SECTION I

Financial Choices

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Calculating Your Family's Future

Many wealthy people have worked hard to amass their wealth, while others have been fortunate enough to inherit a large sum of money. In either case, most wealthy people do not take the time to answer the most important question this book will ask: What is money for? After answering this question, the next step is to calculate how much money is needed to reach your goals. Many wealthy people run out of money or leave far less to their kids or grandkids than they had imagined. The first section of this book, "Financial Choices," helps you consider what you want your money to be for, and helps you set a strategic course to meet your money goals. The three chapters in this section pose hard questions and introduce financial techniques to help you understand the realities of what happens to money through the generations. Although this section of the book may seem very technical, it is the first step to increasing the likelihood that your money will help, not hinder, your children's success, emotional health, and happiness.

The amount of money you decide to spend each year can have far-reaching consequences, both intended and unintended, on your children's future. It can affect the legacy you leave behind, not only in terms of how much financial capital they will eventually inherit, but also in terms of the lifestyle to which they have grown accustomed,

the messages your spending patterns send to them, their expectations (which may not be realistic if you outlive much of your wealth), and their career decisions. In addition to spending patterns, inflation, return on your investments (net of fees), the number of children you have, and the amount of wealth your children will create in the future will all affect the extent to which you will be able to meet your expectations for your children and future generations.

Self-Survey for Intergenerational Equity

Every chapter of this book presents a self-survey so that you can assess your assumptions and beliefs before you read about the subject matter. Please write your answers in the column to the left of each question. Then, after you read through the chapter, turn back to this page, and consider each question once again—this time, writing your answers in the column to the right of each question. By noting any questions you answer differently the second time, you can pinpoint areas of your lifestyle, parenting, and planning that you may want to reconsider and discuss with your spouse, advisors, and children. Perhaps this will lead to changes, subtle or profound, in the way you handle your wealth and improve the chances that it will enhance your family's healthy attitudes, expectations, and decisions concerning money.

Self-Survey about Intergenerational Equity

1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 Disagree, 5 = Strongly Disagree

BEFORE		AFTER
_____	I expect to leave my children enough assets to enable them to live at the same lifestyle our family currently enjoys, regardless of what kind of work they may do.	_____
_____	My children should have to work to support themselves at whatever lifestyle to which they may aspire.	_____

_____ percent	… is the approximate amount of my liquid assets I spend on average each year.	_____ percent
_____ percent	… is the approximate annual return my portfolios have returned, on average over the past ten years.	_____ percent
_____	At the rate I currently spend each year to support my lifestyle, my net worth will continue to appreciate in spending power over time.	_____
_____	My children will be prepared to manage the money they will likely inherit.	_____
_____	My children will be prepared emotionally to handle the assets they will eventually inherit.	_____
_____	My children will be prepared to adjust their expectations and standard of living regardless of whether they inherit substantial wealth or have to make their own way in the world.	_____
_____	I have communicated to my children my plans and expectations about the lifestyle they can expect to achieve (or not achieve) through their future inheritance.	_____
_____	I have considered what kind of legacy I want to leave future generations.	_____

What Is Money For?

There's no single correct answer to this question. Some feel their money is there to spend during their lifetime, and that their children should work to support themselves. Others believe their children should be entitled to the same standard of living as the parents enjoy. Most of us fall somewhere in between. For instance, some feel, especially if their money was inherited rather than earned, that they are stewards, not owners, of that money.

You may want your children to find fulfillment in a meaningful, successful career and the pride that comes from earning their own keep, but you may not want them to have to bear the financial

burden of paying for their home, vacations, retirement, or their children's education.

Some feel compelled to use their money to help society. For instance, some wealthy people decide to bequeath all or a significant portion of their net worth to a foundation, as Microsoft founder Bill Gates and entrepreneur/investor Warren Buffett have done. Buffett's estate, for example, will leave his children enough that so they would never starve; some of the excess has been designated for foundations partly for them, which they manage; the rest he has donated to Bill Gates's foundation.

