BIRCHWOOD CAPITAL

2021 Annual Letter

January 20th, 2022

The Roots Come First

2021 marked the first full calendar year of Birchwood Capital. When people ask me how business is going, they tend to focus on the flexibility and freedom owning your own firm offers. At 30,000 feet, what we do is simple and exciting - *help people retire with confidence*. And there are definite benefits of getting to call the shots. Yet, at ground level, it's messy, stressful, and mundane, just like life.

To state the obvious, creating a valuable and impactful firm for people is hard work. I'm reminded that difficulties are really tests, opportunities to evaluate what holds muster and what is cheap plaster and should be discarded. At Birchwood, we think a lot about who we want to be. Simply put, we want to be a blessing to our community. This vision then formed the foundation that the company is based on, which informs how we communicate with people, where we focus our attention (only retirement planning), what size we want to be (small, family-oriented), and how we want to charge for our services (flat-fee).

Like any farmer knows, there's a lot of waiting before a spout shows up above ground. If I'm honest, many-a-week felt like a year. As much as I wanted to tackle folks in my excitement and showcase Birchwood, business doesn't work like that, especially in such a sensitive area like money and retirement. You have to prove your value over an extended period of time. Thankfully, we received validation of our concept this first-year, much more than we deserved.

For those keeping score, assets for the firm at the start of the year were $5.0 million and we were working with six clients. (Those first six clients are forever my heroes for their willingness to jump into this venture with me). We ended the year with $11.8 million of assets under management and are now working with fourteen families (Both of these numbers have since grown since the beginning of 2022). In the world of finance, this amount is a rounding error. But it's the world to myself and the clients that have invested their retirements with Birchwood.

Most new independent firms take years to reach the marks we've already surpassed, but there's no reason to hand out awards and I'm far from a unicorn. While I think we've built a firm that has many, many benefits to clients, there's a lot of work to be done.

Guilty of Heresy in Wealth Management

One of the core foundations of Birchwood is that we were going to operate off of a flat-fee - total heresy in the wealth management industry.

Here's some of the feedback I received when I told others in the industry I was doing this:

- *"You're leaving a lot of money on the table"*
- *"If clients are willing to pay 1% of assets, why stop them?"*
- *"You're capping your earning potential right from the start"*

Making good decisions is hard enough but nearly impossible with the pressures that accompany traditional financial advisors. The fee structure and sales emphasis at most wealth management firms cause short-term thinking and actions, a conflict with good investment strategy and reducing the long-term benefits to clients.

Incentives matter. Unfortunately, it’s the misalignment of incentives that take the main stage in wealth management. The typical advisor management fee is marketed as a simple way to cover administrative costs, but practically, it’s a mechanism of enrichment through asset gathering.

It’s a simple equation: more assets (AUM) = more fees.

As long as you do enough to “not get fired,” those fees will compound in the advisor’s favor whether or not you’re adding massive value to the client. I’m not into the “heads-I-win, tails-you-lose” way of doing business. If this is going to be a win long-term, then everyone needs to win together. If you took my firm and slapped an asset-fee on it, I left tens-of-thousands-of-dollars on the table. And I’m completely happy with that. From my perspective, that’s money that gets to stay where it belongs - *with the clients*.

Gratefully, Birchwood is in position to provide excellent services, cover its costs, and allow its owner to take something home to the family. Outside of this, the size of my paycheck or our office (if/when we get one) will never be related to the size of the assets managed at Birchwood. We have no interest in “gaining an edge” over clients, especially not in enriching one family at the expense of another’s.

Mr. Market

Month-to-month and year-to-year, what the markets provide are a full course meal of emotional high school drama. What they provide decade-to-decade is much more desirable and satisfactory if you’re able to hang tough. We visualize being part owners of the best U.S. and international businesses that we plan to stick with for a very long time rather than merely owning pieces of paper whose price jumps around day-to-day.

