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Merrill Lynch
Wealth Management

World Wealth Report

2009

World Wealth Report

TO OUR READERS,

Capgemini and Merrill Lynch Global Wealth Management are pleased to present the 2009 World Wealth Report. Our annual report, now in its 13th year, was initiated as our two firms began collaborating to analyze the macroeconomic factors that drive wealth creation, and better understand the key trends that affect High Net Worth Individuals (HNWIs) around the globe.

2008 ushered in an unprecedented global downturn that originated in 2007. What started as a financial crisis soon expanded into the larger economy, affecting mature and emerging markets alike. World equity markets lost a decade of gains, and volatility reached record levels. Our 2008 findings show HNWIs began to lose trust in the markets, regulators, and, in some cases, their financial advisory firms. They also extended their allocations to safer investments—a trend that had its inception a year earlier. As a result, our research shows, cash and fixed-income instruments now make up 50% of HNWIs' portfolios overall, and many HNWIs have retreated to familiar domestic markets.

Restoring trust and confidence in the markets and the industry are resounding themes as we move forward. Our Spotlight identifies the trends and forces driving HNWI client behavior and focuses on specific opportunities that wealth management firms and Advisors can pursue directly to help craft mutually value-creating relationships moving forward into the future.

We are pleased to present this year's Report, and hope you find continued value in its insights.

Dan Sontag
President
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Merrill Lynch & Co., Inc.

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Managing Director
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STATE OF THE WORLD'S WEALTH

HNWI POPULATION AND WEALTH CONTRACT SIGNIFICANTLY

- **At the end of 2008, the world's population of high net worth individuals (HNWIs[1]) was down 14.9% from the year before, while their wealth had dropped 19.5%.** The unprecedented declines wiped out two robust years of growth in 2006 and 2007, reducing both the HNWI population and its wealth to below levels seen at the close of 2005.
- **Ultra-HNWIs[2] suffered more extensive losses in financial wealth than the HNWI population as a whole.** The Ultra-HNWI population fell 24.6%, as the group's wealth dropped 23.9%, pushing many down into the 'mid-tier millionaire'[3] pool.
- **The global HNWI population is still concentrated, but the ranks are shifting.** The U.S., Japan and Germany together accounted for 54.0% of the world's HNWI population in 2008, up very slightly from 53.3% in 2007. China's HNWI population surpassed that of the U.K. to become the fourth largest in the world. Hong Kong's HNWI population shrank the most in percentage terms (down 61.3%).
- **HNWI wealth is forecast to start growing again as the global economy recovers.** By 2013, we forecast global HNWI financial wealth to recover to $48.5 trillion, after advancing at a sustained annual rate of 8.1%. By 2013, we expect Asia-Pacific to overtake North America as the largest region for HNWI financial wealth.

HNWI POPULATION AND WEALTH SHRINK BELOW 2005 LEVELS

At the end of 2008, the world's population of HNWIs was down 14.9% from the year before (see Figure 1) to 8.6 million, and their wealth had dropped 19.5% (see Figure 2) to $32.8 trillion. The declines were unprecedented, and wiped out two robust years of growth in 2006 and 2007.

As a result, the world's HNWI population and its wealth ended 2008 below levels seen at the close of 2005. Annual HNWI population growth had been a robust 7.2% from 2005 to 2007, before reversing in 2008. The same trend was evident in HNWI financial wealth, which grew 10.4% per year in 2005-07, before the steep contraction.

The most significant declines in the HNWI population in 2008 occurred in the three largest regions: North America (-19.0%), Europe (-14.4%) and Asia-Pacific (-14.2%). But behind the aggregate numbers lie some interesting developments in the HNWI populations of those regions:

- The number of HNWIs in the U.S. fell 18.5% in 2008, but the U.S. remains the single largest home to HNWIs, with its 2.5 million HNWIs accounting for 28.7% of the global HNWI population.
- In Europe, the HNWI population decline varied widely by country. For example, the number of HNWIs shrank 26.3% in the U.K., but just 12.6% in France and only 2.7% in Germany, which avoided a steep contraction in part because HNWIs there were more heavily invested in conservative asset classes than those in other countries.
- Japan, which accounts for more than 50% of the HNWIs in the Asia-Pacific region, suffered a relatively mild HNWI decline of 9.9%, but others in the region suffered greater losses, including Hong Kong (-61.3%) and India (-31.6%). The apparent resilience of Japan, however, stemmed largely from the fact that the expansion of the HNWI population there had already been capped by the 2007 slowdown in macroeconomic growth and a weakening stock market (market capitalization was down 11.1% in 2007).

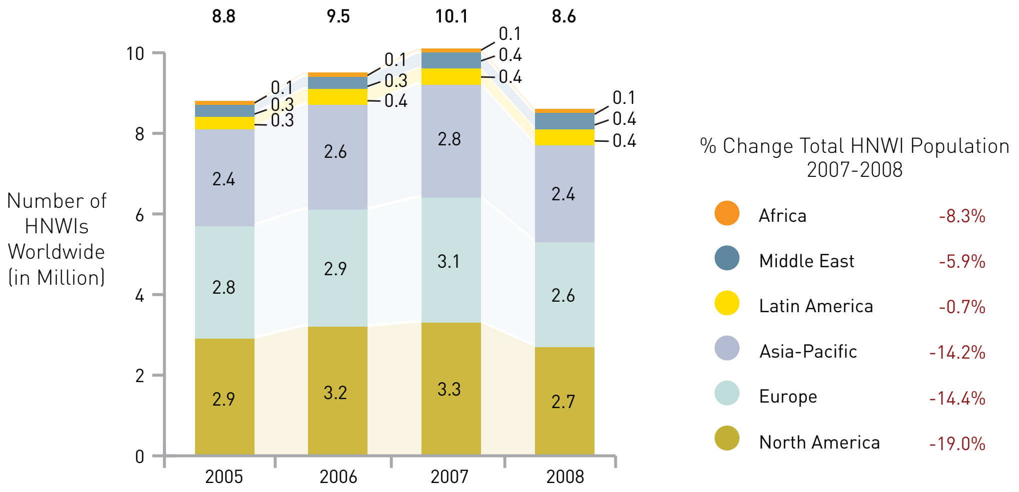
The contraction in the overall HNWI population was exacerbated by the steeper-than-average decline (globally and regionally) in the number of Ultra-HNWIs. A decline in Ultra-HNWI numbers has a disproportionate effect on overall HNWI wealth, because so much wealth is concentrated at their

[1] HNWIs are defined as those having investable assets of US$1 million or more, excluding primary residence, collectibles, consumables, and consumer durables.
[2] Ultra-HNWIs are defined as those having investable assets of US$30 million or more, excluding primary residence, collectibles, consumables, and consumer durables.
[3] Mid-tier millionaires are HNWI having US$5 million to US$30 million

Figure 1. HNWI Population, 2005 – 2008 (by Region)

(In Million)

CAGR 2005-2007 7.2% **Annual Growth 2007-2008 -14.9%**



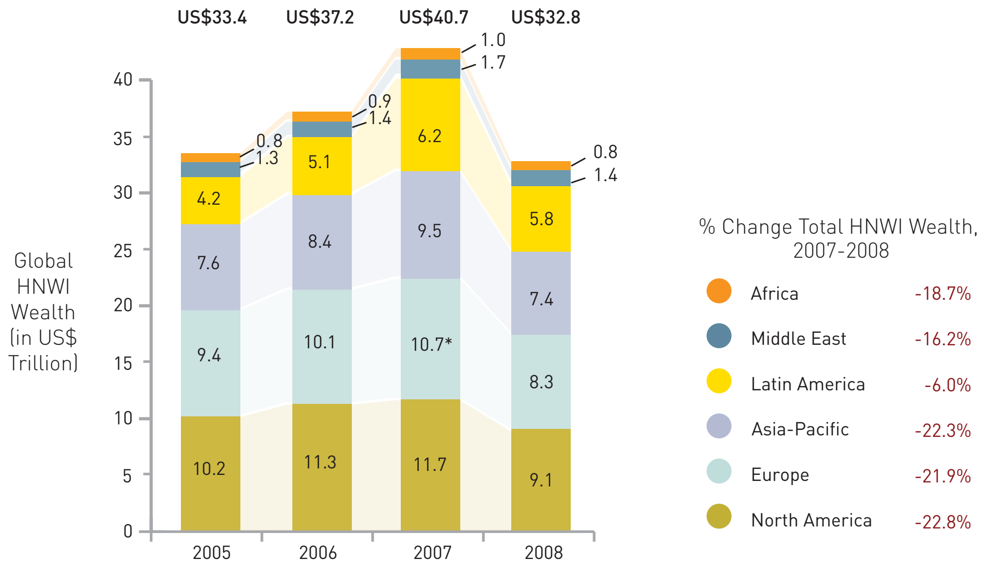
Note: High Net Worth Individuals (HNWIs) have at least US$1 million in investable assets, excluding primary residence, collectibles, consumables, and consumer durables.

Ultra-High Net Worth Individuals (Ultra-HNWIs) hold at least US$30 million in investable assets, excluding primary residence, collectibles, consumables, and consumer durables.

Figure 2. HNWI Wealth Distribution, 2005 – 2008 (by Region)

(US$ Trillion)

CAGR 2005-2007 10.4% **Annual Growth 2007-2008 -19.5%**



*The 2007 number for Europe was restated from 10.6 to 10.7 as a result of updated data becoming available.
Source: Capgemini Lorenz curve analysis, 2009

level (each has investable assets of at least $30 million). At the end of 2008, Ultra-HNWIs accounted for 34.7% of global HNWI wealth, but only 0.9% of the total HNWI population.

The sharp decline in the number of Ultra-HNWIs globally (-24.6%) largely resulted from that group's partiality for more aggressive products, which tend to deliver greater-than-average returns in good times, but delivered hefty losses in 2008. Those losses helped push Ultra-HNWI wealth down 23.9% in 2008, and pushed a large number of Ultra-HNWIs down into the 'mid-tier millionaire' bracket. North America still accounted for the largest concentration of Ultra-HNWIs (30.6k) in 2008 (see Figure 3), though that was down sharply from 41.2k in 2007. Regionally, Latin America retained the largest percentage of Ultra-HNWIs relative to the overall HNWI population (2.4%)—which is far higher than the global average of 0.9%.

In terms of overall HNWI financial wealth, the three largest regions suffered the heaviest losses in 2008, but Latin America—the fourth largest—suffered to a lesser degree (-6.0%). HNWIs in Brazil, the largest country by HNWI financial wealth in the region, saw their wealth decline by 8.4% in 2008, far less than the global average. However, the losses were even smaller for HNWIs in neighboring countries, such as Mexico and Colombia, where equity-market declines were smaller, since selling was not as extensive as in Brazil during the second-half of 2008. In addition, HNWIs in Latin America tend to have relatively conservative asset allocations, favoring fixed income.

GLOBAL HNWI POPULATION IS STILL CONCENTRATED, BUT THE RANKS ARE SHIFTING

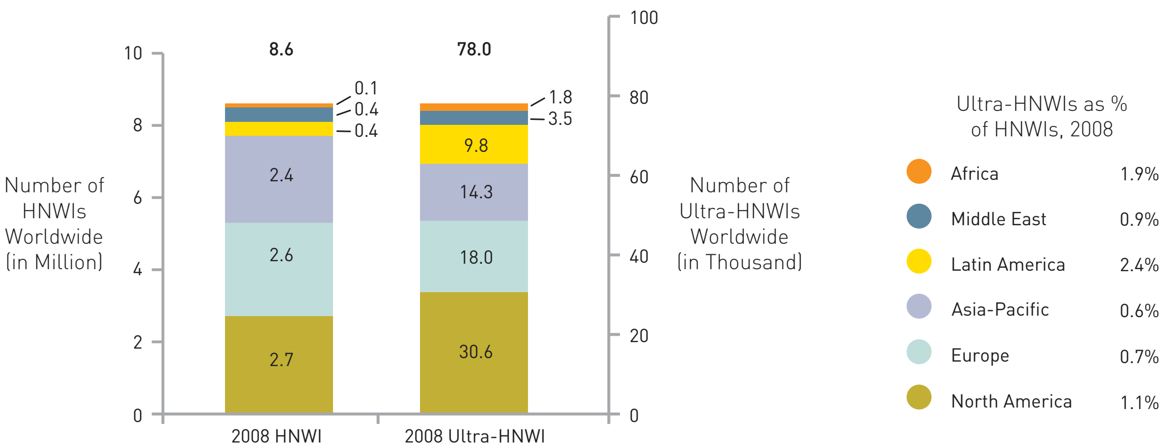
The U.S., Japan and Germany together accounted for 54.0% of the world's HNWI population in 2008, up very slightly from 53.3% in 2007 (see Figure 4), despite the substantial loss of wealth by HNWIs in those countries, particularly the United States. For example:

- China's HNWI population surpassed that of the U.K. to become the fourth largest in the world in 2008 (364k HNWIs), after having exceeded France in 2007. In 2008, despite steep market capitalization losses, the closed nature of China's markets combined with robust macroeconomic growth to help China avoid some of the steep losses felt elsewhere.
- Brazil surpassed Australia and Spain to reach 10th place among HNWI populations globally (131k HNWIs).

It is also striking to note how the financial crisis impacted HNWIs differently in different types of economies. For example:

- Hong Kong's HNWI population took by far the largest hit in percentage terms, with a 61.3% drop to 37k. Hong Kong is unique in that it is a developing economy with an extremely

Figure 3. Geographic Distribution of HNWIs and Ultra-HNWIs, 2008 (by Region)



Source: Capgemini Lorenz curve analysis, 2009

high market-capitalization-to-nominal-GDP ratio (5.76). That ratio indicates Hong Kong is particularly vulnerable to large market capitalization declines like the one experienced in 2008 (-49.9%). By contrast, the ratio is 1.49 in Singapore, and just 0.83 in the U.S. Furthermore, Hong Kong has a very large proportion of its HNWIs in the $1m-$5m wealth band, and many of these HNWIs dropped below the $1m threshold in 2008 due to market losses.

- India's HNWI population shrank 31.6% to 84k, the second largest decline in the world, after posting the fastest rate of growth (up 22.7%) in 2007. India, still an emerging economy, suffered declining global demand for its goods and services and a hefty drop in market capitalization (64.1%) in 2008.
- Russia's HNWI population declined 28.5% to 97k, the seventh largest per-country drop in 2008, after growing at the tenth fastest rate (14.4%) in 2007. Russia's economy decelerated rapidly, in line with the steep decline in global demand for oil and gas. Compounding the problem was the sharp fall in equity markets—down 71.7%, and the largest drop globally.
- The U.K. experienced a 26.3% drop in its HNWI population in 2008, to 362k. A mature economy, heavily reliant on financial services, the U.K. was particularly hard-hit by falling equity and real estate values.

HNWI WEALTH IS FORECAST TO RESUME GROWTH AS GLOBAL ECONOMY RECOVERS

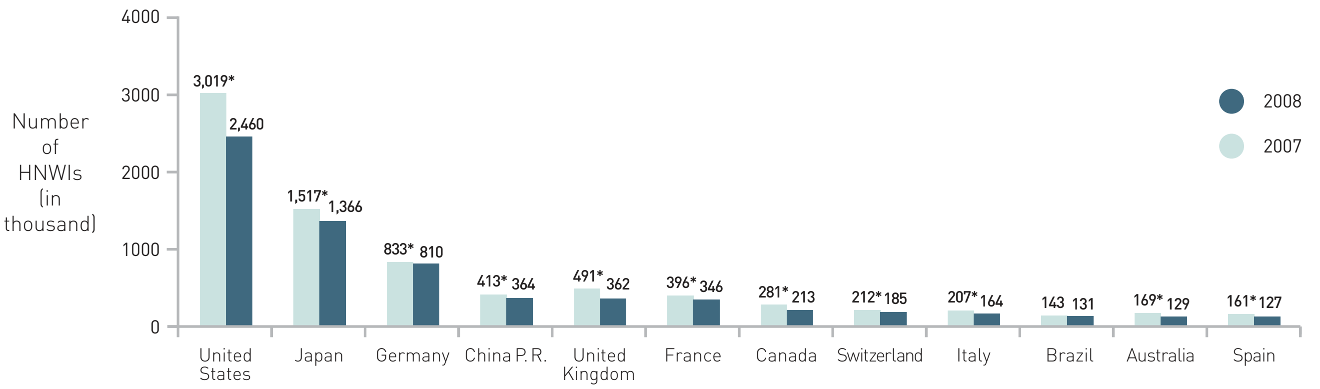
We forecast HNWI financial wealth will grow to $48.5 trillion by 2013, advancing at an annualized rate of 8.1% (see Figure 5). This growth will be driven by the recovery in asset prices as the global economy and financial system right themselves. Also, the 2008 flight-to-safety imperative is expected to ease, encouraging HNWIs to return to higher-risk/higher-return assets, and away from capital-preservation instruments, as conditions improve.

We expect North America and Asia-Pacific to lead the growth in HNWI financial wealth, and predict Asia-Pacific will actually surpass North America by 2013. Growth in these regions will be driven by increased U.S. consumer expenditure as well as new-found autonomy for the Chinese economy, which is already experiencing increased consumer demand.

Latin America is poised to grow again when the U.S. and Asian economies start to pick up, as it has the commodities and manufacturing capability that will be needed during the return to growth. Europe's economic recovery is likely to lag, as several major countries there continue to face difficulties. In the Middle East, oil is expected to be a less dependable driver of wealth in the future, so growth there is likely to be slower than it has been in the past.

