



# WORLD WEALTH REPORT

# 2010

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# World Wealth Report

## TO OUR READERS,

**Capgemini and Merrill Lynch Global Wealth Management** are pleased to present the 2010 World Wealth Report. Our two firms have been working together for more than 20 years to study the macroeconomic and other factors that drive wealth creation, and to better understand the key trends that affect high net worth individuals (HNWIs) around the globe.

The last couple of years have been momentous for wealthy investors and their Advisors. At this time last year, we were analyzing the dramatic effects of the financial crisis, which was quickly turning into a global economic downturn. World equity markets had lost a decade of gains, and volatility had reached record levels. HNWI's were re-allocating to safer investments and retreating to familiar markets close to home, and Financial Advisors were rallying to restore client trust and confidence.

A year later, many markets are recovering well and the broader economy, after contracting across much of the world in 2009, is showing distinct signs of recovery. The HNWI population itself has started growing again, and HNWI wealth is also recovering. But it is clear from HNWI's asset allocations that they are taking a cautious approach to investing and risk-taking. Moreover, it seems the lessons learned from the crisis have changed the way HNWI clients will think about investing for the foreseeable future.

Clients are now much more involved in managing their investment choices, asking for more specialized advice, demanding full product disclosure and transparency. They are more educated about investing and about their own needs. They now understand that when weighing potential returns, they must weigh the risks more thoroughly.

This year's World Wealth Report (WWR) looks at how wealth-management firms are adapting to behavior-driven investing by clients, and are re-evaluating their advisory processes, risk models and service offerings to cater effectively to HNWI clients in this new paradigm.

It is a pleasure to provide you with our findings, and we hope you find continued value in the WWR's insights.



**Sallie Krawcheck**  
President, Global Wealth  
& Investment Management  
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# State of the World's Wealth

- **The world's population of high net worth individuals (HNWIs<sup>1</sup>) grew 17.1% to 10.0 million in 2009,** returning to levels last seen in 2007 despite the contraction in world gross domestic product (GDP). **Global HNWI wealth similarly recovered, rising 18.9% to US\$39.0 trillion,** with HNWI wealth in Asia-Pacific and Latin America actually surpassing levels last seen at the end of 2007.
- **For the first time ever, the size of the HNWI population in Asia-Pacific was as large as that of Europe** (at 3.0 million). This shift in the rankings occurred because HNWI gains in Europe, while sizeable, were far less than those in Asia-Pacific, where the region's economies saw continued robust growth in both economic and market drivers of wealth.
- **The wealth of Asia-Pacific HNWIs stood at US\$9.7 trillion** by the end of 2009, **up 30.9%, and above the US\$9.5 trillion in wealth held by Europe's HNWIs.** Among Asia-Pacific markets, Hong Kong and India led the pack, rebounding from mammoth declines in their HNWI bases and wealth in 2008 amid an outsized resurgence in their stock markets.
- **The global HNWI population nevertheless remains highly concentrated.** The U.S., Japan and Germany still accounted for 53.5% of the world's HNWI population at the end of 2009, down only slightly from 54.0% in 2008. Australia became the tenth largest home to HNWIs, after overtaking Brazil, due to a considerable rebound.
- **After losing 24.0% in 2008, Ultra-HNWIs<sup>2</sup> saw wealth rebound 21.5% in 2009.** At the end of 2009, Ultra-HNWIs accounted for 35.5% of global HNWI wealth, up from 34.7%, while representing only 0.9% of the global HNWI population, the same as in 2008.

## HNWI SEGMENT RECOUPED SIGNIFICANT GROUND IN 2009

### Globally, the HNWI Segment Regained Ground despite Weakness in the World Economy

The world's population of HNWIs grew 17.1% in 2009 (see Figure 1), nearly recovering the unprecedented declines of 2008 even though the global economy contracted (see 2009 in Review). HNWI financial wealth also grew, posting a gain of 18.9% to US\$39.0 trillion (see Figure 2). The star performer was Asia-Pacific, the only region in which both macroeconomic and market drivers of wealth expanded significantly in 2009.

Regional findings show:

- The Asia-Pacific HNWI population rose 25.8% overall to 3.0 million, catching up with Europe for the first

time, after falling 14.2% in 2008. Seven countries within the region actually saw their HNWI populations recover beyond 2007 levels.

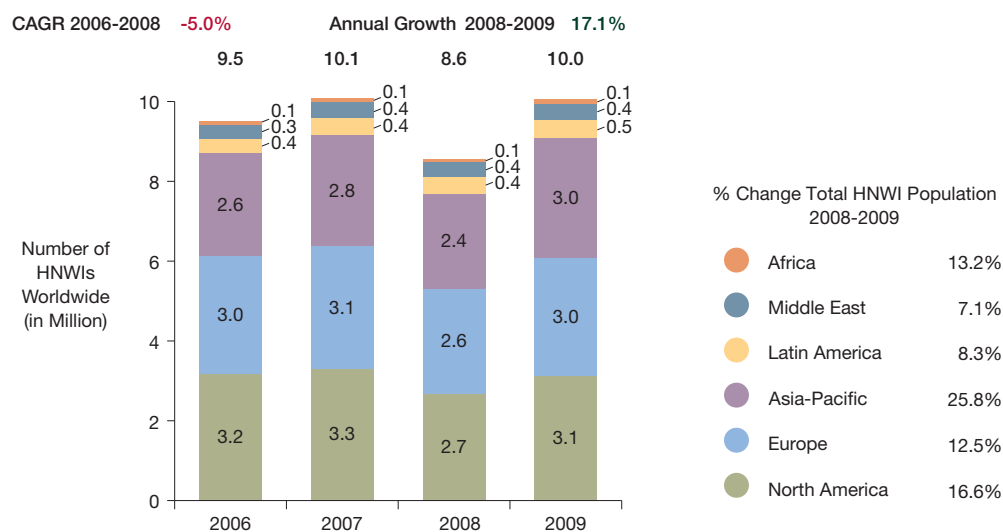
- Asia-Pacific HNWI wealth surged 30.9% to US\$9.7 trillion, more than erasing 2008 losses and surpassing the US\$9.5 trillion in wealth held by Europe's HNWIs.
- After falling 19.0% in 2008, the HNWI population in North America rebounded, gaining 16.6% in 2009. HNWI wealth there rose 17.8% to US\$10.7 trillion. North America remains the single largest home to HNWIs, with its 3.1 million HNWIs accounting for 31% of the global HNWI population.

<sup>1</sup> HNWIs are defined as those having investable assets of US\$1 million or more, excluding primary residence, collectibles, consumables, and consumer durables

<sup>2</sup> Ultra-HNWIs are defined as those having investable assets of US\$30 million or more, excluding primary residence, collectibles, consumables, and consumer durables

FIGURE 1. HNWI Population, 2006 – 2009 (by Region)

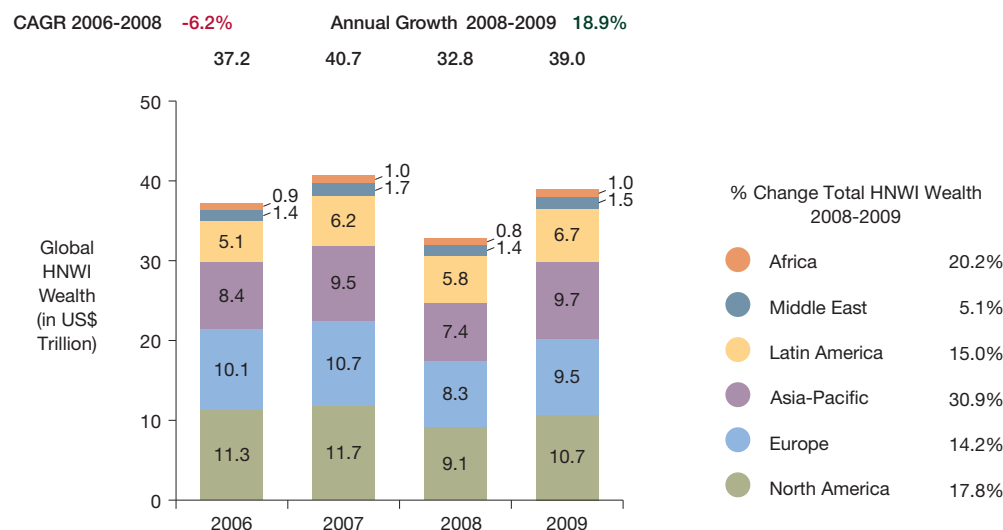
(Million)



Note: Chart numbers may not add up due to rounding  
 Source: Capgemini Lorenz curve analysis, 2010

FIGURE 2. HNWI Wealth Distribution, 2006 – 2009 (by Region)

(US\$ Trillion)



Note: Chart numbers may not add up due to rounding  
 Source: Capgemini Lorenz curve analysis, 2010

- The size and wealth of Europe's HNWIs population grew in 2009, though moderately. Europe's HNWIs population rose 12.5% to 3.0 million after dropping 14.4% in 2008. HNWIs wealth increased 14.2% to US\$9.5 trillion after losing 21.9% in 2008.
- The HNWIs population in Latin America grew 8.3% to 0.5 million, while HNWIs wealth in the region jumped 15%. While the percentage recovery in Latin America in 2009 was not as big as in Asia-Pacific, Latin American HNWIs wealth is now 8% greater than in 2007, while wealth among Asia-Pacific HNWIs has grown just 2% during that time.
- In 2009, Middle East HNWIs population and wealth grew by only 7.1% and 5.1% respectively, as the region was impacted by the Dubai crisis.

While the global HNWIs recovery was generally stronger in emerging and developing nations than in mature ones, most of the world's HNWIs population and wealth remains highly concentrated in three countries. The U.S., Japan and Germany together accounted for 53.5% of the world's HNWIs population in 2009, down only slightly

from 54.0% in 2008 (see Figure 3). And beyond that, the HNWIs ranks remained spread across the globe in much the same proportions in 2009 as they had been in 2008.

