SEVEN INSIGHTS

ON SUSTAINING YOUR WEALTH

TDC
INVESTMENT ADVISORY

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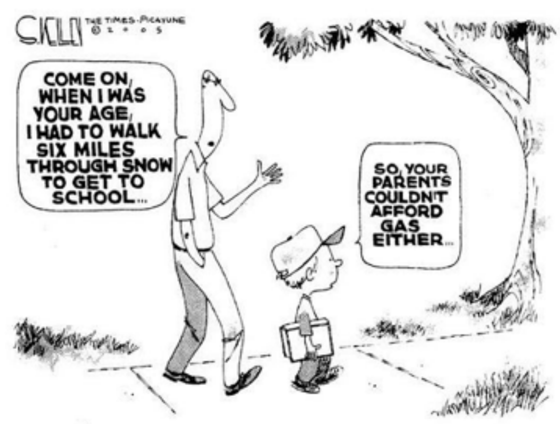
The proverb "shirtsleeves to shirtsleeves in three generations" is pervasive across many cultures. It effectively communicates the concept that the wealth created by one generation is seldom sustained through another two generations.

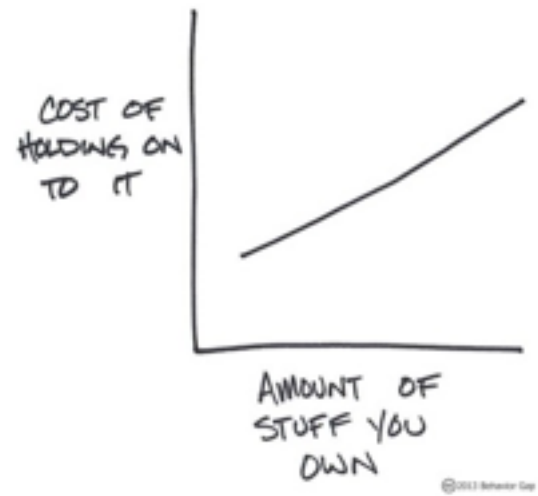
Why is this the case and how can your family be exceptional in your quest to sustain your wealth? Here are some of our observations from decades of working with families on this challenge:

1. **Exponential growth in "headcount" —** It only takes one look at your family tree over multiple generations to grasp this challenge. With an assumption of one spouse and two children per each family member, it's realistic to see a current family of eight (Mom, Dad, two adult children, four grandchildren) expand to a headcount of 18 at the end of 30 years, and expand again to 40 living descendants and spouses alive at the end of 60 years. Even if we were to assume above-average investment returns and no inflation, this inevitable growth in the size of the extended family makes it extremely unlikely that each generation will be able to consume from the family's wealth pool at the same rate as the previous one. At some point, future generations must create additional wealth to make long-term sustainability a reality.

2. **Inflation —** It's a fact of life. From 1926-2013, annual inflation has averaged 3%[1]. Across all 20-year periods since WWII, it has never averaged less than 1.8%. The cost of filling a 15-gallon tank of gas has gone from roughly $12 in 1979 to about $57 today[2]. A box of Kellogg's Corn Flakes has gone from $0.59 to $4.19 over that same time period[3]. If we think about our children and grandchildren, at 3% average inflation, a car that costs $50,000 today will cost $100,000 by the time a newborn gets his college degree (24 years), and will cost $400,000 by the time they retire (72 years). This forces a family that truly has a long-term mindset to re-think what a "safe" investment is. Bank deposits, money market funds and the like offer comfort in their limited "downside", but history tells us they offer very little chance of preserving purchasing power for future generations.



Lack of spending discipline — Spending in a manner that keeps your family on track with its long-term goals can be a challenge, no matter what your level of wealth. But when assets appear abundant, the temptation to consume today at the cost of tomorrow grows even greater. Often, a strong recent performance in the financial markets allows the family to justify a large unanticipated expenditure or a significant increase in the cost of a previously-planned purchase. For example, watching its wealth rise from the significant gains in the stock market over the past five years, the family might decide now is the time to buy a large new vacation home.

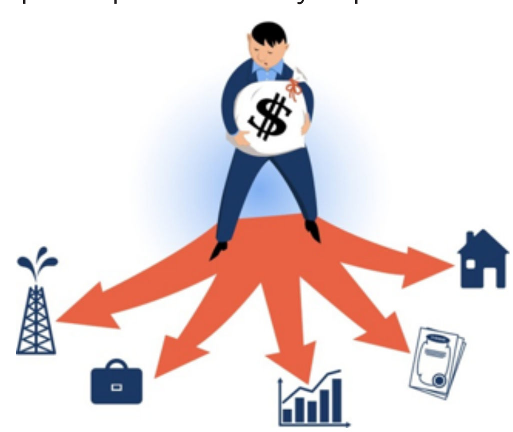


This might be problematic to a family's sustainability in two ways:

First, it's very easy to become emotionally attached to a home. The family's love for its new property isn't a problem in isolation, but it can be if the family over-spent on the home simply because the bull market made them feel wealthy. We all know financial markets go up and down, and having a large amount of wealth tied up in an illiquid asset like a second home could put the family in a bad financial place when markets inevitably turn south.