We recommend that you sit down, preferably with your spouse (if you have one), to sort out what you want your estate to provide the next generation:

- The ability not to have to work, or to take a meaningful but low-paying job
- The ability to give back to society
- The ability to pay for their college education and that of their children
- Some amount of extravagance, such as travel or a vacation house

Whether or not you believe your children are entitled to inherit your wealth, they will need to know your intentions, which will affect their life decisions. If you live lavishly, they may assume they will be able to do so as well once they are on their own. If you live frugally and your children have no idea that they will eventually inherit vast sums, they will need to be prepared emotionally and intellectually to handle that wealth.

One unprepared young woman, Kathy, became enraged when she learned she would be inheriting enough money that she

TEACHABLE MOMENT

If your kids are old enough, which could mean when they know who they are and what they want to be—probably sometime in their twenties—you might want to include them in this discussion about what money is for.

UNINTENDED CONSEQUENCES

The lifestyle you choose to live will create certain expectations in your children as to what lifestyle they will maintain. Communication with your children about this, even when they are mature enough, may be uncomfortable or unpalatable, but it is one of the best gifts you can give them, regardless of how much or how little they may ultimately inherit.

would not need to work to maintain her lifestyle. She had chosen to get an MBA and had pursued a career on Wall Street rather than her passion for art. Had Kathy had any inkling she would not need to support herself, she would have taken a completely different path.

If you have $2 million in assets, your ability to create *intergenerational equity* so that your children will be able to replicate your lifestyle without having to work is not realistic. But perhaps you could create a more modest level of intergenerational equity in terms of providing a roof over your children's head—maybe not a palace, but a modest home in a nice community, or a down payment for a more upscale abode. Or you could supplement what your grown children earn so that they can enjoy a higher standard of living than they otherwise might.

Current Spending versus Future Intergenerational Equity

If you want your children to enjoy intergenerational equity, calculate whether your annual spend rate (as a percent of your net worth) will preserve enough capital for them to enjoy the same standard of living as your family currently enjoys. If you do not work, will they need to? Would you have answered this question the same way in 1929, 1960, 1985, 2005, 2008? What world events might make you think differently?

We talked with many high–net worth investors who analyzed the ability to create intergenerational equity and pointed out what

they think most investors fail to see. Richard Levi, age sixty-one and a father of two children, recalls a presentation he attended several years ago at which the presenter mentioned how rare it is for a family fortune to last past the fourth generation. Levi says the presenter explained that "estate and income taxes along with inflation (and occasional spendthrifts or imbeciles) play a role, but the real killer is that assets expand arithmetically and families expand geometrically."

Even if parents do everything right (however you define "right"), Susan Remmer Ryzewic, who has worked with her family for twenty years, points out unforeseen events can play a big part. "My thoughts are clouded by recent market events [the financial crisis that began in 2008]. No matter how much 'financial and family' planning one might engage in, there are events and mistakes that can change it. It is critical that we all know that the best-laid plans are subject to six-sigma events and may change."

Jeffrey E. Horvitz, who manages his family's third-generation wealth as vice chairman of Moreland Management Company in Beverly Farms, Massachusetts, explains, "I had tried to formalize the spending rate questions for taxable investors with my 'four horsemen' concept: fees and costs, taxes, inflation, and consumption. Lawyers and insurance salesmen have these huge projections where you own California by the third generation. Most get the tax part, sort of, and underestimate the fees, but completely miss inflation." Horvitz has found that compounding of inflation is the secret killer of wealth preservation and growth that most of us, and our investment managers, miss.

Fritzi Hallock, a principal who manages investments for her family office, believes achieving intergenerational equity "is just not possible without some active wealth creation in each generation. My grandparents were one couple in one household. They had two children in two households. Each child had three children (including me)—that's six more households. The next generation has eight children (at this point). How can we all live as well as the household who lived or lives the highest unless we are working ourselves or the wealth is grown?"