Figure 4. HNWI Population by Country, 2008

(in Thousand)



Position in 2007	1	2	3	5	4	6	7	9	8	12	10	11

*2007 data has been revised

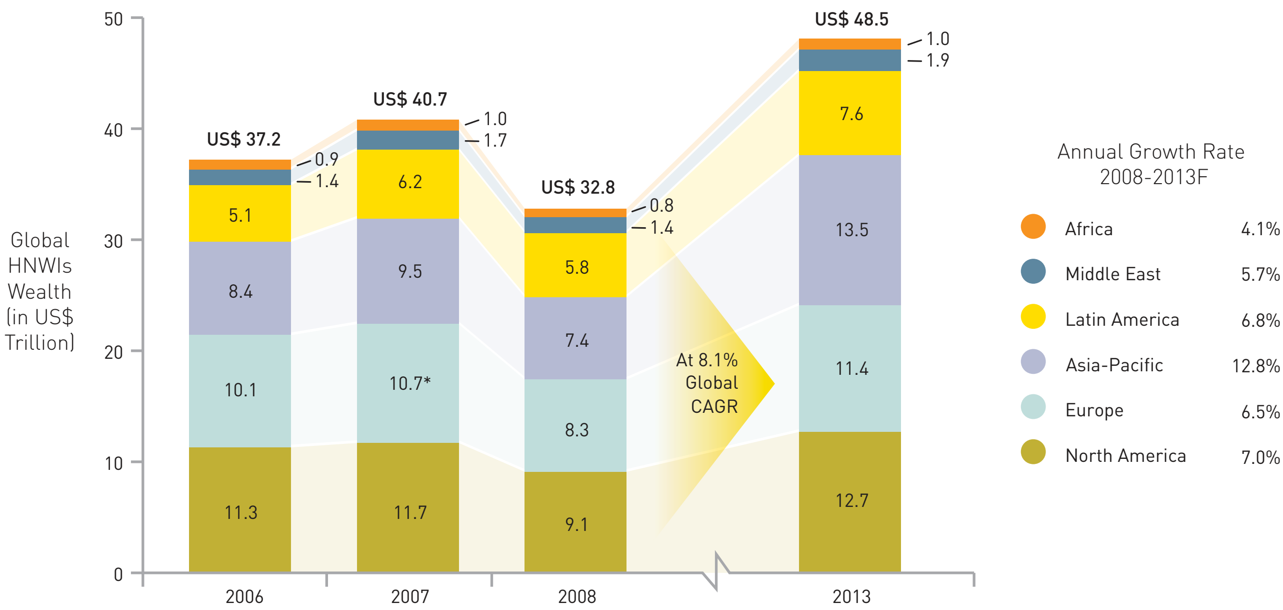
Source: Capgemini Lorenz curve analysis, 2009

Our global forecasts assume continued difficulties for the global economy in 2009. We expect some initial signs of growth in selected countries, which could pick up steam from 2010, but protracted weakness in the global economic and/or financial systems could force a downward revision in our forecast numbers.

Notably, HNWI wealth grew at a strong annualized rate of close to 9% in 2002-07—the recovery years following the bursting of the technology bubble. While the tech downturn and the most recent financial crisis are not identical forms of disruption, we nevertheless expect the recovery in HNWI wealth to be similarly robust this time around, as the business cycle starts to trend back up.

Figure 5. HNWI Financial Wealth Forecast, 2006 – 2013F (by Region)

(US$ Trillion)



*The 2007 number for Europe was revised from 10.6 to 10.7
Source: Capgemini Lorenz curve analysis, 2009

2008 IN REVIEW:
FINANCIAL MARKET CRISIS CULMINATES IN GLOBAL ECONOMIC DOWNTURN

- **The run-up to the global economic crisis had, in hindsight, been 10 years in the making.** Current-account imbalances between creditor and debtor nations had widened, low yields had prompted a rampant search for returns, and the increased complexity and opacity of products had intensified systemic risk.
- **The U.S. financial crisis soon spilled quickly, broadly, and deeply into the real economy worldwide—damaging all the macroeconomic drivers of wealth (GDP, savings and consumption).** National savings rates decreased, but so did consumer spending. The global economy is projected to post its worst performance since World War II.
- **Most asset values, weak in 2008's first half, plunged in the second half, turning the market-performance driver of wealth from challenging to devastating.** Global equity-market capitalization plunged nearly 50%, and global investors fled to fixed-income securities, settling for a return of their investment, not on their investment.
- **There is no clear consensus yet on when and how the global economy will return to growth.** There are some key issues to watch in the coming year, including the fiscal, financial and economic response of governments and financial authorities across the globe, with the U.S. and China as key players.

THE ECONOMIC FALLOUT WAS TEN YEARS IN THE MAKING

Accounts are already legend of the financial crisis that began in 2007 and accelerated in 2008, before spreading to the global economy in 2008. In hindsight, several important trends over the last 10 years marked the run-up to and unfolding of the economic crisis, and make events far more fathomable. These include:

1. **Current-account imbalances between creditor and debtor nations widened over a 10-year period.**
   a) **Creditor nations accumulated massive amounts of reserves.** After financial crises in the late-1990s, Asian and energy-rich nations started hedging against similar shocks by increasing their savings, and building large current account surpluses. Much of the national savings were destined for central bank reserves, especially in China, where foreign currency reserves rose from $0.4 trillion in 2003 to almost $2 trillion in 2008.[4] These funds were invested primarily in low-risk assets, mainly U.S. Treasury securities. For example, foreign investors (private and official) owned nearly 60% of all U.S. Treasuries bonds as of June 2007[5], up from less than 20% in 1994. Sovereign Wealth Funds, such as those of Singapore, Abu Dhabi, and China similarly invested in the U.S. and other mature markets as another means of diversifying their large asset bases.
   b) **Debtor nations spent wildly.** As noted in the 2008 WWR, nations in the developed world, such as Spain, Australia and the U.K.—and certainly the U.S.—had demonstrated unsustainable spending patterns that resulted in large current account deficits. The U.S. consumer has been the strongest single driver of global demand for some time, accounting for $9.2 trillion, or 18.6% of the world's GDP in 2008.[6] This is comparable to the combined GDP ($10.8 trillion[7]) of Japan, China and Germany—the next three largest economies in the world—bolstering the U.S. position as the leading debtor nation.
2. **Low yields prompted a rampant search for returns.** Notably, real interest rates were driven down by strong demand from creditor nations and by government intervention in the early 2000s. This encouraged investors to search for better yields—often in the form of excessive leverage and in novel product alternatives like complex structured products such as mortgage-backed securities (MBS) and collateralized debt obligations (CDOs).
3. **The increased complexity and opacity of many products intensified systemic risk.** Some of the

[4] Economist Intelligence Unit, Country Data for China, March 2009
[5] Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (London, U.K. March 2009)
[6] Economist Intelligence Unit, Country Data for the US, March 2009
[7] Economist Intelligence Unit, Country Data for Japan, China and Germany, March 2009

products designed in recent years to meet the strong demand for yield were highly complex and opaque, certainly compared with standard exchange-traded products. Moreover, it took the rescue of Bear Stearns, the collapse of Lehman, and the crisis at AIG to show the degree to which the market for products like credit default swaps (CDS) relied on a complex and interrelated web of counterparties, which became deeply threatened by the changing environment for the underlying products.

THE U.S. FINANCIAL CRISIS SPILLED QUICKLY, BROADLY, AND DEEPLY INTO THE REAL ECONOMY WORLDWIDE

The financial crisis that started in 2007 and continued into 2008 rapidly escalated and expanded into the general economy in mature markets, and culminated in a steep, global economic downturn, particularly in the last quarter of 2008. Export-driven countries were hit hardest, particularly in Asia, as global demand dried up. Many other countries and markets, especially in the developing world, were struck by a sharp drop in foreign investment, as well as an overall drop in demand. All in all, the macroeconomic drivers of wealth (gross domestic product (GDP), savings and consumption) were all hit hard.

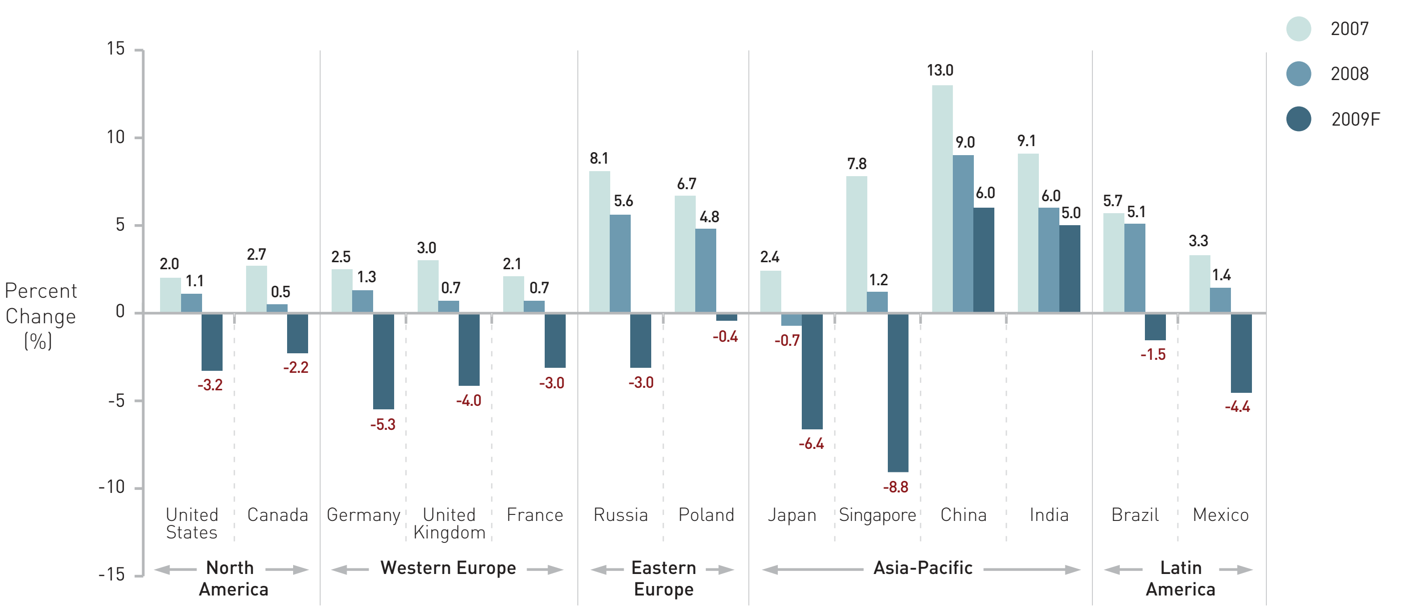
WORLD'S GDP SLUMPED IN 2008, AS ECONOMIES PROVED TO BE MORE INTERDEPENDENT THAN MANY THOUGHT

The global economy is projected to post its worst performance since World War II. There had been a general consensus that certain emerging economies, such as the BRIC nations (Brazil, Russia, India, China), had strengthened to the point that they no longer relied on mature economies for growth. This so-called "decoupling" would theoretically insulate those economies from mature-market downturns as well. However, the decoupling theory was severely tested in 2008, as emerging markets followed in lock-step with the global contraction in GDP (although their declines were not as quick or as steep as those in mature markets—see Figure 6).

World GDP did manage to produce some growth in 2008 (2.0%), but it was down from 3.9% in 2007 and 4.0% in 2006. GDP in G7 economies deteriorated progressively as the crisis unfolded, and ended the year showing growth of just 0.6%. BRIC nations continued to outpace many economies, led by China, despite the steep slowdown in the fourth quarter. Although the crisis spread worldwide, some regions posted relatively strong GDP growth for 2008, especially Latin America (4.0%), and the Middle East and North Africa (5.8%)[8], but that only suggests these regions had yet to experience the full extent of the economic fallout.

Figure 6. Real GDP Growth Rates, 2007-2009F

(%)



Source: Economist Intelligence Unit – April 2009. Real GDP variation over previous year

[8] Economist Intelligence Unit, Regional Data, March 2009. Capgemini Analysis

NATIONAL SAVINGS DECREASED IN 2008, AND SO DID PERSONAL SPENDING

National savings[9] decreased worldwide in 2008, negatively impacting wealth, as there were fewer funds available for future investments. The ratio of combined national savings to GDP fell to 22.6% globally, from 23.1% in 2007, and to 16.4% in G7 countries, down from 17.2%.[10]

It is customary for a decreased level of national savings to coincide with an increase in total consumption (private and public spending). Global government consumption did increase in 2008—by $0.3 trillion worldwide[11]—partly driven by widespread government outlays on financial bailouts and economic stimulus packages.

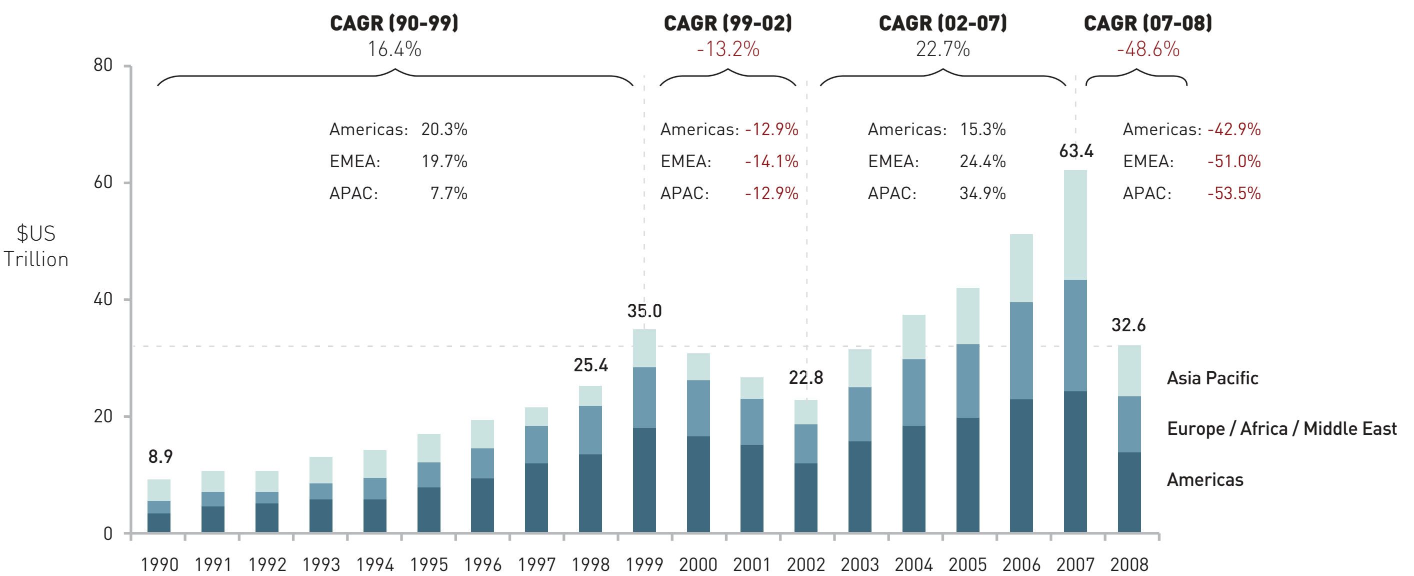
However, 2008 saw a global slowdown in consumer spending, as eroded consumer confidence and scarce credit prompted widespread thrift. The most salient example of this trend was in the U.S., where consumer spending grew just 0.2% in 2008, after a gain of 2.8% in 2007—while the fourth-quarter personal savings rate jumped to the highest rate since the third quarter of 2001 (3.2% of disposable income[12]). In Europe, personal spending grew 1.0% in 2008, down from 2.2% in 2007.[13] The sudden end to rampant spending had a huge impact on the world's GDP—especially given the U.S. consumer's central role in fueling global demand.

MOST ASSET VALUES, WEAK IN 2008'S FIRST HALF, PLUNGED IN THE SECOND HALF

Market performance—another key driver of wealth—turned from challenging to devastating in 2008. Most key assets (equities, fixed income, real estate and alternative investments) experienced a mediocre first-half at best. Then they were hit by a massive sell-off, particularly in the fourth quarter, as investors fled to safe havens like cash, gold, and U.S. Treasuries. Many commodities and currencies—secondary drivers of wealth—also lost value in 2008. Notable market events during the year included the following:

- **Global equity-market capitalization plummeted nearly 50%, dropping below 1999 levels** (see Figure 7). The global drop in equity-market capitalization was perhaps the most salient example of the severity of the crisis, as uncertainty and fear pervaded investor sentiment in every region. In the first half of the year, most equity markets lost value, though there were some notable exceptions. In Latin America, for example, the MSCI index rose 8.0%[14], due mainly to the commodities boom. However, during the second half, and especially after mid-September, equity markets sank across the world—down 42.9% in the Americas, 53.5% in Asia Pacific, and 51.0% in EMEA (Europe, Middle East, and Africa)—for a global loss of market capitalization of more than $30 trillion. Notably, some of the countries with the largest gains in 2007

Figure 7. Market Capitalization by Region, 1990 - 2008



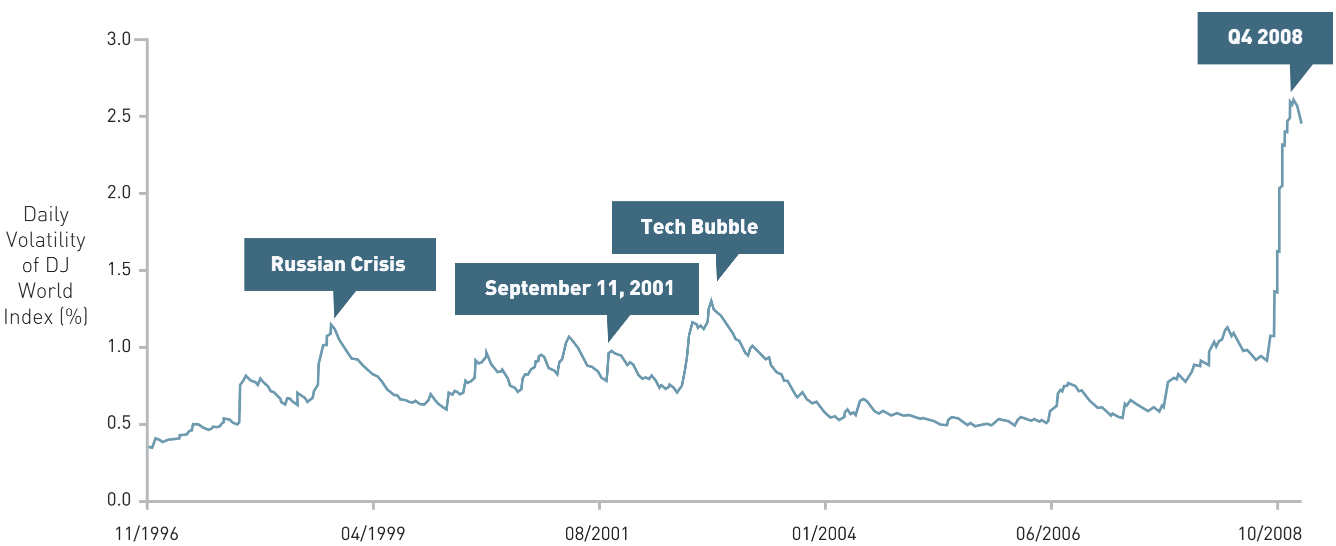
Source: World Federation of Exchanges, April 2009

[9] National Savings = GDP - (Private Consumption + Government Consumption)
[10] Economist Intelligence Unit, Regional Data, March 2009. Capgemini Analysis
[11] Ibid.
[12] U.S. Bureau of Economic Analysis, National Income and Product Accounts Tables: Comparison of Personal Saving in the NIPAs with Personal Saving in the FFAs, March 2009
[13] European Commission. European Commission Interim Forecast, Jan 2009
[14] MSCI Barra, Equity Indexes for select regions, (http://www.mscibarra.com/products/indices/index.jsp)

posted the worst losses in 2008. China's market cap was down 60.3% after a 291% increase the year before, and India was down 64.1% after rising 118.4% in 2007.[15]

