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THE GREATEST WEALTH TRANSFER EVER: UNDONE BY DEMOGRAPHICS

Americans born in the early 20th century who weathered the Great Depression, won World War II, and birthed the Baby Boomers, have often been referred to as the "Greatest Generation," referencing a best-selling book of the same name written in 1998 by Tom Brokaw. Besides being the primary players in the global events that led to the United States becoming the world's pre-eminent power of the last 60 years, the Greatest Generation was projected to make one last imprint on American history: through their productivity and thrift, the Greatest Generation as a group would leave the greatest inheritance in recorded history to their Boomer children. In keeping with the "great" rhetoric of their era, this event was deemed the "Greatest Wealth Transfer Ever" (GWTE) by the financial media.

When the conversation about the coming Greatest Wealth Transfer Ever began about a decade ago, Baby Boomers couldn't help but see this predicted event as a potential windfall. These generous inheritances would be a "bailout" for their own lagging retirement savings, and settle their extensive borrowing. Having given birth to the Baby Boom generation, the Greatest Generation would now fund its retirement. It was a great storyline, with a tidy, feel-good ending. And almost too good to be true…

A June 11, 2012, *Wall Street Journal* article by Anne Tergesen titled, "Counting on an Inheritance? Count Again." begins:

> **For a growing number of boomers, things aren't going according to plan. The post-war generation is living longer – and many are spending their savings along the way. And, of course, many of them also took a hit in 2008.**
>
> **The result is that, as a group, boomers likely won't be getting as much of an inheritance as they hoped. Even worse, far from receiving a bequest, a growing number are tapping some of their *own* savings to help their cash-strapped parents make ends meet.**

What happened? And how did it happen so fast? Has the Greatest Wealth Transfer Ever (GWTE) vanished?

An examination of the events of the past decade can uncover a number of factors that have converged to create a pessimistic perspective on the GWTE ever coming to fruition. The bursting of the real estate bubble, the stock market's subsequent decline, and the recent economic recession certainly played a part. Technology has been a major influence as well. The Information Age has reshaped manufacturing, expanded medical knowledge and treatment, and created a global economy; what happens in China, Russia, or Europe impacts the financial lives of Americans, and vice versa. But the variable with arguably the greatest impact has been demographics. And demographics are strong determinants of long-term economic outcomes.

The obvious demographic indicator is: the Greatest Generation substantially exceeded the life expectancies of the preceding generations. As Tergesen states, this means some would-be inheritances are either delayed or consumed. Consumption of accumulated wealth is often accelerated by longer life spans, because living longer today usually entails significant medical and healthcare expenses at the end of life.

A not-so-obvious factor is the connection between America's financial behavior and Baby Boomer demographics. This relationship made for unique economic possibilities. But as the demographics have changed, many of these economic relationships have become unworkable. The wealth creation associated with the Greatest Generation

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was built on expansion, particularly of the population. During the period prior to World War II, the national fertility rate had been declining, due largely to the economic distress of the Great Depression. A March 2009 report from the Population Reference Bureau put the national fertility rate during the pre-war years at 2.3, (i.e., American women of child-bearing age averaged slightly more than two children). During the Baby Boomer period (roughly 1946-1964), this number increased to nearly 3.5.

Combine this robust population growth with a post-war economy converting from making armaments to consumer products, and the result was a powerful economic explosion. New families needed new homes, new cars, and new schools. And as technology advanced, there were new things to make, new markets to enter and new workers to make them. There was always more – more demand, more work, more money to make.

Boom times are well-suited for credit expansion. When the market seemed limitless, both lenders and borrowers believed the potential profits far outweighed the risks. And it was true.

The American economy was so productive it overwhelmed most of the dubious financial decisions made by individuals, businesses and governments. Prior to the emergence of the Baby Boom, American consumers were cautious about personal debt; within a decade, financing became an accepted practice for automobiles, furniture, washing machines and TVs. Unions could negotiate generous pensions from corporations because projected expansions could overcome unreasonable assumptions. Although Social Security, implemented during the Great Depression, failed to meet its actuarial assumptions in response to increased life expectancies, an expanding population kept the program solvent. And governments at all levels could borrow, confident the growing next generation would pay for it all.

A lot of the "conventional" paradigms of personal finance were formed from this expansion mindset. The standard retirement age of 65 was intended to make room for an increasing cohort of younger workers to support the previous generation. Retirement planning was a "three-legged stool" of Social Security, a company pension, and personal savings. You bought more house than you could afford, with the longest mortgage, knowing market values would rise. These ideas presumed a growing population.

The credit-fueled expansionist financial model works – as long as there are ways for the economy to expand, like markets overseas and new technologies. But a primary engine of economic growth is new babies. And for a variety of reasons, the Baby Boomers have not reproduced like the Greatest Generation – and neither have the generations that have followed them.

