Chairman’s Message: Solving the Hassle Map
Tom McCullough

The last few months have been a busy time for me and for Northwood. In the last two months, I have been to Shanghai, Rwanda and London on a mix of work and personal travel.

First, I thought I would mention Rwanda; since it is not a typical destination. As many of you know, my wife Karen has been involved in education work in that country for over ten years. She currently works with a charity that is helping to reform and improve education - including reducing dropout rates (particularly for girls), improving learner-centred vs. rote teaching, boosting skills training for teachers, and eliminating physical punishment (which is still common). I went with her this year to see the inspiring progress in the schools in rural Western Rwanda.

This was part of a bigger trip that had me in three continents in as many weeks – Africa, Asia and Europe. Because of some unfortunate last minute cancelled flights and a substantially delayed departure in Rwanda, there was also a brief layover in Istanbul, where I was (just barely) able to make my connection, but my luggage did not! I had a series of important meetings in Shanghai the next day with people who were flying in from other provinces around China, so I had to get there and look presentable.

As many of you know, lost luggage is a royal pain. It meant filling out innumerable forms to identify the bags, buying replacement clothes in (the not-inexpensive) Heathrow airport, spending hours on the phone trying to locate my luggage once it eventually arrived in Shanghai, and spending yet more hours trying to get the proffered compensation from Turkish Airlines (#*@!%) for the expenses I incurred. After weeks of effort, and dozens of conversations, they offered me a paltry $150. Argh!

All of this made me think of ‘hassle maps’.

So, what is a hassle map? It is the combination of problems and frustrations consumers experience when they use a product or service. The ‘hassle map’ idea comes from Adrian Slywotzky in his book, Demand: Creating What People Love Before They Know They Want It. I heard him speak at the Rotman School of Management a few years ago and have since read his book. In it, he cites examples of companies and products that have not only reduced consumer frustration with existing solutions, but also turned users into enthusiastic fans -- iPad, Nespresso, Kindle, ZipCar, the Eurostar train (that runs under the English Channel) and Wegman’s (a U.S. grocery store) -- just to mention a few.

This concept also has application in the financial and investment field. Since reading Slywotzky’s book, I have been asking people to describe their own financial hassle map. In one such interaction with an affluent entrepreneur (and a prospective client at the time), I heard a pretty typical list of things that drive people crazy about how their personal financial affairs are (or maybe aren’t) managed.

Here’s what he said: “I have no effective ‘bring forward’ system to make sure important tasks get done, and this weighs me down. My cash management is poor and I often find myself with large chunks of cash in various random accounts. And because I have multiple accounts, when I need cash or want to reduce an investment holding, I don’t know which position to sell. I need monthly bookkeeping. I am overwhelmed with the paper associated with numerous investment and banking accounts, with no overall summary. I am behind on my corporate tax returns. My will is out of date. My mother’s affairs need attention. I also know that if something happened to me, things would be left in a bit of a mess. I find it all quite frustrating and unsettling and I’m sure I am wasting money. I would like to have my personal affairs run properly, like a business. But I can’t do it myself.”

As a family office, we specialize in solving people’s hassle maps and making their lives easier. Everyone’s hassle map is different, depending on their personality and financial circumstances. But the common element in a proper financial management solution – with no hassles - is almost always clear goals, an integrated plan and proactive expert management, just like how you would run a business. Imagine!

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The Northwood
PERSPECTIVE
Northwood’s 15th Anniversary - Direction, Perspective and Confidence

Scott Hayman, CPA, CA, CFP, TEP

This year we are celebrating Northwood’s 15th anniversary. We started in 2003 with a three-word vision for what we wanted to deliver to our client families - Direction, Perspective and Confidence - and that is still true today.

**Direction** involves helping each family figure out what their goals are, where they want to go, what do they really want to do, and what is ‘north’ for them. A deep discovery process at the beginning of the relationship (and ongoing discovery throughout the relationship) helps create a solid foundation for all other decisions to come. Clients draw on our expertise and experience to help them chart a good course for their families.

**Perspective** puts everything in the proper context and allows for easier and better decision-making. Instead of being bombarded with all of the individual one-off choices of unconnected investments, products, and advisors, our integrated and objective approach puts all of the decisions on the same page and helps families make good choices and avoid ‘missing the forest for the trees’. Our broad expertise and experience in family and financial matters are valuable resources for our families.

