



BIRCHWOOD CAPITAL

2022 Annual Letter

January 23rd, 2023

In 2022, the markets decided to test everyone's resolve including this new business', in its second full year. The S&P was down -18.0% and US treasury bonds had one of their worst years ever (-17.8%). As I've covered extensively in my quarterly market overviews and blog posts, there was torment everywhere. No need to sugarcoat it.

I always tell clients that while Birchwood may manage it, it's their money. They get the final say in how it gets used. And yet, while asset values fell across the board, I couldn't excuse myself from the pain. Having a small firm means you really know your clients. It's a double-edged sword, however. You celebrate when things go well and you feel horrible when things don't. Their losses felt like my losses. But I'd take hardship with close people over glory by myself.

You never know what will happen when the going gets tough and how people will handle it. To clients' credit, none of them capitulated. Everyone stuck with their strategies. Sure, there were a lot of discussions and frustrations (who likes to see their money go down?!), but clients stuck to their long-term plan. That says way more about the types of people I am lucky enough to work with than it does about me.

That doesn't mean we're handing out awards. We still have our work cut out for us. We may experience a recession this next year or come to find out that last year was a phenomenal buying opportunity. Either way we must be fastidious in our attention to an ever-changing retirement landscape.

What Success for Birchwood Looks Like

In a characteristically rash move, we expanded world headquarters by 252 square feet this year. While I can jest about our small operation, I'm excited for our new office where clients and myself can gather for meetings. It provides an efficient meeting space and maintains our ethos of being lean and mean. We'd rather keep the funds in clients' accounts than charge them for an upscale office staffed with multiple people. Trust me - the sparkling water tastes the same no matter where you drink it.

We welcomed eight more clients to the Birchwood family this past year. For those keeping score, assets managed by the firm at the start of 2022 were \$11.8 million, and we were working with fourteen clients. We ended the year with \$24.3 million of assets under management and are now working with twenty-two families. While these 'vanity' metrics are nice to share, we do not measure the success of Birchwood based upon its size.

As much as this industry loves to tout how much money is managed by their firm and how fast they are growing, once you reach for the next \$20 million, \$100 million, or \$1 billion, the goalpost will always keep moving. It nets out as unsustainable ambition. Our focus is to love the clients today in real, practical ways instead of always reaching for the next one:



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- Hand-writing birthday and thank you cards. Such a small thing.
- Getting back to clients' questions promptly. Such a small thing.
- Admitting when I've done something wrong and making the person whole. Such a small thing.
- Going to a tax seminar when I'd rather do something (anything!) else. Such a small thing.
- Not needing peer recognition to pump up my ego. Such a small thing.

These small things may not add up to a Fortune 500 firm, but they will add up to a firm that has built deep, impactful, and meaningful relationships with clients. That's what success at Birchwood looks like today and in the years to come.

The Learning Never Stops

"Wait...you mean to tell me you learned something? No way!"

That was the timely sarcastic response I got from my mentor when I shared about the problems I faced last year and what I would have done differently. I guess when they handed out the "do-everything-perfect serum" at the new founder's club, I must have missed the dose. No one executes perfectly and I am certainly no exception. Warren Buffett offers me a little bit more comfort: *"To try to live your life totally free of mistakes is a life of inaction."*

While you're not working with a perfect advisor, you are working with one who is continually fighting to learn, as my mentor correctly pointed out. After all, if you're always right, you're not learning. If you're not learning, then clients are getting short-changed.

Here's two things I learned after the markets we had last year:

Bonds

- **You need to hold bonds with durations that correspond to liquidity needs.** It's not enough to buy a US bond market index for an entire fixed-income allocation. This works great for equities, and yes, it still completes the mission of being low-cost and a great long-term holding, but it doesn't factor in the timing of near-term withdrawals. The US bond market has a duration close to 10. If rates rise (like they did drastically in 2022), a bond fund with a duration of 10 will drop in price much further than a bond fund with a duration of 2. If money is going to be withdrawn soon, that money needs to either be in cash or a much shorter-term duration investment.
- **There's not a lot (if any) of diversification benefits to international bonds.** Most international bond funds are hedged to the dollar, which eliminates the benefit of diversification. You're then just getting an interest rate, which is what you'd get anyway with domestic bonds. Diversification is touted across all areas of finance. This is true for stocks. Not necessarily for bonds. Remember, bonds are fixed debt payments over a time period. This is a completely different structure from stocks.