- **Equity-market volatility dwarfed levels seen in recent crises.** The rapid meltdown in equities occurred amid record levels of volatility. The CBOE Volatility Index, which many wryly dub "the Fear Index", surged in mid-September 2008 to the same levels seen during the stock market crash of October 1987. The daily volatility of the Dow Jones Global Index (see Figure 8) did the same, and displayed levels comparable to those seen in the Great Depression of the 1930s. Those volatility levels dwarfed anything seen in the last 10 years, including the aftermath of the Asian financial crisis, the collapse of Long-Term Capital Management, the bursting of the Tech Bubble, and the September 11th terrorist attacks in the U.S.
- **Faith in equity-market diversification proved to be misplaced.** Traditional attempts at equity diversification offered no respite, even to savvy investors, as the second-half 2008 sell-off afflicted most regions, types of company, and industries. Data confirm that a more diversified equity portfolio, which would have helped investors in previous crises, would not have protected them in the last quarter of 2008. In comparing two versions of the MSCI World Index, one weighted by market capitalization and the other equally weighted (i.e., more diversified), we see that when the tech bubble burst, the more diversified portfolio lost 37% of its value, while the less diversified portfolio lost 48%. By contrast, the two indexes performed similarly in the late-2008 sell-off, and the more diversified index actually lost more value (41% vs. 38%[16]).
- **Global investors fled to fixed-income securities, looking for a return of their investment, not on their investment.** U.S. Treasuries outperformed every other fixed-income security in 2008, increasing 13.9% on a total-return basis, as demand surged in a flight to quality (see Figure 9). The flight-to-safety was so intense that yields of short-term U.S. Treasuries actually dipped below zero in mid-December, when investors were primarily concerned with preserving their capital. Total returns on investment-grade corporate bonds were down nearly 7%[17], while corporate junk bonds fell 23.5% in the US and 28.2% in Europe, their worst year in record, according to the ML US and Euro High Yield indexes.
- **Many commodities saw a boom-to-bust cycle.** Commodities rallied in the first half of 2008, when crude oil prices neared $150 per barrel, and gold reached $1,000 per troy-ounce. But, particularly after the collapse of Lehman Brothers, commodity prices sank, as investors started to liquidate positions in a shift to safer assets. The Dow Jones-AIG Commodities Benchmark plunged 55%[18] from its peak in

Figure 8. Daily Volatility of DJ World Index, 1996 - 2008



Source: Dow Jones World (W1) Index – Daily close values from January 1st, 1993 to December 31st, 2008; Capgemini analysis

[15] World Federation of Exchanges, 2007-2008 market capitalization statistics.(http://www.world-exchanges.org/statistics)

[16] MSCI Barra. Equity Indexes for select regions. (http://www.mscibarra.com/products/indices/index.jsp). Capgemini Analysis.

[17] Liz Rappaport and Serena Ng, "Bonds on Leading Edge of Crisis; 'Not a Single Place to Hide'", *Wall Street Journal*, Jan. 2, 2009

[18] Dow Jones. Historical Dow Jones – AIG commodities benchmark. (www.djindexes.com)

early-July of 147.6 points to 65.8 points in early-December, wiping out all the gains accumulated since 2002. Gold proved to be the exception, as it benefited from its attractiveness as a safe-haven holding, and prices posted a gain of 5.8%[19] for the year. Moreover, although jewelry is still the predominant use of gold, uses of gold as an alternative to cash soared in 2008: Bar hoarding jumped by 60%, official coins by 44%, and Exchange Traded Funds rose 27%.[20]

- **Real Estate losses intensified toward year-end.** Real estate was another case in which a clear but steady downtrend in the first half of the year was dwarfed by sharp losses in the second. Housing prices fell in many nations in 2008, making it one of the worst real estate years on record.[21] Declines were evident worldwide, including Ireland (-11.8%), the UK (-21.3%), Hong Kong (-13.4%), South Africa (-7.8%) and Dubai (-11.0%), where residential unit sales were 45% lower in the fourth quarter than in the third.[22] Luxury residential real estate prices also fell 25% on average globally.[23] The U.S. housing market continued to deteriorate, with a 19.5% loss for the year.[24] However, real estate prices did remain constant or increase slightly in some countries, including Japan, China and Germany.

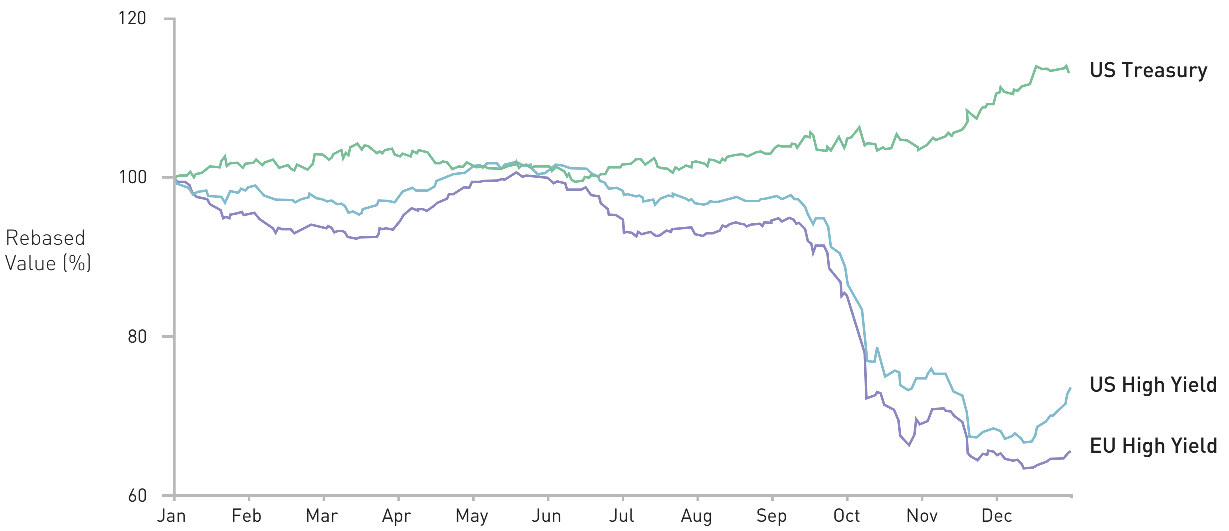
  REIT prices also ended the year sharply lower. After peaking at 1,574.9 at the end of February 2007, the Dow Jones Global REIT benchmark index declined steadily, to around 1,000 (base value) in July 2008, where it held until mid-September 2008. Thereafter, however, a heavy sell-off pushed the index down more than 50% in a matter of weeks. The index had bottomed at 474.5 points by the end of October 2008, and closed the year at 621.8 points.[25]

- **Few hedge funds escaped the losses, even with alternative strategies.** Hedge funds had the worst performance in their history in 2008, belying the theory that hedge funds naturally outperform in rough markets. The fact that too many funds were holding a very similar asset base proved lethal once the equities sell-off accelerated at the year's end. According to the Credit Suisse/Tremont Hedge Fund Index, leading hedge funds globally returned a loss of 16.7%. Moreover, hedge funds faced liquidity constraints, with hard-to-trade investments accounting for up to 20% of total portfolios of approximately $400 billion.[26]

  Assets managed by global hedge funds tumbled 25% to $1.5 trillion from nearly $2 trillion at the start of 2008. Nevertheless, some skilled managers were able to generate alpha despite adverse market conditions. The most successful strategies were Managed Futures, with an 18.3% cumulative return for the year, as well as Dedicated Short, which returned 14.9%.[27]

Figure 9. US Treasury Index vs. US, Europe High Yield Index 2008 – Rebased

(1/2/2008=100)



Source: Merrill Lynch. US Treasury Master, US High Yield Master, and Europe High Yield Master daily values 2008

[19] Carolyn Cui, "Commodities: Great, Then Ugly", *Wall Street Journal*, Jan. 2, 2009
[20] World Gold Council and GFMS Ltd. Identifiable gold demand (tons), 2009
[21] Anton Troianovski, "Real-Estate Markets Still Plumb for Bottom", *Wall Street Journal*, Jan 2, 2009
[22] Global Property Guide Time Series Database, 2009 (Ireland, Hong Kong, UK and South Africa). Merrill Lynch GCC Quarterly Report, Feb 2009 for Dubai
[23] Kay Coughlin, President & CEO, Christie's Great Estates. Interview by Capgemini, April 2009
[24] Global Property Guide Time Series Database, Case-Shiller House Price Index, composite 10 cities, seasonally adjusted, March 2009
[25] Historical Dow Jones Wilshire REIT Index Values, www.djindexes.com
[26] Gregory Zuckerman and Jenny Strasburg. "For Many Hedge Funds, No Escape", *Wall Street Journal*, January 2, 2009
[27] Credit Suisse Tremont Hedge Index. One for the History Books: Hedge Fund Performance in 2008, Jan 26, 2009

- **Most currencies had a mixed year, but the U.S. dollar ended higher.** During the first half of 2008, currencies such as the euro and the Brazilian real appreciated against the U.S. dollar (10.4% and 7.1%, respectively), while others remained stable (British pound, -0.1%), and a few lost value (Canadian dollar, -3.2%[28]). However, this trend changed drastically in the second half of the year, after commodities prices sank, and the global economic crisis worsened tangibly. Two significant second-half devaluations against the U.S. dollar were the Brazilian real (-46.2%) and the British pound (-38.0%). In late-2008, the U.S. dollar and the Japanese yen both surged, fueled in part by widespread purchases from investors unwinding currency carry trades. In the process, the yen appreciated 14.9% against the dollar.[29] The dollar also attracted buyers in the second half of 2008 when the U.S. started to look like a stronger economy than many of its trading partners.

WATCHING THE ECONOMIC HORIZON

Current conditions suggest any recovery will be slow, as the crisis continues to permeate world economies. There is no clear consensus yet on when and how the global economy will recover, but there are certainly some key factors required:

- **The U.S. is crucial for global economic recovery.** The majority of economists agree the U.S. recession will end in the third or fourth quarter of 2009.[30] However, while there have been some initial signs of growth following government intervention, the outlook for longer-term growth will depend largely on private-sector activity. Moreover, U.S. private consumption is imperative for a sustained, long-term global recovery as the U.S. to date has fueled approximately one-fifth of world GDP—more than any other economy by far. Economists expect unemployment to increase throughout the rest of the year and only begin to dissipate in 2010.
- **China is an important engine for growth.** China has shown some increased signs of growth, mainly due to its domestic stimulus spending (a $585 billion package announced in November 2008). China's stock market rose 8.4% during the first few months of 2009, outperforming all G7 economies.[31] However, the private sector seems to have had a more significant contribution than in the U.S., with a rise in car and housing sales suggesting increased confidence in the domestic Chinese economy.[32] These positive signs are also important for the global economy, as China's renewed appetite for products, particularly raw materials, would help other economies. However, these signs should be treated with caution, since Chinese exports are still declining, global demand remains low, and global unemployment, particularly in Asia, continues to rise.
- **Interdependence of the global economy still prevails.** The road to recovery will require close cooperation among countries, given the enduring interdependence among global economies. For example, creditor nations may be able to sustain themselves on their surpluses in the short and mid-term, but they will eventually need the force of fueling economies, including the important private-consumption component, to help resuscitate global and local demand in their economies, and reduce global imbalances. Similarly, while in the past the BRIC nations were viewed together as decoupled engines of global GDP growth, Brazil and India will likely support global growth, rather than fuel it, in the current environment, and Russia is expected to require a longer period of repair before it can regain its pre-crisis growth levels.
- **A recovery of the global banking system is critical.** One of the fundamental drivers for economic recovery is credit availability—which is heavily dependent on banks' balance sheets. Although some key indicators of the banking system, such as the TED[33] spread, have improved considerably, they are still at worse levels than before the crisis. Furthermore, it is not clear how much time it will take banks to complete the shedding of toxic assets, but it will be difficult for them to extend significantly more credit to the private sector until they do. And without credit availability, it is much more difficult for the private sector to resume taking the risks necessary for a sustained global recovery, such as increasing employment, business investments, and taking up loans.
- **Global fiscal and economic policies, and politics, will shape the road to recovery.** Financial authorities and regulators from around the world quickly harmonized their calls for a global response to a global crisis. The Group-of-Twenty (G-20) Finance Ministers and Central Bankers pledged in April 2009 to act to restore confidence, growth, and jobs, repair financial systems to restore lending, and strengthen financial regulation to rebuild trust.[34] However, it remains to be seen how governments will respond to politically sensitive issues (e.g., government spending, taxation, protectionism, regulation) that will arise in driving growth. A meaningful recovery of the global financial system is not expected before 2010, which underscores the importance of governments, regulatory agencies and financial institutions getting fiscal, monetary and macroeconomic policies right.

[28] Ozforex. Historical data for select currencies against the U.S. dollar. (www.ozforex.com)
[29] Ibid
[30] Phil Izzo, "Economists See a Rebound in September", *Wall Street Journal*, April 9, 2009
[31] MSCI equity indexes for select China and G7 countries from Jan. 1, 2009 to April 10, 2009
[32] Andrew Batson, "China Turns a Corner as Spending Takes Hold", *Wall Street Journal*, April 11, 2009
[33] TED Spread = Difference between yields on Treasury bills and those on dollar denominated deposits of major commercial banks outside the U.S. If the spread widens, it signals investor concerns on the financial system.
[34] Group of Twenty Finance Ministers and Central Bank Governors, *The Global Plan for Recovery and Reform*, G20.org, statement released April 2, 2009

HNWIs SOUGHT REFUGE IN CASH, FIXED INCOME AND DOMESTIC INVESTMENTS IN 2008

- **HNWIs reduced their exposure to equities across the globe in 2008, but allocated more to fixed-income instruments.** By year-end 2008, equities accounted for 25% of total global HNWI financial assets, down from 33% a year earlier, and fixed-income accounted for 29%, up from 27% a year earlier.
- **HNWIs kept far more cash/deposits in 2008—**of global HNWI financial assets, 21% was in cash-based holdings at the end of 2008, up 7 percentage points from pre-crisis levels in 2006.
- **HNWIs also had slightly more of their financial assets allocated to real estate holdings,** which rose to 18% of the total global HNWI portfolio from 14% in 2007. They also sought **safety in home-region and domestic investments**, which increased significantly in all regions in 2008—and by a global average of 6.8%, continuing a trend that began in 2006.
- **HNWIs are expected to remain fairly conservative investors in the short term,** with capital preservation being a priority over the pursuit of high returns. Looking toward 2010, though, the profile of HNWI portfolios is likely to shift as economic conditions improve, instigating a tentative return to equities and alternative investments as HNWIs regain their appetite for risk.

HNWIs REDUCED EXPOSURE TO EQUITIES IN 2008 AMID SHIFT TO SAFETY, SIMPLICITY

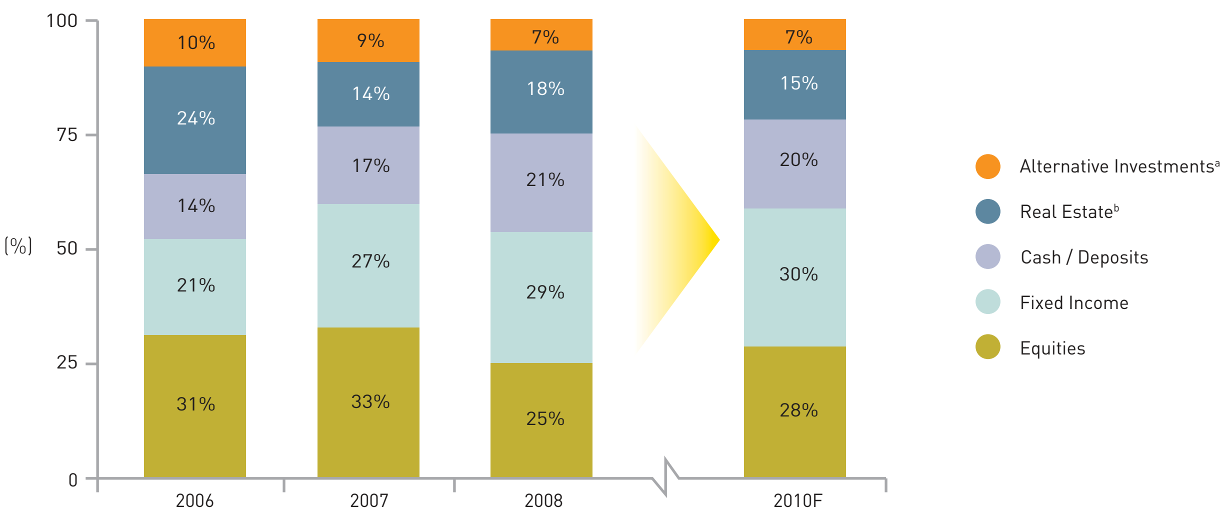
HNWIs increased the proportion of their assets held in safer, simpler, more tangible investments in 2008, and reduced their relative holdings of equities and alternative investments (see Figure 10).

As global stock markets sold off in 2008, HNWIs joined those retreating from equity investments. Accordingly, the proportion of wealth allocated to equities by HNWIs globally dropped by 8 percentage points (to 25%).

North American HNWIs also significantly reduced their exposure to equities—an asset class they have long favored—

Figure 10. Breakdown of HNWI Financial Assets, 2006 - 2010F

(%)



[a] Includes: Structured products, hedge funds, derivatives, foreign currency, commodities, private equity, venture capital
[b] Includes: Commercial Real Estate, REITs, Residential Real Estate (excluding primary residence), Undeveloped Property, Farmland and Other
Source: Capgemini/Merrill Lynch Financial Advisor Surveys 2007, 2008, 2009.

to 34%, from 43% in 2007, but that was still 9 percentage points above the global average allocation to equities.

Elsewhere, HNWIs also scaled back on their equity holdings amid stock-market volatility and declines. The allotment was 21% in both Europe and the Middle East by the end of 2008, down 10 percentage points from 2007 levels in each case. In Latin America, it was down 8 percentage points to 20%.

HNWIs, WARY OF MARKETS AND RISK, KEPT MORE CASH IN 2008

As the global banking and financial crises worsened, and credit tightened, HNWIs became more risk-averse and wary of complex products in 2008, with global net inflows into money market funds exceeding $455 billion for the year.[35] Ultimately, there was a significant increase in the amount of HNWI wealth in cash-based holdings—an average of 21% of overall portfolios, up 7 percentage points from pre-crisis levels in 2006.

