FINANCIAL POST

Saturday, July 3, 2010

Legacy stash easily blown

Michael Nairne, Serious Money

An ancient Chinese proverb claims that "wealth does not pass three generations." Most cultures have similar sayings about the limited life of family wealth. The American "shirtsleeves to shirtsleeves in three generations" is thought to have evolved from the old Lancashire proverb "there's nobbut three generations atween a clog and clog." The Italian saying "from stables to stars to stables" grasps the transitory nature of family wealth in particularly vivid terms.

Indulging in an unaffordable lifestyle is a guarantee of wealth depletion. It is a particular problem of mega-earners from the corporate world and is endemic among professional athletes and entertainers. Multimillion-dollar paydays can encourage a first-class way of life that includes a palatial home, multiple vacation properties and luxurious travel. There is rarely enough savings to create the capital necessary to fund this lifestyle when the big bucks finally stop.

Without downsizing, capital depletion is inevitable. And humans being humans, the tendency is to bury one's head in the sand. When I worked in Los Angeles, I remember one actress, whose best earning years were behind her, repeatedly cancelled meetings to discuss selling her vacation home. Unfortunately, procrastination amplified the problem as her expensive lifestyle eroded her investment assets at an ever-growing pace.

Unaffordable lifestyles also cause wealth erosion for many affluent retirees. Here, the budget crisis doesn't occur quickly but creeps up over the years as inflation drives up the cost of living.

A failed marriage is another top reason for wealth destruction. More than a third of Canadian marriages result in divorce before the 30th anniversary. Studies have shown that diminishment in family wealth is far greater than simply splitting the assets. Legal fees and the cost of running two households add up.

Excessive risk-taking is another wealth destroyer. This can range from sheer speculation to impulsive overreaching to inadequate diversification. More than once, I have seen former business owners get caught up in active stock trading during boom times only to suffer major losses as bear markets hit.

Other times, it is an impetuous investment with a hot manager whose sizzling numbers go into free fall, triggering a regretful sale

Business failures demolish family wealth. The combination of an economic downturn and excessive debt is a formula for disaster. Losses here are particularly painful because the business interest often dominates the family's balance sheet.

A rare but devastating annihilator of wealth is fraud. Some of the victims of Earl Jones and Bernie Madoff suffered instant impoverishment. Corporate frauds such as Enron and WorldCom eviscerated thousands of their employees' investment retirement accounts.

Taxes erode family wealth. Unfortunately, many families compound this problem by failing to take full advantage of the many legitimate tax deferral and avoidance techniques available.

Maybe the biggest reason for family wealth dissipation is the loss of work ethic and thriftiness that the founding generation possessed. Raised in affluence, the younger generation often does not develop the habits, discipline and resourcefulness to preserve, let alone build, wealth.

Family wealth often vanishes over time. Fortunately, much of this erosion can be avoided with proactive wealth management. Financial education for the children, estate and prenuptial planning, cash management and budgeting, and a diversified investment strategy can all help ensure the third generation isn't back in shirtsleeves.

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