The following section presents the example of Bob, a forty-year-old man with a net worth of $10 million. We will create a spreadsheet calculation of Bob's intergenerational equity using several variables. The results of this calculation may help you understand how these variables impact future intergenerational equity with the wealth you have amassed. Keep in mind a long-term view over several generations. We focus on the spend rate, as that is the only variable fully under your control that may allow you to achieve intergenerational equity. Few wealthy people consciously consider the ramifications of their spending. Even those who do tend to grossly overestimate how much they think they can spend without eroding their principal. For instance, many wealthy individuals believe that, like charitable endowments, they can spend 5 percent of their net worth per year and still preserve their capital. Our calculations demonstrate that a more realistic spend rate is closer to 1 percent to 2 percent.

What follows is a fairly technical explanation of how we arrived at the 1 percent to 2 percent spending level. If you are a numbers person, the remainder of this chapter will show how we come to our conclusion. If you are not a numbers person, you may simply want to skim this chapter and go to our Web site (www.KWandC.com), where you can plug your numbers into our intergenerational equity calculator to see your personal results.

The point of this section is to calculate whether or not your current annual spending will allow you to meet your intergenerational equity goals, whatever they may be. If you find you will not be able to meet those goals, it's better to learn that sooner rather than later so you can weigh your options: finding ways to cut back on your spending, creating additional wealth, or lowering your intergenerational equity goals (and your family's expectations about that).

Here's how to make these calculations:

■ **Write down the current value of your assets.** You may want to read this chapter with your browser opened to our Web site (www.KWandC.com), where you will find a calculator that will enable you to plug in your actual numbers to figure out where you stand vis-à-vis intergenerational equity.

■ **How much are you actually currently spending?** We are going to assume, for this exercise, that our hypothetical Bob is spending about 5 percent ($500,000 per year) to support his current lifestyle, which includes a nice primary residence, a lovely vacation home on a lake with a beautiful boat, a ski trip to Aspen, Colorado every winter, a couple of long weekends in the Caribbean or Mediterranean each year, a few cars, and a nanny for his kids.

■ **Select a reasonable rate of return.** Of course, at the same time Bob is withdrawing funds to maintain his lifestyle, the balance of his portfolio is accruing interest or appreciating. For instance, if he has invested most of his assets in the stock market, his expected rate of return, pre-tax, will be in the neighborhood of 10 percent.[1] That's the annualized rate of return the S&P 500 has produced between 1926 and 2007. Your first impression might be that this is not a good number to use. In 2000 or 2008, people would have definitely felt that 10 percent was too high. However, remember that we want to take a long-term look over 100 years, or several generations. The years 1926 to 2007 include the Great Depression as well as the boom times of the eighties and nineties. During those times 10 percent may have seemed too low. It is important not to be swayed by current events but to use them as a guide. Estimating over a long period is best. In any one year, the numbers will not reflect current conditions. We will suggest numbers, but you should choose what you think is correct given your current understanding of what the future might bring. Then go to our Web site and enter your information based on those assumptions.

We picked the average of the S&P 500 over a long period because, even with the best, brightest, and most expensive investment advisors, the average wealthy member of the Institute for

1. According to http://www.moneychimp.com/features/market_cagr.htm (accessed July 6, 2009), the average return of the S&P 500 since 1950 has been 8.66 percent. Between 1996 and 2007 the rate was 8.83 percent. Money Chimp argues that the average may not be the right thing to look at and suggests, instead, using the real Compound Annual Growth Rate. The number is about 1 percent lower in both periods above.

Private Investors (IPI) has not done much better. In fact, as **Exhibit 1.1** illustrates, for each year between 1996 and 2008, this group was asked what their return was. The average for the group during the first eleven years (1996 through 2007) was 10.3 percent. Interestingly, the S&P 500 returned 10.6 percent during this same time period. So an average portfolio of this highly sophisticated investor group as a whole achieved about the same return as the S&P 500.

Many wealthy investors believe they are smarter than the market. In 2005 this group was asked to predict how their portfolio would perform that year. The following year, they were asked to compare their previous expectations to their actual results. How did this group actually do? The Institute for Private Investors Family Performance Tracking® 2006 – Part I survey found that almost half—47 percent—of their portfolios returned less than the 9.4 percent expected benchmark return, 27 percent came in right at 9.4 percent, and 26 percent achieved more than what they expected. We often over-estimate how our portfolios are performing or how they will perform in the future.