The proportion of cash-based holdings was highest among HNWIs in Japan (30%), where the savings rate has been traditionally high, and was nearly as high in the rest of Asia (26%, up 5 percentage points from 2007). By contrast, HNWIs in North America—where the use of credit is a ubiquitous source of funding and payments—held the lowest amount of cash/deposits as a percentage of their total portfolios (14%, up only 3 percentage points).

Cash-based investments held outside of the formal banking system (e.g. held in a vault etc) totaled 19% of global HNWI cash and deposit-based investments. HNWIs across Asia (excluding Japan) held the highest proportion of cash outside of an account—29%, largely reflecting the lack of confidence HNWIs had in the regions' emerging-market banking systems, which tend to be less transparent than those in more developed markets. North American HNWIs held the least amount of cash outside of an account, at 14% of cash holdings.

HNWIs, SEEKING SAFETY, ALSO ALLOCATED MORE WEALTH TO FIXED INCOME

HNWIs continued to allocate an increasing proportion of their investments to fixed-income investments in 2008, bringing the allotment to 29% of global HNWI portfolios at the end of 2008, up 2 percentage points from 2007.

In fact, many HNWIs around the world were willing to eschew returns altogether in favor of safety. For example, HNWIs were among the investors who bought zero-yield US Treasury bills in the second half of 2008, happy to settle for a return of, not on, their capital.

Latin American HNWIs allocated the highest proportion among regions to fixed income investments (40%), though that was up just 1% from 2007. Their preference for fixed income largely reflects their traditionally low risk appetite. Conversely, HNWIs in emerging/developing Asia (i.e., excluding Japan) allocated a much smaller proportion (17%) of their overall portfolio to fixed income investments.

REAL ESTATE, ESPECIALLY RESIDENTIAL, REGAINED SOME OF ITS APPEAL FOR HNWIs IN 2008

Real estate investments picked up again in 2008, rising to 18% of total HNWI financial assets from 14% in 2007, when its share had dropped by 10 percentage points from the year before. The return to real estate reflected the preference of HNWIs for tangible assets, as well as a trend toward bargain-hunting, especially in commercial real estate and newly built segments,[36] but also in residential real estate, where prices saw the worst decline on record. Inflation hedging may also have spurred some buying.[37]

Overall, residential real estate[38] accounted for 45% of total HNWI real estate investments at the end of 2008. Luxury residential property values dropped in 2008 to levels last seen in 2003 and 2004, prompting some HNWIs to buy, particularly "once in a lifetime" properties.[39]

The emerging regions of the Middle East and Asia-Pacific (excluding Japan) had the highest HNWI allocation to real estate investment (25% and 23%, respectively), and the greatest proportion of residential real estate (54% and 58%, respectively). Both regions have experienced an exponential boom in real estate investment over the last few years, but a steep drop in end-user demand has combined with lack of available financing to fuel a rapid decline in prices, particularly in the fourth quarter of 2008.

Within the Middle East, the biggest change in the real estate market has been the shift in buyer profile—from short-term speculative investors back to professional investors, who focus on cash-on-cash yield potential[40] (i.e., focusing on the return on invested capital, not the asset value itself). Real estate in the Middle Eastern lynchpin of Dubai peaked in September, before falling about 25% in value during the fourth quarter of 2008.[41]

HNWI holdings of commercial real estate accounted for 28% of total HNWI real estate holdings, little changed from 29% in

35 Reuters, "Money market funds big winners in 2008", April 21, 2009, http://uk.reuters.com/article/fundsNews/idUKLNE50602X20090107
36 Knight Frank/Citi Private Bank, The Wealth Report [Online], March 24, 2009, www.knightfrank.com/wealthreport/TheWealthReport2009.pdf
37 Kay Coughlin, President & CEO, Christie's Great Estates. Interview by Capgemini, April 2009
38 Not including primary residence
39 Kay Coughlin, President & CEO, Christie's Great Estates. Interview by Capgemini, April 2009
40 Colliers International, GCC Real Estate Overview Second Quarter 2009 [Online], April 21, 2009, http://www.colliers-me.com/marketreports.aspx
41 The Economist, "Dubai: A new world", April 25, 2009, http://www.economist.com/finance/displaystory.cfm?story_id=13527891

2007. Typically, there is little correlation between commercial and residential real estate performance, as the key drivers of strength in each market differ. However, the financial crisis has impacted drivers of demand in both markets—including economic growth, rates of unemployment, consumer spending and personal income, mortgage availability, consumer confidence, and demographics.

Latin American HNWIs had the highest allocation in the world to commercial real estate (31%), following the huge boom in commercial real estate across the region since 2006.

Farmland and undeveloped property, meanwhile, comprised 15% of aggregate global HNWI real estate portfolios in 2008, but that share was much higher (31%) in Latin America, where a significant amount of wealth has traditionally been derived from agricultural businesses.

Notably, Ultra-HNWIs held more of their real estate holdings in commercial real estate than HNWIs did in 2008 (33% of the total vs. 28%), while holding less in residential real estate (39% vs. 45%). This is largely because Ultra-HNWIs have more assets at their disposal, and tend to have broader and more diversified portfolios than HNWIs, allowing them to more comfortably allocate a greater proportion of their wealth to less-liquid assets.

HNWIs continued to reduce their holdings of real estate investment trusts (REITs) in 2008. REIT investments are generally more liquid than direct property ownership, so HNWIs were quick to sell as soon as real-estate sentiment started to turn negative. Only 10% of HNWI real estate holdings were in REITs by the end of 2008, down from 17% in 2007, and 22% in 2006. REITs continued their steady decline in performance from 2007 into the first half of 2008, before plummeting more than 50% in the second half of 2008. REIT investment fell the most in North America—to 14% of the region's overall HNWI real-estate investments. That was down 11 percentage points from 2007, but that year had seen a relatively large allocation to REITs in historical terms.

HNWIs REDUCED THEIR HOLDINGS OF ALTERNATIVE INVESTMENTS

HNWIs also continued to reduce their holdings of alternative investments as a whole in 2008 (from 9% of the aggregate portfolio to 7%). Hedge fund investments accounted for 24% of alternative investments by the end of 2008, down from 31% a year earlier, as the hedge fund industry as a whole posted its worst-ever performance and HNWIs shifted to more traditional investments vehicles.

HNWIs in Europe and Latin America saw the largest drop in hedge fund allocations, with both regions seeing their allotments drop by 16% from 2007 totals, to 18% and 32%, respectively.

Commodities, meanwhile, accounted for a slightly larger share of the aggregate HNWI portfolio at the end of 2008—13% vs. 10% in 2007—as flight-to-safety purchases of gold (which saw its eighth straight year of price increases) offset the general decline in commodities prices and HNWI investment. HNWIs in North America had the highest allocation to commodity investments (16%), as instability in the banking system fueled the flight to safety.

Foreign currency investment comprised only 14% of overall HNWI alternative investment allocations, but that proportion was much higher among HNWIs in Japan (27%) and the rest of Asia (25%), as HNWIs sought to hedge the currency exposure of their asset holdings.

Allocation to structured products jumped to 21% from 15% in 2008, as HNWIs pursued the type of structured vehicles with provisions that protect capital (not complex, opaque structures), and sought to capture superior returns to conventional fixed-income investments.

HNWIs SOUGHT REFUGE IN INVESTMENTS CLOSE TO HOME

Amid turbulence in the world economy, HNWIs retreated to familiar territory in 2008, continuing a trend toward home-region, and domestic investment that began in 2006. This trend has been marked by a reduction in North American assets as a percentage of overall HNWI holdings.

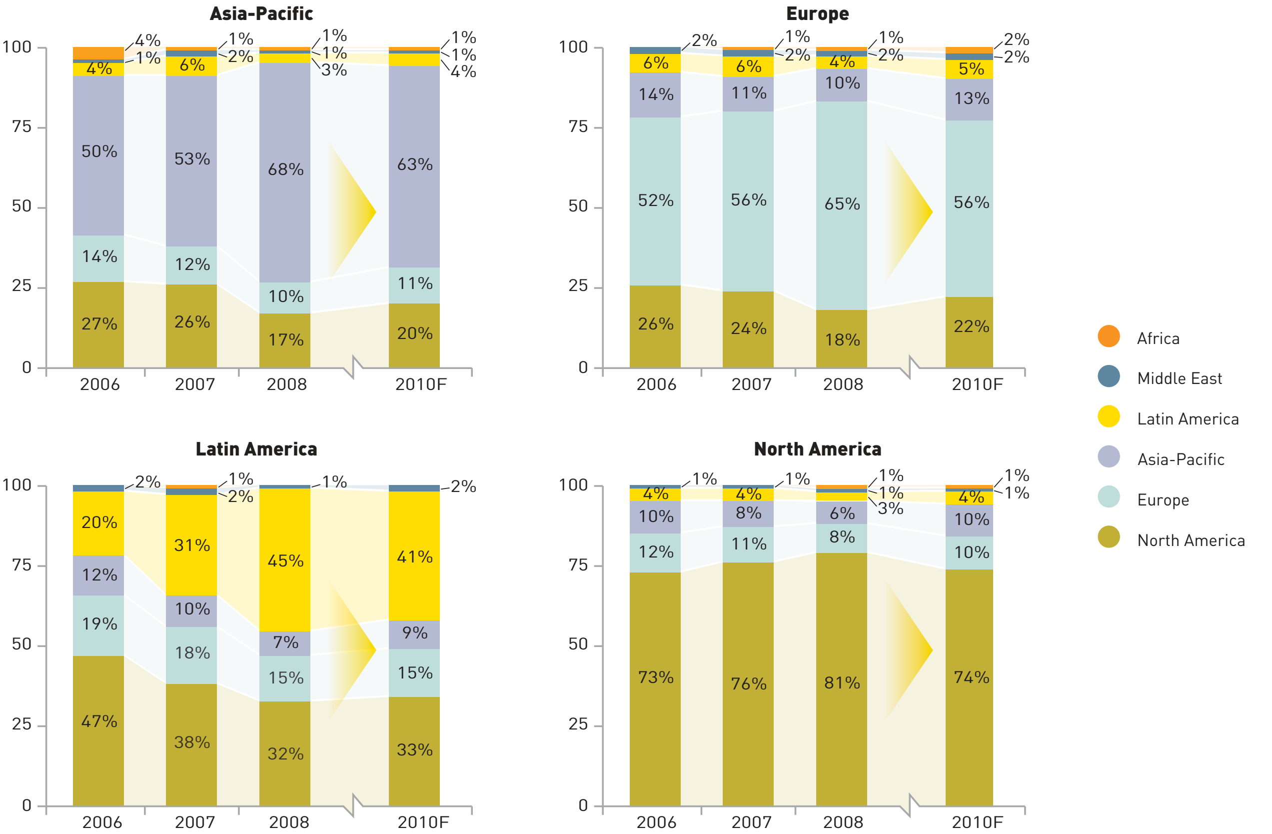
North American HNWIs increased their own domestic holdings, though, to 81%, up 8 percentage points from pre-crisis levels in 2006 (see Figure 11).

Most notably, the economies of Asia-Pacific and Latin-America sharply increased home-region investment from 2006 to 2008 (by 18 percentage points and 25 pts, respectively).

Latin America has experienced an especially steep increase in home-region investment, rising from 20% of global investments in 2006, before the crisis, to 45% in 2008. This in part reflects the significant investment opportunities (e.g., equities) within the region over those years. In addition, government-driven fiscal incentives in Latin America, along with relatively high interest rates, have encouraged HNWIs to repatriate offshore investments.

Figure 11. Breakdown of HNWI Geographic Asset Allocation, 2006 - 2010F

(%)



Note: Data for the Middle East not depicted, however trend remains same
Source: Capgemini/Merrill Lynch Financial Advisor Surveys 2007, 2008, 2009

In Asia-Pacific home-region investment accounted for 68% of overall HNWI investments, a level second only to North America, where 81% of investment is domestic. Notably, when home-region investment began to rise in 2006, it reflected an opportunistic pursuit of high returns. In 2008, the motivation became safety, as Asian HNWIs fled the instability in more mature markets.

HNWIs ARE EXPECTED TO REMAIN FAIRLY CONSERVATIVE INVESTORS IN THE SHORT TERM

In the short term, we expect HNWIs to remain moderately conservative in their investment allocations, with capital preservation being a priority over the pursuit of high returns.

Looking toward 2010, the profile of HNWI portfolios is likely to shift as economic conditions improve. In particular, there is likely to be a tentative return to equities and alternative investments as HNWIs regain their appetite for risk. We also expect fixed-income holdings to increase slightly, as investors move some of their increased allocations of cash and short-term deposits back into longer-term, higher-yielding investments.

At a regional level, there is likely to be a substantial shift in home-region HNWI investment activity. Overall, European HNWIs are expected to scale back their regional investment to the 2007 level of 56% of the total, while their investment in Asia is expected to rise, most likely in developing Asian economies, where returns are expected to be higher (see Figure 11).

North American HNWIs are also expected to cut back on domestic investment, more than reversing the 2008 increase, and putting their overall domestic allocation at 74% of the total in 2010 (down 2 percentage points even from 2007). However, increased North American investment by other HNWIs should offset these outflows, especially if the U.S. economy recovers, with North America remaining the top destination for HNWI investments overall.

WORLDS HNWIs SCALE BACK
ON THEIR INVESTMENTS OF PASSION AMID ECONOMIC UNCERTAINTY AND RISING COSTS

The financial crisis and economic uncertainty of 2008 clearly had an impact on HNWI investments of passion and lifestyle spending, with luxury goods makers, auction houses, and high-end service providers reporting significantly reduced demand worldwide.[42] The cost of luxury items also rose: The Forbes Cost of Living Extremely Well Index (CLEWI), which tracks the cost of a basket of luxury goods, rose 12% from 2007 to 2008, double the rate of inflation.

Outright global demand was weaker for luxury collectibles (e.g., automobiles, yachts, jets), luxury consumables (e.g., designer handbags, shoes, clothes), art, and jewelry, but there was also a shift in luxury-purchasing habits, as many HNWIs looked to secure their wealth in assets with long-term tangible value.

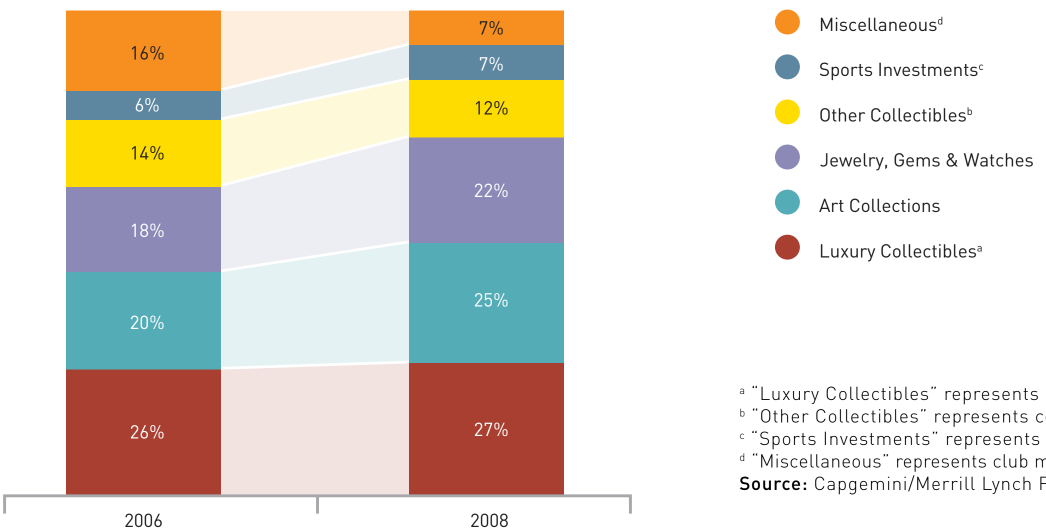
Actual HNWI spending patterns also varied considerably, as always, from region to region, between mature and emerging nations, and between wealth bands. For instance, demand for luxury goods fell significantly in mature markets (which account for more than 80%[43] of world-wide luxury-goods sales), as the financial crisis deepened in the first half of 2008. At that time, demand was still strong from emerging markets, but as the year wore on, emerging-market HNWIs also pulled back, amid declines in key sources of their wealth (oil, commodities, and stocks).

LUXURY COLLECTIBLES REMAINED THE PRIMARY HNWI PASSION INVESTMENT, BUT DEMAND WAS DOWN

Luxury collectibles continued to account for the largest portion of HNWIs' passion investments in 2008—27% of the total among HNWIs globally (see Figure 13), and 33% and 29% respectively among HNWIs in Japan and North America.[44] The global-average allocation to luxury collectibles was up marginally from the pre-crises level of 26% in 2006, but 2008 clearly saw an outright decline in demand for all of the major purchases in the collectibles bracket.

Private jet owners sold their planes in increasing numbers, as existing and potential HNWI customers of private jet manufacturers continued to feel the impact of declining corporate profits and tight credit markets. Business jet orders for Bombardier, the world's leading business jet maker by value of deliveries, fell 42% in 2008 (from 452 to 262). Orders from previously high-volume business segments, in particular fractional-ownership groups such as NetJets, slowed considerably.[45] As of the end of November 2008, the number of used jets available for sale worldwide had risen by 62% from a year earlier to reach an all-time high.[46]

Figure 12. HNWI Allocations of Passion Investments, 2006 vs. 2008



[a] "Luxury Collectibles" represents luxury automobiles, boats, jets, etc.
[b] "Other Collectibles" represents coins, wine, antiques, etc.
[c] "Sports Investments" represents sports teams, sailing, race horses, etc.
[d] "Miscellaneous" represents club memberships, guns, musical instruments etc.
Source: Capgemini/Merrill Lynch Financial Advisor Surveys 2007, 2009

[42] *"Luxury goods sales to drop as much as 20% in first two quarters of 2009 according to latest Bain & Company luxury forecast"*, Bain & Company press release, April 20, 2009
[43] Ibid
[44] Capgemini/Merrill Lynch Financial Advisor Survey, 2009
[45] Kevin Done, "Business aircraft makers face severe test", February 8, 2009, www.ft.com/cms/s/0/15a51a1a-f613-11dd-a9ed-0000779fd2ac.html
[46] The Economist, "Corporate jets - Deeply Uncool", January 8, 2009, http://www.economist.com/displaystory.cfm?story_id=12906373

Luxury car demand also sank in 2008, with sales down in the U.S. at all major luxury makers—Porsche (down 25.2%), Maybach (32.6%), Lamborghini (21%), Mercedes (11.5%), and BMW (9.7%). Emerging markets provided some solace, with Bentley sales up 53% in China and 18% in the Middle East in 2008, although Bentley's global sales figures were down 24% from record high levels of 2007.[47] Luxury car purchases, it seems, are moving like many markets for the wealthy from the hyper-priced and exotic to the more reasonably priced and familiar.

