

The Third-Generation Curse: Impatience vs. Patrimony-Building

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There is a famous proverb in the United States: “From shirtsleeves to shirtsleeves in three generations.” Interestingly, many diverse nations have the equivalent saying: “Rice paddies to rice paddies in three generations” in Japan; “Clogs to clogs is only three generations” in England; “Wealth never survives three generations” in China; “The father buys, the son builds, the grandchild sells, and his son begs” in Scotland: these are just a few colorful examples.

In more than forty years taking care of families and their patrimonies, I have become convinced that all families have clear, often predictable, financial winners and losers — and that losers often belong to the third generation. Fortunately, not all members of that generation are necessarily doomed to take that role.

In western developed nations, we tend to believe that winners and losers are determined by social and cultural factors. But it seems to me that to be so universal, the idea of a third-generation “curse” must be more deeply rooted in human nature itself.

Missing the Incentives of the First Generation

First-generation fortune builders usually had an original, often disruptive idea. Some were immigrants (as so often in the United States) and had to surmount the barriers and prejudices associated with their origins. Many simply did things differently, either in their neighborhood or in their industry. But as a rule, most founders of multi-generational fortunes surmounted significant adverse odds. Their overriding incentive was to survive this adversity and, willingly or not, *they succeeded by being different*. Following generations, in contrast, were eager not to differentiate too much from their friends and neighbors.

Guardians of the Temple

Members of the second generation were often close enough to the first-generation creators of the family fortune to realize that they might not possess the entrepreneurial talent, the single-minded drive to work and fight for an overriding goal. Or possibly the conditions that had enabled the building of the original fortune were no longer so favorable. Instead, the second generation believed their primary responsibility was to preserve the patrimony that was left in their custody, for the use of future generations.

That in itself is a greater challenge than is generally realized. Years ago, a client member of a second generation instructed me, “All I want is to leave my two sons a fortune equivalent to what I received, after taxes and the erosion in purchasing power due to inflation.” When I attempted to calculate the extent of the damage imposed by 40% inheritance taxes and 5% annual inflation, \$100 would only be worth \$15 in purchasing power for each son after 15 years. If my memory serves me well, to achieve my client’s goal would have required *an annual investment return of 13.8%*!

It's well recognized that the main psychological motivations for making money (i.e., investing) are greed and fear. With the challenging responsibilities toward future generations that had been left on their shoulders, fear of losing the family's presumably irreplaceable patrimony, or letting it erode, tend to be the main psychological driver of the second generation.

Impatience and a Sense of Entitlement Before Responsibility

As a rule, many members of the third generation lack the single-minded drive of the first generation or the sense of historical responsibility that characterized the second generation. Its members feel that the family fortune has been built and preserved for them and that they are, unquestionably and without restriction, entitled to it. And, though they may not acknowledge it, these inheritors have usually had a comfortable youth and adolescence, so they are not as motivated as their predecessors to work harder than most of their peers for what they want.

Part of the problem is that the newcomers view their predecessors through the prism of these generations' *lifestyles* rather than recognizing the sense of purpose, hard work, and even sacrifice that made those lifestyles possible. An additional factor is that in recent decades life expectancies have been steadily increasing in most of the world. Generations now tend to last longer, as does their control of family patrimonies. Not surprisingly, third-generation members often become impatient to assume the privileges, if not always the responsibilities, that they perceive previous generations to have effortlessly enjoyed.

A Character Fault: FOMO

One of the greatest handicaps in investing successfully for the long term is impatience, most often amplified by FOMO (Fear Of Missing Out).

Clearly, when the proverbs cited in this paper's introduction became popular, modern mass media, 24-hour business-news TV channels and, of course, the Internet did not exist. But, in my mind, these recently-developed technologies shape opinions more uniformly than in the days when personal experience counteracted second-hand news distribution. The newest generations are more likely to behave as a crowd, with all the excesses and limitations that crowd psychology warns us against.

Here, I speak from personal experience — taking into account all the compliance restrictions meant to prevent the selective use of examples and other performance-embellishing gimmicks. So I will resort to generalities implying no specific mention of past performance (which, in any case and as the traditional disclaimer reminds us, is no guarantee of future performance).

I recently reviewed the performances of several accounts that I had managed for 30-plus years in a style that evolved marginally over that period but could be described as "contrarian investing disciplined by a strong value filter."

The lessons I drew from that examination were:

- Value investing and/or significant cash reserves tend to yield performance that is better than the leading stock-market indices during down markets, *but only marginally*. In traditional bear markets, the invested portion of portfolios – even if selected along value criteria – still loses "some" value.
- The big difference comes from having maximum opportunities *after* markets have had big declines. Histories of financial markets often feature anecdotes about operators

who made a fortune by buying aggressively at or around the bottoms of major market declines. Often omitted from the narrative is the question of where the money to invest came from. The answer is that investors had cash *before* these big declines – most often because they refused to participate in the preceding euphoria or complacency.

- The problem with impatience and FOMO (reminder: Fear Of Missing Out) is that they amplify and extend *momentum* moves: the more markets keep going up, the more followers feel they are missing something by not participating. As a result, more investors want to jump on the bandwagon, at ever higher prices. This is how speculative bubbles form, and with diminishing fundamentals to support rising prices, it is hard to determine when they will burst. But burst they always do.

The last ten years have represented one of the longest and most powerful momentum episodes in my memory, exaggerated by the aggressive policies of most central banks (quantitative easing and, eventually, an unprecedented \$17 trillion of *negative interest-rate* lending worldwide).

When bankers and governments pay investors to borrow money, the notion of risk disappears, and the idea that making money is easy gains broad acceptance. As a result, the FOMO bug has spread fast and wide in recent years, promising to bring what it has always done in the past: what I referred to [in a previous paper](#) as a Minsky Moment, when the markets' excesses and increased risk-taking are corrected by a painful return to sanity.

Of course, third-generation inheritors have been the most vulnerable to the FOMO epidemic. But only witches and wizards can reverse a curse. Wealth managers are left to hope that those generational members who have escaped the FOMO infection will allow them to preserve some of the family fortunes.

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