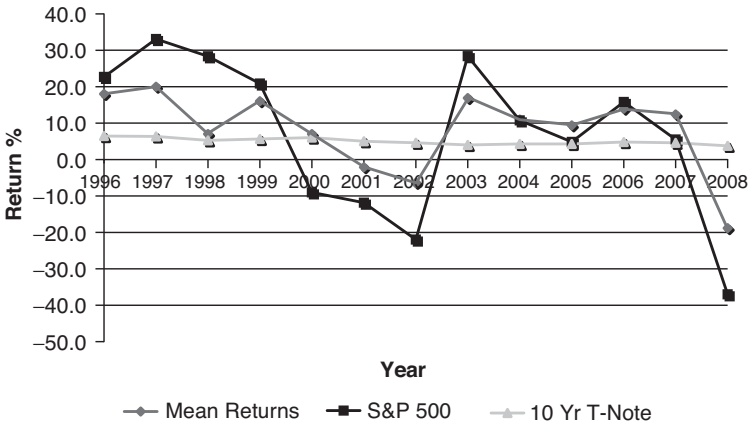

Exhibit 1.1 Return Trends 1996–2008

Source: Institute for Private Investors Family Performance Tracking® Survey Data.

However, this group tended to under-perform during up years and outperform the S&P 500 during down years. Exhibit 1.1 bears this out during the 2000, 2001, 2002, and 2008 bear markets. If you insist that you do better, that's great. But remember, during down years, you may need to dig into principal. If you have a down year and lose 20 percent of your portfolio, to make that up you will need several years of 14 percent to 15 percent returns. The most pronounced example is that if $100 drops to $50, you would need a 100 percent rate of return to get back to even.

Collin, an acquaintance, claimed his portfolio had been returning 14 percent over that same period. When prodded, he admitted that he was boasting only about his winners, not his losers, and that some investments, such as bonds and cash in the bank and money market funds, returned far less. After further thought, Collin realized, in fact, his total portfolio indeed earned about 10 percent.

Therefore, whether you are a passive investor or you get up every day and trade, over the long term it's difficult to make more than the S&P benchmark. The main exceptions are those who own an active business. Therefore, plug in whatever rate of return you want (on our online calculator or your own spreadsheet).

- **Subtract investment fees**, which can include banking fees, management fees, family office fees, and accounting or legal investment advice. An estimate of these fees is 1 percent, which brings Bob's return down to 9 percent.
- **Subtract taxes.** For our calculations, we will only consider two forms of taxes: federal and state income taxes.

State income tax rates vary depending on where you live. We'll assume a combined federal and state income tax for a high–net worth person to be about 25 percent. Tax rates periodically change and different investments have different tax consequences; if you've invested a large portion of your portfolio in long-term tax-free bonds, your income taxes will be lower than someone who puts the lion's share in the stock market.

Your tax advisor can recommend which rate is best for you to assume in the long term. Bob's 25 percent will further erode

his 10 percent investment returns (9 percent after investment fees) by 2.5 percent. That leaves him with just a 6.5 percent rate of return.

We are not factoring in inheritance taxes for this calculation. We assume that you'll be savvy enough over your lifetime to mitigate that tax rate as much as you can by using all the tools available to transfer your money during your lifetime into estate tax-free trusts. If you've purchased life insurance to cover any estate taxes that are not protected in such trusts, you should include your annual premiums in your annual spending budget to figure out how much you can spend each year to meet your intergenerational equity goals. You should also include any fees you pay professional estate planners, including lawyers and accountants, each year into your annual spending budget.

■ **Factor in inflation.** History tells us long-term inflation averages 3 percent to 4 percent per year. In the seventies, inflation was at double digits, while in 2008, during the spike in gasoline prices, the CPI (consumer price index) was running at about 3.8 percent. If your purchases are weighted heavily on food and fuel, your personal inflation rate would have been higher that year. In mid-2009 the CPI went down to about 3.3 percent. You should factor in a different inflation rate than the government reports, based on the goods and services you consume.