The yacht market offered another indicator that HNWIs were scaling back on passion investments. Attendance at yacht shows was down in 2008, prices were slashed, and the pool of unsold yachts grew. In the super-yacht market, there were reportedly discounts of up to a third being offered on yachts valued upward of $30 million, and sales of high-end pleasure boats plunged after a decade of unprecedented growth. From 1997 to 2007, Beneteau's annual sales grew from $235 million to more than $1.4 billion—only to sink 50% in 2008.[48] Also notable was the drop in demand from buyers that have been active in recent years—in particular HNWIs from the Middle East and Russia, where wealth was hit by sharp declines in the price of oil and commodities.

FINE ART ATTRACTED HNWI BUYERS SEEKING TANGIBLE VALUE; DISCRETE PRIVATE SALES JUMP

Fine Art remained the primary passion investment for Ultra-HNWIs in 2008 (27% of their total passion investments), and was the second-largest (25%) for HNWIs. For HNWIs, the allocation to Fine Art actually rose from the pre-crisis allotment of 20% in 2006, as investors gravitated to assets with a more enduring value. However, the art market still had a tumultuous year—ranging from a speculative buying frenzy to a price correction of about 30%.[49]

Global Fine Art auction sales totaled $8.3 billion in 2008, down $1 billion from 2007, with U.S. Fine Art sales generating $2.9 billion, down $1 billion from 2007. Sales in London generated $2.96 billion in 2008, up a bit ($271million) from the year before.[50] Notably, though, private sales nearly doubled, as some HNWI sellers sought discretion, and a quicker sale turn-around.[51] Declining sales in the popular Contemporary Art category—in which sales generated 34% less than in 2007[52]—was driven largely by a decline in consignments, as well as some investors refraining on purchases. The profile of the art buyer also changed, with demand shifting to more traditional types of art, such as Impressionists or earlier forms of art.[53] The decline in the art market prompted cutbacks by auction houses at Sotheby's and Christie's, which have been resizing their organizations and abandoning capital guarantees to sellers.[54]

As in previous years, more European (30%) and Latin American (27%) HNWIs invested in Fine Art than did their Asian (23%), North American (21%), and Middle Eastern (17%) counterparts.[55] Still, the number of Middle Eastern buyers at Christie's auctions globally has risen 400% since 2004, so Mideast buyers now rival Russian buyers in terms of sales.[56] Still, while investors from emerging markets have increasingly helped fuel the rise in Art sales, prices have come down globally, allowing serious collectors and connoisseurs to buy at more 'reasonable prices'.

HNWIs ALLOCATED MORE TO JEWELRY, GEMS, AND WATCHES THAN BEFORE THE CRISIS

Jewelry, gems and watches attracted the third largest share of passion investment overall (22%), and the top allocation in Asia and the Middle East. HNWIs certainly devoted proportionately more to this category in 2008 than the 18% allotted in 2006, before the crisis, suggesting HNWIs were more likely to perceive jewelry, gems, and watches as "safer", tangible investments that might retain long term value.[57] Ultra-HNWIs devoted a relatively lower percentage (20%) to this category.

Nevertheless, the overall growth in global jewelry sales slowed markedly in 2008—to 2.5% growth from 9% in 2007, as the European and American markets cooled.[58] Despite the challenging global circumstances, the historic Wittelsbach blue diamond (35.56cts) fetched $24.3 million in a London auction in December 2008, the highest price for any diamond or jewel ever sold at auction.[59] Watches were the only category in which healthy sales growth was evident (9%), and that increase was largely due to emerging-market demand.[60] Sotheby's Geneva auction house recorded record sales of about $15 million on watches, including a Patek Philippe that sold for $1.55 million.[61] Sales and interest in the Middle East and Asia have continued to stay strong in this category, despite the crises.

[47] Hannah Elliot, Luxury Cars Aren't Selling Either, January 14, 2009, www.forbes.com/2009/01/14/detroit-luxury-automakers-biz-manufacturing-cx_he_0114luxcars.html
[48] Carol Matlack, "Downturn Hits Europe's Luxury Yacht Makers", *BusinessWeek*, April 13, 2009
[49] *2008 Art Market Trends*, April 2009, Artprice.com, (http://imgpublic.artprice.com/pdf/trends2008_en.pdf)
[50] Ibid
[51] Toby Usnik, Christie's Corporate Communications, interview by Capgemini, April, 2009
[52] 2008 Art Market Trends, April 2009, www.artprice.com (http://imgpublic.artprice.com/pdf/trends2008_en.pdf)
[53] Javier Espinoza, "In The Name Of Art", *Forbes*, February 4, 2009
[54] Alexandra Peers "The Fine Art of Surviving The Crash in Auction Prices", *The Wall Street Journal*, November 20, 2008
[55] Capgemini/Merrill Lynch Financial Advisor Survey, 2009
[56] Stefania Bianchi, "Christie's Jewels Sale Sees Dubai Wealthy Shrug Off Econ Woe", *The Wall Street Journal*, April 28 2009
[57] Capgemini/Merrill Lynch Financial Advisor Survey, 2009
[58] *"Luxury goods sales to drop as much as 20% in first two quarters of 2009 according to latest Bain & Company luxury forecast"*, Bain & Company press release, April 20, 2009
[59] *Christie's 2008 Global Art Sales Total $5.1 billion*, Christie's press release, February 12, 2009
[60] *"Luxury goods sales to drop as much as 20% in first two quarters of 2009 according to latest Bain & Company luxury forecast"*, Bain & Company press release, April 20, 2009
[61] Jewelers Specialty Insurance Services, Jewelers Block &Fine Arts Newsletter - *High End Jewelry Auction Mixed*, December 2008, Volume 2, Issue 12

ALLOCATIONS TO OTHER COLLECTIBLES HELD STEADY WITH PRE-CRISIS LEVELS

Investments in Sports Investments (e.g., in teams, race horses) and Other Collectibles (e.g., wine, antiques, coins, memorabilia) accounted for 7% and 12%, respectively, of all passion investments in 2008. Those proportions were steady around pre-crisis levels of 2006, but again, outright demand for these items was clearly weaker in 2008.

For example, the Liv-ex 100 index, which tracks the price of 100 of the world's best investment-grade wines, has fallen steadily since July of 2008. Some wine investors, hit by the global financial fallout, resorted to selling their collections of expensive claret in a bid to raise cash.[62] Even the Bordeaux wine market, which was once impervious to market fluctuations, froze after Lehman collapsed in September 2008. However, by the year's end, Bordeaux sales had revived to more normal levels, as "affordable luxuries" became favored.[63]

LIFESTYLE SPENDING ROSE ON HEALTH/ WELLNESS, BUT DROPPED ON LUXURY TRAVEL

Notably, Health and Wellness was the only lifestyle spending category to see a significant increase in spending in 2008. Of surveyed HNWIs, 54% globally, and 64% of those in the Asia-Pacific region, said they increased spending on this category[64]—which includes activities like high-end spa visits, fitness-equipment installations, and preventative medicine procedures like full body scans.

Economic uncertainty did, however, cut into HNWI spending on luxury and experiential travel. Forty percent of HNWIs overall, and 55% of HNWIs in North America, said they reduced such spending[65]—dashing early hopes that luxury travelers would not spurn travel during the financial turmoil.[66]

Purchases of luxury consumables also fell, and 43% of all surveyed HNWIs, and 60% of those in North America, said they spent less on luxury consumables in 2008.[67] Luxury goods maker Bulgari announced a 38% lower operating profit in the third quarter of 2008, compared with the same period in 2007, with sales for accessories falling by 16%.[68] Richemont, the world's second-largest luxury goods firm, reported that its sales fell 7% in the last three months of 2008.[69]

RECESSION TOOK TOLL ON PHILANTHROPY AS 2008 WORE ON

While not exactly an investment, philanthropy is nevertheless a passion for many HNWIs and Ultra-HNWIs. There was little change in the allocation of HNWI wealth to philanthropy in 2008 in the first half of the year[70]—but charitable giving was severely impacted in the fourth quarter, as HNWIs gave less, and focused on fewer causes.[71] Moreover, the real impact of the financial crisis will probably become more evident in 2009. Indeed, 60% of North American HNWIs said they would be giving less in 2009 due to the economic downturn, though 54% of HNWIs in Japan said they planned to give more.

ECONOMIC WOES ARE LIKELY TO SUPPRESS DEMAND FOR PASSION INVESTMENTS INTO 2009

While HNWIs and Ultra-HNWIs will always indulge in their passions, economic conditions are expected to suppress their demand in 2009. Although the renowned Yves Saint-Laurent collection, which sold for $0.5 billion in February of 2009, was dubbed the "sale of the century", Christie's is forecasting lower volumes of sales for the year.[72] Some HNWIs and financial institutions may be putting their art onto the market to raise funds and capital, but sellers are also hesitant about the market, and may want to wait for an overall market return before putting pieces up for auction. The last art market downturn, which started in 1989, lasted for 4 years, but art experts say the market could prove to be more resilient this time around, as recent buying was more broadly based, including buyers in Asia, Russia and the Middle East.[73]

While auction sales will likely diminish in 2009, the quality and rarity of a piece—whether art, an antique, or jewelry—could quickly drive activity, since many serious collectors and connoisseurs still seem willing to lay out cash for an unique piece.

The global luxury goods industry, meanwhile, could well fall into recession, with an expected decline in global sales of 10% in 2009.[74] Nevertheless, name-brand luxury goods like Hermes and Cartier are expected to be resilient, as their exclusivity and brand heritage continue to appeal to the wealthiest of global consumers.[75] Nevertheless, 'affordable (and aspirational) luxury goods,' more widely accessible to HNWIs and the 'mass-affluent'[76] may suffer more of an impact amid perceptions that such purchases are a needless extravagance in tough times.

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63 Mehmet Yorukoglu, House of Burgundy, Inc., New York, interview by Capgemini, February 2009
64 Capgemini/Merrill Lynch Financial Advisor Survey, 2009
65 Ibid
66 PricewaterhouseCoopers LLP, Travel & Tourism: *A rough ride for luxury travel?*, December 2008
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69 Tacy LTD - Richemont Jewelry House Sales down 12% in Q4 2008, DIB, January 21, 2009, https://www.diamondintelligence.com/magazine/magazine.aspx?id=7537
70 Robert Frank, "The Wealth Report: Giving by the Rich to Remain Strong in 2008", *The Wall Street Journal*, August 20, 2008
71 Jan M. Rosen, "In Uncertain Times, Donors Hold Back", *The New York Times*, February 26, 2009
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73 *The Economist*, "A special report on the rich - A thing of beauty", April 2, 2009, http://www.economist.com/specialreports/displaystory.cfm?story_id=13356594
74 "*Luxury goods sales to drop as much as 20% in first two quarters of 2009 according to latest Bain & Company luxury forecast*", Bain & Company press release, April 20, 2009
75 "*Worldwide luxury goods market growth projected to slow substantially by end of year and head into recession in 2009*", Bain & Company press release, October 29, 2008
76 Individuals with US$100,000 to US$1,000,000 in investable assets

SPOTLIGHT:
OPTIMIZING CLIENT-ADVISOR-FIRM DYNAMICS IS KEY AS WEALTH MANAGEMENT FIRMS TACKLE CRISIS FALLOUT

- **More than a quarter of HNWI clients surveyed withdrew assets from their wealth management firm or left that firm altogether in 2008,** primarily due to a loss of trust and confidence.
- **Wealth management profitability was negatively impacted due to lower Assets under Management (market losses and attrition) and an increase in low-margin asset allocation.**
- **Strategic levers can improve client retention and attrition by addressing clients' heightened demand for transparency and simplicity:** statement and reporting quality, online access and capabilities, risk management and due diligence capabilities, desired product options and fee structures.
- **While firms need to be client-focused,** attention must also be given to the tools and support mechanisms Financial Advisors need, particularly strong firm communications and client reporting.

WEALTH MANAGEMENT FIRMS FACE A NEW INDUSTRY REALITY AS CRISIS TESTS CLIENT CONFIDENCE AND LONG-STANDING BUSINESS MODELS

The global economic and market downturn has clearly shaken the trust and confidence that HNWIs placed in markets, regulators, financial institutions, and the very principles of portfolio management. Very few HNWIs or Ultra-HNWIs have gone unscathed amid the broad and deep decline in asset values, and many have shifted wealth to safer, more conventional and liquid investments. Some HNWIs have also spread their assets across more institutions as a means to mitigate risk.

Advisors and wealth management firms are working to help their HNWI clients through the crisis and its aftermath. They recognize events have taken their toll, and have sought to increase communication, and offer more simplicity and transparency to the wealth management process to help restore eroded trust.

However, wealth management firms face discrete challenges of their own. Many are part of larger financial institutions that have suffered substantial write-downs and losses tied to excessive leverage. These units may face significant pressure when it comes to retaining current clients and attracting new ones during these turbulent times. More broadly, the economics of the wealth management business model are being tested as market prices decline and clients withdraw assets—threatening the sustained and robust growth in assets under management (AuM) that has long powered the industry.

In this environment, wealth management firms need to pay particularly close attention to client satisfaction, but our research[77] shows that firms and Advisors may not fully understand what is motivating their clients to leave or stay. Moreover, firms may be misjudging how satisfied their own Advisors are with certain critical service and support areas.

This Spotlight, in presenting some of our research findings, provides Advisors and wealth management firms with insights on how to optimize their efforts to guide clients and Advisors through the crisis and its fallout, and how to identify opportunities for improving client relationships and experience and effectively enable Advisors going forward.

AUM SHOWED CRITICAL DECLINE IN 2008 AS ASSET VALUES SANK AND CLIENTS DIVERSIFIED

Of all HNWI clients surveyed, 27% said they withdrew assets or left their wealth management firm in 2008. In other words, given a global HNWI population of 8.6 million, each holding an average of $3.8 million[78] in investable assets, trillions of dollars of HNWI financial wealth were potentially shifting among firms in 2008.

The ability to grow AuM is a key profit driver for wealth management firms, but most saw assets decline in 2008.

[77] This research is based on quantitative and qualitative research. All survey samples are statistically significant, including those of wealth management executives across nearly 50 firms, hundreds of HNWI clients, and over 1350 financial advisors.

[78] Capgemini Lorenz curve analysis, 2009

Among 15 leading firms we profiled[79], AuM fell an average of 22%, compared with 17% AuM growth in 2007. Market factors had a significant impact, with the value of global HNWI financial assets falling 19.5% in 2008, but the desire of clients to allocate assets across more providers was also an issue.

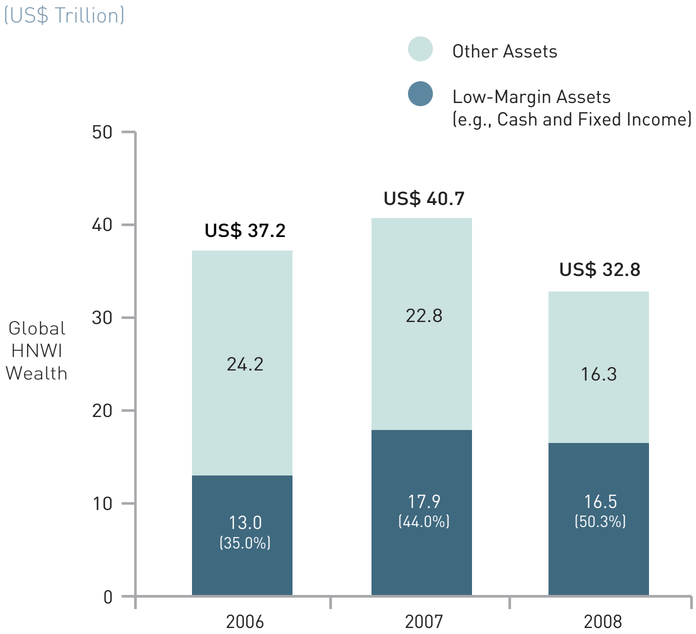
Notably, while firms and Advisors are limited in what they can do to mitigate widespread portfolio declines of the type seen in the crisis of 2008, they can be proactive in addressing the drivers of provider diversification—which relate heavily to the broader drivers of client retention and attrition that we will discuss later.

AUM MIX ALSO SHIFTED TO LOWER-MARGIN PRODUCTS

An outright decline in AuM was accompanied by a shift in the AuM mix, with clients allocating more holdings to low-margin asset classes, such as cash, cash equivalents, and fixed-income products. (Fixed income generated an average margin of just 31.4 basis points in 2007 which may have slimmed even further during 2008.)[80]

Fifty percent of HNWI assets were in these low-margin classes at the end of 2008, up from 44% a year before, and 35% at the end of 2006 (see Figure 13). (We reported in the 2008 WWR that this asset shift was already under way in the second half of 2007, when financial-market conditions started to deteriorate.)

Figure 13. HNWI Allocation of Investable Financial Assets, 2006 - 2008



Source: Capgemini Analysis, 2009

AS AUM SHIFTS PRESSURED THE COST BASE, FIRMS JUGGLED CLIENT NEEDS AND EXPEDIENCY

By definition, any loss of assets under management affects the cost base for wealth management firms, and the impact of this trend was tangible in 2008. The cost-to-income ratio rose sharply among the firms we profiled—to 74% in 2008 from 68% in 2007—even though many firms moved quickly to try and stem that cost-base growth.

Wealth management firms employed a wide range of short and long-term cost-cutting measures, from reducing head-count to realigning/freezing compensation, along with budget cuts for line items like travel and marketing. As a result, the growth in costs did slow markedly—to just 6% between 2007 and 2008 from 17% between 2006 and 2007.

PROFIT ISSUE IS UNDENIABLE AS WEALTH MANAGEMENT FIRMS EVALUATE STRATEGY

Despite the upheaval in the industry, wealth management generally fared far better than other financial services in 2008. Businesses like investment banking bore the brunt of revenue declines, as weakening economic conditions undermined ubiquitous activities like trading and underwriting, and balance sheets were hit by write-downs in assets like mortgage holdings.