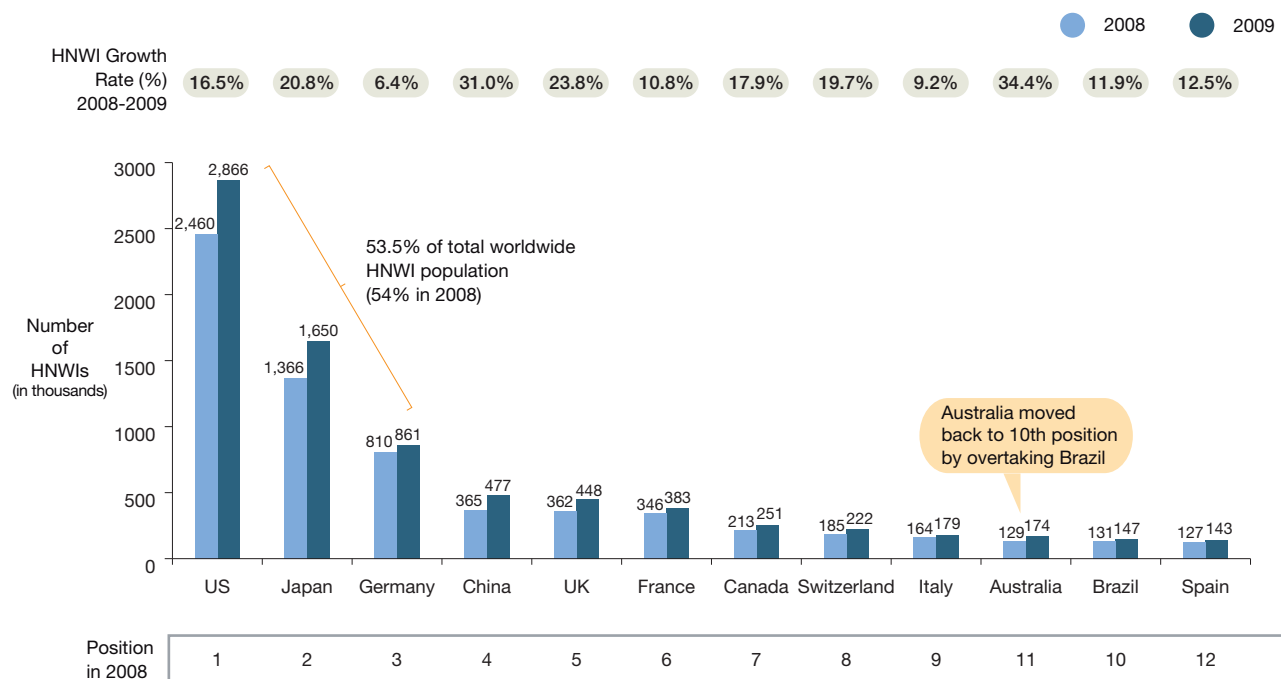
### Asia-Pacific HNWIs, Hit Especially Hard in 2008, Led Recovery in 2009

Several Asia-Pacific countries experienced greater-than-average growth in their HNWIs populations in 2009. In fact, the region was home to eight of the world's ten fastest-growing HNWIs populations. Hong Kong and India led the pack, after experiencing mammoth declines in their HNWIs bases in 2008.

In Hong Kong, the rebound followed a sharp resurgence in the stock market, where market capitalization surged 73.5% in 2009 after falling about 50% the previous year. Market capitalization is a powerful driver of wealth in Hong Kong, which has a very high market-cap-to-nominal-GDP ratio. (Market capitalization is almost 11 times that of GDP, compared with the global average of 0.8 times.) That ratio makes Hong Kong particularly

FIGURE 3. HNWIs Population by Country, 2009

(Thousand)



Source: Capgemini Lorenz curve analysis, 2010

vulnerable to losses in wealth when the market declines as it did in 2008, but also produces outsized gains in wealth when stock prices rise.

Hong Kong also has a very large proportion of HNWI's in the US\$1 million-US\$5 million wealth band, so many had been quickly relegated to the "mass affluent"<sup>3</sup> bracket during the losses of 2008—and many were just as quickly promoted back to HNWI status when asset prices rose in 2009.

As a result of these dynamics—and given the low base at which HNWI population numbers stood after the 2008 losses—Hong Kong's HNWI population posted a gain of 104.4% in 2009. This was by far the strongest rebound in the world but since it followed a 61.3% decline in 2008, the number of HNWI's at the end of 2009 was still only 79% of the number at the end of 2007.

In India, the HNWI population grew 50.9% in 2009. India also has a relatively high market-cap-to-GDP ratio (two times GDP) and its stock-market capitalization more than doubled in 2009, after dropping 64.1% in 2008. The recovery was also underpinned, however, by the strong outlook for India's underlying economy.

China remained the world's fourth largest HNWI base, with 477,000 HNWI's, up 31.0%. Stock market capitalization in China soared more than 100% in 2009, as the economy grew at a rapid 8.7% pace.

Australia, meanwhile, moved back up to tenth position in the HNWI-population rankings, overtaking Brazil, after many of those who had fallen into the "mass affluent" category in 2008 regained their HNWI status. In Australia, HNWI's in the lowest (US\$1 million-US\$5 million) wealth band account for 55.4% of all HNWI wealth, so far more HNWI's fall out of the HNWI category when wealth declines than is the case in Brazil—where a staggering 87% of HNWI wealth lies in the hands of Ultra-HNWI's.

## Not All of 2008's Big Losers Recouped Their Losses in 2009

Notably, not all the hefty losers of 2008 were able to recover the lion's share of their losses. In many cases, the rebounds were tempered by underlying macroeconomic concerns.

For example:

- The HNWI population grew strongly in the U.K. (23.8%) and in Russia (21.3%), but those gains did not come close to recouping the losses of 2008. In both cases, stock market capitalization surged, but was apparently more than offset by the effects of the contracting economy. GDP shrank by 5.0% in the U.K. and by 7.9% in Russia, while the stock markets rose 49.6% and 103.6% respectively.
- Some countries, such as Ukraine, Turkey and Greece, are experiencing persistent weakness in their markets and economies. Greece is a prime example, and its HNWI population continued to decline in 2009 (by 1.2%).
- Similarly, the United Arab Emirates (UAE) lost around 19% of its HNWI population in 2009, mainly due to the crisis in Dubai and the significant fall (-48.0%) in real estate prices.

## Ultra-HNWI Segment Showed Outsized Gains in Ranks and Wealth

Ultra-HNWI's increased their wealth by a striking 21.5% in 2009, far more than the average in the HNWI segment as a whole. This resurgence followed a mammoth 24.0% loss in wealth for Ultra-HNWI's on aggregate in 2008, and was most likely due to a more effective re-allocation of assets.

A disproportionate amount of wealth remained concentrated in the hands of Ultra-HNWI's. At the end of 2009, Ultra-HNWI's represented only 0.9% of the global HNWI population, but accounted for 35.5% of global HNWI wealth. That was up slightly from 34.7% in 2008.

<sup>3</sup> Individuals with investable assets of US\$100,000 to US\$1,000,000

North America still has the largest regional concentration of Ultra-HNWIs. At the end of 2009, the number of Ultra-HNWIs there totaled 36.3k (see Figure 4), up from 30.6k in 2008, but that was still down sharply from 41.2k in 2007. Regionally, Latin America still has the highest percentage of Ultra-HNWIs relative to the overall HNWI population—2.4%, compared with the global average of 0.9%.

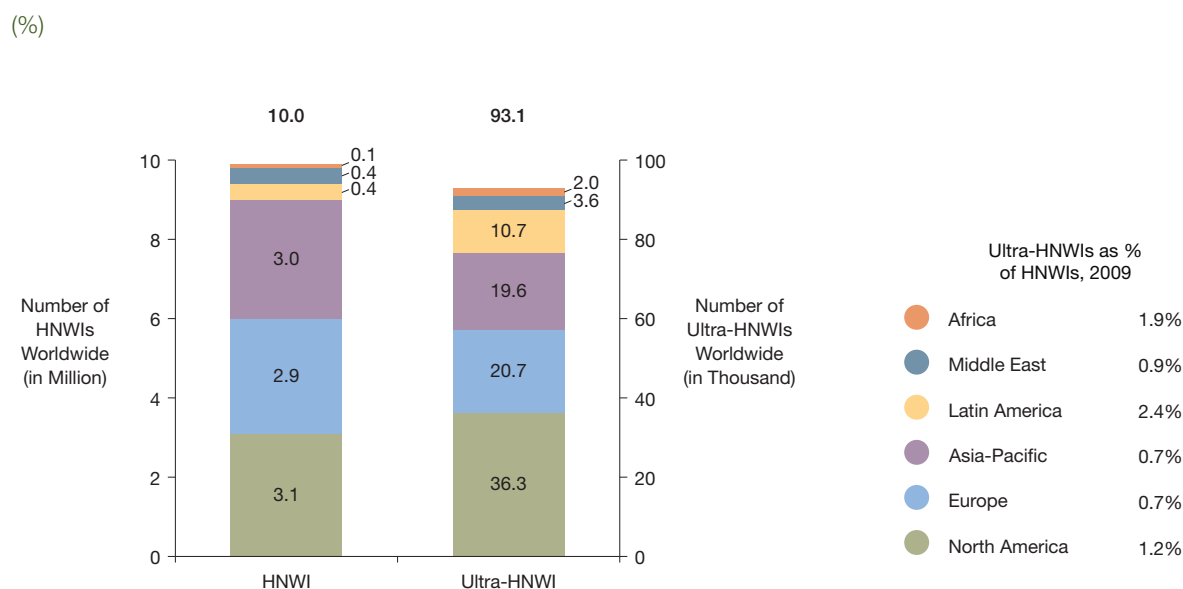
### Asia-Pacific will Likely be the Powerhouse of HNWI Growth in Coming Years

On aggregate, the number and wealth of HNWIs around the world recovered significantly in 2009, but Asia-Pacific was the showcase, thanks to a solid performance in both the economic and market drivers of wealth. Going forward, the BRIC (Brazil, Russia, India, and China) nations are expected to again be the drivers for their respective regions. In Asia-Pacific, China and India

will continue to lead the way, with economic expansion and growth likely to keep outpacing more developed economies. The region's HNWI growth is likely to be the fastest in the world as a result. In Latin America, Brazil is similarly expected to remain an engine of growth. Russia is also expected to display strength due to its commodity-rich resource base.