And the result of a clear sense of their own direction (‘North’) and being able to objectively see the whole forest (or ‘wood’), provides an important sense of trust and confidence. **Confidence** that clients are headed the right way, they are making sound decisions, and they have someone experienced and objective with them on the journey, who is looking out for their interests.

It’s a better way to travel, and it has been our privilege to have walked this path with families for 15 years.

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**Rotman Family Wealth Management Program IV Successfully Completed**

For the fourth consecutive year, the University of Toronto offered the Rotman Family Wealth Management Program. The 4-day intensive program was held in Toronto from April 12th to 15th, and coincided with a very unseasonable ice storm!

Despite the weather, the 18 participants enjoyed the classroom portion of the program, and the many opportunities to get to know and learn from other attendees in similar circumstances. Tom McCullough and other wealth management leaders will teach the next edition of the program in May 2019.

For more details on the course (including registration information) please visit: [http://tinyurl.com/od5kr7s](http://tinyurl.com/od5kr7s)

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**New Book: Wealth of Wisdom**

We are pleased to announce that Tom McCullough’s second book will be published later this year. The book is entitled, *Wealth of Wisdom: 50 Questions Wealthy Families Ask and Answers from the World’s Top Family Wealth Experts*. The book was co-authored by Tom and Keith Whitaker and is published by John Wiley and Sons. Keith is the President of Wise Counsel Research, and like Tom, he has spent decades working with families of wealth.

The idea behind the book is to identify 50 questions that virtually every family of wealth asks themselves, and then provide answers from some of the foremost thinkers in the world on these subjects. Some of these questions include:

- How much money should we leave to our children and when?
- What is the most useful definition of ‘risk’ for family investors?
- How can you prepare for longevity and mental incapacity among family members?
- How do you manage conflict in your family?
- What rate of return should you expect on your investment assets?

The book features chapter length essays from leading family wealth experts including Howard Marks, Jean Brunel, Christopher Brightman, Jim Grubman, Jay Hughes, John Davis, Meir Statman and many more.

*Wealth of Wisdom* will be available for sale in the fourth quarter of 2018.
Investing 101 – Risk-Free Return
Claire Hunt, CFA, MBA

This is the first installment of a series that will explore a number of finance and investment concepts in both theory and in practice.

Let’s assume a hypothetical situation where you have a particular sum of money which you don’t immediately need, suppose $1 million, and you are offered a choice between two options:

1) Give up your $1M in exchange for the identical sum of money (with absolutely no risk) exactly one year from today; or
2) Simply hold on to your $1M.

Which option would you prefer?

A rational individual would obviously prefer Option 2. Why would anyone lock up their assets, even with no risk, without being compensated for doing so?

The rational preference for assets in the present vs. identical assets in the future is the foundation of what economists call “time preference”. The amount of compensation (usually in the form of an interest rate) required to incent people to temporarily part with their capital is known as the “time value of money”.

Back to our scenario… let’s introduce another option,

3) Give up your $1M in exchange for $1.1M (with absolutely no risk) exactly one year from today.

That would represent a 10% annual rate of return on your money, in exchange for taking no risk. In the current environment, it’s likely that a rational individual would prefer Option 3 over the other two options. If that’s the case, we could conclude that, at least in the current environment, investors would demand an interest rate somewhere between 0% and 10% on a risk-free investment.

Economists and financial analysts call this the “risk-free rate” or “Rf”. Open any finance textbook to any random formula, and there’s a good chance that it makes reference to a “risk-free” interest rate. This concept is foundational to nearly all of finance. After all, if we’re evaluating whether a certain expected return adequately compensates investors for the risks they’re going to bear, then we should first have some sense of what return they should expect without any risk.

Enough theory… let’s test this out in practice. What exactly is a “risk-free” asset in the real world, and what return does it earn?

Depositing money with a bank can currently earn around 1.35% per annum in a high interest savings account (HISA) but this isn’t really risk free. Amounts over $100,000 aren’t eligible for CDIC (Canada Deposit Insurance Corporation) deposit insurance protection, so in the unlikely event of the bank failing, all of your money might not be repaid. The default risk of a bank is extremely low, but it can’t be ignored.