Inflation means $1 today will be worth about 97 cents in one year (at the long-term inflation rate of 3.15 percent),[2] or, to put it another way, you will need $1.03 next year to buy the same goods you bought this year for only a $1.00. Depending on our calculations, we will look at inflation using one of these perspectives. Specifically, when we are looking at the value of a portfolio, we will use the descending numbers to reflect how inflation erodes future value. When we are looking at how inflation erodes spending power, we will use the ascending numbers to reflect how much you have to spend after inflation to maintain a steady lifestyle. Just a 2 percent to 4 percent

2. Based on data obtained from http://www.bls.gov/cpi/#tables July 2009.

TEACHABLE MOMENT

Will saving money in a one-year certificate of deposit (CD) provide the same buying power, after inflation, when it comes due? Try an experiment with your kid. Find something she wants to buy and have her put the money in a one-year CD. See if she can afford it after a year. Is there money left over to reinvest?

inflation rate can be a large hurdle to keep up with your spending rate even if you want to leave nothing behind. For the purposes of our calculation, we'll use 3 percent.

Let's say Bob spends 5 percent of his portfolio every year. **Exhibit 1.2** shows what his portfolio will look like over time. His assets, in forty years, would double to $20 million, and his spending rate would be about $1 million. That sounds wonderful.

Exhibit 1.2 Portfolio Growth

SPEND RATE @ 5% OF ASSETS	CURRENT YEAR	20 YEARS	40 YEARS
Age of Person	40	60	80
Projected Investment Return after Fees	9%	9%	9%
Tax Rate	25%	25%	25%
Inflation Rate	3%	3%	3%
Value of Liquid Assets	$10,000,000	$14,147,782	$20,015,973
Annual Increase/ Decrease to Portfolio after Taxes and Spending	$175,000	$247,586	$350,280
Actual Annual Spending @ 5%	$500,000	$707,389	$1,000,799

However, if we look at his annual spending in **Exhibit 1.3**, we find that to keep up with inflation, his buying power has actually been reduced. At age eighty he would only be able to live at 61 percent of his current lifestyle. That's because, to keep up with inflation, Bob would need to spend $1.6 million, and he will only be spending $1 million per year in forty years.

To keep up with inflation and maintain his buying power, Bob's spending will have to increase by 3 percent per year. He may have more dollars to spend due to future growth of his assets, but that will only

Exhibit 1.3 Inflation Erosion

SPEND RATE @ 5% OF ASSETS	CURRENT YEAR	20 YEARS	40 YEARS
Age of Person	40	60	80
Projected Investment Return after Fees	9%	9%	9%
Tax Rate	25%	25%	25%
Inflation Rate	3%	3%	3%
Value of Liquid Assets	$10,000,000	$14,147,782	$20,015,973
Annual Increase/ Decrease to Portfolio after Taxes and Spending	$175,000	$247,586	$350,280
Actual Annual Spending @ 5% of Assets	$500,000	$707,389	**$1,000,799**
Inflation-Adjusted Annual Spending @ 3% Per Year	$500,000	$903,056	**$1,631,019**
Future Buying Power (Lifestyle)	100%	78%	**61%**

buy him the same amount of goods as it does today. We will continue to use 3 percent as our buying power inflator. As **Exhibit 1.4** illustrates, Bob's $500,000 dollar spending rate would have to grow to about $900,000 in twenty years, and almost $1.6 million in thirty-nine years, to maintain the same buying power as today. We use thirty-nine years instead of forty, as Bob's portfolio will not last him forty years.

This is because Bob's spending and inflation would greatly erode his future portfolio value. As **Exhibit 1.5** illustrates, even after factoring in his portfolio return (less taxes and investment fees), his assets would be negative $354,989 in thirty-nine years.

So much for intergenerational equity! If he spends more and more each year to keep up with inflation, not only will our Bob not have anything to leave his children, he will, in fact, run out of money in thirty-nine years, when he is seventy-nine years old.