We don’t try to shuffle holdings (or as Warren Buffett calls it: “ play gin rummy”) when the markets look dire - which they inevitably will from time to time. Our job is to maintain exposure though good times and bad because that is what produces the best results. As it’s been said, time in the market is way more important than timing the market.

This brings me to the Quarterly Market Overviews I write after the end of each quarter. We include no narrative with our quarterly reports and no outlook on the future performance of markets. This is on purpose. Our clients have very long-time horizons in regard to investing, and it is difficult to say anything new or meaningful each quarter about events of long-term significance. I will lay out the facts as they are and describe what tax, legal, and legislative changes have transpired that we can incorporate into our planning.

When you do receive a communication piece from us, you can be assured it will come from the fellow you are paying to run the business (read: Stephen). Your advisor has a firm belief that clients are entitled to hear directly from the President as to what is going on. Client communication should not be turned over to a staff specialist or public relations consultant who is unlikely to be in a position to talk frankly on an advisor-to-client basis.

Paying Business School Tuition

Samuel Johnson once quipped that when a man knows he is going to face the gallows, "it concentrates his mind wonderfully." When the security blanket of a well-paying job is severed, as was the case when I quit my prior job to launch Birchwood, there's little room to waste time.

The world is in fact your oyster with no direct boss or formal structure but with that comes a lot of distractions. The real trick is then separating what has an impact and worth spending time on versus what is just "playing office." With that being said, there were still plenty of siren's songs, and I didn't miss out on paying some first-year business school tuition.

Here were some things I could have learned quicker:

- **Done is better than perfect (because perfect is never done).** You need to nail it when it comes to the work that you do for clients, but sometimes you hold yourself to an impossible standard for your own work. Learning to develop a tolerance for imperfection on matters of less importance is a good thing.
- **Become a smart quitter.** I quit trying to gain a following on Twitter (no one noticed I haven't posted for a year). While I've learned a ton from that medium, spending the time to craft a tweet that no one cared about wasn't going to pay the bills. Also, I quit trying to write 'amazing' blog posts and podcasts. Instead, I wrote what I felt what retirees needed to know and used saved time to meet people face-to-face.
- **Get comfortable being uncomfortable.** Most of the time you feel like you aren't working hard enough because nothing is happening, unlike when you make a mistake and get instant feedback. When you're doing the right things and crickets start playing, it feels worse than making mistakes because at least then you're getting a response. Failure is loud but progress is whisper quiet. Be diligent and persevere.

People Really Matter

In large part, businesses obtain the client constituency that they seek and deserve. If they focus their thinking and communication on short-term results or short-term stock market consequences they will, in large part, attract clients who focus on the same factors. We try everything in our power to limit market conversations because in the grand scheme of things, it is the least interesting thing going on. Clients have dreams and goals, and we want to align their finances with those things that bring joy to their lives.

We feel very lucky to have attracted the clients that we have. All of them are savvy, diligent and extremely kind. In our first full year of operation, we had zero clients leave on their own. This reflects a group of clients who understand our operation, approve of our philosophy, and share our expectations. And we hope to deliver on those expectations. We're still only planning on working with a limited number of clients to keep the firm small and personal (the exact number is unknown but it's definitely less than 100). For our part, we do not view Birchwood clients as faceless numbers, but rather as co-adventurers who have entrusted their retirements to us for what may well turn out to be the remainder of their lives.

Additionally, I'm grateful to be surrounded by board members who are as willing to call me an idiot as they are to give me a bear hug. Both are necessary. Thank you to: Greg Moser, Brendon Marks, Ryan Kruger, and Megan Nelson. And thank you to Matt and Holly Lewry for being my business mentors. These folks donated their sparse free time to guide me this past year. I wouldn't be where I am without your insights and wisdom. Thank you for believing in me.

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I'll end this letter by saying that I love running Birchwood Capital. It's been an absolute dream of mine, and I hope I never have to wake up. I'm thankful I get to partner with such incredible people that have made this journey so much fun and enriching.

Stephen H. Nelson
President