real legacy they are going to leave; not just money, but values. This has spawned an increased desire for family meetings and improved family communication.

Another factor is the evolution of the modern family itself. Family breakdown is now common and an increasing number of families are becoming multi-jurisdictional (as children move and marry). These and other developments in the family system can add financial, legal and relational issues to the management of families and wealth.

The statistics tell us that most family wealth doesn’t make the transition from generation to generation very well, and the highest likelihood of ‘the baton being dropped’ is at the moment it is passed from one runner to the next. That is why the expression ‘shirtsleeves to shirtsleeves in three generations’ is so common in every culture. Most wealth is dissipated or lost in the transitions. But it doesn’t have to be this way.

Continued

There are steps that wealthy families can take to mitigate the effects and protect their wealth. Our soon-to-be-released book, *Family Wealth Management: 7 Imperatives of Successful Investing in the New World Order* (co-authored with five-time author and family wealth expert Mark Haynes Daniell), suggests seven things that families can do to ensure they manage and transition their wealth effectively given the complications and challenges of the current environment and the unique goals and desires of their own family.

These two trends – rising risk and complexity, and a need for closer connection between the issues of family and finance – both argue strongly for the central role of a family office in the lives of wealthy families. More than ever, families need advisors who can help them manage their way through these challenges. Advisors will have to stay true to core principles, but also be vigilant and adaptable, as change is constant and there are surprises around every corner. 

Working Effectively with Your Accounting Firm

Barrett Lyons, CPA, CA, CFP



At Northwood, we regularly work with our clients' accountants to complete the family's various tax and accounting needs. Our role is to co-ordinate with the accounting firm to ensure our clients have taken advantage of the tax savings opportunities that are available and appropriate for them, to ensure the details of their financial lives are reported accurately, and to reduce the risk of tax exposure to the family.

An independent qualified accounting firm plays a vital role in a family's financial life, and for those families that don't use a family office, below are some things to consider when working with your family's accounting firm:

- **Share all the details of your financial life** - Many firms are only working in one 'silo' of a family's financial life and are not involved in the others (i.e. investing, legal, philanthropy, etc.). Not knowing the details of these other silos limits their ability to spot opportunities and be proactive. It may not be until a significant life change or tax issue arises that an opportunity is uncovered, but engaging the firm in the entire picture of your financial life will aid in identifying opportunities and limit exposure ahead of time.
- **Scope and fees** – The expectation of fees and the level of service you are receiving should be clear on both sides. If your fees only cover tax return preparation then you can't expect tax planning advice. The scope of the work should be clearly documented in the engagement letter along with fees. If you are engaged for planning advice ensure that you review your overall plan at least annually (see next point below) and that any life changes and/or budget changes have been reflected in your plan if applicable. Be up-front and ask your accountant each year if you are maximizing the tax planning opportunities available to you and let them know that you expect them to communicate any that become available. This will prompt them to be more engaged with your family's overall financial plan, but of course will also become part of your fee.
- **Meet at least annually** – Depending on your relationship and the magnitude of the work that is being completed, you may not have had an extensive conversation with your accountant since your initial engagement. Taking the time to sit down with them will allow the firm to get to know you, your family, and your overall financial situation better, which will provide them with the requisite facts and information to identify opportunities that may be available to your family. The

workflow at traditional accounting firms can be extremely 'lumpy' in terms of volume due to deadlines. So if your accountant does not have time to sit down with you during their busy season because they are saddled with tax returns, ensure you set a separate time to review your file in its entirety, and have an in-depth discussion.

- **Take an active interest** – If your relationship is such that the only communication you have with your accountant is sending them your tax return information in a shoebox each year, then it is difficult to put the onus on them for making sure all planning opportunities have been considered. They will simply take the information provided and compile tax returns without contemplating the bigger picture. If this is the case for your family, it will be prudent for you to be more engaged in the details of your planning to ensure that all the bases are covered. This may involve some education, but if you come across any planning ideas that you think could benefit your family and are unsure, ask your accountant if they make sense for your situation.
- **Match your needs with your accountant's level of service** – Occasionally we find that High Net Worth families have outgrown their existing accountants as their complexity and wealth has expanded considerably. Their accountant may have been with the family since they started their business or was a friend from school days that served their purpose at that time but not in the current state. With wealth comes greater complexity and the family may be better served by a different firm that has a greater breadth of knowledge and experience, rather than a 'one man show'. On the other hand, if you are at one of the 'big four' firms you will be paying significant fees. If you don't require this magnitude of expertise you may be better served with a mid-sized or small firm. Finding the right fit is important.

