Observations for Guiding Generational Wealth

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“I think that any wealth creates a sense of trusteeship... It is characteristic of the new generation which has created wealth to have some amount of responsibility for it.”
-AZIM PREMJI, Indian business tycoon

"Where there's a will...I want to be in it."
-ANONYMOUS

Cornelius Vanderbilt died in 1877. His fortune was built in the railroad and shipping industry. At the time of his death, he had amassed a fortune worth an estimated $215 billion in today’s dollars (that’s more wealth than Bill Gates and Jeff Bezos *combined*). In 1977, roughly three generations later, the family gathered at Vanderbilt University (named in his honor) for a family reunion. One family member remarked that there wasn’t a millionaire left among all of the descendants. On the other hand, the Rockefeller empire chugged on like a freight train, becoming one of the gold standards in preserving legacy wealth. Obviously, two families starting with fortunes took very different paths.

Times have changed, but people of varying wealth are still faced with many of the same questions these legendary families faced. Below, I outline some of the experiences we’ve witnessed through helping our clients face these challenges. While there are certainly no right answers, it is my hope that some of what we’ve learned can help individuals tackle a topic that’s often considered taboo within families. Many often struggle with making decisions around these delicate subjects and, after realizing the complexities involved, simply decide to avoid the conversations altogether. My goal is not to tell you what makes sense for your family but, instead, urge readers to see what can be done along the way to protect their family while maintaining certain core financial values.

Below, I provide a collection of observations around this topic as well as some experiences we’ve helped our clients navigate. It’s likely that only parts of this will apply to you, but I can think of few clients who feel that they’ve dedicated enough thought or resources to the matter. If nothing else, it’s my hope that this can start a dialogue between your family and the necessary supporting advisors.

CHANGING ATTITUDES
Earlier in his career, our Family Office Director, Mark Nicoletti, was part of the Getty Family’s Investment Division. The family was so wealthy that they often flew without luggage to their destination; upon arrival, they bought new outfits for the purpose of the trip. Mark witnessed first-hand the old school approach to wealth-building, where the overarching goal was to preserve and pass on as much as possible from one generation to the next. Today, Mark has commented that many of his clients are shifting their view on generational wealth.

Bill Gates has really championed the idea of leaving a philanthropic legacy over passing money to the next generation. He’s openly insisted on leaving his children a modest amount. (Modest to him would likely equate to winning the Powerball for the average person.) Nonetheless, his view is progressive as it challenged the precedent of dynastic wealth. This would have been considered heresy 100 years ago. But, this isn't specific to just the world's richest people. We have witnessed clients of all sizes wrestle with how much they want to leave to their children. Many settle on the idea that they want to leave them "enough to do something, but not enough to do nothing." The most common fear they all share is the notion that inherited wealth will demotivate their children.

WHISTLING PAST THE GRAVEYARD

Another commonality we've seen across many clients, small and large, is an overwhelmingly unwilling attitude to discuss their wealth with the next generation. For the client who plans to leave $2 million to 4 children and 6 grandchildren, it's possible to avoid the conversation altogether as it's more easy to conceal. For the client worth hundreds of millions, whose children are used to flying private planes and owning a 20,000 sq ft ski chalet, it's likely a gross underestimation of their offspring's perceptive skills. Even if we were to assume these clients were able to obscure their children's ability to detect just how wealthy they may be, is it the right approach?

A FOOL AND HIS MONEY ARE SOON PARTED

Perhaps the most interesting outlook on significant wealth comes from one of my favorite clients. Over cocktails, I confessed that I have mixed feelings over exposing my kids to nicer things. This client came from significant wealth and watched as siblings with the exact same head start ended up literally broke. Intuitively, I found myself anticipating a response along the lines of "I will not make the same mistake of my parents by not protecting my kids from losing it all." Instead, in typical fashion, the client offered a fascinating response: "I plan to let them do what they want. If they lose it, they didn't deserve to have it. If they make more, good for them." The concept of letting wealth get destroyed through some Darwinian process is both fascinating and even refreshing. In the end, most clients will find this too extreme, but it certainly is food for thought.

OLD WEALTH VS. NEW WEALTH

I've observed something interesting between old money and new money. New money has a need to spend. They want to prove they belong. Often times, new money feels the need to announce that they've arrived. That said, they are often far more accepting of others. Newer money typically wants to give more to their kids than what they received, giving them a sense of accomplishment. Old money is different. It is often far more discrete and places an enhanced emphasis on privacy. Sometimes, this is a result of inner family rivalry, but other times it's just family values being handed down. Older wealth is often more organized and has done more planning.

BEST PRACTICES WE'VE SEEN WITH CLIENTS

After working with many different family dynamics over the years, I've attempted to compile some experiences that have provided constructive learning experiences for anyone facing this situation.

Articulate your values

While conversations about wealth can be personal and awkward, especially specifics, it's critical to clearly outline your expectations around your values for money. You don't have to detail how much money you have to convey that you expect them to create their own success, and that the lifestyle they had growing up may not be what they experience as they become independent adults. Further, conveying your values about generosity, debt, and the right and wrong uses of wealth will help them understand your family expectations, while avoiding revealing financial details. Over 50% of baby boomers do not fully disclose their wealth to their offspring, while 13% never discussed it at all. Lack of discussions leave family members susceptible to being unprepared to deal with eventualities.