However, HNWI-wealth creation is always driven by a mixture of economic and market factors, and 2009 suggests macroeconomic concerns can contain upside HNWI performance, even when market performance is stellar. Around the globe, then, the creation of HNWIs and wealth is likely to depend heavily on the success each country has in managing the nascent economic recovery while driving expansion and handling ongoing domestic and global challenges in financial conditions.

FIGURE 4. Geographic Distribution of HNWIs and Ultra-HNWIs, 2009 (by Region)



Note: Chart numbers may not add up due to rounding

Ultra-HNWIs are defined as those having investable assets of US\$30 million or more, excluding primary residence, collectibles, consumables, and consumer durables

Source: Capgemini Lorenz Curve Model; Capgemini World Wealth Report 2009



# 2009 in Review:

## MANY DRIVERS OF WEALTH REBOUNDED, BUT ECONOMIC RECOVERY IS STILL NASCENT

- **World gross domestic product (GDP) contracted 2% in 2009**, as the effects of the global financial crisis worked their way deeply into the fundamentals of the global economy. Europe was hit hardest, with GDP shrinking by 4.1% in Western Europe and by 3.7% in Eastern Europe. In Asia-Pacific excluding Japan, however, there was positive GDP growth of 4.5%.
- **Governments around the world stepped up efforts to stimulate economic recovery and support the financial system.** Governments implemented a wide array of measures to try and keep their economies from sliding into recession as financial conditions remained challenging. Those efforts included fiscal stimulus by many nations, but most sizably by the U.S. and China.
- **Key drivers of wealth experienced strong gains.** Many of the world's stock markets recovered, and global market capitalization grew to US\$47.9 trillion in 2009 from US\$32.6 trillion in 2008, up nearly 47%. Commodities prices dropped early in the year, but rebounded sharply to end the year up nearly 19%. Hedge funds were also able to recoup many of their 2008 losses.
- **The global economic recovery remains nascent.** World GDP growth is likely to be positive in 2010-11 and is expected to be led by Asia-Pacific excluding Japan. However, sustained economic recovery is contingent upon the timely withdrawal of government stimulus along with the return of growth in private consumption.

## WORLD ECONOMY CONTRACTED IN 2009, BUT ASIA-PACIFIC KEPT GROWING

### World GDP Contracted in 2009, Hit by the Effects of the Global Financial Crisis

World GDP contracted 2.0% in 2009<sup>4</sup>, after growth of 1.8% in 2008, as the fundamentals of the global economy were gripped by the effects of the global financial crisis. In Western Europe, GDP shrank 4.1% in 2009, driven primarily by Germany and the U.K. Eastern Europe and Latin America were also hit hard, and GDP contracted by 3.7% and 2.3% respectively<sup>5</sup>. The GDP contraction in

Europe and Latin America was primarily due to the drop in exports and reduction in industrial production (manufacturing, mining and utilities). However, economic growth was evident in some parts of the world. GDP grew 4.5% in Asia-Pacific excluding Japan, helped in particular by strong GDP growth of 8.7% in China and 6.8% in India<sup>6</sup> (see Figure 5). GDP also expanded by 1.4% in the Middle East and North Africa<sup>7</sup>.

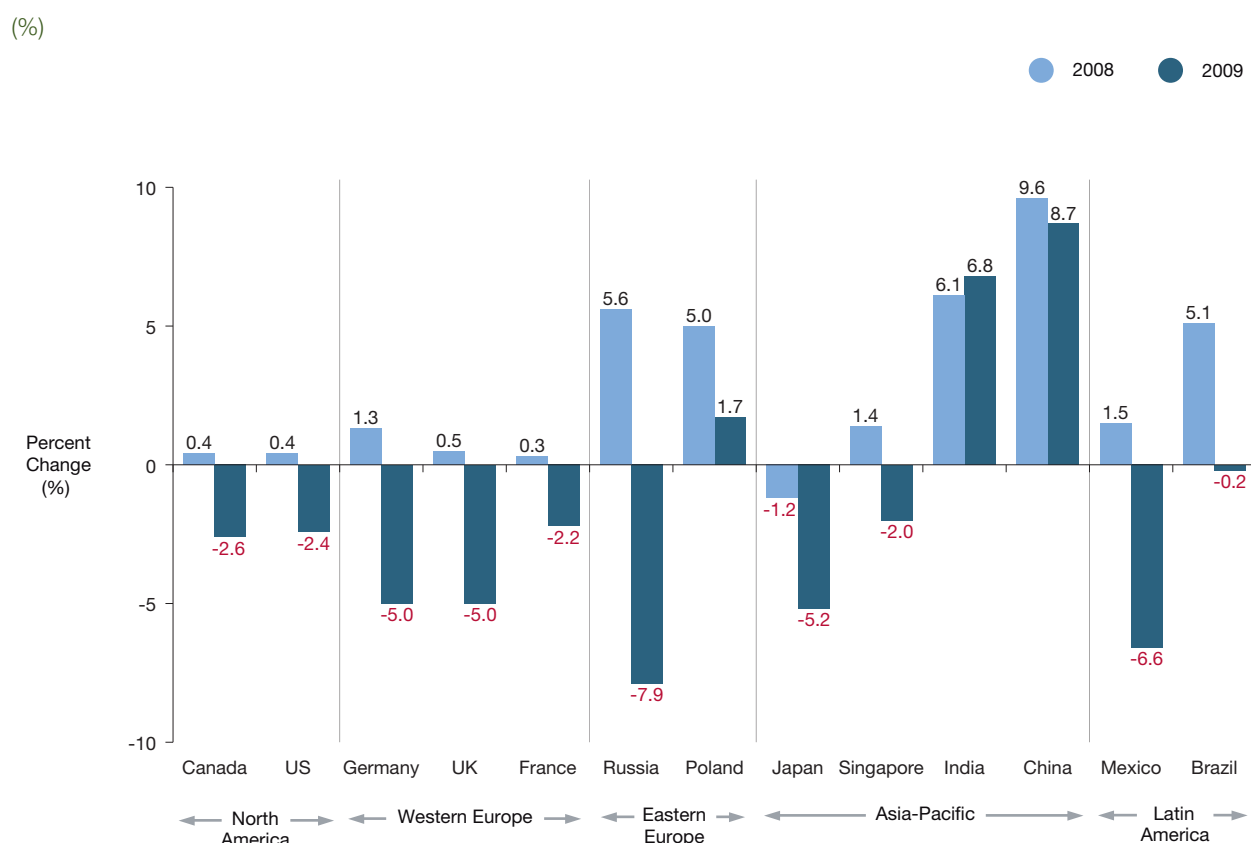
<sup>4</sup> Economist Intelligence Unit, Regional Data, April 2010

<sup>5</sup> Ibid

<sup>6</sup> Ibid

<sup>7</sup> Ibid

FIGURE 5. Real GDP Growth Rates, 2008-2009



Source: Economist Intelligence Unit – April 2010. Real GDP variation over previous year.

### Fiscal Stimulus Worldwide Sought to Stave Off Recession

At the start of 2009, the effects of the global financial crisis were becoming starkly evident in many weak economic indicators. Aggregate demand was in sharp decline across the world, and most countries had only limited room to reduce short-term interest rates to drive demand. To keep their economies from sliding into recession, or at least to limit the downside, many countries implemented fiscal stimulus plans, using government spending to provide much-needed support.

Some initiatives were more aggressive than others. South Korea, Russia and China were among the most forceful, implementing fiscal stimulus measures amounting to more than 2.5% of GDP<sup>8</sup>. At the other

extreme, Italy's discretionary fiscal stimulus amounted to just 0.1% of GDP<sup>9</sup>. In absolute terms, the largest fiscal stimulus was implemented by the U.S. (US\$787 billion), followed by China (US\$586 billion). In the U.S., stimulus spending was directed primarily at immediate tax relief and direct aid to states and individuals, as well as infrastructure-spending provisions thought to buoy longer-term investment in projects such as high-speed rail, health technology, broadband, a smart electrical grid, clean cars and batteries, and renewable energy. In China, the main beneficiary was infrastructure (railway, road, irrigation and airport construction), followed by allocations to earthquake rebuilding efforts. The other major areas of allocation were Public Housing, Rural Development and Technology advancement.

<sup>8</sup> Executive Office of the President: Council of Economic Advisors, "The Effects of Fiscal Stimulus: A Cross-Country Perspective", September 10, 2009

<sup>9</sup> Ibid

Global stimulus measures clearly yielded economic benefits, but the government spending spree also led to a sharp increase in public debt in many major economies. In 2009, public debt in the U.S. remained the highest at US\$6.7 trillion (up 24.3% in 2008–09), closely followed by China at US\$6.2 trillion (up 29.0%)<sup>10</sup>. The combined deficits of European governments are now more than double the 3% mandated under the European Union law<sup>11</sup>.

