BIRCHWOOD CAPITAL

2023 Annual Letter

January 22nd, 2024

Life and the outcomes of our days can either be seen through the lens of gain or gifts.

As I reflect back on this year, there were times, I admit, when I was overwhelmingly frustrated with myself, my work, and my health. When the results of the day didn't seem to meet my expectations, I was left with worry and dissatisfaction. When the goal was to solve some sort of problem or achieve some sort of gain, I was left wanting.

But when I look back more closely, every circumstance was a gift. There was the gift of deepening friendships when I needed it the most. The gift of depending on family. And yes, even struggle and pain can be an incredible gift. But we'll touch on this in a second. Don't go anywhere.

For the firm, here's how the year shook out in numbers:

In 2023, the U.S. equity market returned almost 26%. All stock asset classes were up above double digits. Even bonds got in on the action with the U.S. Aggregate up 5.5%. Client portfolios were able to rebound and climb back to where we were before 2022 happened.

We welcomed 4 more clients to the Birchwood family this past year. For those keeping score, assets managed by the firm at the start of 2023 were $24.3 million, and we were working with 22 clients. We ended the year with $38.3 million of assets under management and are now working with 26 families. As I say every year: these 'vanity' metrics are nice to share, but we do not measure the success of Birchwood based upon its size.

Deviant Growth

"Don't be overly impressed by size. What counts above all is quality."
- Bernard Arnault*, Chief Executive of LVMH

*richest man in world and owns Louis Vuitton, Christian Dior, Tiffany & Co. and Dom Perignon Champagne

Over the years, I've talked with a lot of people who are searching for financial advice. Those first conversations are genuinely great 90% of the time, but sometimes they can be harsh. I had one guest ask me if I wanted to "try that again" when I accidentally stuttered on the phone.

Recently, I was asked by a guest how much in assets I managed. My 'vanity metric' alarm bells started ringing, but I acquiesced to her request. She responded saying she didn't feel comfortable working with an advisor where her assets would make up 10% of my firm's total AUM.

Ah, the downfalls of being small. But hey, I'm good with being a little atypical.

In wealth management, there are two types of firm setups for two different types of clients - the "orthodox" and the "deviant."

The "orthodox" firm is pretty impressive and much more comfortable to park your financial questions and resources at. Big, nice office, a room full of advisors, associates, client service managers, a trading team, investment committee, and maybe some compliance or legal staff. And most people who need financial advice end up here. If you reason from first principles, you can see why. Do you think their first concern is the quality of the advice relative to the amount they are paying? Absolutely not. Their objective is to find safety. And more often than not, that "safety" is sold in a beautiful package of sophistication, high staff numbers, sparkly investment strategies, and lots of AUM to back it up.

Does the quality of the investments chosen for these clients compensate for the minimum asset requirement and percentage of asset fee? Again looking at first principles, probably not. Do you think the first concern of the analysts is how we can keep costs low so client assets can compound? No way. Their number one objective is to look good for their boss or Chief Investment Officer, so their boss can look good as he presents the ideas to the investment committee. After all, how long can you suggest to keep doing the same darn thing to an investment committee? What would be the point of a committee and what would your clients think who expect you to have great, new investment ideas?

From the analyst to the CIO to the investment committee to the advisors to the clients, there's heightened career risk and an increasing desire to have the investments "look" good even if that means increasing complexity, so everyone can stay happy and the firm can keep collecting its AUM fee.

On the other hand, the "deviant" way is to kick corporate jostling to the curb, decide on an investment strategy that works (read: low-cost, passive), and keep the frictions that separate the clients from achieving their financial and investment plans to a bare minimum. This is the field where Birchwood loves to play ball.

People's lives are messy. My life is messy. We're human. And sometimes this mess is hard to untangle, understand, and work through when you're 1 of 100+ clients and there's been a silo-ing of roles at a large firm between advisor, financial planner, and investment manager. Yes, there may be safety in numbers, but it comes at a real cost. We know that you can't offer a perception of "safety" and do the real, good work that needs to be done. People who recognize this are in for a real treat when they come through our doors.

To do this right involves a few things. A fee structure that is completely transparent and isn't affected by how much money someone has, but rather how much value the client receives. It means a commitment to integrity, excellence, effort, and humility. And it means thinking long and hard about the right way to grow.

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I always wanted to "stay small." A one-man shop is lean and mean. I never liked any separation between client and financial planner. It offers the flexibility to be nimble and the service to be personal.

But then there's the saying: "Small businesses don't stay small on purpose." In other words, a firm should grow if it isn't shooting itself in the foot. Most of the time, according to SMB investor Brent Beshore "small businesses are loosely functioning disasters." So if we can just keep our shoes tied and our hair combed, then we're in good shape and growth will be inevitable.