Tax-Loss Harvesting (TLH)

- **TLH is not a panacea.** Harvesting losses saves on income taxes today, but it also may increase taxes in the future. It's hard to know definitively whether it will play out positively or negatively. To guarantee a positive outcome, use TLH to offset a one-time income event, or to take advantage of limited time tax law change (like child tax credit), or pair with a Roth conversion and use the \$3,000 loss deduction to offset the income created. We did TLH this year for clients where warranted. It's a great strategy, but it's just not a sure-fire thing for all like everyone says it is.

Thankfully, the learning took place “around the edges” of the practice. You won't find anybody betting the mortgage on cryptocurrency at Birchwood.

The Slow Burn

I still believe I'm in the honeymoon phase of my business where everything is fresh, new and exciting. Part of me knows this feeling will never go away. I truly love what I do and find myself [“tap-dancing to work”](#) on Mondays. That doesn't mean absolutely everything is Christmas morning. Here's one area of struggle: the production of the [Real Retirement Podcast](#).

The podcast is difficult for me. I'm not a gifted speaker and am dreadful off the cuff. I write every episode word-for-word, which is horribly inefficient. Each time I hit publish, I get the feeling that it's a very average episode, nothing spectacular. The internet has ruined the average person trying to do diligent work because everything we see is made by the best to ever do it.

If the sign above the players' entrance to the field at Notre Dame reads 'Play Like a Champion Today,' the sign above Birchwood's door reads [‘Remember Your Helmet.’](#) I fully realize that I'm not the most gifted or talented voice out there. But I try to keep things simple and do the very basic fundamentals (like remembering my helmet).

Any satisfying accomplishment takes years to achieve. Accepting the reality of slow progress allows me to keep plugging along. I'd rather keep pushing than wait a few years to get started while still looking for a cheat code that will never come.

Writer James Clear says what I'm trying to embody: *"The responsibility of any creator is to do the work, not judge it. Your job is to fall in love with the process, not grade the outcome."*

Using the Best Ideas From Others

“What has been will be again, what has been done will be done again; there is nothing new under the sun. Is there anything of which one can say, “Look! This is something new”? It was here already, long ago; it was here before our time.” (Ecclesiastes 1:9-10, NIV)

Learning from the past is one of the best ways to build the businesses of today. We have hundreds of years of history with thousands of companies. There is so much to learn from all of these founders and companies that succeeded (Andrew Carnegie, Amazon, Steve Jobs, JD Rockefeller, Kinkos, In-N-Out



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Burger, Rolls Royce - to name a few). By studying this rich history you can pull those great ideas from the past and apply them to your business and create a whole new thing!

There are certainly no new tricks at Birchwood Capital. We're simply trying to learn and understand the old tricks better. Everything that needed to be said has been said, but no one was listening so we get to say it again. In my study of history, here's two brief ideas I'm trying to implement at Birchwood:

- **Staying small and being hard to kill.** This idea comes from [Paul Graham](#). We don't have any committees or people to manage for that matter. I wanted to create something that I enjoy - and frankly, I hate corporate/internal meetings (I love meetings with clients - don't confuse the two!) - so there are none. Additionally, the smaller your workforce, the cheaper your company is to operate (no bloated payroll) and hence, the harder it is for a new company to run out of money. Lastly, small means speed. We make decisions and then act. Something that would take months for other companies to do, we can do in an instant.
- **Delighting your clients.** This idea comes from Amazon, Warren Buffett, and Paul Graham. Clients must be obsessed over. Warren Buffett says to "pretend that every single person you meet has a sign around his or her neck that says, 'make me feel important.'" It informs how we adjust our fees each year, how meeting rooms are situated, what type of written correspondence we send out, how we celebrate client milestones, etc. This is an area where I feel like I have much room to grow.

I'll end this letter with much gratitude. Thank you to the board members who were, at times, even more excited for this company than I was: Greg Moser, Brendon Marks, and Ryan Krueger. Thank you to my mentors - Matt and Holly Lewry - and your timely wisdom. Thank you to my wife who delicately questions my wild ideas to keep me on the right track (invaluable!). Thank you to my kids - Rylynn & Brayden - who always love my wild ideas but prefer a big hug. And thank you to the clients who make this job so fun, challenging, and purposeful.

Stephen H. Nelson
President