### Central Banks Cut Interest Rates and Kept Them Low

Although interest rates were already low in much of the world, many central banks made additional cuts during Q1 2009. Moreover, most countries kept rates low for the whole year, recognizing the need to provide support for the fragile global economy by keeping the price of money down—making it cheaper for individuals and businesses to borrow, and reducing the interest costs on debt. The Bank of England cut the Official Bank Rate from 2.0% in January to 0.5%<sup>12</sup> in March amid depressed confidence and persistent problems in international credit markets. The U.S. Federal Reserve kept its federal funds rate between 0.0% and 0.25%<sup>13</sup> during 2009, and the Bank of Japan retained its Basic Discount rate at 0.3% throughout the year<sup>14</sup>.

### National Savings as a Percentage of GDP Decreased Worldwide in 2009

Changing levels of national savings<sup>15</sup> affect wealth by making more or less funds available for future investment. In 2009, world national savings as a

percentage of GDP dropped to 21.3% from 23.3% in 2008<sup>16</sup>. The drop was especially sharp in Western Europe, mainly due to the contraction of GDP by 4.1% and the increase in government spending from US\$3.06 trillion in 2008 to US\$3.13 trillion in 2009<sup>17</sup>. Among developed nations worldwide, the decline was led by Germany (from 25.7% in 2008 to 20.9% in 2009) and Japan (from 25.5% to 21.4%)<sup>18</sup>. Both countries had experienced a contraction in GDP. Emerging economies experienced a lesser drop than the developed ones. China and India in particular experienced only slight declines, largely because of their strong GDP growth.

### Private Consumption Dropped Marginally in 2009

Despite the challenging economic climate, global private consumption dropped only marginally to US\$29.3 trillion in 2009 from US\$29.4 trillion in 2008<sup>19</sup>. North America accounts for a third of all private consumption worldwide, and levels there dipped to US\$9.9 trillion from US\$10.0 trillion in 2008<sup>20</sup>. Western Europe, which also accounts for nearly 30% of global private consumption, similarly slipped to US\$8.5 trillion from US\$8.6 trillion. Notably, though, private consumption did not rise in either region even though consumer confidence was steady or rising after having sunk during the crisis. In Asia-Pacific excluding Japan, private consumption rose to US\$4.0 trillion from US\$3.8 trillion, the second straight year of healthy gains, but the region still accounts for only about 14% of global private consumption<sup>21</sup>.

<sup>10</sup> Economist Intelligence Unit, January 2010

<sup>11</sup> Mark Scott, "Europe's Delicate Dilemma", Bloomberg Businessweek, January 25, 2010

<sup>12</sup> Bank of England, Official Bank Rate statistics, <http://www.bankofengland.co.uk>, accessed March 15, 2010

<sup>13</sup> Federal Reserve, Federal Funds Rate statistics, <http://www.federalreserve.gov>, accessed March 15, 2010

<sup>14</sup> Bank of Japan, Basic Discount Rate statistics, <http://www.boj.or.jp/en/index.htm>, accessed March 15, 2010

<sup>15</sup> National Savings = GDP – [Private Consumption + Government Consumption]

<sup>16</sup> Economist Intelligence Unit, Regional Data, February 2010

<sup>17</sup> Ibid

<sup>18</sup> Economist Intelligence Unit, Country Data, January 2010

<sup>19</sup> Economist Intelligence Unit, Regional Data, February 2010

<sup>20</sup> Ibid

<sup>21</sup> Ibid

## KEY MARKET AND OTHER DRIVERS OF WEALTH SHOWED STRONG GAINS IN 2009

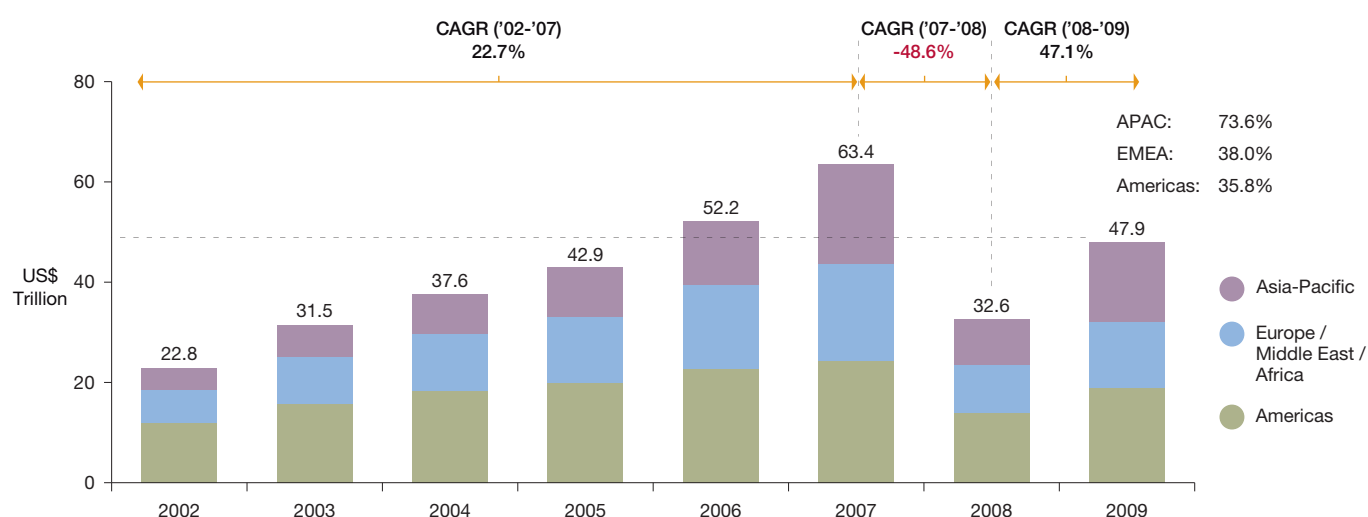
Strong gains were evident in 2009 in many aspects of market performance, another key driver of wealth. Major asset classes (equities, fixed income, real estate and alternative investments) all rebounded after severe losses in 2008. Commodities also posted substantial gains, while the performance of currencies remained heavily tied to underlying economic performance.

Notable market developments during the year included the following:

- Global equity-market capitalization rose nearly 47.1% in 2009 to reach US\$47.9 trillion** (see Figure 6). Global equity markets had collapsed in 2008, when capitalization sank 48.6%, and dropped close to 2003 levels. In 2009, however, equity markets rebounded strongly, after an initial dip in Q1 2009, to end the year above 2005 levels. Global equity-market capitalization rose 47.1% to stand at US\$47.9 trillion by the end of the year<sup>22</sup>. Short-term investors cashed in on the attractive investment opportunities in equities by taking advantage of the consistent upward trend across indices. Market capitalization increased across all regions, but was led by Asia-Pacific and
- Latin America.** The strongest growth was seen in the BRIC (Brazil, Russia, India and China) nations, where market capitalization more than doubled.
- Equity-market volatility plunged from record highs in 2008, but remains high.** The rapid meltdown in equities in 2008 occurred amid record levels of volatility, but that volatility plunged in 2009, and has continued to drop in 2010. The daily volatility of the DJ World Index had sunk to 1.30% by end-2009 from 2.48% at the beginning of the year and 2.56% at its peak in mid-September 2008 (see Figure 7). In early-2010, volatility declined further as crisis fears continued to fade, though as per mid-April, volatility levels still remained above those seen during the Asian financial crisis and after the September 11th terrorist attacks in the U.S.
- Global real estate turned positive.** The global real estate market had suffered heavy losses in 2008, causing a drop of 49.2% in the DJ Global Select REIT Index<sup>23</sup>. In 2009, however, housing prices recovered moderately in most countries, largely due to government intervention. Hong Kong posted the greatest gains, with housing prices up 20.8%<sup>24</sup>, helped in part by a

FIGURE 6. Equity-Market Capitalization, 2002-2009 (by Region)

(US\$ Trillion)



Source: World Federation of Exchanges, March 2010

<sup>22</sup> World Federation of Exchanges, market capitalization statistics, <http://www.world-exchanges.org/statistics>, accessed March 9, 2010

<sup>23</sup> Dow Jones, Dow Jones Global Select REIT Index, <http://www.djindexes.com>, accessed February 4, 2010

<sup>24</sup> Global Property Guide, Variation of monthly prices adjusted for inflation for the December 2008- December 2009, February 2010



massive influx of buyers from mainland China. In the U.K., the recovery was mainly driven by low interest rates and a lack of supply. In the U.S., housing markets stabilized as the U.S. Federal Reserve drove interest rates to 50-year lows, and in China, housing prices and sales were boosted by direct government intervention. The DJ Global Select REIT Index ended the year with total returns of 32.2%, with Canada (86.4%) and Singapore (83.7%) emerging as the top performers<sup>25</sup>.

Although the residential real estate market has managed to bounce back somewhat, the recovery could be hard to sustain without ongoing government intervention. Commercial real estate prices, meanwhile, are unlikely to recover broadly until there are substantial gains in drivers of commercial real estate demand, such as job growth, rising incomes and private consumption, and widespread economic growth.