If you’re not comfortable accepting bank credit risk without the CDIC backstop, you could lend your money directly to the Government of Canada by purchasing a 1-month Treasury bill that currently yields 1.11% annualized, and is fully guaranteed.

The likelihood of the government failing to repay its loans is almost nonexistent, but that’s not because our federal government is more solvent than our banks. On the contrary, as of fiscal year 2017, the federal government’s liabilities ($1.097 trillion) exceed its assets ($465.5 billion) by around $632 billion.

Fortunately, the government’s ability to repay its loans doesn’t rely on its balance sheet. It comes from two advantages that the banks will never have: (1) the ability to collect tax dollars, via the Canada Revenue Agency, and (2) the ability to issue a virtually unlimited number of Canadian dollars, via the Bank of Canada. Unfortunately, issuing new currency puts additional money into circulation, which is generally inflationary.

So while the Government of Canada’s ability to print Canadian dollars makes it a virtual certainty that it will repay the dollar amount of your loan, those dollars may be worth less in the future than they were when you made the loan. The uncertainty surrounding the future purchasing power of your dollars is “inflation risk”, and it can turn your expected risk-free nominal return into a real loss of purchasing power.

In the real world, unlike the world of economic theories or finance textbooks, there is no such thing as an absolutely risk-free asset. So in practice, what are financial analysts to do? We still need an Rf input if we’re going to use our favourite formulas.

By convention, we use the market yield on highly-liquid government securities as a practical estimate of the “risk-free” rate. It’s not perfectly risk-free, as it still includes inflation risk, but it’s about the closest thing to a riskless asset that is traded in sufficient volume to serve as a meaningful market indicator.

So the best answer we can give to the question of “What return can I get with zero risk?” is this:

“While nothing’s entirely risk free, you’ll earn a little better than 1% annualized holding a government bond. Unfortunately that isn’t even likely to cover inflation, especially after tax”.

Conclusion… even if you want to just retain your purchasing power, you’ll have to accept some risk. ☹️
The Wigmore Association is a group of eight leading family offices from around the world, of which Northwood is a founding member. Wigmore’s Chief Investment Officers (CIOs) held their Spring 2018 meeting in Shanghai on March 14 & 15.

This edition of the Wigmore CIOs meeting saw the group welcome a variety of guest speakers: a chief economist, a former Ambassador to China, a technology analyst, and the head of a major global consumer company’s Chinese operations. We also met with a number of representatives from Chinese investment firms covering a variety of asset classes. Our meeting concluded with a visit to one of China’s largest and fastest-growing wealth management firms.

Key Learnings

- The Chinese consumer appears to have whole-heartedly embraced Deng Xiaoping’s famous (and likely misquoted) slogan “To get rich is glorious”. If Chairman Mao was alive today, he would probably be dismayed to see Shanghai’s streets filled with Porsches and BMWs driving past billboards advertising Rolex and Louis Vuitton.

- While there may be legitimate concerns about the transparency of China’s state-owned enterprises (SOEs) and the health of the banking sector, the country’s private sector economy is vibrant and dynamic. The pace of innovation, entrepreneurship, and business growth is difficult for foreigners to appreciate. It was remarked that what gets done in a single year in China would require something like seven years to achieve in other parts of the developed world.

- The Chinese investment markets are still in the early stages of their development, and remain highly speculative at present. Investors have a staggering risk appetite, and they have return expectations to match. If it doesn't promise 20% returns, investors aren't interested. "Getting rich" still takes priority over "staying rich".

- Private investments are almost exclusively venture and growth stage companies. Once a rarity, the Chinese landscape is now densely populated with "Unicorns" (private start-up companies valued at over $1 billion). Investors boast about how many unicorns they are invested in.

- The retail investing public still seems to view the stock market as a casino, leading to repeated bubbles and panics. Investment managers who employ a fundamental approach can generate impressive excess returns (alpha), but their portfolios inevitably come with a big serving of market risk (beta). We met with one such manager who had generated a 26% annualized return since 2004 but still lost nearly 65% in the 2007-08 crisis.

- Securities Market Regulators have been inconsistent and heavy-handed with their interventions. When the 2016 stock market bubble began to burst, regulators reacted by banning short selling, and declared that all short positions had to be immediately covered. Some listed stocks were halted entirely, but only for a period not to exceed 36 months. And for some reason, investors collectively shrugged and carried on trading the remaining listings.