How could this be? After all, his portfolio is growing at 6.75 percent, after investment-management fees and taxes. That leaves him with $675,000 to spend and reinvest. The problem is that in reality, he is spending after-tax dollars, not pre-tax dollars. For instance, in year one, his $500,000 spending is 5 percent of the value of his portfolio. However, his $500,000 spending equals 74 percent of his after-tax investment returns—that leaves only $175,000 to be added to the portfolio to be reinvested. Bob is adding less then 2 percent to his portfolio each year while inflation is at 3 percent. The problem gets worse each year if he increases his *spending* to keep up with inflation.

For Bob's *assets* to keep up with a 3 percent inflation rate, he will need to reinvest about 3 percent back into the portfolio. This will allow

Exhibit 1.4 Inflation-Adjusted Spending

INITIAL 5% SPEND RATE, THEN KEEP UP WITH INFLATION	CURRENT YEAR	20 YEARS	39 YEARS
Age of Person	40	60	79
Spending to Keep up with Inflation @ 3% Per Year	$500,000	$903,056	$1,583,513

Exhibit 1.5 Running Out of Money

INITIAL 5% SPEND RATE, THEN KEEP UP WITH INFLATION	CURRENT YEAR	20 YEARS	39 YEARS
Age of Person	40	60	79
Projected Investment Return after Fees	9%	9%	9%
Tax Rate	25%	25%	25%
Inflation Rate	3%	3%	3%
Value of Liquid Assets	$10,000,000	$11,772,096	**$(354,989)**
Annual Increase/ Decrease to Portfolio after Taxes and Spending	$175,000	$(108,439)	$(1,607,475)
Inflation-Adjusted Annual Spending @ 3%	$500,000	$903,056	$1,583,513
Future Buying Power (Lifestyle)	100%	100%	**100%**

the portfolio to compound and increase in value at the same rate as inflation. **Exhibit 1.6** shows that if Bob spends about 3.75 percent of his portfolio each year instead of 5 percent, he will be able to sustain that spending rate into perpetuity as long as taxes, investment fees, and investment returns stay the same on average over the years.

At this rate, what will Bob have left to leave his children?

■ **Consider how many children you have.** The U.S. Census calculates that today, a woman can expect to have in her lifetime an average of two children.[3] If Bob has two children and wants to achieve perfect intergenerational equity for both of them, he will need to spend less than the

3. *Source*: U.S. Census (http://www.censusbureau.biz/Press-Release/www/2006/cb06ff07-2.pdf).

Exhibit 1.6 Adjusting Spending to Preserve the Portfolio

SPEND RATE @ 3.7% OF ASSETS	CURRENT YEAR	20 YEARS	40 YEARS
Age of Person	40	60	80
Projected Investment Return after Fees	9%	9%	9%
Tax Rate	25%	25%	25%
Inflation Rate	3%	3%	3%
Value of Liquid Assets	$10,000,000	$18,237,274	$33,259,816
Annual Increase/ Decrease to Portfolio after Taxes & Spending	$305,000	$556,237	$1,014,424
Actual Spending @ 3.7%	$370,000	$674,779	$1,230,613
Inflation-Adjusted Annual Spending @ 3%	$370,000	$668,261	$1,206,954
Future Buying Power (Lifestyle)	100%	101%	**102%**

3.7 percent we arrived at to maintain his buying power and pay taxes and investment fees. If he has three children, he would need to spend even less to achieve perfect intergenerational equity by age 80.

Because no one knows at what age they will die, or when they may want to begin future distributions to their children, **Exhibit 1.7** uses a 1 percent spend rate to demonstrate how this may plays out.