A February 16, 2012, *USA Today* article, citing the Population Reference Bureau, found "The U.S. population is growing at the slowest rate since the Great Depression," and that the U.S. fertility rate "is estimated to have fallen to 1.9." This drop below the replacement rate of 2.1 is attributed to the recession, and is expected to inch up slightly. But it is a far cry from the expansive birth rates of five decades ago. Population demographics in the United States have changed.

And if the demographics have changed, it means many of the financial assumptions will have to change as well – for everyone. Need confirmation of the necessity of a new financial perspective? Look at the European Union. Aging, stagnant populations cannot support their country's social programs, pay their national debts, or expand their economies. And there is a growing awareness that "stimulus spending" – a concept designed for expanding populations – may no longer be a solution.

Bringing the impact closer to home, fewer American workers today have institutional "automatic" programs for financial security. Two of the three legs of the Greatest Generation retirement stool – Social Security and pensions – are wobbly or vanishing for the Boomers and successive generations.

Going forward, government-administered social welfare programs will struggle because there won't be enough people working to support the recipients. The Social Security Administration reports that today 19% of Americans currently receive a monthly benefit check; that's almost one in five. As the first wave of Baby Boomers approach their mid-60s, the percentage is going higher – with proportionately fewer workers left to pay the bill.

At the same time, employers and governments are unloading their pension and other "legacy" benefit programs as fast as they can. In June, General Motors announced it was transferring a portion of its pension plan to a private insurer, giving 42,000 retirees the option of receiving a lump-sum distribution or a monthly annuity check from the insurance company. GM management indicated the decision was due to a desire to see its "pension obligation reduced significantly." A front-page headline from the June 23, 2012 *Wall Street Journal* announced "More than 40 states have moved to trim pension costs since the financial crisis."

Over time, national economies will adjust to these demographic changes, and establish new working models for profitability. Some optimistic observers see the recent financial turmoil as a shake-out that will usher in an era of sustainable growth, i.e., a stabilized population coupled to a slow, steady rate of expansion. But the transition to this financial paradise may be bumpy.

For the present, the most effective responses to these demographic-influenced changes are at an individual level. By their sheer size, governments and large corporations are often slow to adjust to changing paradigms, but individuals don't face the same restrictions. While the details will vary with individual circumstances, there are general ways in which changing demographics may reshape your financial perspectives.

If you want an inheritance or a retirement fund in your financial future, ***you will have to plan for it.*** You can't expect to work 30 or 40 years, then stroll down to Human Resources at age 65 and say "So, what are my retirement options?" And the likelihood of leaving or receiving an "accidental inheritance" is slim to non-existent.

Beyond taking greater responsibility, the new demographics may fundamentally alter many important long-term financial decisions. The biggest change: that most

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Americans will work longer. The financial feasibility of owning a home (and where you choose to live) may need to be re-evaluated. Borrowing should be re-thought as well, for a house or other items. Changing demographics will influence your choice of retirement accumulation formats. Business models for capitalizing, starting and maintaining a profitable business will be different. And addressing the medical expenses and living arrangements of aging family members will require greater financial attention.

The economic impacts of changing demographics are slow-moving but inevitable. For aware individuals, these trends can present great opportunity. In contrast, those who persist on operating from old assumptions based on the demographics of the past are exposing their financial futures to greater risk.

DO YOUR FINANCIAL DECISIONS TODAY REFLECT THE DEMOGRAPHICS OF THE FUTURE?

ARE THERE WEALTH TRANSFERS THAT REQUIRE PLANNING TO MAKE SURE THEY OCCUR?

HOW LONG WILL IT TAKE TO RECOVER FROM THE GREAT RECESSION?

At regular intervals, the Federal Reserve conducts a Survey of Consumer Finances (SCF), an in-depth assessment of changes in consumers' net worth and income across the country. The findings from the latest survey, covering 2007 to 2010, were released in June 2012. The time frame is significant, as it provides a before-and-after financial snapshot of American households in relation to the recent economic downturn. For most Americans, it isn't a pretty picture. Here's a *Washington Post* summary from a June 11, 2012, article: "The Federal Reserve said the median net worth of families plunged by 39% in just three years, from $126,400 in 2007 to $77,300 in 2010. That puts Americans roughly on a par with where they were in 1992."

Gary Halbert, writing in the June 19, 2012, *Forecast and Trends* newsletter, was more blunt: "Put another way, **two decades of accumulated prosperity simply vaporized in 2007-2010."**

The SCF net worth calculation considers all assets such as a home, savings, investments and other items. In this context, it's easy to explain the steep decline in Americans' net worth: a double-whammy of a real estate bubble and stock market crash.