Investment Outlook

While the economy is booming and it may appear that there’s nothing holding back China’s relentless growth, there are a few significant risks.

- While the government has tightly regulated the official banking sector, banks and risky borrowers have turned to opaque “off-balance-sheet assets” (also know as the “shadow banking system”). The Financial Stability Board estimates there is $7 trillion in Chinese shadow banking debt, but nobody truly knows how much off-balance sheet debt is outstanding. It could potentially pose systemic risk to the stability of the financial system in China and beyond.

- China’s new economy companies, being quite dynamic and mostly equity funded, may be resilient enough to endure a financial crisis, however, the old economy companies (which include banks, SOEs and the majority of China’s largest listed industrial stocks) are still centrally-planned, distinctly bureaucratic, and their true balance sheets can be a mystery. These state-controlled companies could be at risk in a crisis, especially because the interests of their foreign shareholders may not be their highest priority.

- Most importantly, it doesn’t appear that China really has any need for foreign capital. There is an over-abundance of domestic wealth, and wealthy Chinese are eager to move their money out of China (which has become difficult since the government initiated a US$50,000 annual limit on capital transfers out of the country). Foreign investors may want to be careful in a market where some domestic investors are looking to get out.

Despite the strong economy and growth prospects, because of the above risks, it is wise to take a cautious approach to direct or public market investments in China. If you decide to venture into investing in China, the goal is to find investment managers who possess the necessary expertise to safely navigate the hidden dangers of the Chinese financial markets, along with the edge to generate reliable returns with reasonable risk levels.
Northwood Staff Profile – Barrett Lyons

Barrett Lyons, CPA, CA, CFP, CIM

In this quarterly feature, we help our readers to get to know some of the people who work at Northwood Family Office. This quarter we interview Barrett Lyons, who has been on the client service team at Northwood since 2010.

1. What do you do at Northwood Family Office?

My role at Northwood is as a client advisor and I am responsible for a number of families and foundations. My original designation is a CPA (Chartered Professional Accountant), and I also have a CIM (Chartered Investment Manager), and a CFP (Chartered Financial Planner) to help round out my planning and investment knowledge base. I am also registered with various provincial securities commissions as a Portfolio Manager. Internally, I head up the management of client accounting and tax needs, and help build Northwood’s relationships with the various professional firms that our clients require.

After being with the firm for eight years now, I’m slowly growing some grey hair and have been lucky enough to accumulate some valuable experience working with great client families and foundations.

2. What did you do before you joined Northwood?

I joined KPMG after completing my undergrad at McMaster University. While there, I put in the time to complete the required audit hours to obtain my Chartered Accountant designation (CA, now CPA). The training and experience was very valuable, but being an auditor was not for me. I then joined the KPMG tax team where I cut my teeth working on a number of corporate, trust, and personal files. I enrolled in the ‘In-Depth Tax Program’ which is the standard for tax professional training in Canada. I really enjoyed my time with the group there and learned a great deal technically that I apply in my current role. One of my clients at the time was a single family office and that triggered my interest in pursuing a role with Northwood.

3. What do you think separates Northwood from the typical investment advisory firm?

What sets us apart is our breadth of capabilities that allows each client to see value from us in different ways. Every family and foundation is unique and has specific things they are looking to us for, and our model provides us the ability to service those needs. For some clients, it could be helping them manage the affairs of their elderly parents and educating their adult children (on top of managing their own affairs!), and for another client it could be helping them think through how to build a strategy to achieve their goal of establishing a family foundation. The list of examples goes on, and obviously life changes and the areas where families need help evolves. Irrespective of how a client sees value, I like to think that we are helping them see the big picture, achieve their goals, and feel confident that their smaller daily details are looked after as well.

4. How has working at Northwood changed since you joined in 2010?

When I joined the firm it was quite small. I was one of six members at the time, and I’m happy to say that five of the six team members are still with the firm. Even at 15 people now, we are still a tight-knit group, but it has been exciting to build the team out and add new people with different skillsets as we continue to grow.

One thing that hasn’t changed is that every day is still different, we still have great clients (just more of them), and it’s still fun to come to work and tackle the challenges that come with growing and improving the firm and looking after clients.