Note that the buying power is truly the ability to achieve intergenerational equity. At 1 percent, Bob could almost support three adult children at the original buying power he had when he was forty. Because his kids will want or need cash before he dies, Bob will want to share this intergenerational wealth while he is alive. For Bob to

Exhibit 1.7 What You Can Leave Behind

SPEND RATE @ 1% OF ASSETS	CURRENT YEAR	20 YEARS	40 YEARS
Age of Person	40	60	80
Projected Investment Return after Fees	9%	9%	9%
Tax Rate	25%	25%	25%
Inflation Rate	3%	3%	3%
Value of Liquid Assets	$10,000,000	$30,591,975	$93,586,896
Annual Increase/ Decrease to Portfolio after Taxes and Spending	$575,000	$1,759,039	$5,381,247
Actual Spending @ 1%	$100,000	$305,920	$935,869
Inflation-Adjusted Annual Spending @ 3%	$100,000	$180,611	$326,204
Future Buying Power (Lifestyle)/ Intergenerational Equity	100%	169%	287%

maintain his $100,000 lifestyle (a 1 percent spend rate), he will not need to spend the almost $1 million he can draw on at age eighty or the $300,000 that he will have at age sixty. He can distribute to his children some or all of the excess of his 1 percent spend rate in any given year.

Other Factors

If you are in the money-making mode, and you therefore have not completed your "endowment," you can add how much you expect

your saved earnings will add to your estate during your remaining expected work years. Or, perhaps you know that at some point you will inherit a large sum. (Our Web site will include a separate calculator that will allow you to factor in any ongoing wealth creation or eventual windfalls.)

Let's look at how that might affect future intergenerational equity. Let's say your current net worth is $5 million, and you are currently making $1 million a year from your active business endeavor or your salary. Assume you are supporting your lifestyle from your business earnings and are putting away 25 percent or $250,000 per year. When you retire, what will you start off with in your "endowment?" Here is the calculation: the $5 million you had in savings and the amount you add to it will grow on average 9 percent per year from investments. (As we discussed earlier in this chapter, you will have to subtract the taxes you will have on your investments and add to it the $250,000 contribution from your active business or employment to savings each year.) As **Exhibit 1.8** shows, your current net worth will grow to almost $12 million. However, if we adjust that wealth to today's buying power, it will be worth more like about $10 million after inflation in ten years.

Therefore, you will have to decide how much to spend and how much to save or give to your kids during your lifetime to achieve the intergenerational equity you may want to leave behind, and at what age.

Getting back to Bob, so far we have assumed that he will never spend any more money than his current spend rate. But people can end up spending more money during some periods of time. Bob may have more children. A divorce could cost him big time. Plus, older kids tend to cost more. Then again, perhaps in Bob's later years he pares back his lifestyle: he may decide to travel less, reduce spending on "toys," and sell one or more of his homes, lowering his annual expenses. You can play with different assumptions about your future spend rate on our online calculator (www.KWandC.com) or your own spreadsheet.

We have also assumed thus far that future generations' assets depend solely on the current generation's net worth. As we mentioned earlier, that wealth will unlikely be able to support the growing

Exhibit 1.8 Factoring in Wealth Creation and Windfalls

YEARS	START	10	15	20
Current Net Worth	$5,000,000	$11,964,350	$18,016,029	$26,405,127
Investment Return @ 9%	$450,000	$1,076,791	$1,621,443	$2,376,461
Annual Taxes on Investments @ 25%	$(112,500)	$(269,198)	$(405,361)	$(594,115)
Annual Contri-bution to Net Worth (Savings)	$250,000	$250,000	$250,000	$250,000
Annual Increase in Wealth	$587,500	$1,057,594	$1,466,082	$2,032,346
Reduction in Buying Power Due to Inflation @ 3%	$-	$2,304,197	$4,619,827	$8,044,432
Inflation-Adjusted Wealth @ 3%	$5,000,000	$9,660,153	$13,396,202	$18,360,694

family, as your children have children, and each of them have children. Even if every member of future generations lives a moderate lifestyle and manages the family money wisely, your descendants are unlikely to maintain that affluence without each future family member generating further wealth. That may or may not trouble you. If it does, you would be wise to try to motivate your children to pursue a profession, learn how to invest and manage wealth, and develop

UNINTENDED CONSEQUENCES

One family office director was concerned for one client's children. The family always flew on their private jet. At the parents' current spend rate, it was clear there wasn't going to be any money left for the kids to maintain that lifestyle, and they would be ill-equipped to deal with the emotional baggage and basic skills when they eventually have to fly commercially. Growing up with a wealthy lifestyle can leave offspring clueless about how to handle a different lifestyle.