■ **Hedge funds recouped many of their 2008 losses.**

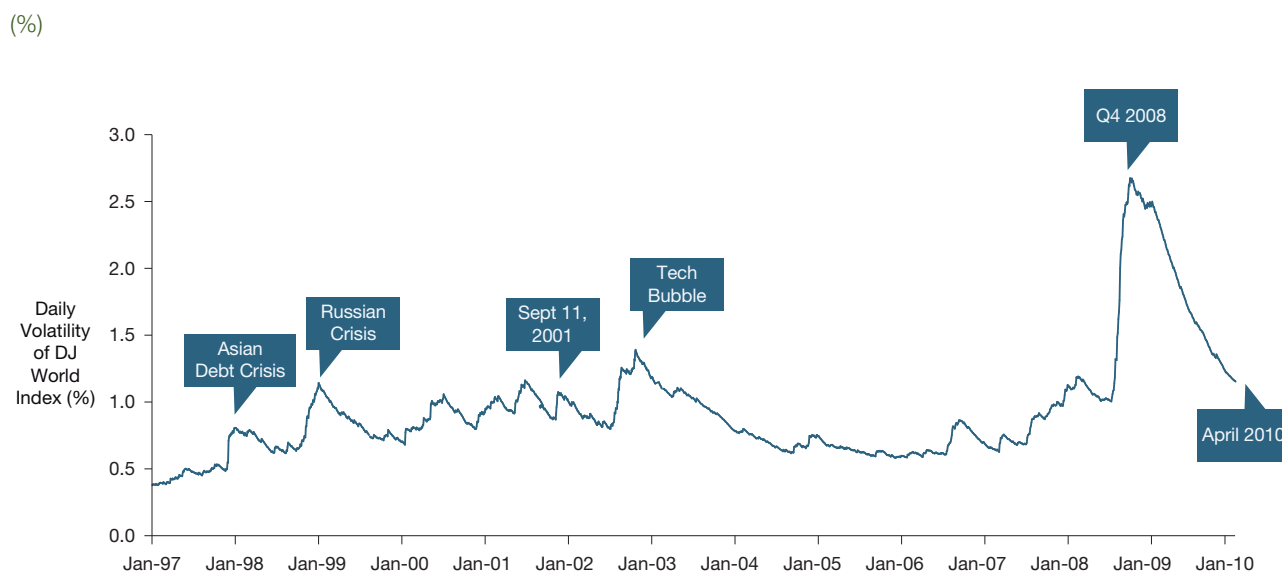
Hedge fund managers remained cautious at the beginning of 2009 after assets plunged US\$500 billion in 2008 from their end-2007 peak of US\$1.9 trillion<sup>26</sup>. Many managers initially kept 50% to 60% of their portfolios in cash, and some restricted redemptions, sparking an outcry among investors. However, hedge funds reinvested as the markets stabilized, and contributed to the resurgence in stocks and bonds.

Hedge funds received more than US\$1 billion in net investments in Q3 2009, experiencing the first quarter of positive inflows since Q2 2008<sup>27</sup>. This influx brought industry-wide assets to US\$1.5 trillion. The Credit Suisse/Tremont Hedge Fund Index posted a year-end return of 18.6%<sup>28</sup>. In the near future, however, hedge funds are likely to face a variety of challenges, including increased regulation and higher taxes.

■ **The US dollar remained volatile during the year.**

Investors bought dollars in Q1 2009 amid demand for a safe haven while stocks remained in decline. By April, however, investors began to move away from the dollar as central banks around the world stepped up efforts to support their economies. The dollar's slide was compounded by the relative weakness of the U.S. economic recovery. By the fall, some countries including Australia were even raising interest rates, while the U.S. Federal Reserve maintained key rates near zero. Encouraged by the availability of cheap money, investors borrowed dollars to buy stocks, gold, commodities and other currencies. In December, however, U.S. data on employment and retail sales were surprisingly positive, while credit-rating agencies painted a gloomy picture about some of the European economies. This led to a slide in the euro by about 6.0% against the dollar in just three weeks<sup>29</sup>. At the end of

FIGURE 7. Daily Volatility of DJ World Index, January 1997 - April 2010



Source: Dow Jones World (W1) Index – Daily close values from January 1st, 1997 to April 15th, 2010; Capgemini Analysis

<sup>25</sup> Dow Jones, Dow Jones Global Select REIT Index, <http://www.djindexes.com>, accessed February 4, 2010

<sup>26</sup> Jenny Strasburg and Gregory Zuckerman, "Hedge Funds Regain Some Swagger", *Wall Street Journal*, January 4, 2010

<sup>27</sup> Ibid

<sup>28</sup> Credit Suisse/Tremont Hedge Fund Index, <http://www.hedgeindex.com>, accessed February 4, 2010

<sup>29</sup> Joanna Slater, "Up-and-Down 2009 for Dollar", *Wall Street Journal*, January 3, 2010

the year, the dollar was up against the yen by 2.1%, but was down against most major currencies, especially the Brazilian real (-25.2%), Canadian dollar (-14.3%) and British pound (-9.9%)<sup>30</sup>.

- **Commodities posted strong gains in 2009, but could not wipe out 2008 losses.** The Dow Jones-UBS Commodity Index (DJUBS) rose 18.7% in 2009, recouping only some of the 36.6% drop posted in 2008<sup>31</sup>. The 2009 commodity rally was driven by metals as hopes of a global economic recovery spurred demand, and fears of inflation encouraged hedging. Copper recorded gains of 139.0% as industrial demand soared, and ended the year at US\$3.3275/pound<sup>32</sup>, which was around 18% less than the highs of 2008. Silver prices rose steadily to end 2009 with a gain of 57.5%<sup>33</sup>. Strong demand from automakers increased demand for platinum, which is used in catalytic converters, and lead, which is used in car batteries. Platinum prices rose 63.3% to end the year at US\$1,466/oz<sup>34</sup>, and lead more than doubled in price to US\$2,416 a metric ton.
- **Oil prices ended 2009 at US\$79.4/barrel, a gain of 78.0% on the year<sup>35</sup>.** Prices more or less tracked the economy, falling at the beginning of the year, before moving higher as fears about the financial crisis began to ease. Prices also rose on expectations of long-term

demand, especially from emerging markets. Despite the sustained gains of 2009, prices ended below the US\$145/barrel high reached in July 2008. That high had been followed by a steep decline that left oil prices sharply lower by the end of 2008. Analysts expect oil prices to rise in 2010 as economies around the world continue to stabilize.

- **Gold prices soared in 2009, fuelled by broad investor demand.** Gold prices increased steadily throughout 2009, registering a total increase of 26.9% for the year<sup>36</sup>. The price of gold peaked in early-December at US\$1,212/oz, but dropped to US\$1,104/oz at the end of the year amid profit-taking. Challenging economic conditions impacted industrial and jewelry demand for gold, which dropped 16.0% and 20.0% respectively in 2009<sup>37</sup>. However, gold saw hefty buying by funds and individual investors alike, seeking insurance against possible inflation and a declining dollar. The world's biggest gold ETF, SPDR Gold Shares, increased its gold holdings by 45.0% to more than 1,133 metric tons<sup>38</sup> in 2009. Central banks around the world, especially those of China and India, were net buyers of gold in 2009 after decades of selling. Gold prices are likely to rise further in early 2010, but may face downward pressure thereafter, due to expectations that interest rates will rise around the world.

## SUSTAINED GLOBAL ECONOMIC RECOVERY DEPENDS ON RETURN OF PRIVATE CONSUMPTION AND CAREFUL HANDLING OF GOVERNMENT-STIMULUS WITHDRAWAL

The global economy was supported by extraordinary measures from governments around the world in 2009. Central banks favored highly expansionary monetary policies, with interest rates at record lows in many countries, and fiscal stimulus was implemented to support economic recovery. As a result, signs of economic resurgence were emerging in many key

sectors in numerous countries in early-2010, but that growth remains nascent. In fact, sustained global economic recovery will depend heavily on how well governments manage their use of, and exit from, their fiscal stimulus policies, and whether private consumption can re-emerge to drive a sustained global recovery.

<sup>30</sup> Ozforex, Historical data for select currencies against the U.S. dollar, <http://www.ozforex.com.au>, accessed February 2, 2010

<sup>31</sup> Dow Jones, Dow Jones Commodity Index (DJUBS), <http://www.djindexes.com>, accessed January 29, 2010

<sup>32</sup> Carolyn Cui, "Metal Rally Has Legs to Keep Running", Wall Street Journal, January 3, 2010

<sup>33</sup> Kitco, London PM FIX Prices, <http://www.kitco.com>, accessed February 11, 2010

<sup>34</sup> Ibid

<sup>35</sup> U.S. Energy Information Administration, Cushing, OK WTI Spot Price FOB, <http://www.eia.doe.gov>, accessed January 28, 2010

<sup>36</sup> Kitco, London PM FIX Prices, <http://www.kitco.com>, accessed February 11, 2010

<sup>37</sup> World Gold Council, "Gold Demand Trends: Fourth Quarter and Full Year 2009", February 17, 2010

<sup>38</sup> Carolyn Cui, "Metal Rally Has Legs to Keep Running", Wall Street Journal, January 3, 2010

In the year ahead, there are numerous key economic issues to watch, including the following:

- **World GDP is forecast to grow in 2010 and 2011, after contracting in 2009.** Asia-Pacific excluding Japan is expected to show the strongest GDP growth of any region, with growth of 7.0% in 2010 and 6.4% in 2011<sup>39</sup>. That would outpace growth in the G7 developed nations. The region's GDP growth is likely to be led by China and India, where independent engines of growth, such as domestic consumption, are expected to be strong. In Latin America, the growth is expected to be led by Brazil, amid expanding credit, strong demand for commodities and substantial capital inflows. The outlook for Russia is also promising, as the country stands to benefit from higher prices for oil and base metals, especially if the global recovery is sustained.
- **Financial conditions are still challenging.** The tightening of bank lending standards has moderated somewhat, but bank lending is likely to remain sluggish as banks wait to see the extent of additional loan write-offs. Corporate bond issuance increased significantly following a rebound in equity markets, but those issues have not been able to make up for the scaling back of new bank lending to the private sector<sup>40</sup>. Sovereign debt ratings have come under pressure in some countries struggling with large government deficits and debts. Cross-border bank financing is still contracting in some regions, and is likely to affect domestic credit growth.
- **How and when governments withdraw stimulus will be critical.** If governments exit their supportive policies prematurely, they are likely to undermine global growth. In fact, the immediate withdrawal of stimulus measures could increase the chances of an economic recession similar to that seen in the U.S. in 1937 and in Japan in 1997<sup>41</sup>. Conversely, if governments overly prolong stimulus, it could inflate fiscal deficits to unmanageable levels, and undermine the prospects for long-term growth.
- **Return of vibrant private consumption is essential.** The global economy is showing clear signs of recovery, but that revival is still underpinned by the effects of government stimulus. A sustained recovery will require a

return to vibrant private consumption, which depends heavily on employment, overall consumer confidence and spending, as well as income. Global unemployment grew 14.4% to 211.5 million in 2009<sup>42</sup>, and is expected to keep rising, but the employment recovery is expected to be gradual, and companies are likely to try raising productivity before they add employees. Consumer confidence is rising from the lows of early-2009 but remains tenuous. Given current conditions, private consumption is expected to grow only mildly in 2010 in North America and Western Europe—which together account for more than 60% of global private consumption. Other major contributors to global private consumption include Japan, Germany, the U.K., France and China, which will all face similar issues within their own economies. Each contributes from 3% to 9% to global private consumption.