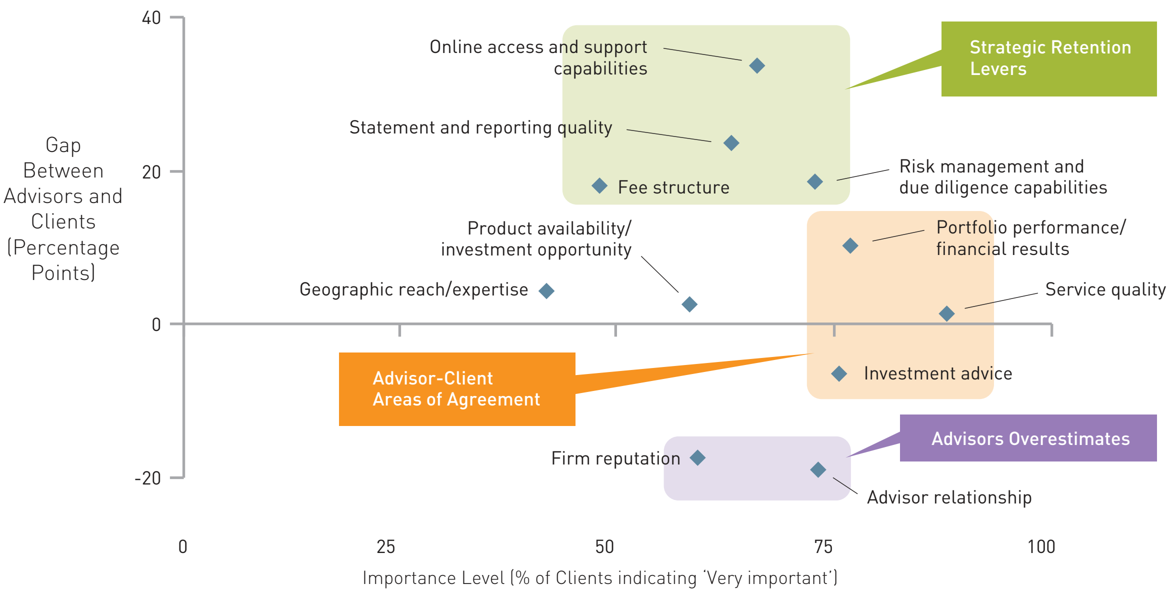
In fact, among the firms we profiled, wealth management divisions significantly outperformed other business lines, widening the gap between the profitability of firms and wealth management divisions—a gap that had already begun to appear in 2007 (In 2006, pre-tax profit margins were equal to 30% for both wealth management divisions and the entire bank, widening in 2007 before arriving at 24.5% in 2008 for wealth management firms vs. -9.2% for all business lines combined of profiled global firms). Moreover, several leading executives said wealth management played a critical role in the success or sustainability of diversified banking companies during the challenges of 2008. Some institutions even say they are reorganizing around three or four core divisions—in which wealth management will be featured prominently.

Despite the relative strength of wealth management firms, profits remain an obvious concern, as firms deal with decreased margins and are forced to cut costs—often to mitigate losses incurred in other bank divisions. The conundrum for many firms is how to make pragmatic business decisions (including cost cuts) that are appropriate to the tough operating environment, but still maintain and further client-service efforts.

[79] We analyzed the leading wealth management firms by AuM using primary and secondary research sources.

[80] Scorpio Partnership, Private Banking KPI Benchmark 2008 (June 2008).

Figure 14. Strategic Levers of Client Retention in 2008



Source: Capgemini Analysis, 2009

Our research findings identify and explain what drove clients to leave or stay with their Advisor or firm in 2008. As such, the results offer wealth management executives perspective on how to prioritize their efforts to improve client service/experience and enable Advisors going forward—while balancing those efforts against the challenging economics of the day.

CLIENT RETENTION AND ATTRITION ARE COMPLEX DYNAMICS

SERVICE QUALITY WAS BY FAR THE TOP DRIVER OF CLIENT RETENTION IN 2008

Importantly, Advisors generally understand the top drivers of client retention. For example, 88% of surveyed HNWI clients said service quality was a "very important" reason for staying with their wealth management firm in 2008, and 87% of Advisors anticipated that would be the case. Advisors also understand the similarly high priority clients place on portfolio performance and investment advice.

Beyond these outright priorities, however, our analysis shows four other drivers that are highly influential in prompting clients to stay with a firm/Advisor, yet are vastly underestimated by Advisors.[81] We use the term "levers" to describe these influential but under-tapped drivers.

These levers offer significant potential for improvement, because they contribute tangibly to retention in a way many Advisors apparently do not fully understand. This suggests firms and Advisors have yet to address them fully. (By contrast, firms are likely to have dealt extensively with drivers of retention that Advisors already understand well.)

These high-potential levers for improving client retention (see Figure 14) are as follows:

- Online access and capabilities, which were deemed very important by 66% of clients, but only 32% of Advisors—a 34-percentage-point gap.
- Statement and reporting quality (63% vs. 39%, a 24-pt gap).
- Risk management and due diligence capabilities (73% vs. 54%, a 19-pt gap—(see Sidebar: Firms Can Act to Rebuild Shaken Investor Confidence through More Holistic Risk Management).
- Fee structures (48% vs. 30%, an 18-pt gap).

The retention analysis also revealed some areas that Advisors over-value, particularly their own relationship with the client (92% said the relationship was very important in driving a client's decision to stay, while only 73% of clients concurred), and their firm's reputation (76% vs. 59%). This suggests Advisors have yet to adjust to the new reality in which trust and confidence in Advisors, firms and the financial system have been eroded (as we discuss next).

[81] In our analysis, a factor had to be cited as 'very important' by a statistically significant percentage of responding clients to qualify as an influential driver of retention in and of itself, before we evaluated the discrepancy between Advisor and client perceptions about the role of that driver.

HNWI ATTRITION WAS FUELED BY WIDESPREAD LACK OF TRUST/CONFIDENCE IN 2008

In 2008, a loss of client trust and confidence took its toll on the entire wealth management industry. Of surveyed HNWI clients, 46% said they lost trust in their primary Advisor and an equal percentage in their wealth management firm, but their misgivings were more extensive even than that. For example, 78% said they lost trust in the financial system's regulatory bodies, which were supposed to be help guard against the type of staggering market and corporate losses that occurred in 2008.

It is not surprising then that so many HNWIs were motivated to withdraw assets from their primary wealth management firm, or to leave that firm altogether. As noted earlier, more than a quarter of surveyed HNWIs said they moved assets in 2008, suggesting trillions of dollars in HNWI assets were in motion—and available to firms that could show clients a strong value proposition. This stark reality demonstrates the challenge for wealth management firms as they position themselves to try to retain, recapture, and compete for new AuM in the months and years ahead.

Furthermore, behind the aggregate trends in attrition, there were some notable dynamics among segments of our surveyed populations of clients and Advisors. These trends could require a specific and proactive response from wealth management firms.

For example:

- **Younger and middle-aged HNWIs, were more likely to leave or withdraw assets in 2008.** As new generations begin to make up a larger percentage of the HNWI population, firms will need to take a closer look at the needs and expectations of these younger, more vocal HNWIs. This group may, for instance, demand a more innovative use of technology and media for communication than traditional clients.
- **Clients whose wealth is derived from sources such as income and business ownership had a greater tendency to defect,** while clients whose wealth is inherited or built through investment performance were more likely to stay. This is a significant finding, because fully 52% of HNWI wealth was generated from business ownership in 2008, while income accounted for another 18%. This indicates that a significant portion of clients have a higher-than-average propensity to defect, and so their needs require proactive management.
- **Advisors aged 41+ were better able to retain clients during 2008** (of Advisors who were successful in retaining clients, 62% were from the 41+ age bracket) than younger Advisors (38%). This suggests that clients value experience in an Advisor, particularly when being guided through a crisis.
- **Of those Advisors that kept clients in 2008, 69% operated in a team-based model,** while only 31% were from an individual-advisory model. Executives in several regions told us the industry is starting to embrace the team-based model as the preferred approach for serving HNWIs going forward, and this finding confirms the validity of that shift.

Seeing the implications of just these few findings indicates that dealing with client/AuM retention is likely to be far more complex than it might appear. For one thing, although huge amounts of wealth did shift between providers in 2008, our research shows provider diversification was not in and of itself a major driver of attrition—suggesting HNWIs were actually prompted to defect or move assets because they were dissatisfied on other counts.

WHILE TRUST IS PARAMOUNT, SPECIFIC LEVERS HAVE SIGNIFICANT POWER TO CURTAIL ATTRITION

In fact, our research confirms loss of trust and confidence was actually the most powerful driver of attrition among HNWIs in 2008, and the importance of the trust issue to clients is widely understood by Advisors.

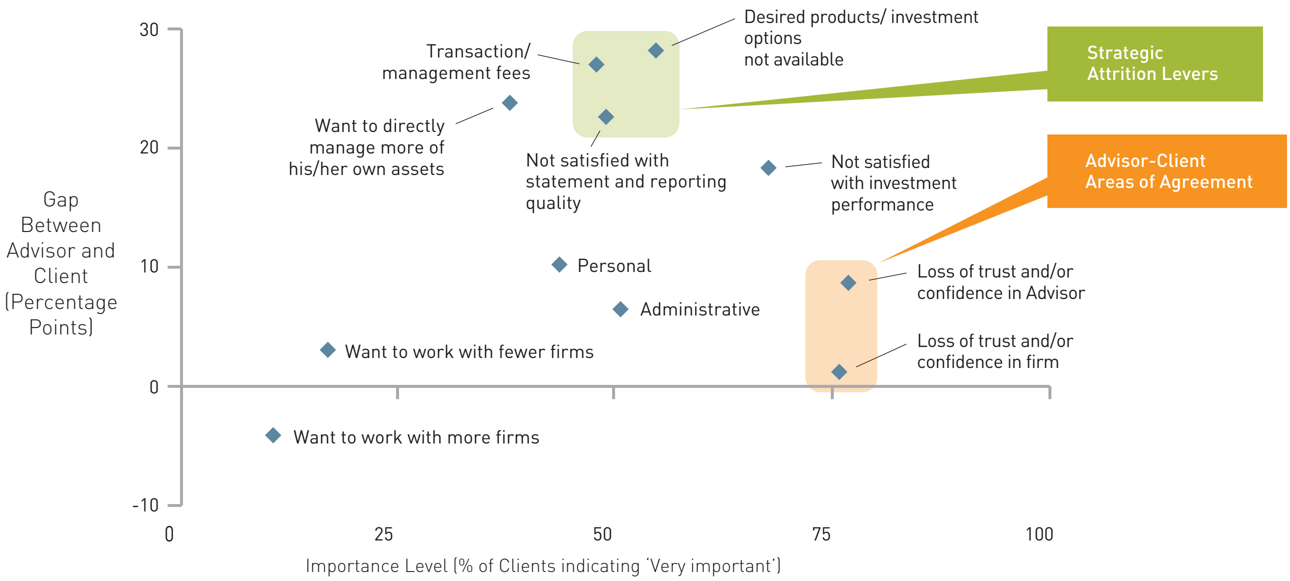
Not surprisingly, though, clients most often said loss of trust in their Advisor had or would prompt them to defect or move assets, while Advisors said loss of trust/confidence in the firm was the number one driver of client attrition. This is consistent with Advisors over-valuing their role in client retention.

To study attrition dynamics, we again used a gap analysis of the Advisor/Client Surveys to identify levers of improvement—once more focusing on those areas that were a priority for clients in 2008 but were underestimated by Advisors.[82] Our analysis identified three levers with significant potential for stemming attrition. They are (see Figure 15):

- The availability of product/investment options, which was ranked as "very important" by 55% of clients but only 27% of Advisors—a 28-percentage-point gap.
- Statement and reporting quality (49% vs. 26%, 23-pt gap).
- Transaction/management fees (48% vs. 21%, 27-pt gap).

[82] In our analysis, a factor had to be cited as 'very important' by a statistically significant percentage of responding clients to qualify as an influential driver of attrition in and of itself, before we evaluated the discrepancy between Advisor and client perceptions about the role of that driver.

Figure 15. Strategic Levers of Client Attrition in 2008



Source: Capgemini Analysis, 2009

FIRMS CAN PULL ATTRITION/RETENTION LEVERS TO POSITION FOR LONG-TERM SUCCESS

Finding a way to satisfy customers, and keep them loyal, will be critical to the long-term success of any wealth management firm, given the evolving competitive landscape.

Our research shows that from 2006 to 2008, there was a large increase in the number of providers across the board, and HNWI clients have identified which types of firms they plan to use in 2009. There are three key outcomes of changing HNWI perceptions and preferences:

- **Local and regional banks are poised for success** (HNWI client data indicates usage of local/regional banks will rise 31% in 2009 and beyond from 2008). Amid growing qualms about the stability of the financial markets, HNWIs have begun to see local and regional banks as safer alternatives, at least temporarily, since those institutions were less exposed to the more esoteric products that caused the demise of larger counterparts.
- **Large, global and national banks will be challenged** to regain the role of trusted Advisor, as client data indicates HNWIs will use 6.6% more of these firm types in 2009 and beyond, which is a slower pace of increase than the avg. 7.6% rise from 2006-2008. However, large global and national banks are possibly the best equipped to address certain strategic levers of client retention and attrition (client reporting, online access, product/investment options, and due diligence for risk management).
- **Independent Advisors may struggle** (data indicates HNWI clients will use 8% fewer Independent Advisors in 2009 and beyond than they did in 2008, after that usage rose an avg. 14.7% from 2006-08). Prior to the crisis, HNWIs may have deliberately chosen Independent Advisors, believing them to offer an alternative perspective to mainstream firms. However, the financial crisis, and related fraud scandals have served to undermine HNWI confidence in the ability of some Independent Advisors to provide adequate due diligence and risk management capabilities.

In this highly competitive environment, firms will need to be proactive in mitigating AuM attrition, and improving client retention rates. By combining insights garnered from both the attrition and retention analyses, and deploying improvement initiatives to under-developed capabilities accordingly, firms should be in a better position to meet their clients' expectations going forward and, ultimately, to retain and recapture AuM.

On an aggregate basis, for example, our results show fee structures and client statements/reporting quality are common denominators in client retention and attrition, so the average firm may benefit most from pulling these levers first.

In charting the way forward, however, firms should also pay close attention to the satisfaction of Advisors, which our research shows is vital to preventing AuM outflows.

ENABLING ADVISORS IS KEY TO DELIVERING ON BUSINESS GOALS

Of surveyed Advisors who said they were dissatisfied with the service and support enablement provided by their firms,[83] fully 90% lost clients in 2008, so it is clearly in the best interests of firms to make sure Advisors are satisfied with the core service components of Advisor enablement.

Satisfaction also varied among Advisor types. For example:

- Advisors aged 41+ and those with more years of experience tend to be more satisfied—as do those who have a longer tenure at their current firm.
- Those Advisors that categorized their practice model as 'investment Advisors' (IAs) were far more likely to be dissatisfied (61% of the dissatisfied Advisors were IAs), while those that worked as relationship managers (RMs) are quite likely to be satisfied (49% of satisfied Advisors were RMs). This finding is perhaps not surprising, though, given that IAs are usually more hands-on with clients and portfolios than are relationship managers, who delegate more of the portfolio management to internal and external managers.

Given these differences, it suggests firms should analyze the characteristics of their Advisor segments when deciding on the appropriate mix of enablement tools. This will help to ensure Advisors are properly aligned with the firm's business model and strategic goals.

FIRM COMMUNICATIONS/DIRECTIVES AND CLIENT REPORTING ARE KEY ADVISOR ENABLERS

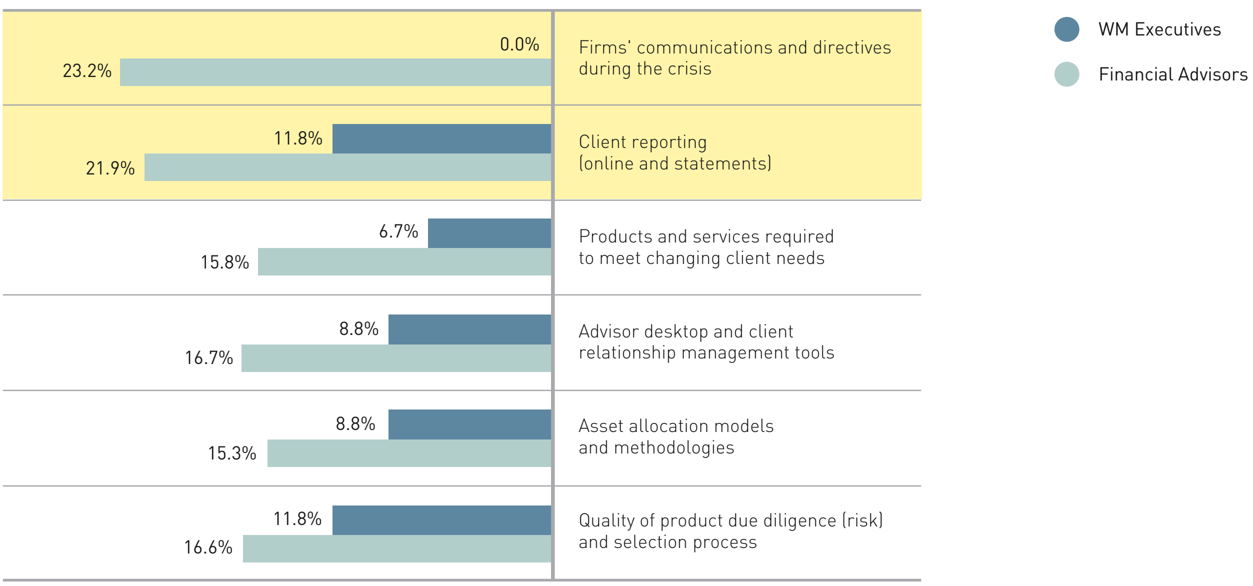
Our findings confirm firms need to vigorously address Advisor perceptions and needs through clear and frequent corporate communications, particularly in times of crisis.

In fact, firms underestimated how dissatisfied Advisors were with all support areas (see Figure 16), but most notably client reporting and firm communications.

- 23% of Advisors were dissatisfied with firm communications and directives during the crisis, yet practically none of the CxO level executives interviewed thought that Advisors were dissatisfied on that count. This suggests firms should take a deeper look at Advisor expectations. Interestingly, interviewed executives indicate they are focusing heavily on improving client communication and intimacy, but communication with Advisors may be lagging—especially if firms believe their Advisors have dealt well with this crisis. Our findings serve as a reminder that firms should not underestimate the need to address Advisor perceptions and needs vigorously, through clear and frequent corporate communications, particularly in times of crisis.
- 22% of Advisors were dissatisfied with client reporting, but only 12% of executives said they would be. As we noted earlier, Advisors themselves underestimated the value

Figure 16. Advisor Satisfaction with Service and Support Enablement in 2008

(% of Respondents Indicating Advisor Dissatisfied)



Source: Capgemini Analysis, 2009

[83] Advisors were classified as "dissatisfied" if they voiced some degree of dissatisfaction over major enablement tools provided by firms (i.e., tools/capabilities over which Advisors have least control, such as 'Advisor desktop' and 'client relationship management' tools).

clients place on reporting, so Advisors and executives could be compounding the tendency of their firms to under-value something valued highly by clients.