TEACHABLE MOMENT

How did you make your money? Is most of your wealth from your own earnings, investing acumen, entrepreneurial expertise, luck, or inheritance? What stories—with lessons learned along the way—can you impart to your children about your successes and failures along the way? Do you expect your children to make their own way even if eventually they will inherit significant money?

at least some limits to their lifestyle—which we cover in Sections II (Intellectual Choices) and III (Emotional/Spiritual Choices).

Comparing 1929 and 2008

It's not hard to get a bit depressed and wonder how you can possibly create intergenerational equity when the market tanks the way it did in 2008. But few people consider that during a market crash, other variables change—some to our advantage:

- Inflation usually goes down or becomes negative (which economists call *deflation*).
- You can use tax losses to cover future gains, reducing the tax you will need to pay in the future.
- If you are not making money in the market, you may owe no tax at all on your portfolio.
- There may be great investing opportunities for those who won't lose too much sleep before their picks have a chance to reward them.

Remember, our model for Bob is based on long-term equilibration back to financial norms since 1926. Even if the rate of return changes, it is likely that other numbers will change in the calculation and that plugging in new assumptions for all of the numbers may help you create intergenerational equity for at least a portion of the lifestyle you want to hand down to your children.

Where to Go from Here

If you find that based on your current spend rate, you will not be able to leave your children enough assets to enjoy the same lifestyle, you have some thinking to do. Many wealthy individuals believe that their children will be much happier and emotionally healthier if they are forced to make their own way in the world. Perhaps you'd like to leave them some start-up capital to finance their own business or provide them with a rainy-day fund to protect them from some of life's inevitable crises, be they financial, medical, or emotional.

It makes sense to take time to evaluate your values and goals about intergenerational equity and then have the information to figure out if your current lifestyle will enable you to achieve those goals.

This is a feedback loop. You start with an assumption about the lifestyle you want to maintain with intergenerational equity. If the formula shows it's not possible to achieve your initial assumptions about full intergenerational equity, you may have to adjust those assumptions or consider other choices. For instance, you may in your heart want your kids to live your lifestyle, but ultimately you may realize the best you can do is provide them with a vacation home and an education. Or you can find ways to reduce your own spending. Or you can find ways to earn money so your net worth will grow enough to achieve complete intergenerational equity.

There's no right or wrong goal concerning intergenerational equity. You can have a different set of rules for yourself than for your kids — you can enjoy spending what you want and leave behind whatever is left over, if anything. The only real mistakes are:

■ unconsciously assuming, and leading your children to assume, that they will be able to achieve the same lifestyle you currently live,

without realizing that at your current spend rate, that will not be possible;

- not preparing your children financially and emotionally for living a much more modest lifestyle, if they will need to; and
- failing to prepare them financially and emotionally if they will inherit significant wealth.

Whether or not your children will be able to live off of your estate eventually, they will be able to decide what kind of education and career they want and feel they need, based on an accurate picture about future intergenerational equity.

In the United States, our children have generally always ended up better off than their parents were. Our ancestors came into this country with nothing; they worked and managed to save a bit; maybe they started a business that the next generation built up, or their children went to college and entered lucrative professions.

In many cases, parents who inherited all their wealth may feel differently than parents who built their own fortunes. One third-generation family business owner, for instance, feels he should be a steward of the wealth that his family spent eighty years amassing. Another parent, an entrepreneur and brilliant investor, decided his grown children would, for the most part, be left to their own devices to achieve any lifestyle they wanted. He left most of his fortune to various charitable organizations and a relatively modest amount for his children so that they would never have to worry should they encounter serious problems. He also created a family foundation for his children to manage, to enable them to support causes that reflect their values and passions. In case you haven't guessed, this person is Warren Buffet.

The next chapter will present important issues about trusts and trust. Before moving ahead, please return to the beginning of this chapter and re-take the self-survey. Note which questions you answer differently now, and consider what the ramifications could or should be in terms of the parenting and lifestyle choices you make day to day and the plans you have made for your family's future.