Beyond these major factors, numerous other issues have the potential to restrain world growth. They include fears of inflation, especially in Europe, and spillover from problems in individual institutions or countries. In early-2010, for example, the fiscal crisis in Greece and the effective default of one of Dubai's largest government-owned companies offered sobering reminders that unforeseen problems can quickly undermine consumer and business confidence and restrain growth if not credibly managed.

Going forward, then, governments around the world will be juggling several challenges, including the need to maintain appropriate fiscal stimulus and support healthy growth, the imperative to correct unhealthy economic imbalances, and the need to nurture the conditions necessary to encourage private consumption. Regulatory reform will present additional challenges to markets and economies. Governments around the world are each considering and implementing reform measures, but the financial crisis proved that global economies are now highly interdependent, and attempts to coordinate international supervisory frameworks and market regulations will continue for some time. Specific reform measures, and the speed with which they are executed, has the potential to impact investors, markets and economies significantly.

<sup>39</sup> Economist Intelligence Unit, Regional Data, April 2010

<sup>40</sup> International Monetary Fund, "World Economic Outlook Update: A Policy-Driven Multispeed Recovery", January 26, 2010

<sup>41</sup> Ibid

<sup>42</sup> International Labour Organization, "Global Employment Trends", Geneva, January 2010

# HNWIs Warily Returned to Markets in 2009 in Cautious Pursuit of Returns

- **HNW investors cautiously returned to the markets in 2009 as fears over the financial crisis eased.** However, they favored predictable returns and cash flow, as evidenced by the rise in HNWI allocations to fixed-income instruments, to 31% from 29%. Equity holdings also rose, to 29% from 25%, as the world's stock markets recovered. Cash holdings declined slightly.
- **HNWIs overall had proportionally more invested outside their home regions by the end of 2009 than they had a year earlier.** This shift countered a widespread trend toward asset repatriation to home regions during the crisis. The decline in home-region investments was most marked in Europe, where such holdings dropped to 59% of overall portfolios from 65% in 2008. Among Latin American HNWIs, by contrast, home-region allocations were up 3 percentage points to 47%. In general, HNWIs' allocations to emerging markets rose overall, and to Asia-Pacific in particular, as investments flowed to regions and markets expected to have the most growth in the coming years.
- **By 2011, HNWIs are expected to further reduce their home-region investments, and look to those regions in which growth is expected to be more robust.** North American HNWIs, who have typically held a large portion of assets in their own region, are shifting those allocations to become more geographically diversified. They are gravitating in particular toward regions in which growth is anticipated, especially Asia-Pacific and Latin America. Home-region allocations are also expected to drop among Europe's HNWIs, who are also likely to invest more in Asia-Pacific.

## HNWIS SOUGHT TO RECOUP LOSSES IN 2009, BUT TOOK A MEASURED APPROACH

As projected in the last WWR, HNWI investors began to regain their appetite for risk in 2009, especially as the year wore on and the global economy showed signs of recovery. As a result, there was a tentative but tangible shift in HNWI asset allocations, both in aggregate and by region.

### HNWIs' Exposure to Equities and Fixed-Income Increased as Crisis Fears Abated

The proportion of HNWI assets held in equities increased slightly in 2009. At the same time, the share held in fixed-income rose, and cash-based holdings dropped, suggesting that while HNWIs were keen to pursue returns and recoup some of their 2008 losses, they also valued predictability in returns and cash flows.

More specifically, a number of tangible shifts in the worldwide portfolio of HNWI financial assets occurred in 2009 (see Figure 8), including the following:

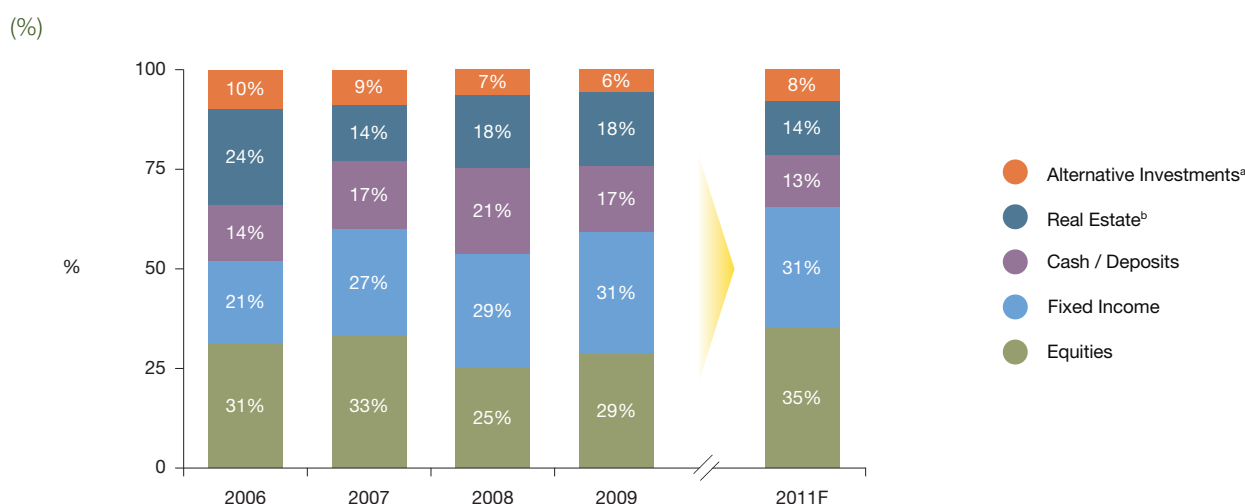
- Of global HNWI assets, 31% were held in fixed-income instruments by the end of 2009, up from 29% in 2008. This reflected the crisis-driven desire to secure predictable cash flows. The Barclays Capital Global Aggregate Bond Index returned 9% on the year.
- Globally, equities accounted for 29% of total HNWI financial assets at the end of 2009, up from 25% a year earlier as many of the world's stock markets recovered sharply. Global market capitalization rose to US\$47.9 trillion in 2009 from US\$32.6 trillion in 2008, up 47%<sup>43</sup>.
- Equity holdings among European HNWIs rose from 21% of total assets in 2008 to 26% in 2009 as European stock market capitalization grew by 38%<sup>44</sup>. Among North American HNWIs, who have long favored equities as an asset class, equity holdings edged up from 34% of total holdings in 2008 to 36% in 2009 as stock values rose. North American HNWIs remain far more heavily invested in equities than the 29% global average.

<sup>43</sup> World Federation of Exchanges, Market capitalization statistics, <http://www.world-exchanges.org/statistics>, accessed March 9, 2010

<sup>44</sup> Ibid



FIGURE 8. Breakdown of HNWI Financial Assets, 2006-2011F



<sup>a</sup> Includes structured products, hedge funds, derivatives, foreign currency, commodities, private equity, venture capital

<sup>b</sup> Comprises commercial real estate, real estate investment trusts (REITs), residential real estate (excluding primary residence), undeveloped property, farmland and other

Source: Capgemini/Merrill Lynch Financial Advisor Surveys 2007, 2008, 2009, 2010

- HNWIs from Latin America and Japan remained the most conservative, with HNWIs in each region holding 52% of their aggregate portfolios in either cash/deposits or fixed-income, despite surging equities prices. However, this is not unusual for Latin American HNWIs, who typically hold a higher percentage of assets in fixed income than HNWIs in other regions.

By 2011, aggregate allocations to equities are expected to rise to 35% of HNWI holdings, with fixed-income holdings steady at around 31%, as HNWIs regain their risk appetite but seek to strike a balance in their portfolios.

### Residential Real Estate Regained Some of Its Appeal for HNWIs in 2009

Overall, the proportion of HNWI assets dedicated to real estate remained unchanged at 18% in 2009, after increasing in 2008, when HNWIs showed a preference for tangible assets and sought to capture some bargains as real-estate prices slumped. More specifically, though:

- Of all real-estate assets, the share dedicated to residential real estate<sup>45</sup> rose—to 48% from 45%—as prices recovered across much of the globe.
- Commercial real estate holdings dipped slightly to 27% from 28% as the sector experienced falling rental incomes, weak demand and increased supply.
- REIT holdings increased to 12% from 10% of all HNWI real-estate assets as the Global REIT

Benchmark Index grew 23.8%. That index remains far below the highs of 2007, though<sup>46</sup>.

HNWIs in Asia-Pacific excluding Japan still have the world's highest allocation to real estate investment overall, and to residential real estate in particular, after an exponential boom in real estate investment in recent years. Direct real estate investment in the region jumped 56% year-on-year in the second half of 2009 to an estimated US\$25 billion<sup>47</sup>. By end-2009, 28% of the assets held by the region's HNWIs were in real estate.