As with any other advisor relationship, open, honest and frequent communication is essential to a good working relationship and in most cases will cover off all of the items mentioned above. However, if your situation is too complex or time consuming for you to manage personally you may consider a family office to work with your accountant and other advisors on your behalf. 

Summer Reading List

Scott Hayman, CPA, CA, CFP, TEP



Here, once again, is our Annual Summer Reading List, a popular feature in the Northwood *Perspective*. Each year in June, we chair the Canadian Private Family Office Summit in Banff, Alberta. We ask each of the speakers to share their favorite book ideas and then we publish the list in the Northwood *Perspective*, just in time for summer. Enjoy!



Private Wealth Issues

- Raising Financially Fit Kids, *Joline Godfrey*
- The Millionaire Next Door, *Thomas J. Stanley and William D. Danko*
- Navigating the Dark Side of Wealth: A Life Guide for Inheritors, *Thayer Cheatham Willis*
- The Future of You, *The Legacy Wealth Coach Network*

Self-Development

- Change Your Questions, Change Your Life: 10 Powerful Tools for Life and Work, *Dr. Marilee Adams*
- The Way Of Transition: Embracing Life's Most Difficult Moments, *Williams Bridges*
- The 4 Disciplines of Execution: Achieving Your Wildly Important Goals, *Sean Covey, Chris McChesney, and Jim Huling*
- Conscious Living: Finding Joy in the Real World, *Gay Hendricks*
- Unconditional Parenting: Moving from Rewards and Punishment to Love and Reason, *Alfie Kohn*
- Fierce Conversations: Achieving Success at Work and in Life One Conversation at a Time, *Susan Scott*
- How to Say It to Seniors: Closing the Communication Gap with Our Elders, *David Solie*

Biography/History

- The Sleepwalkers: How Europe Went To War In 1914, *Chris Clark*
- Guns, Germs, and Steel: The Fates of Human Societies, *Jared Diamond*
- The Year of Magical Thinking, *Joan Didion*
- Civilization: The West and the Rest, *Niall Ferguson*

- Man's Search for Meaning, *Viktor E. Frankl*
- Unbroken: A World War II Story of Survival, Resilience, and Redemption, *Laura Hillenbrand*
- Seven Deadly Sins: My Pursuit of Lance Armstrong, *David Walsh*

Psychology

- Moonwalking with Einstein: The Art and Science of Remembering Everything, *Joshua Foer*
- Drive: The Surprising Truth About What Motivates Us, *Daniel H. Pink*
- The Visual Display of Quantitative Information, *Edward R. Tufte*

Economics/Investments

- Lords of Finance: The Bankers Who Broke the World, *Liaquat Ahamed*
- Business Stripped Bare: Adventures of a Global Entrepreneur, *Richard Branson*
- Great By Choice: Uncertainty, Chaos, and Luck—Why Some Thrive Despite Them All, *Jim Collins and Morten T. Hansen*
- Good To Great: Why Some Companies Make the Leap...And Others Don't, *Jim Collins*
- This Time Is Different: Eight Centuries of Financial Folly, *Carmen M. Reinhart and Kenneth Rogoff*

Fiction

- The Mission Song, *John le Carré*
- The Sisters Brothers, *Patrick Dewitt*
- Bleak House, *Charles Dickens*
- The Burn Palace, *Stephen Dobyns*
- Still Alice, *Lisa Genova*
- The Plot Against America, *Philip Roth*
- The Ultimate Gift, *Jim Stovall* 🌲



For more information, please call Tom McCullough or Scott Hayman at

Main: (416) 502-1245
www.northwoodfamilyoffice.com

Email: tmccullough@northwoodfamilyoffice.com
shayman@northwoodfamilyoffice.com

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