

The Northwood Perspective

Control What You Can, Conservatively Estimate the Rest



Northwood Family Office is Canada's leading independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for wealthy Canadian and global families.



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Managing Aspects of a Wealth Plan

Investors face a world full of unknowns, which can play havoc with our plans and aspirations. Investment returns are unknown, future trends in inflation are uncertain, correlation among asset classes is a moving target, and the level of market volatility is, well, volatile. Interestingly enough, the investment industry spends most of its time focused on forecasting the above economic factors, despite substantial evidence that it is almost impossible to do so accurately or consistently.

"Investors are hopeless at forecasting, yet it may be at the heart of their investment process."

-James Montier, Grantham Mayer Otterloo

Obviously some investments can be forecasted more accurately. A five year bond portfolio is more predictable than a basket of equities, and dividends are more predictable than the associated capital gains. It doesn't mean that investors should not have expectations for their investments. It's just that markets are notably fickle in terms of when and how the returns will be delivered. And if the timing of the returns doesn't match up with the timing of the family's spending needs, there may be a problem. We can look to the current market for a gauge on relative metrics and compare them to historical levels to give an indication of where we might be in the current market, but, as many know, past performance is not an indicator of future returns.

Given this backdrop, what is an investor to do to help manage the elements of a wealth plan? Find the items that are *controllable* and manage them well.

Elements of Control

So, what things can be predicted or controlled?

Taxes

Every dollar saved in taxes goes into the pocket of the investor. In that way it is a 'certain' additional return with no added risk. There are a number of ways to save taxes depending on the family's jurisdiction and tax regime, including income splitting, trust and other tax structuring, deferral of taxable gains, and tax-effective investment products.

Investment costs

Similar to taxes, every dollar saved in costs also goes into the pocket of the investor. It pays to minimize these investment costs wherever it makes sense. Costs can include investment management fees, trading, custodial and advisory costs and transaction fees.

In a low return environment, the current fixed income market for instance, exercising control of these two factors in particular – taxes and costs – can have a significant impact on the net investment return available to the family.

Personal expense control

While not always easy, some components of family expenses can in fact be controlled. Some expenses are discretionary and other expenses can be cut back. In some cases, assets (like homes or other personal use assets) that require ongoing spending can be sold.

Personal budgeting

At the very least, future family expenses can be predicted. Having a reasonable idea of what those expenses are likely to be and how much investment return will be required to fund them is one of the most important factors in planning and portfolio management. It allows the investor to target a return (and the attendant risk) that is reasonable and appropriate to meet their needs, and can prevent investors from 'reaching for extra' return at the worst possible time.

"More money has been lost reaching for yield than at the point of a gun."

-Raymond DeVoe, Jr.

Personal decisions

When you think about it, there are actually quite a few other things you can control. You can decide how much longer you will work (and receive income), which can be very significant for large income earners. You can decide when you sell (or don't sell) the family business. You can decide to take money off the table in good times to cover the inevitable bad periods. And you can decide how much future flexibility you want to gain by reducing debt.

Investment strategies

There are also investment decisions you can control that will affect the outcome in your portfolio. You can decide to buy investments at a discount to their true value to provide you with a certain margin of safety when markets decline. You can decide to reinvest your dividends or allow your interest to compound (i.e. not withdrawing the funds). And you can rebalance your portfolio by buying more of an asset class when it declines. In addition, if you have the financial capacity and ability to withstand volatility, you can buy less-liquid or higher-risk assets that normally have to pay investors a premium to own them.

Build a comprehensive plan

Knowing and documenting what your family's goals are and establishing a long-term plan to achieve them that considers the impact of each of the items discussed, and also considers worst case investment scenarios, can help investors exercise control over their emotions and provide comfort in turbulent markets. An investment policy statement can also provide much-needed self-discipline to help save the portfolio from the effects of rash and unwise reactions.

Conservatively Manage the Unpredictable

As for the things you can't control, like investments returns, the wise risk management route is to use conservative estimates in your planning models. Positive surprises are rarely a problem, whereas negative surprises can play havoc with family plans.

The investment industry spends a lot of time trying to forecast things that really can't be predicted. For investors looking for a more sensible and predictable financial life, it is wiser to focus on the elements you can predict or control, and use conservative estimates for the ones you can't.

Northwood Family Office

Northwood Family Office is Canada's leading independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for wealthy Canadian and global families. Northwood also serves as a Chief Investment Officer (CIO) for client families, helping them assess their objectives, design an appropriate investment policy, select and manage investment managers and provide comprehensive reporting.

Northwood client families typically have \$10 million or more in family net worth.



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