HNWIs in Asia-Pacific excluding Japan also had the greatest proportional exposure to residential real estate (60% of all real-estate investments). For many in that region, residential property remains a highly attractive investment because tight supply and strong demand endure in most prime locations. The price of luxury residences in Asia-Pacific grew by 17.1% in 2009, with prices in cities like Hong Kong, Shanghai and Beijing surging by more than 40%<sup>48</sup>, reaching record global levels<sup>49</sup>. In North America, luxury real estate sales began to recover, particularly in the secondary-home market, but sales still predominate at the lower end of the luxury market, as investors look for value and bargains<sup>50</sup>.

In the Middle East, HNWI holdings of real estate dropped to 23% of all investments from 25% in 2008 as hotspots such as Dubai experienced a major slump in demand.

<sup>45</sup> Not including primary residence

<sup>46</sup> Dow Jones, Dow Jones Global Select REIT Index, <http://www.djindexes.com>, accessed February 4, 2010

<sup>47</sup> CB Richard Ellis, "Asia Investment MarketView 2H 2009", <http://cbre.com>

<sup>48</sup> Knight Frank, "The Wealth Report 2010", <http://www.knightfrank.com>

<sup>49</sup> Kay Coughlin, President & CEO, Christie's Great Estates. interview by Capgemini, April 2010

<sup>50</sup> Ibid

Commercial real estate was held in the highest proportions by HNWI in Europe. However, those holdings—32% of all their real-estate investments vs. the global average of 27%—reflected an inability to shed assets in the illiquid markets more than a desire to be heavily invested in commercial interests.

Ultra-HNWIs again held more of their real estate holdings in commercial real estate than HNWI did overall in 2009 (32% of the total vs. 27%), while holding less in residential real estate (45% vs. 48%).

Farmland and undeveloped property, meanwhile, comprised 6% and 8% respectively of aggregate global HNWI real estate portfolios in 2009, little changed from 2008. However, the Farmland allocation was much higher (23%) in Latin America, where a significant amount of wealth has traditionally been derived from agricultural businesses, and the undeveloped land allocation was much higher in the Middle East (21%), where such land has been in speculative demand amid the real-estate boom.

HNWI holdings of real-estate investment trusts (REITs) rose in 2009 to 12% of all HNWI real-estate assets from 10% as the Global REIT Benchmark Index grew 23.8%. That index remains far below the highs of 2007, though<sup>51</sup>.

REIT holdings are proportionally higher among HNWIs in North America and Japan, where REIT returns have been relatively attractive and the product itself is more readily available and more familiar to investors. The U.S. High Total Returns on All REITs Index rose 27.4% in 2009, and the average dividend yield on J-REITs was 6.8% vs. 1.3% for the 10-year Japanese Government Bond (JGB)<sup>52</sup>.

### **HNWI Holdings in Hedge Funds Rose though Alternative Investments Held Steady Overall**

HNWIs' holdings of alternative investments were little changed overall in 2009 at 6% of the aggregate portfolio vs. 7% in 2008. However, allocations to hedge funds rose to 27% of the alternative-investment total from 24% as the hedge fund industry recovered from its dismal performance in 2008. The Credit Suisse/Tremont Hedge Fund Index posted an 18.6% return in 2009.

Among HNWIs from Latin America, hedge funds clearly dominate alternative-investment holdings and accounted for 49% of all such holdings in 2009, when the Eureka Hedge Latin American Hedge Fund Index rose 26.9%. The picture is similar in Europe, where HNWIs held 32% of alternative investments in hedge funds in 2009 when the Eureka Hedge Europe Index returned 21.85%.

Commodities also accounted for a larger share of the aggregate alternative investment HNWI portfolio in 2009—16% vs. 13% in 2008. That amount was boosted in particular by HNWIs buying gold as insurance against possible inflation and dollar weakness. The price of gold rose 27% in 2009, its ninth straight year of gains. HNWIs from North America have a much higher-than-average allocation to commodities (24%), but they also have access to a wider array of commodity-based instruments, such as exchange traded funds, so have more opportunities to buy.

Foreign currency investment comprised only 13% of overall HNWI alternative investment allocations, but that proportion was much greater among HNWIs in Japan (28%) and higher too among HNWIs in the rest of Asia (20%) and the Middle East (20%) as HNWIs sought to hedge against local currency fluctuations.

The share of alternative investments dedicated to structured products was little changed in 2009 at 20% as HNWIs continued to hold the type of structured vehicles that offer capital guarantees (not the more complex, opaque structures that contributed to the financial crisis) and sought to capture superior returns to conventional fixed-income investments. Among Japanese HNWIs, in fact, structured products are the single most popular form of alternative investment as they offer the potential for yield when prevailing interest rates are low.

### **Geographical Diversification Was Evident in HNWI Asset Shifts in 2009**

The geographic distribution of HNWI assets also shifted in 2009 while HNWIs generally sought higher returns and greater geographic diversification in their portfolios (see Figure 9).

The following trends were especially notable:

- HNWIs in all regions except Latin America increased the relative share of holdings in markets outside their home regions in 2009. European HNWIs had 41% of their holdings in investments outside Europe, up 6 percentage points from 2008, marking the largest such shift. The underlying trend was similar among HNWIs in North America, who reduced their home-region holdings by 5 percentage points to 76%. Even Asia-Pacific HNWIs sought opportunity outside their own thriving region, reducing home-region allocations by 4 percentage points to 54%.
- HNWIs' allocations to emerging markets rose overall. Of global HNWI holdings, the amount dedicated to Asia-Pacific investments rose to 22% of aggregate

<sup>51</sup> Dow Jones, Dow Jones Global Select REIT Index, <http://www.djindexes.com>, accessed February 4, 2010

<sup>52</sup> Dow Jones, Dow Jones Global Select REIT Index, <http://www.djindexes.com>, accessed February 4, 2010, CB Richard Ellis, "Asia Investment MarketView 2H 2009", <http://cbre.com>

portfolios from 19% in 2008, and 13% was tied up in Latin America, up from 11%, as the equity markets in those regions surged.

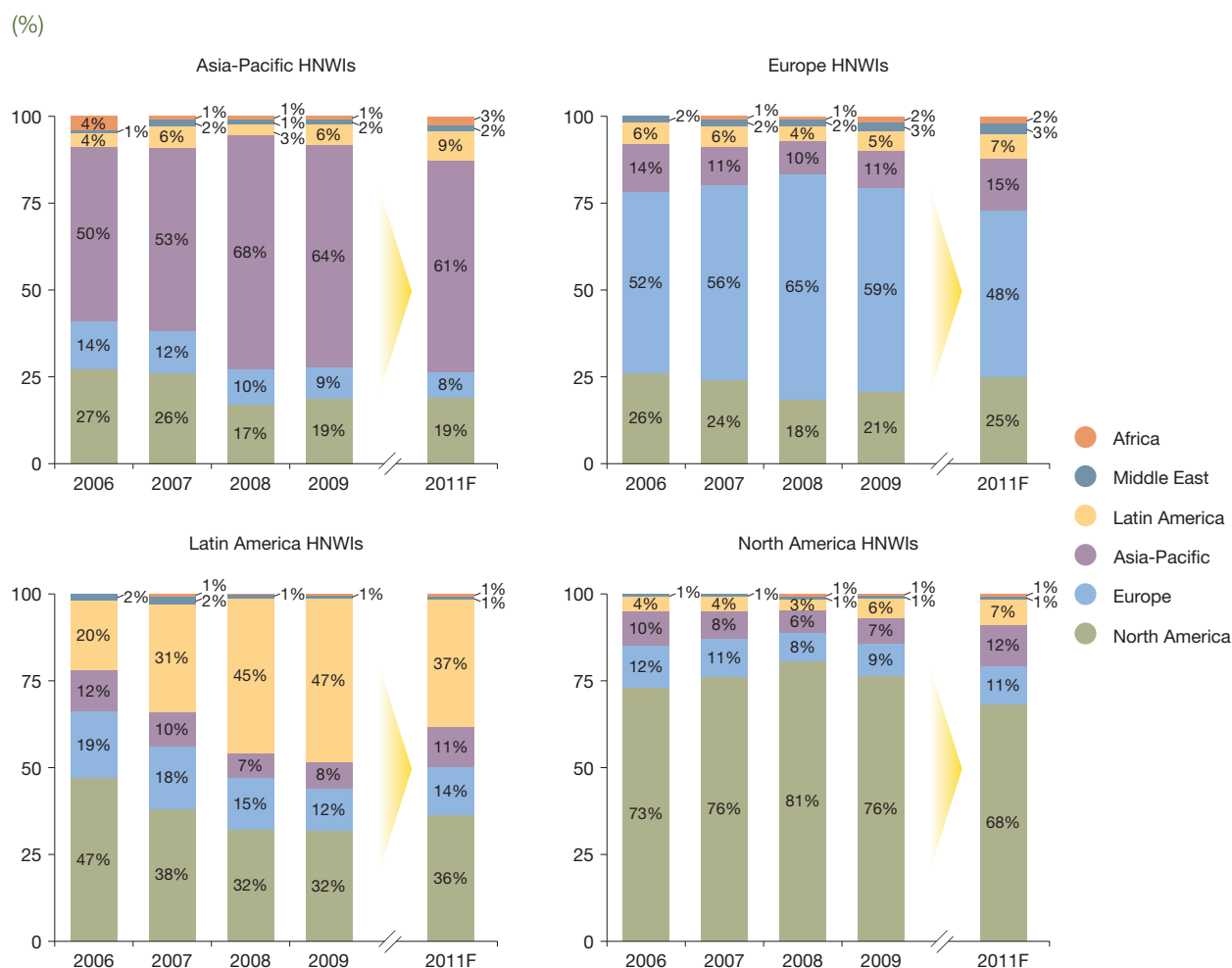
- Latin American HNWIs actually increased domestic allocations by 2 percentage points to 47%, part of an ongoing trend that has seen HNWIs pursue significant investment opportunities (e.g., surging equities) in the region in recent years. Government-driven fiscal incentives in Latin America and high interest rates relative to more developed economies have also encouraged HNWIs to repatriate offshore investments.