Involve them early
Involve your family by getting them to track and buy a few stocks in a small “play” investment account, or directly giving them some type of investment in the family company. Often, we’ve seen that when the next generation feels first-hand what goes into making investment or business decisions, they tend to handle wealth more responsibly.

Customize to your goals
Trusted advisors can help shape your generational transfer to meet your family criteria. For example, you can set milestones for when your children of grandchildren can access assets. If you want to go a step further, you can add specific provisions that only allow access to money at the discretion of a trustee who ensures the benefactors are complying with whatever standards you outline.

Avoid unintended consequences
Recently, a client with significant real estate holdings realized that in the event of their death, the children would be forced to urgently sell properties to meet the tax liability from their estate. This creates significant financial stress at a time that’s likely to be laden with emotion. Using a series of tools, we were able to create the liquidity necessary to pay the taxes without having to sell expensive properties that could be hard to liquidate quickly.

Get professional help
Many people deal with this and have valuable experience. We have a client who has two children, one was quite competent and financially savvy while the other struggled with substance abuse. In the original version of the client’s Will, the more responsible sibling was set to play gatekeeper to the assets of the less responsible sibling. Our director of Wealth Strategies, Jeff Eulberg, who happens to have significant experience in this space, was able to illustrate the flaw in this arrangement, essentially forcing one sibling to chaperone the spending habits and behavior of the other in the event of the client’s passing. While on the surface, the original structure of the Will seems to make sense, Jeff advised that the client pick another relative to serve as the trustee, removing the tension between siblings. The client instantly agreed and changed the language of the Will.

Establish a baseline of financial literacy
Only recently have a few universities started to require financial literacy as a core requirement for students. Many children of wealthy individuals find themselves entering adulthood without basic knowledge of finance. Concepts such as debt, interest rates, and inflation are not understood even at a basic level. Those receiving substantial wealth from the prior generation without knowledge of these concepts are in a vulnerable situation as they are completely reliant on their advisors. We sometimes see an advisor whose age is on par with that of the individual who has made the wealth, not the one who is inheriting it. This leaves the benefactors scrambling to hire a replacement advisor who is their vintage, a daunting task for someone who is a financial novice.

EASIER SAID THAN DONE
Almost everything written in here is easier said than done. It’s awkward, time-consuming, and sometimes a bit morbid to talk about the topic of wealth transfer. Giving someone advice is often

easier on the person giving it than on the person who has to execute it. While we can’t replace the role of a parent, many clients have sought our help facilitating some of these discussions because they felt it would be a more natural dialogue coming from an advisor. Not long ago, a client of ours was dreading telling his daughter why her future husband needed to sign a prenuptial agreement. Having a 3rd party can often limit some of the potentially explosive family dynamics that comes with wealth. Above all else, we’d encourage clients to not do the “ostrich” and stick their heads in the sand. Most of the family train wrecks we see are when kids are thrust into situations they are totally unprepared to handle. If you have issues or questions that pertain to your family’s financial plan or intergenerational wealth transfers, please reach out—we would love to help.

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OUR CURRENT LIKES AND DISLIKES

No changes this week.

LIKE

- Large-cap growth (during a correction)
- International developed markets (during a correction)
- Cash
- Publicly-traded pipeline partnerships (MLPs) yielding 7%-12% (we like them even more after their recent correction)
- Intermediate-term investment-grade corporate bonds, yielding approximately 4%
- Gold-mining stocks
- Gold
- Select blue chip oil stocks (wait for a pull-back after their recent strong run)
- Mexican stocks (at lower prices after this year’s robust rally)
- Bonds denominated in renminbi trading in Hong Kong (dim sum bonds)
- Short euro ETF (due to the euro's weakness of late, refrain from initiating or adding to this short)

NEUTRAL

- Most cyclical resource-based stocks
- Short-term investment grade corporate bonds
- High-quality preferred stocks yielding 6%
- Mid-cap growth
- Emerging stock markets, however a number of Asian developing markets, ex-India, appear undervalued
- Select European banks
- BB-rated corporate bonds (i.e., high-quality, high yield)
- Investment-grade floating rate corporate bonds
- Long-term Treasury bonds
- Long-term investment grade corporate bonds
- Intermediate-term Treasury bonds
- Long-term municipal bonds
- Intermediate municipal bonds with strong credit ratings
- Emerging bond markets (dollar-based or hedged); local currency in a few select cases
- Solar Yield Cos (taking partial profits on these)
- Large-cap value
- Canadian REITs (on a pull-back after a healthy recent run-up)

DISLIKE

- US-based Real Estate Investment Trusts (REITs) (once again, some small-and mid-cap issues appear attractive; also, some retail-exposed REITs look deeply undervalued)
- Small-cap value
- Mid-cap value
- Small-cap growth
- Lower-rated junk bonds
- Canadian dollar-denominated bonds (the loonie is currently overbought)
- Short yen ETF (in fact, the yen looks poised to rally)
- Emerging market bonds (local currency)
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- Floating-rate bank debt (junk)
- US industrial machinery stocks (such as one that runs like a certain forest animal, and another famous for its yellow-colored equipment)