The INVESTMENT LETTER

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All In the Family

Everyone loves a great success story. There's even a popular expression that illustrates the dramatic rise from humble beginnings: "From Rags to Riches."

Sadly, all too often, those success stories then go in the opposite direction - back to rags. This is true particularly when wealth is passed through generations. This phenomenon, sadly, is such a common occurrence that most cultures also have an expression that illustrates the wealth lost.

In China, there is a proverb; 富 不过三代 *"Fu bu guo san dai"* which translates to *"wealth does not pass three generations."* In Brazil the expression is, *"Pai rico, filho nobre, neto pobre" – "rich father, noble son, poor grandson."* In Italy they say *"Dalle stalle alle stelle alle stalle" – "from the stables to the stars and back to the stables."* Across cultures, the common theme is that wealth often does not last across multiple generations.

This is a topic that is perhaps more relevant now than ever before as we are in the midst of the greatest wealth transfer in history, with an estimated $59 trillion in assets being passed from one generation to the next.[1]

Much of that wealth, however, will not last long. According to some studies up to 65% of familial wealth is lost by the second generation and 90% is gone by the third generation.[2]

We must therefore ask ourselves, why is this the case? And can we do anything about it?

Why Does This Happen?

Given that so many cultures have observed the same phenomena, it's safe to say this is a human condition not one of culture, geography or race. In fact it's basic human psychology to treat earned money differently than unearned money, regardless of whether it is found, stolen, won or inherited.

Understanding that this is a natural, subconscious way of thinking about money is the first step towards working to ensure that wealth can last across generations. It is also helpful in not placing unwarranted blame at the feet of the recipients.

One often cited, albeit extreme, example of found money being spent much more quickly than earned money is the phenomena we often observe in lottery winners. By most estimates, some 70% of lottery winners end up filing for bankruptcy. It is clear that a rapid influx of money, particularly when unexpected can, and often does, create more financial harm than it does good.[3]

Perhaps even more shocking is that nine out of every ten lottery winners believe that their newly found wealth will be gone by the third generation. This is a shockingly defeatist attitude and one that may be well based in fact but need not be considered a foregone conclusion.[3]

Unlike lottery winners, many people that stand to inherit wealth are aware of its existence and the circumstances under which they receive the windfall. This, however, causes another problem - one of pent-up demand. Purchases that may have gone unfulfilled, whether it's cars, houses, vacations or others goods and services become immediately within reach once an inheritance is received. In this respect the spending can over shoot the inheritance much like with many lottery winners.

Similarly to pent-up demand, some of those who stand to inherit wealth have driven up their credit card and loan balances so as not to have the pent up demand be an issue. In these cases, pent-up demand has been replaced with interest payments and debt, which can quickly erode an inheritance.

What Can Be Done About It?

There is not one answer or solution to this question. Furthermore, despite best efforts, some people will still find ways to get themselves in financial hot water. However, there are some steps we can take with the proper planning and priming.

Planning – Whether it's the proper documents to determine how familial wealth is split, or setting up limitations and timelines for how much spending can be done once inherited, proper planning can be a powerful tool in making sure wealth is used judiciously.

Priming – Allowing for some 'pre-inheritance' can be a valuable learning tool for both sides. For one it helps alleviate some of the concerns of debt or pent up demand discussed previously. It also allows insight into how the inherited money may be spent in the future, allowing for adjustments such as spending safeguards to be put in place. Finally, it allows mistakes to be made with a relatively small fortune, and hopefully leads to well-learned lessons when the entire inheritance is received.

Where to Start

In the wealth/investment management industry, generational transitions are typically poorly carried out, with the focus being on the actual financial transaction, and not on the ongoing management and administration of the account. In our experience, while the financial and planning components are important they are only part of the solution.

The ongoing relationship is critical to maintain as it has intellectual and human capital components on both sides that can be beneficial when seeking to minimize taxes, planning for further transfers or continuing to manage certain accounts in accordance with the previous generations wishes.

Helping those that inherited wealth prudently manage and grow that wealth is why Investment Counsel, over its 85 plus year history, has helped families move through these difficult transitions time and time again. This is one of the core strengths of our firm and it's one of the main reasons our relationships are measured in generations, not years.

Across multiple generations of families, overseeing, managing and growing wealth for subsequent generations to enjoy is what we excel at.

Investment Counsel News

Inside the Office

Due to overwhelmingly popular demand, Investment Counsel has extended our client's Kiplinger subscription for another year!

Outside the Office

Mike managed to tear his rotator cuff in a mountain biking crash. A few weeks of rest and he should be good as new.

Sources:

[1] http://www.cnbc.com/id/101711232

[2] http://www.newsmax.com/Finance/StreetTalk/family-wealth-heir-children/2014/06/25/id/579236/

[3] http://brandongaille.com/22-lottery-winners-bankrupt-statistics/