FIRMS CAN FOCUS IMPROVEMENT EFFORTS ON TOOLS VALUED BY KNOWLEDGEABLE ADVISORS

To optimize efforts to improve Advisor satisfaction, firms can also narrow their focus to the specific enablement tools valued by Advisors who are already well-informed.

We characterize 'well-informed' Advisors as those whose responses are closely aligned with clients on questions about attrition. These Advisors have a better understanding than most of why HNWI clients leave/withdraw assets from their wealth management firm. According to these Advisors, the following enablement tools are very important for servicing clients:

- Quality client statements and reporting (according to 79% of well-informed Advisors).
- Customer relationship management (73%).
- Online access to information/services (69%).
- Client website/portal (59%).

Importantly, a significant gap can be found between the opinions of these experts and those who do not fully appreciate client attrition drivers. For example, while the vast majority of well-informed Advisors say quality client statements and reporting are very important to servicing clients, only 45% of poorly informed Advisors say the same. There are similar gaps in perceptions regarding other enablement counts (see Figure 17), so wealth management firms will want to make sure they are especially listening to well-informed Advisors when evaluating their client-service strategies—especially since service quality is the number one driver of client retention.

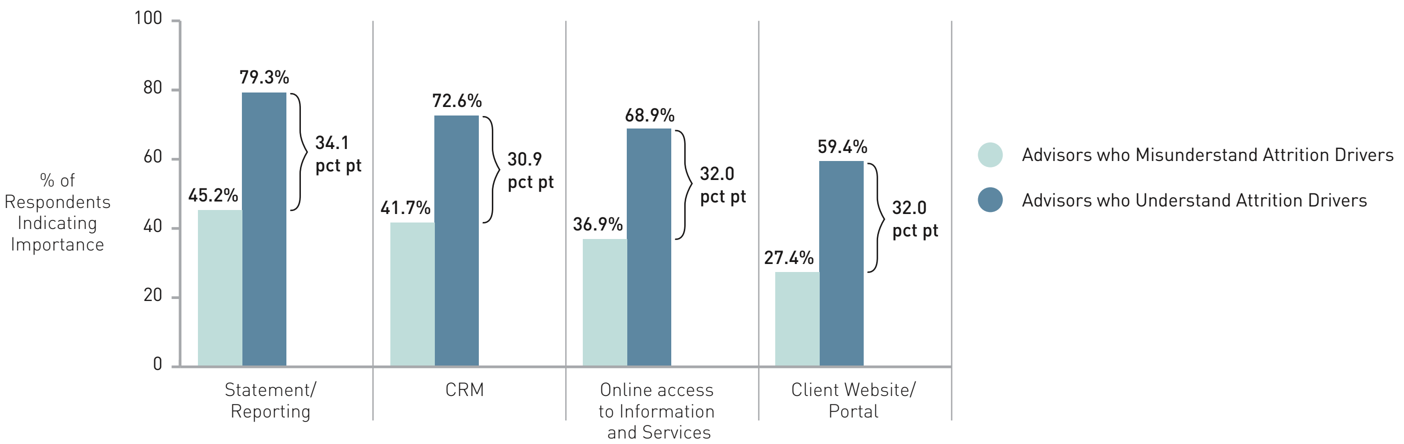
CONCLUSION

Our research shows the numerous demands wealth management firms now face in a bid to get the best out of fluid firm-advisor-client dynamics. As a result, firms need to look anew at the assumptions behind their value proposition, and see how that proposition must change with the times.

In the Way Forward, we look at some of the practicalities involved for firms in assessing which of these differentiating levers has the most potential to drive retention and stem attrition of clients and assets going forward.

Figure 17. Advisor Sentiment toward Importance of Tools for Client Service

(% of Advisor Respondents)



Source: Capgemini Analysis, 2009

FIRMS CAN ACT TO REBUILD SHAKEN INVESTOR CONFIDENCE THROUGH MORE HOLISTIC RISK MANAGEMENT

The dramatic downturn in 2008 severely shook the confidence of HNWIs in the ability of traditional risk management practices to mitigate their downside exposure. Wealth management firms acknowledge confidence is shaken, but many still underestimate how the erosion of trust has and could affect client relationships.

To assuage HNWI concerns and restore their confidence, firms may need to re-evaluate how best to align their clients' financial/risk profiles and personal goals with their true risk appetites. This will likely involve improving firms' due diligence practices, and building more comprehensive risk assessments.

2008 PROMPTED HNWIs TO QUESTION THE STRENGTH OF PORTFOLIO RISK MANAGEMENT PRACTICES

Risk management frameworks are deployed at many levels in financial institutions—from the enterprise-wide to the product levels—but we are largely talking here about the frameworks that apply to HNWIs individuals, their personal risk profiles, and the portfolio-construction process. The unprecedented events of 2008 rattled investors in general, but the following issues (separately and together) served in particular to undermine HNWIs' trust and confidence in the adequacy of wealth management firms' due diligence and risk practices in assessing and managing their portfolio risks:

- The widespread investment losses incurred by firms around the globe eroded confidence in financial institutions—most of which were struggling to manage their own portfolios, and swallow massive write-downs.
- Many firms, it transpired, had failed to assess and fully convey to clients the implications of product risks. HNWI client portfolios suffered as products and asset classes failed to behave as anticipated—in outright performance, and compared to the risks implied in their credit ratings. For instance, some firms lumped together an extensive range of diverse products into a single category, such as putting U.S. Treasuries and certain structured products into a "fixed-income" bucket. Even when such products were comparable from a credit-ratings standpoint, some key inherent characteristics, such as liquidity, potential downside and complexity, were different.
- Weaknesses in due diligence and risk assessment practices also came to the fore, negatively impacting clients, when it appeared many firms had failed to recognize market fraud. For example, in the aftermath of various high-profile global fraud cases, such as the Ponzi schemes perpetrated by Bernard Madoff ($65 billion) and Allen Stanford ($8 billion), some clients discovered they had been exposed to these schemes via their Advisors without even realizing it. This issue may have demonstrated a lack of watchfulness and communication by some wealth management firms and Advisors.

These issues confirm the need for due diligence of products to be done by an independent assessment group to help ensure the risk profile of products is thoroughly evaluated.

Our research[84] confirmed the extraordinary circumstances of the crisis negatively impacted perceptions of firms' due diligence and risk management practices. Both Advisors and HNWI clients ranked risk management and product due diligence capabilities as one of the top reasons clients chose to stay with or leave a wealth management firm in 2008. Nevertheless, many Advisors underestimated that very client need. Of HNWI clients surveyed, 73% said risk management and due diligence capabilities were an important factor in their decision to stay with their firm in 2008, while only 54% of Advisors said it was a reason clients did and would stay.

Moreover, many wealth management executives overestimated the quality of their firm's due diligence and risk management capabilities. For instance, when asked about these processes, 50% of surveyed executives said they were satisfied with the current quality, compared to 40% of Advisors. This may be because executives believe that their firms execute their risk processes diligently, but that the analyses themselves are overly simplistic, resulting

[84] Research compares responses to the same question in the Financial Advisor and Client Surveys—see methodology

in a systemic failure to deliver investor risk profiles of the quality sought by clients and Advisors. For example, some wealth management firms only employ basic profiling categories that peg an individual's risk tolerance somewhere on a scale from "Aggressive" through "Moderate" to "Conservative". A more comprehensive risk assessment would help them understand client risk appetites on a far more granular level.

Firms clearly need to close any gaps between perception and reality as to risk and due diligence capabilities—both by improving those processes, and by doing a better job of communicating to clients the specific risk implications of different products, and the risk-weighted role played by such products in a given portfolio. The need to understand the risks of each product, and communicate the implications thoroughly to clients, could be especially challenging for Advisors who use open product architectures with access to a wide variety of products from different sources.

COMPREHENSIVE RISK ASSESSMENTS ARE FUNDAMENTAL GOING FORWARD

In the last two downturns, the portfolios of HNWIs who had gone through a comprehensive risk assessment fared better than those of HNWIs who did not. Research shows, for example, that during the 2000-02 technology bubble downturn the portfolio of a HNWI who completed a comprehensive risk assessment would have lost 6.1%, whereas a more conventional risk assessment for the same HNWI would have resulted in a 15.1% loss.[85] Similarly, HNWIs who took advantage of a comprehensive risk assessment in 2008 suffered smaller losses than those HNWIs who did not.[86]

A comprehensive risk management assessment can be characterized by three key elements:

1. **Behavioral finance** is a relatively new field that encompasses "soft" factors, such as the emotion around economic decisions—emotion that is known to skew perceptions about risk. Behavioral-finance approaches provide a more complete picture of the way clients make investment decisions. This provides a richer level of detail that makes it possible to go beyond the traditional "Conservative", "Moderate", and "Aggressive" portfolio-model labels often used for individuals.
2. **Scenario analysis** can be used to assess and communicate to clients, in a thorough but simple way, the potential impact of extreme scenarios on a portfolio —from market trends to personal events like loss of income. This assessment should go beyond traditional measures such as standard deviation, to provide a detailed picture of extreme scenarios, including potential cumulative losses over a period of time. Moreover, scenario analysis can leverage elements from behavioral finance to show clients the potential dollar amount at stake whether a position's value goes up or down. This is especially helpful because evidence suggests losses elicit a far greater negative reaction in investors than the positive reaction produced by gains of the same magnitude.
3. **Deeper diversification** refers to an exhaustive and granular analysis of a wide range of asset categories and products, which avoids generalization and increases the transparency in the client portfolio. Diversification should occur not just along asset classes, but *within* asset classes. For example, this type of approach can draw a distinction between the role of "fixed income" in a portfolio designed to generate future returns vs. one designed to preserve capital. Moreover, deeper diversification should generally be better able than a random set of overlapping investments, or even a portfolio allocation model, to create a truly diversified portfolio. For instance, it could be said that virtually any equity portfolio lost money in 2008, regardless of its regional, company size or industry focus, while deeper diversification helped investors who also had solid allocations in gold and U.S. Treasuries to cushion the losses.

These elements can lay the foundation of a holistic risk assessment, which also incorporates a thorough understanding of clients' financial and personal goals. Accordingly, a client might initially identify him or herself as a "Moderate/ Aggressive" investor, but might reconsider their position after learning the potential portfolio impact of a confluence of events like loss of income along with unexpected market losses. As a result, the investor might put more emphasis on containing personal risk, and less on pursuing returns (which may also involve more risk). This shift would clearly change the Advisor/firm approach to portfolio design and execution for that HNWI.

Additionally, looking at client risk by portfolio value alone is probably not sufficient. Understanding the client risk in totality, at their total wealth level is also important. Clients' liquidity needs, income requirements, time horizons, risk tolerance need to be integrated into the full risk assessment along with performance expectations.

[85] Chhabra, Ashvin, "Beyond Markowitz – A comprehensive Wealth Allocation Framework for Individual Investors", Merrill Lynch. 2005
[86] Christopher Wolfe, Managing Director, Merrill Lynch. Interview by Capgemini, April 2009.

USING HOLISTIC RISK ASSESSMENTS CAN ADDRESS CLIENT RISK PROFILES IN A MORE INNOVATIVE WAY

Ultimately, then, holistic risk assessment can directly drive the portfolio-construction and investment advisory-process (see Figure 18).

The HNWI's appetite for personal, market, and aspirational risk are weighed against their precise goals and needs—after full disclosure of the potential risks and dollar impact of e.g., a confluence of events or extreme scenarios.

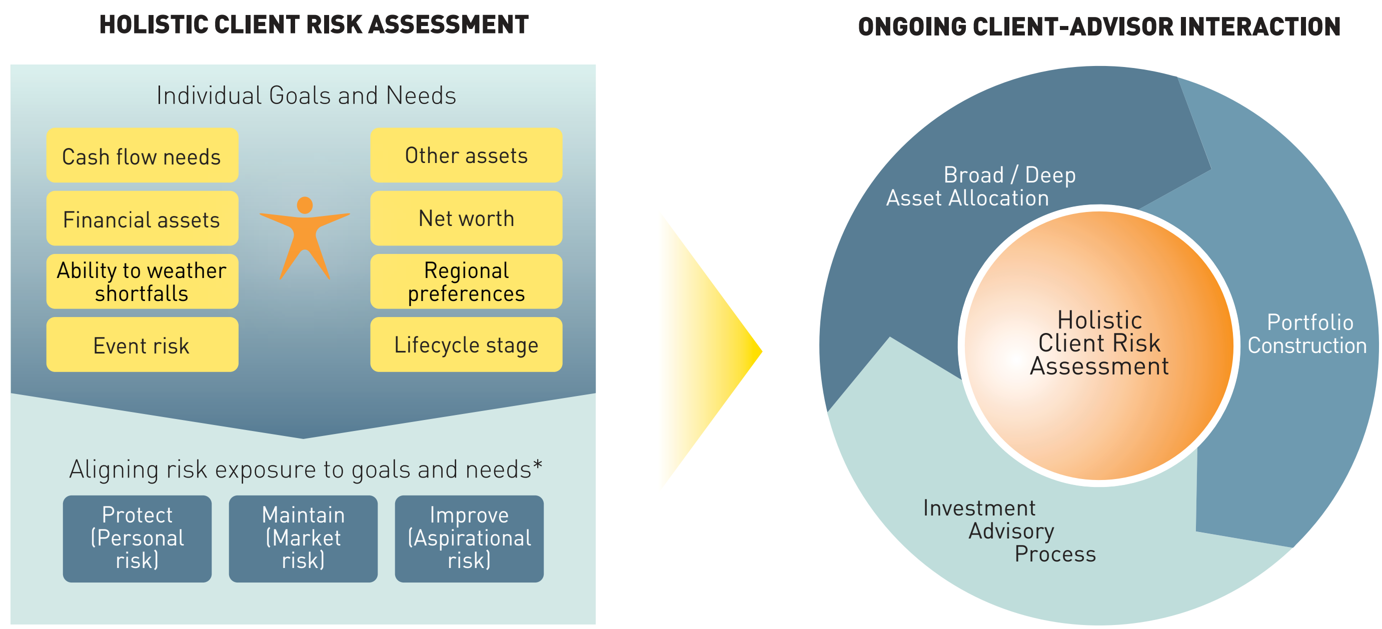
A thorough holistic risk assessment could help ensure the subsequent, inter-related phases of the portfolio-management and individual risk profiling process will be more effective. Those basic stages are:

- **Broad and deep asset allocation,** i.e., finding the most suitable combination of a wide range of asset classes and products therein, given the holistic risk assessment.
- **Portfolio construction,** i.e., allocating investments to specific products whose risks and function the client fully understands. The Advisor or investment-team role is essential in helping ensure the selection is done in a strategic way, in line with deep diversification processes, and a proper risk-appetite appraisal—in the context of the client's total level of wealth.
- **Investment advisory process,** i.e., creating an ongoing relationship with the client to monitor portfolio performance—not just of the portfolio itself, but against the client's total wealth picture, so adjustments can be made for changing life events and needs, and evolving market conditions.

Several wealth management firms are already leading the industry in helping their HNWI clients to understand their true risk tolerance through these kinds of deeper assessment processes. These innovative processes help firms to understand how clients emotionally process and make decisions about preserving, maintaining, and growing their investments.

By participating regularly in holistic risk assessments, HNWIs are likely to feel a far greater level of confidence in the risk management and due diligence practices at their wealth management firm. They will also be better informed, and more qualified to participate directly in creating their own personalized investment strategy. For wealth management firms, then, stronger and more comprehensive risk assessments are a cornerstone of regaining HNWI client trust.

Figure 18. Holistic Client Risk Assessment as a Core Element of Ongoing Client-Advisor Interaction



***Note:** "Protect" goal refers to client desire to minimize losses in falling markets; "Maintain" goal is to minimize risk during unremarkable markets (e.g., using a deeply diversified portfolio); "Improve" goal is to maximize returns in rising markets

WAY FORWARD: FOR WEALTH MANAGEMENT FIRMS, SUCCESS NOW RIDES ON THEIR CAPACITY TO RESTORE CLIENT TRUST AND CONFIDENCE, THEREBY GROWING SHARE OF HNWI AUM, AND MANAGING IT PROFITABLY

The financial crisis has produced seismic shifts in the wealth management industry heightening the prospect that only some will emerge from the disruption as winners. What presents a distinct opportunity to some firms—and a threat to others—is that HNWIs are more engaged than ever in finding the best management for their assets, their conception of what constitutes best has changed. As a result, opportunities exist for firms of all types and scale to compete for assets—yet at the same time a dominant position built on one set of principles may be less secure in the future.

In our research, we interviewed dozens of wealth management executives, surveyed hundreds of HNWI clients and thousands of Advisors. The message was clear: HNWI trust and confidence has been severely tested—by outright market losses, opacity in products and fees, and perceived failures in the asset/product selection and management process.

Critically, HNWIs have also turned their misgivings into action. Many have moved or further diversified their assets among a greater number of firms in the hopes of mitigating their risks and losses, or to demonstrate outright dissatisfaction. In addition, many have reallocated their wealth to less risky assets. Our research also shows that some have fled to local banks and wealth management firms in search of more traditional practices, and simpler products and fee structures.

In the process, some firms have been net winners of AuM, others have not. However, even the winners are likely to find themselves managing investment activities that will be costly for them to support in the long term, in light of the extensive services they currently provide. Moreover, simply attracting clients and assets in this environment is just the start of the challenge. For the short-term, newly attracted assets are likely to be parked in cash and cash-equivalents, so the onus will remain on firms to demonstrate a compelling and evolving value-proposition, as the market recovers and clients begin to lean toward measured and then greater risks.

FOUR KEY PRINCIPLES REDEFINE SUCCESS

In this new environment, firms therefore may need to redefine “success” around four key principles:

- **Retaining existing assets.** It is critical to understand and improve on the factors most likely to increase the retention of clients and their assets, now that HNWI propensity to defect is so high. As explained earlier, the top drivers of retention are quality service, portfolio performance, and investment advice, but Advisors already understand those drivers quite well. The highest potential for improvement lies in “differentiating levers”. Those levers are drivers of retention that most firms still have ample room to improve—statement and reporting quality, online access and capabilities, risk management and due diligence capabilities, and fee structures.
- **Shifting portfolio allocation models toward mutually value-creating assets.** HNWI risk appetites have changed, at least for now, so firms should focus on client-allocation models on averting downside risk—which will greatly contribute to rebuilding confidence and re-establishing client-advisor trust. This approach may not generate the returns of the past—for either firm or client—but should help achieve the goal of building relationships that can create sustained value over time.
- **Acquiring client assets.** Capturing new client assets could hinge directly on presenting an attractive proposition relative to heightened client demands. In some cases,

success in attracting clients may be as simple as offering a proposition that directly addresses issues specifically driving dissatisfaction in an existing relationship.
- **Optimizing operations** will require sustained focus and measured actions to align the client and Advisor needs of the service model with the new revenue realities. With nearly half of all HNWI assets in lower-performing, lower-fee asset classes, there will be an impact on profitability—likely a significant one. Thus the mandate is to carve out costs so as to invigorate the firm's viability, while preserving brand integrity, and responding effectively to client and Advisor priorities.