Hulbert notes that "We had the worst housing bubble on record, with home values plunging by 60% in some areas of the country." During the same period, "The Dow Jones Industrial Average peaked at **14,164** on Oct. 9, 2007, and then plunged by more than half, to **6,547** on March 9, 2009. While the stock markets have recovered much of the lost ground over the last three years, many Americans bailed out during the recession and never got back in."

The numbers are sobering; and become even more so when you begin to calculate how long it might take to recover from these losses. Consider the following:

If the 2010 median net worth of $77,300 is equivalent to the median net worth of 1992, it is possible to calculate the average annual rate of growth in median net worth from 1992 to 2007, when the amount reached $126,400 before the recession. For this 15-year period, the average annual growth in net worth was slightly less than 3.35%. (See Fig.1)

Beginning Balance: **$77,300** **FIG.1**
Annual rate of Growth: **3.35%**

Year	Yr-End Balance	Year	Yr-End Balance
1993	$79,890	2000	$100,615
1994	$82,566	2001	$103,986
1995	$85,332	2002	$107,469
1996	$88,190	2003	$111,069
1997	$91,145	2004	$114,790
1998	$94,198	2005	$118,636
1999	$97,354	2006	$122,610
		2007	$126,718

If a 3.35% rate from 1992-2007 were to persist in the future, it would take 15 years for the average American household to simply return to their 2007 level of wealth.

Of course, there have been periods where net worth has increased at a much faster rate. What if the annual rate was 5%? (Fig. 2)

Beginning Balance: **$77,300** **FIG. 2**
Annual rate of Growth: **5.00%**

Year	Yr-End Balance	Year	Yr-End Balance
1	$81,165	6	$103,589
2	$85,223	7	$108,769
3	$89,484	8	$114,207
4	$93,959	9	$119,918
5	$98,657	10	$125,914
		11	$132,209

At 5%, the return to the 2007 baseline is reached in slightly more than 10 years, which is better, but still a long time. If the projection was cautiously optimistic, with an annual rate of growth of 8%, the recovery time would be a bit past 6 years.

But these calculations are nothing more than math exercises. For the projections to be relevant, they must reflect reasonable real-world expectations. What is a "realistic" rate of growth for Americans' net worth?

FACTORS AFFECTING RECOVERY OF NET WORTH

For a swift recovery in net worth to occur, three real-world factors must be favorable:

- **Incomes must be high enough for families to save significant amounts.**
- **Since housing is a relatively illiquid asset (homeowners can't quickly sell their homes to reallocate their portfolio or minimize losses), market values must rebound.**
- **Investment returns must improve.**

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Right now, none of these factors can be viewed as trending positive.

First, adjusted for inflation, Hulbert reports that families' incomes have continued to decline, a trend that predated the financial crises in 2007: "Median family income fell from **$49,600** in 2007 (adjusted for inflation) to **$45,800** in 2010. Note that these numbers are already 18 months old, and conditions could actually be worse today." Furthermore, the percentage of American families saving *anything* fell to **52%** in 2010, down from 56.4% in 2007.

If Americans aren't saving, the only way their net worth can increase is if existing assets grow in value. For many Americans, one of their biggest existing assets is a home. While some areas of the country have shown a bounce-back in residential values, a February 2012 report from Zillow Real Estate Research forecasts the market will not bottom out until 2013. After the bottom, values will likely match GDP growth, which has hovered between two and three percent annually in recent years.

If real estate isn't anticipating a quick bounce-back, that leaves investments. Conservative, guaranteed accumulation vehicles are currently yielding record-low interest rates. Bank savings pay less than 1%, and even longer-term Certificates of Deposit are barely at 2% annual return. The U.S. stock market, as represented by the S&P 500, has been quite volatile since its October 2007 peak, experiencing several run-ups and sell-offs; as of June 21, 2012, it remained 11% below the 2007 high watermark. And, as economist Kenneth Goldstein told the *Huffington Post* on February 13, "The economy that we had before the recession is gone. It's not coming back."

Given the status of these real-life factors, projecting an annual net worth growth rate of 2% isn't unreasonable or pessimistic. It just makes recovery a lot longer. (Fig. 3):

The possibility of taking 25 years to just break even for three years of losses is staggering. Which makes the following point: **Some of the best financial strategies are those that avoid losses.** Steady progress, even with a lower rate of return, often provides the greatest chance of long-term financial success, simply because you avoid the devastating impact of investment loss – in both time and money.

The conventional mantra for real estate or stock market investing has been to ride out the roller-coaster of gains and losses and benefit from the overall upward trend. Historically, the numbers bear out this approach – over the very long-term. But recent events may compel American households to have a greater appreciation for the advantages of **balancing their portfolios with asset classes that emphasize steady growth over spectacular possibilities**.