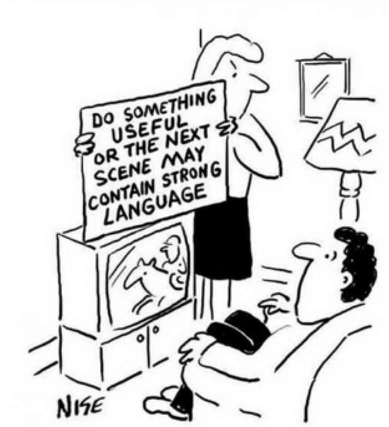
Second, homes and other significant purchases are also typically accompanied by a "we don't do this every day" justification. What families often fail to recognize is that the one-time purchase price of the new home can be rivaled by a stream of less-obvious "every day" carrying costs (real estate taxes, maintenance, furnishings, dues) that increase the family's expenses into perpetuity. While it's unrealistic for any family to live according to a precise year-to-year budget, those that are disciplined enough to set aside some of a bull market's riches for "a rainy day" while being accurate and realistic about the true long-term costs of major purchases will improve their odds of sustainability over multiple generations.

3. **Lack of investing discipline —** Newly-acquired liquid wealth often opens up a wider array of potential investments to a family. Hedge funds, private equity deals, real estate ventures and new businesses being started by friends or ex-colleagues are just a few of a never-ending stream of the investments that might be pitched to a wealthy family. The solicitor who introduces the family to the "deal" usually isn't objective, and thus highlights all of the potential benefits of the opportunity, but rarely spends much time on the risks. To combat the temptation to invest in the "pitch du jour", the family (usually with its advisor), should seek to create and maintain a clear investment strategy. This strategy should include:



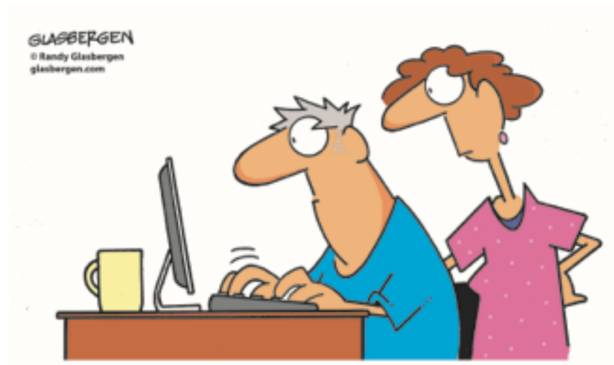
How much (if any) they are willing to commit to investments that can't be easily sold, a requirement to describe why they believe their "illiquid" investments are more attractive than their other liquid assets, and clear metrics for how they will measure and assess the performance of these investments to ensure the family's capital is being used prudently and productively.

4. **Inability to productively "fill the time void" —** For families fortunate to have enough liquid wealth that holding a "9-to-5" job is no longer required, using time productively is often a challenge. This might apply to the "wealth creator," who worked 12-hour days for 30 years, or the following generations, who might see employment and productivity as "optional" given the wealth that is available to them. In either case, the fact that productivity doesn't appear to be necessary often results in family members filling their time with activities that are financially detrimental. These activities might be anything from more frequent and extended travel to creating speculative business ventures that require significant capital to start and maintain.



   In any case, wealthy families focused on sustainability should find ways to differentiate spending on the things they truly enjoy versus expending capital simply because they are bored. They should also consider filling the "time void" with activities that enhance their other forms of capital, such as building new relationships, acquiring additional skills and embracing new physical and intellectual challenges.

5. **Ineffective family communication —** While many of the items above relate directly to financial sustainability, maintaining the family's core values is equally important to its long-term success. As children grow to have interests and children of their own, it becomes harder and harder to sustain a common set of values across the family's members. The only way to solve this challenge is to find ways to keep family members communicating with each other. This might include developing a shared family blog or website or holding an annual family retreat.



"Dear Andy — How are you? Your mother and I are fine. We both miss you and hope you are doing well. We look forward to seeing you again the next time your computer crashes and you come downstairs for something to eat. Love, Mom and Dad."

   While these "connecting" events and activities should give family members opportunities to play together and enjoy each other's company, they should also provide a forum to discuss tougher topics like wealth, relationships and any conflicts that might exist in the family. Like a successful company, the more the members of a family enjoy spending time with each other while also addressing their challenges, the more likely they are to achieve success in creating their desired legacy.

6. **Lack of a clear plan —** Above all, most families who fail to sustain wealth don't take the time to establish goals, and don't have an awareness of what it will take to accomplish those goals. They don't think about and discuss the multitude of trade-offs that exist in their quest for sustainability. A well-constructed plan will start with the family discussing and defining its purpose: What values do we wish to foster in future generations? How can we maximize our human capital? What relationships do we value? Next, the family should define its financial objectives in light of that purpose.

That definition might include conversations around:

- How much do we wish to prioritize consumption by the current generations at the expense of later ones?
- How much wealth do we wish to transfer to the younger generations?
- How well can we emotionally tolerate short-term downturns in the value of our investments?
- How will we inform and educate our younger generations about our values and history?

The planning process should include modeling to assess the impact of the trade-offs, and allow the family to chart a course that matches its identity and its goals.

Thinking about all of these topics might appear daunting and even somewhat painful at first, but the longer the family goes without creating a roadmap to success, the more likely it is to end up lost. To paraphrase the famous interchange in Alice in Wonderland: If you don't know where you're going, any road will get you there[4]. Of course, planning is not a one-time exercise; change is inevitable in our world. But those families who commit to periodic planning and maintaining awareness of all the challenges described above are likely to find themselves in good position to achieve the sustainability they seek.

[1] Dimensional Fund Advisors
[2] www.randomuseless.info
[3] www.foodtimeline.org
[4] Lewis Carroll www.TFOphoenix.com