5. Tell us a little bit about your life outside Northwood

My wife and I have three young sons at home aged from four months to five years old. We lovingly refer to our boys as ‘Team Chaos’ because they are very active and keep us busy. In my little spare time these days, I like try to play hockey, spend time with my wife and friends, or simply enjoy quiet time to relax and read the newspaper or a magazine. I’m looking forward to more outdoor activities and adventures as our boys get older – last year was an intro to camping and fishing.

6. Will there be anymore sons in your future or are you stopping at three?

We are definitely done! I failed on my part to add a girl to the family but we are very fortunate to have three healthy boys. Plus I don’t want to end up like this....

In 2010, I spent five months backpacking across Asia and seeing the wonders of the continent. In Shanghai, I saw the illuminated skyscrapers of Pudong, and was amazed to learn that only 20 years prior to my visit, the whole area had been a swamp on the wrong side of the Huangpu River.

In Thailand, I spent time in the islands of the Andaman Sea, crowded with young people from all corners of the world. Once again, I was astounded to learn that these islands had been an unvisited and foreign paradise to all but the most intrepid of travelers as recently as a generation ago. There was change occurring rapidly across the Asian continent, and progress (and its problems) were apparent everywhere I went.

However, there was one place where it seemed like time had stopped ticking entirely. While spending a week in Seoul (a glittering metropolis of 10 million people that made Toronto seem like a sleepy provincial capital), I spent a day visiting the Demilitarized Zone (DMZ) between North and South Korea, a place frozen in time since the end of the Korean War in 1953.

The DMZ is roughly 250 km long and 4 km wide, and for the last 65 years, it has split the Korean peninsula in two. On one side lies the modern economic miracle that has taken place in South Korea over the last generation, while on the other lies North Korea, one of the most economically backwards and repressive countries in the world. I remember peering over the fence to North Korea and wondering if this structure would ever come down during my lifetime. At the time, it seemed impossible.

Fast-forward only eight years and suddenly the prospect of peace on the Korean peninsula seems possible. After North Korea’s nuclear missile tests last winter, and Donald Trump’s threat of “fire and fury like the world has never seen”, the situation seems to have improved markedly. The détente started with the two Korean nations competing under a joint flag at the Winter Olympics in February, and culminated with the North and South Korean leaders meeting for the first time in a decade last month. Now there is talk of President Trump meeting with the North Korean leader (possibly at the DMZ itself), and a new peace agreement between the two Koreas.

Now all this progress could still very well amount to nothing. Trump is an unpredictable negotiator and it is difficult to know the true motives of Kim Jong-un. That said, not many people could have imagined the current situation a year ago.

These rapid changes on the Korean Peninsula brought to mind an article that our Chairman, Tom McCullough, wrote in The Northwood Perspective in 2013. In that piece, Tom discusses George Friedman’s book, The Next Hundred Years, and his conclusion is that it is impossible to predict what the World will look like 20 years out. He uses the example of Germany in 1920, a country recently defeated in World War I and facing a staggering cost to rebuild itself. At the time, no one could have imagined that in 20 years Germany would rebuild its economy and military, conquer France, and look set to dominate the rest of Europe. I think the thing to remember is that the world is constantly evolving, and what seems impossible at one time, can become the status quo twenty years later. Many of these events can be hard to predict, but it is generally safe to assume that the world will be a vastly different place in 2038 than it is now.

We have a similar mindset in the work we do for our client families. At Northwood, we have some families who have been clients of the firm since we opened our doors 15 years ago. Over the lifespan of our relationship with them, these families have sent children to college, celebrated weddings, and welcomed new members to their families. They have bought and sold businesses, and seen their investment portfolios tick steadily upward over time. As a result, their financial pictures and their needs are different today than they were in 2003. Northwood’s job has been to stay abreast of their changing needs and make sure they remained on track to meet their goals.

Who is Northwood Family Office?
Northwood Family Office is an independent, privately-owned boutique family office which provides comprehensive Net Worth Management™ for wealthy Canadian and global families. Northwood clients have significant family net worth, typically $10M+. The firm acts as a Personal CFO or Chief Advisor to client families using a dedicated team of professionals who oversee and manage their integrated financial affairs. Northwood Family Office is Canada’s leading independent multi-family office and has consistently been ranked the ‘#1 family office in Canada’ in the Euromoney Global Private Banking survey. For more information, visit our website or contact Tom McCullough for a confidential conversation.