To make astute decisions toward achieving success, each firm should differentiate their short and long-term priorities. Firms that succeed in retaining and attracting clients and their assets now—even if these assets remain in cash and equivalents—will be in a stronger position to generate revenues in the long term. Similarly, aggressive cost management will clearly generate short-term benefits, but firms that pursue cost-cutting as a survival strategy will in fact cripple their strategic ability to drive revenues in the long term.

HOW TO MOVE FORWARD? FOCUS ON THE CLIENT MANDATE

The most tangible baseline capabilities HNWIs demand in a wealth-management relationship are service quality, investment advice, and investment performance—all of which feed directly into less the quantifiable but critical overarching qualities of trust and confidence. However, there are other key capabilities on which HNWIs now place a high priority after the events of 2008—capabilities that have been largely under-tapped by firms, so they offer significant potential as "differentiating levers" of client retention/attrition going forward (see Figure 19).

These levers are largely focused on capabilities in which most firms have already invested but HNWI expectations remained unfulfilled. As a result, especially given recent market forces, HNWIs are now equivocally demanding these capabilities from their "trusted advisors", and primary wealth management firms.

The implication for wealth management firms is that, in light of this mandate, they should re-evaluate whether the capabilities they provide really are a) simple and transparent, b) of demonstrable value to existing and potential HNWI clients, and c) good enough to retain and attract clients in a newly competitive environment.

Our research does not advocate that firms attempt to excel on every lever—which will most likely result in undue complexity. Rather, the research supports benchmarking current capabilities and Advisor perceptions against global and regional realities to assess which of the levers should be the focus, and what specific measures are most suitable.

FACT-BASED BENCHMARKING MAY DEBUNK LONG-HELD BELIEFS

In conducting a fact-based benchmarking of capabilities, firms may well debunk some of the industry tenets and assumptions they have long used to prioritize their investments. They may also recognize why focusing on the client-service priorities they once had—such as geographic presence, reputation and brand, and the Advisor relationship—may have relatively little influence on retaining and attracting clients in this new environment.

Robust reporting tools and Online portals offer a classic case in which HNWI priorities have shifted—eclipsing what was acceptable before the crisis. Our research concludes Advisors whose perceptions of value are well-aligned with those of their clients already recognize that online portals enhance client-advisor relationships, and do not act as a disintermediating force. In fact, the right tools will be essential going forward to provide a factual basis for client-advisor collaboration, and meet the heightened demand for transparency. Moreover, innovative collaboration tools, combined with online reporting capabilities, are likely to be a critical need among younger HNWIs, who the survey shows are more likely to defect.

Client reporting capabilities are obviously in place at most firms, but their inadequacy has caused concern and suspicion among HNWIs in the post-crisis paradigm. One industry executive we interviewed shared a case in which a European Ultra-HNWI asked her primary banker in the fourth quarter of 2008 for a detailed report on the level and performance of her holdings. When 10 days had passed without a reply, the client asked another of her other Advisors—at a smaller firm—how long such a report would take. The reply was "within a day", and the client promptly transferred over $25 million from the larger firm to the smaller one. This was not an isolated incident.

Clearly, HNWIs have learned first-hand the merits of prompt, transparent information during the crisis—whether it is needed to make investment decisions or simply to calm their concerns. Firms are courting attrition if they underestimate how crucial this long withstanding priority has become.

Similarly, the issue of **fee structures** has come to the fore among clients who may have grudgingly accepted ambiguity when their asset values were skyrocketing, but now feel more than justified—when viewing their shrunken portfolios—in demanding a full accounting of how fees are calculated and levied. Again, simplicity and transparency are key.

In perhaps the most alarming indication of the shift in client priorities, firms are also finding that long-standing high-value customers (e.g., HNWIs or Ultra-HNWIs who have kept their inherited wealth with the same firm for many generations, or even a single client who has remained loyal for many years) are becoming more demanding across all levers. We are already observing wealth management firms whose long-held clients are now asking Advisors to submit proposals, so they can directly compare the specifics of their offering—fee structures, reporting capabilities, and so on—with that of competing Advisors at other firms.

TACTICAL APPROACH TO CAPABILITIES STILL REQUIRES STRATEGIC UNDERPINNINGS

For firms, the first step to success is undertaking a frank assessment of their ability to demonstrate the capabilities HNWIs demand.

The tactical priorities should be to focus on whatever is the appropriate mixture of investment in the differentiating levers, given the firm's business model, priorities and short-term financial situation. Whatever the specifics, firms must ultimately hold themselves accountable for meeting client demands for a high degree of transparency, due diligence, and simplicity, as well as stellar core capabilities.

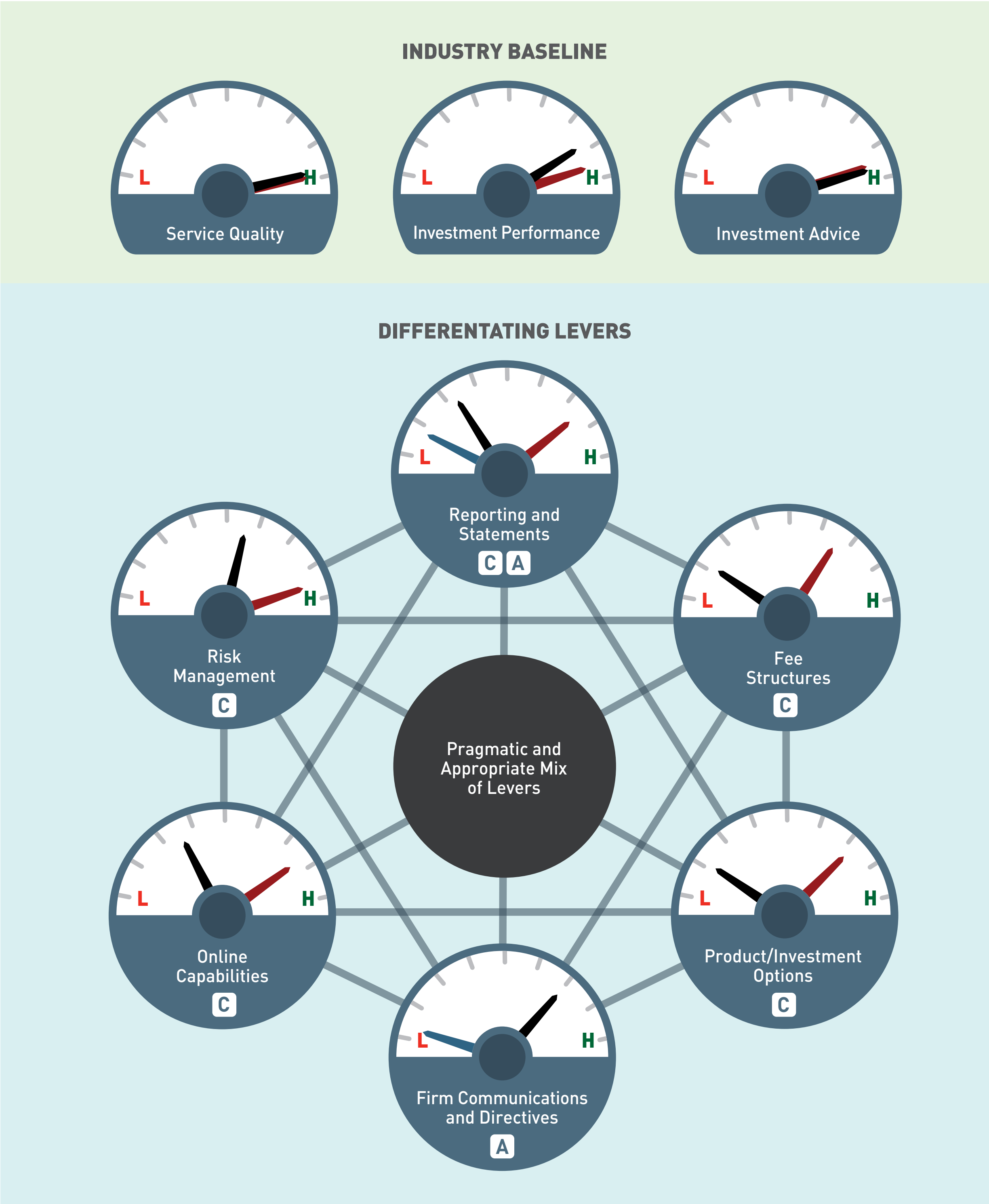
However, to deliver successfully on differentiating levers, such as client reporting, online portals, risk and due diligence, it would be prudent for firms to refresh and recommit their long-term operational strategy, comprising:

- **Client Experience**—initiatives that support and enhance the client-advisor-firm relationship, especially differentiators such as meaningful client segmentation, touch-point alignment and collaboration, operational design, as well as personalized services. These are usually the most visible to clients.
- **Practice and Portfolio Management**—alignment of the organization from a business and technology perspective, including a variety of advisor-practices models needed to optimize different client-advisor relationships.
- **Risk Management and Due Diligence**—simplified and transparent communication to clients about due diligence, institutional and product-risk management processes, and the risk-weighted role played by products in a given portfolio.
- **Enterprise Information and Services**—coherent enterprise-wide vision and strategy for information, data and business processes which shapes the technology mandate for driving operational effectiveness.

The overarching goal is **to identify and capture synergies** from the investment in different levers to deliver a return—in terms of the firm's ability to retain and grow AuM, and become the client's primary and trusted Advisor.

Ultimately, current events—the global market crisis, world-wide generational wealth transfer, the changing shape and size of the global HNWI population—have presented wealth management firms with a defining moment from which to (re-)emerge as leaders. While it isn't yet clear which firms will thrive in the long term, it is clear that wealth management firms will need to re-evaluate many of their long-standing assumptions about trust and value, and respond proactively and rationally to the new realities facing their clients, Advisors, and the industry.

Figure 19. Wealth Management Client Servicing Framework



C Lever for Managing Client Retention and Attrition

A Lever for Enabling Advisors through Service and Support

Global Client Priority Level

Global Advisor Priority Level

Global Firm Priority Level

Note: The industry baseline and differentiating lever results are based on 2008 data

APPENDIX A: METHODOLOGY

The World Wealth Report covers 71 countries in the market-sizing model, accounting for more than 98% of global gross national income and 99% of world stock market capitalization.

We estimate the size and growth of wealth in various regions using the Capgemini Lorenz curve methodology, which was originally developed during consulting engagements with Merrill Lynch in the 1980s. It is updated on an annual basis to calculate the value of HNWI financial wealth at a macro level.

The model is built in two stages: first, the estimation of total wealth by country, and second, the distribution of this wealth across the adult population in that country. Total wealth levels by country are estimated using national account statistics from recognized sources, such as the International Monetary Fund and the World Bank, to identify the total amount of national savings in each year. These are summed over time to arrive at total accumulated country wealth. As this captures financial assets at book value, the final figures are adjusted based on world stock indexes to reflect the market value of the equity portion of HNWI wealth. In conjunction with the Economist Intelligence Unit's efforts to provide the most accurate data, select historical figures have been updated since publication in previous reports.

In 2005, we revised the methodology to move from reporting only annual regional findings to include country level information. Wealth distribution, which differs by country, is based on formulized relationships between wealth and income. Data on income distribution is provided by the World Bank, Global Insight, Economist Intelligence Unit and by countries' national statistics. We then use the resulting Lorenz curves to distribute wealth across the adult population in each country. To arrive at financial wealth as a proportion of total wealth, we use statistics from countries with available data to calculate their financial wealth figures and extrapolated these findings to the rest of the world. Each year, we continue to enhance our macroeconomic model with increased analysis of domestic economic factors that influence wealth creation. We work with colleagues around the globe from several firms to best account for the impact of domestic, fiscal and monetary policies over time on HNWI wealth generation.

The financial asset wealth figures we publish includes the values of private equity holdings stated at book value as well as all forms of publicly quoted equities, bonds, funds and cash deposits. It excludes collectibles, consumables, consumer durables and real estate used for primary residences. Offshore investments are theoretically accounted for, but only insofar as countries are able to make accurate estimates of relative flows of property and investment in and out of their jurisdictions. We accommodate for undeclared savings in the report.

Given exchange rate fluctuations over the past years, especially with respect to the U.S. dollar, we assess the impact of currency fluctuations on our results. From our analysis, we conclude that our methodology is robust and exchange rate fluctuations do not have a significant impact on the results.

The translation to U.S. dollars is made using a yearly average exchange rate. The WWR model calculates cumulative wealth in U.S. dollar terms using a time series of data going back over 100 years, so that the impact of a sharp currency appreciation for a year or two has a negligible effect. For example, our analysis shows that if exchange rates in 2008 had remained at the same level as in 2007, global HNWI wealth in 2008 would have been only 0.2% lower than our reported figure of US$32.8 trillion.

The information contained herein was obtained from various sources; we do not guarantee its accuracy or completeness nor the accuracy or completeness of the analysis relating thereto. This research report is for general circulation and is provided for general information only; any party relying on the contents hereof does so at its own risk.

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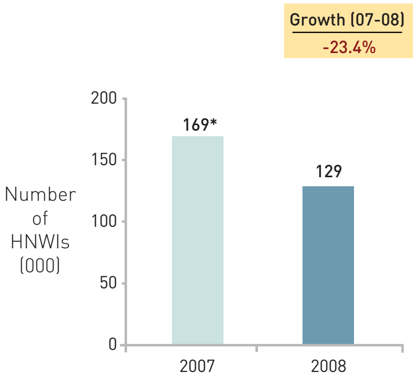
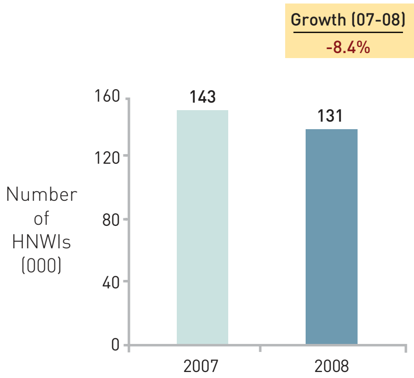
APPENDIX B: SELECT COUNTRY BREAKDOWN



Australia



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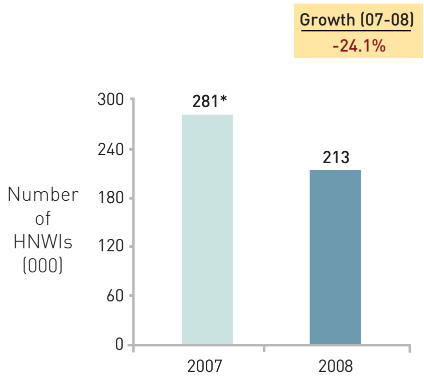
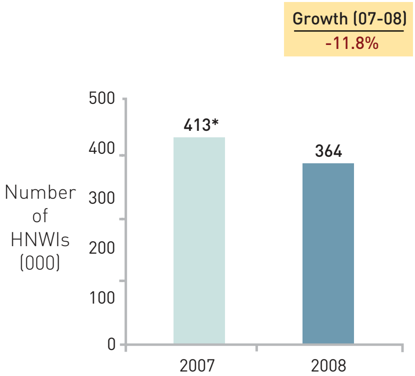
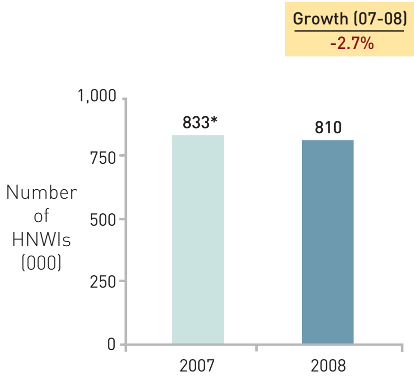


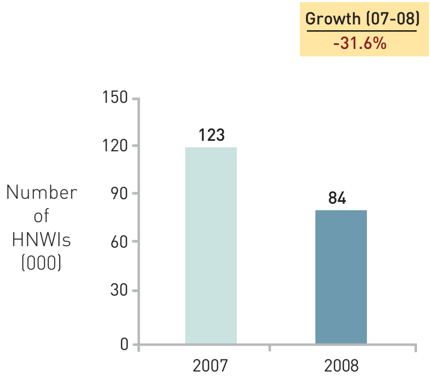
Canada



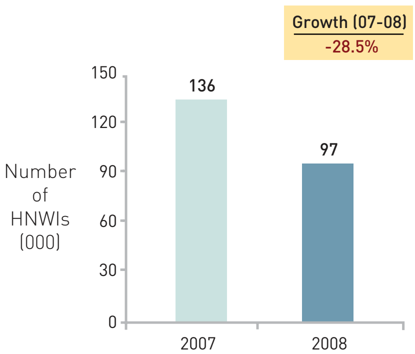
China



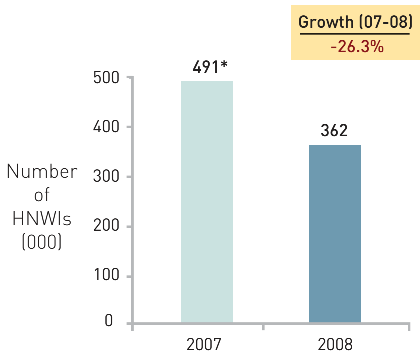
Germany



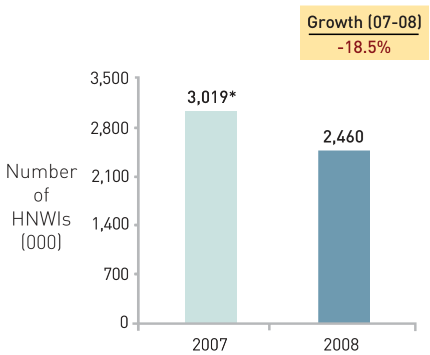
India



Russia



United Kingdom



United States

*2007 numbers are restated values due to market sizing model upgrades
Source: Capgemini Lorenz curve analysis, 2009

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Capgemini
CONSULTING TECHNOLOGY OUTSOURCING

Merrill Lynch
Wealth Management

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- 202 trees were left standing as a result of the recycled paper used in this project.
- 10,070 gallons of water were saved.
- 16,638 pounds of global warming gases were avoided.
- 23,879 kilowatt-hours of energy were saved (8,200 kWh of energy can heat and cool an average US home for one year).
- 389 cubic feet of solid waste were kept out of a landfill.

GREEN PRINT

FSC
Mixed Sources
Product group from well-managed forests, controlled sources and recycled wood or fiber
Cert no. SGS-COC-2807
www.fsc.org