Instead of "staying small," I'd adopted a new term: "growing small." I'm sure someone at McKinsey will give me a high-five for that corporate jargon term, but what I mean by it is figuring out how to preserve the character of Birchwood and keep our service level high while we inevitably get larger. If I'm honest, this service standard is hard to do. The day-to-day operating brutality of a small business tries very hard to make an owner bow to its will and reduce the high standards. The white glove service usually ends up looking more like yellow-rubber-cleaning-glove service. That's a non-starter in my book. So before our service standards even get a whiff of dropping, I want to get ahead.

As such, with the client growth we've experienced in our first few years, we're looking to add our first administrative manager to the firm. We still have the focus of only working with 50 or so households, so this new person isn't there to help us add the next 100 clients. They will be there to help *serve* the 26 we already have and the remaining 24 or so we hope to add.

When evaluating candidates, these will be the top qualities I'll be looking for:

- Gritty
- Empathetic
- Curious
- Full of Integrity
- Courageous

If you know someone who might be interested in the position, drop me a note (stephen@birchwoodcapital.com).

Having a Growth Mindset

I am lucky to say that I have very few regrets in life. The downside is that I'm scared to break the streak. One of my biggest fears is regretting something I won't have the courage to do in the future. As such, sometimes I take risks.

I had an ideal in my mind of wanting to go on adventures with my family. The outdoors is one of our favorite places to be. So, after obsessively searching high and low for an adventure vehicle, I pulled the trigger on a 1991 Toyota Land Cruiser. I won't bore you with the details as I wrote about it earlier this year. Long story short, it didn't pan out the way I had hoped. It actually brought a lot of misery, fear, pain, and a trip to the emergency room. There's plenty of people who go through much harder things, and I'm not trying to put myself on the same level as those dealing with much tougher situations (cancer, death, job loss, etc.) This one, I guess, hit differently because it was something I willingly walked (ran?) into instead of having life knock into me.

No one wants to go through painful times, yet the perspective and wisdom we get coming out of a valley is unmatched. For sure, I wish I could get wisdom without having to go through a tough season, but I tend to be a bit stubborn, so life has a way of teaching me the lessons I need to learn anyway.

I was speaking about this to a friend who said something wise. "*Well, now you can relate more to people who want to make a big purchase because you know what that feels like"* This is very true. I tend to be a frugal and analytical person. If there's a tried and true path of making good decisions with money, then I'm going to follow it. There wasn't much sympathy for budget-breaking emotional decisions that people do everyday. But now, I've been there. I understand the feeling and even the reasoning for doing something like that. I can no longer look down, but can instead offer a hand to say, "I've been there. Let's figure it out." We can pick ourselves up, give lots of grace, learn from it, and keep striving for quality financial decisions.

Another example, whenever I run across a client situation or a market environment that I'm unsure about, it can play out two ways in my mind: Fixed or growth mindset. The internal monologue of my fixed mindset says, "*I have my CFA charter. I should know how to do this stuff. It should come easy. Because it's not, I must not be good enough for this work. Why would any client want to work with me?"*

With the growth mindset it goes something like this: *"I have my CFA charter which means* ***I love to learn.*** *Sure, I don't know everything and even this situation is stumping me right now, but I know I will find an answer eventually. I'll give it my full effort and I'll get to learn lots of new things along the way."*

One mindset identified me as "smart." The other mindset identified me as someone "who loves learning." Both shared the exact same subject (CFA charter) but came to wildly different conclusions and points to journey from. I highly recommend Dr. Carol Dweck's book *Mindset* if you want to learn about the false way our mind speaks to us.

Fixed-minded advisors often think of themselves as finished products. Their role is simply to impart their knowledge to their clients. Another meeting. Another meeting. Another meeting. Imparting. Imparting. Imparting. But that gets boring! And it gets worse when you don't know the answer to something and think that you should! Identity crisis! "You're obviously not any good!" "Why would any client want to work with you?!" Not a fun place to land.

Isn't the work we do just as much for the advisor's learning and enjoyment as it is learning and problem solving for clients? Or as Dr. Dweck says, *"Why waste time proving over and over how great you are, when you could be getting better?"*

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Gratefulness is how I will continue to conclude these letters. Thank you to my clients who put a lot of trust in our work. You make this job exciting and purposeful. Thank you to my mentors - Matt and Holly Lewry - and your timely wisdom. Thank you to my family: my wife, who is so encouraging throughout the year, and my kids, who remind me a successful day is not whether I've solved a problem, but if I've loved well.

Stephen H. Nelson
President