"There are two times in a man's life when he shouldn't speculate: When he can't afford it and when he can."
– Mark Twain

THE ENDURING VALUE OF AN INHERITANCE

"Someone's sitting in the shade today because someone planted a tree a long time ago."
– Warren Buffett

Here's an ironic observation: While our life expectancies have increased, our perspectives on time have shortened, particularly in regard to prosperity, wealth accumulation and inheritance.

Two hundred years ago, pioneer families homesteading on the American prairie understood wealth creation and financial security came with a long time horizon. Clearing the land, erecting a home, and developing a farm were long, arduous undertakings. Prosperity was uncertain, and in many instances, success was not going to be seen by the first generation, but by successive generations who could build on the foundations of their ancestors.

The Industrial Revolution dramatically changed this multi-generational view of wealth accumulation. For fortunate entrepreneurs, technology and mass production condensed the wealth-building process. Captains of industry like Andrew Carnegie, Cornelius Vanderbilt and Henry Ford not only amassed astounding fortunes, they did it fast enough to transition from work to luxury to philanthropy in one lifetime. Their rags-to-riches examples are a template for financial success today – only in the Information Age, the pace of wealth accumulation can be even faster.

But while stories of individual financial success prove that opportunity for massive wealth is available to almost anyone, these out-sized examples obscure another economic reality: Inherited wealth can still make a big difference.

Consider the following excerpt from an article by Adrian Reyneri, posted April 9, 2012, on millionairecorner.com:

> "About one-third of high net worth investors attribute their wealth in part to inheritance, according to a Millionaire Corner survey completed in the first quarter of this year. High net worth individuals have $5 million to $25 million, not including primary residence. Inheritance appears to play a smaller role in the fortunes of less affluent investors. Just under 30% of Millionaires – those with investable assets of $1 million to $5 million – attribute their wealth to inheritance. The share falls to 26% for Mass Affluent investors – those with $100,000 to $1 million, not including primary residence."

These statistics don't in any way diminish the fact that it is possible to accumulate significant wealth in a single lifetime even if you are starting from zero. But if close to 30% who are wealthy say inheritance was a significant factor in building wealth (see graph), perhaps a greater emphasis on multi-generational financial strategies is in order.

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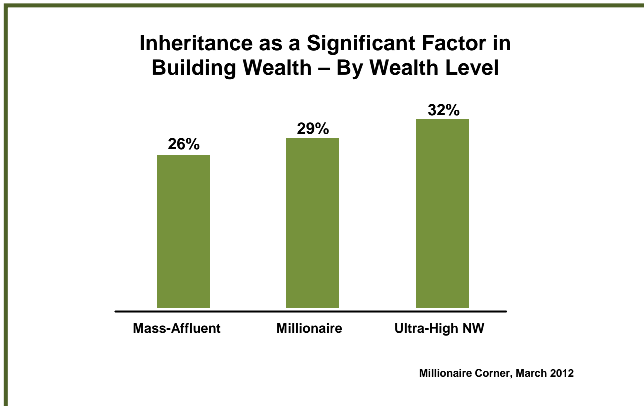
However, some information indicates there's a disconnect for Baby Boomers when it comes to inheritance compared to other generations, both older and younger. Here is a June 23, 2012, "Weekend Investor" summary in the *Wall Street Journal*:



> Just 55% of baby boomers said it was important to leave money to their children, according to a U.S. Trust survey of investors with at least $3 million in investable assets. By contrast, some three-quarters of people between the ages of 18 and 47 and those 67 and older said leaving money to their children was a priority.

In a June 18, 2012, Reuters article on the topic, some baby boomers said their ambivalence toward inheritance was based on the belief that "Each generation should create its own wealth." And another long-held objection is that receiving unearned wealth will blunt initiative or encourage spendthrift behavior in the recipients

These may be legitimate concerns, but hardly reasons to categorically dismiss the value of inheritance.

Under normal circumstances, parents will have plenty of time to train and evaluate the ability of their children to handle increased wealth in a responsible manner; by the time the parents pass, these children should have established careers and children of their own. (Even in ancient times, Solomon pronounced that "A good man leaves an inheritance to his children's children," understanding that many legacies benefit grandchildren more than children.) Properly prepared, beneficiaries can receive great blessings from an inheritance.

Maximus, the hero of the Oscar-winning 2000 movie, "Gladiator" tells his soldiers before battle that "What we do in life echoes in eternity."

IF YOU WANT SOME OF YOUR FINANCIAL EFFORTS TO ECHO IN ETERNITY, PLANNING TODAY IS A NECESSITY.

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