By 2011, HNWIs from both North America and Europe are expected to reduce their home-region allocations quite sharply, marking a significant shift for these HNWIs, who are used to favoring their own markets.

HNWIs in Europe are expected by 2011 to have shifted their home-region allocations to 48% of all assets from 59% in 2009 and 65% in 2008. Among HNWIs in North America, the home-region allocation is expected to drop to 68% from 76% in 2009 and 81% in 2008.

While HNWIs from the mature economic regions of North America and Europe are expected to continue increasing their allocations to Asia-Pacific in search of higher returns, HNWIs in Europe are also likely to increase their North American holdings to inject stability into their portfolios. More broadly, though, the regional asset-allocation shifts are likely to reflect a desire by HNWIs to diversify, with some investors shopping around for increased returns and others seeking greater stability.

FIGURE 9. Breakdown of HNWI Geographic Asset Allocation, 2006-2011F



Note: Total for the chart may not add to 100% due to rounding

Data for the Middle East is not depicted, but showed the same trend toward increased investment outside of the home region

Source: Capgemini/Merrill Lynch Financial Advisor Surveys 2007, 2008, 2009, 2010

# HNWIs Cautiously Returned to Passion Investments in 2009

- **As HNWI cautiously returned to financial markets, they also returned to passion investments in 2009.** Outright global demand remained weaker than before the crisis in many passion categories, such as luxury collectibles (luxury automobiles, boats, jets), Art, and jewelry, though demand began to grow in the latter half of 2009.
- With financial markets still in flux, **some HNWIs indicated they are approaching their passion investments as “investor-collectors”**, seeking out those items that are perceived to have tangible long-term value. The two categories that are most attractive to these “investor-collectors” are Art and Other Collectibles (coins, antiques, wines, etc.).
- **The demand for passion investments overall is expected to increase in 2010** as wealth levels rebound. This is evidenced by the fact that auction houses, luxury goods makers and high-end service providers all reported signs of renewed demand toward the end of 2009, and in the early part of 2010.

## Luxury Collectibles Accounted for the Largest Share of Passion Investments in 2009

Luxury Collectibles (e.g., luxury automobiles, boats, jets) accounted for 30% of HNWIs' overall passion investments in 2009, up from 27% a year earlier (see Figure 10). However, that larger share was of a substantially smaller outright allocation than in 2007, before the financial crisis had fully emerged. Major increases were recorded in Europe, Latin America and Asia-Pacific excluding Japan.

The wealthy from North America allocated the most (31%) to Luxury Collectibles among the passion categories, closely followed by those from Europe and Latin America with 30%. There also seems to be a growing demand for luxury collectibles in emerging markets, especially China, as the HNWI allocation to the category grew by 8 percentage points from 21% in 2008 to 29% in 2009.

Sales of yachts, jets and luxury cars have all been hit very hard by the financial crisis, and all continued to show profound weakness in 2009 as a whole. However, some signs of buying started to emerge in the second half of 2009, and results are expected to improve tangibly in 2010.

Global yacht sales tumbled 45% in 2009, and 80% of yacht manufacturers were forced to suspend or shut down their operations<sup>53</sup>. But 2010 started on a good note, with

yacht brokerages in the U.S., for example, closing nearly 30% more boat sales in the first quarter than a year earlier, and at a total valuation 70% higher<sup>54</sup>.

The jet business similarly was one of the hardest hit by the crisis. In normal times, 12% of the worldwide private jet fleet is for sale, but that figure soared to 18% in July 2009 as inventory swelled. However, sales since then have risen every month<sup>55</sup>.

The luxury car market has floundered in developing and mature markets, but luxury car makers have reported strength in some key emerging markets. For example, German luxury car maker BMW reported double-digit growth in China and Brazil in 2009, and Audi (a unit of Volkswagen AG) has also reported sharply higher sales in China<sup>56</sup>. Early signs in 2010 point to a global revival in the luxury car industry. The collectible-car market has also begun to show signs of life. The three largest auto auctions in Scottsdale, Arizona (home to some of the largest and well-attended auto auctions in the world) generated US\$122.6 million in sales in January 2010, up 8% from a year before<sup>57</sup>.

## Art Remains Key to HNWIs as a Passion and as a Sound Investment

Overall, 22% of HNWI passion investments were held in Art at the end of 2009, down from 25%. There was also a decline in the proportional share of

<sup>53</sup> Wang Ying, "Chinese Yacht Firms Set Sail in the Domestic Market", China Daily, April 10, 2010

<sup>54</sup> "Big-Boat Sales Spur Brokerage Gains", Trade Only Today, April 7, 2010

<sup>55</sup> Geraldine Fabrikant, "The Well-Off Are Spending Again - but Carefully", The New York Times, April 9, 2010

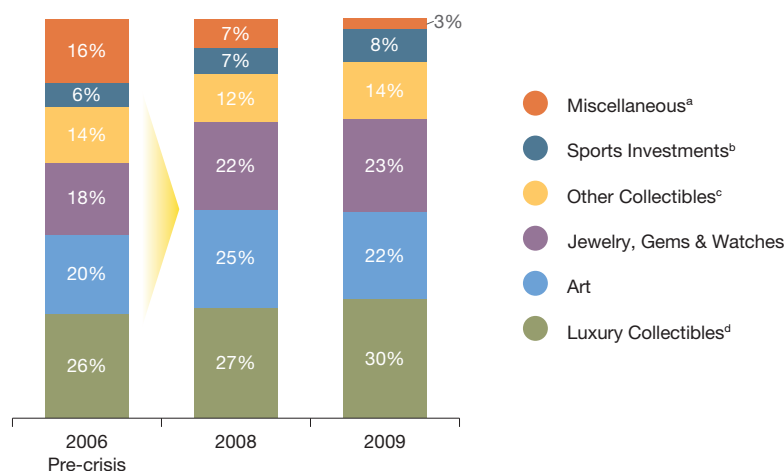
<sup>56</sup> Jack Ewing, "BMW and VW Results Show Money Is Still in Selling Luxury Cars", The New York Times, March 11, 2010

<sup>57</sup> Peter Corbett, "Car Auctions Bring in US\$122.6 million Despite Storms, Recession", The Arizona Republic, January 26, 2010



FIGURE 10. HNWI Allocations to Passion Investments, 2006 vs. 2008-2009

(%)



<sup>a</sup> "Miscellaneous" represents club memberships, travel, guns, musical instruments, etc.

<sup>b</sup> "Sports Investments" represents sports teams, sailing, race horses, etc.

<sup>c</sup> "Other Collectibles" represents coins, wine, antiques, etc.

<sup>d</sup> "Luxury Collectibles" represents automobiles, boats, jets, etc.

Source: Capgemini/Merrill Lynch Wealth Management Financial Advisor Surveys, 2007, 2009, 2010

Art holdings by Ultra-HNWIs. Art represented 25% of all Ultra-HNWI passion assets, down from 27% in 2008 when Art had been their primary passion investment. The proportion of passion investments allocated to Art in 2009 was the highest in Europe and Latin America at 27%.

Notably, while many HNWIs buy and hold art as connoisseurs, there are also numerous "investor-collectors," who view Art as a good financial investment<sup>58</sup>. In fact, among HNWI "investor-collectors," Art is the most likely of all such investments to be acquired for its potential to gain value<sup>59</sup>. Art investors in countries such as India, China, and the Middle East also have a higher predilection to hold tangible assets like Art as a possible inflation hedge<sup>60</sup>.

Global Fine Art auction sales totaled only US\$4.6 billion in 2009, down by a hefty US\$3.7 billion from 2008<sup>61</sup>. Contemporary art sales contracted as demand returned for Old Masters and Modern Art, which were perceived to have more price stability and were therefore more attractive to HNWIs and Ultra-HNWIs who were seeking less risk in all investment decisions during the crisis.

While private sales are still popular, the Fine Art markets seemed to be rebounding rapidly across all categories by early-2010, with sellers confident enough in demand to bring rare, high-value items to auction, and buyers proving especially quick to pay top dollar for one-time opportunities or, for example, rare items with extensive provenance attached<sup>62</sup>.

Notably, the Fine Art markets thrived in much of Asia-Pacific even during the general market weakness of 2009. China's auction revenues rose 25% to US\$830 million in 2009, helping China to gain market share from the U.K. and U.S., though it maintained its third place overall. U.K. sales generated US\$1.9 billion less in 2009 than in 2008 and U.S. sales were down US\$1.6 billion.

Also notable is the increasing tendency of Fine Art collecting to expand across borders, periods and categories as the investor base widens and diversifies. In April 2010, a mid-17th Century South East Persian rug sold for nearly US\$10 million at Christie's, reflecting the substantial HNWI appetite for all types of Fine Art<sup>63</sup>.

<sup>58</sup> Michael Plummer and Jeff Rabin, Artvest Partners, interviewed by Capgemini, New York, April 2010

<sup>59</sup> Capgemini/Merrill Lynch Financial Advisor Survey 2010

<sup>60</sup> Ibid

<sup>61</sup> "2009 Art Market Trends", March 2010, Artprice.com, [http://imgpublic.artprice.com/pdf/trends2009\\_en.pdf](http://imgpublic.artprice.com/pdf/trends2009_en.pdf)

<sup>62</sup> Toby Usnik, Christie's Corporate Communications, interviewed by Capgemini, New York, April 2010

<sup>63</sup> Ibid

### Proportionally More Assets Were Held as Jewelry, Gems and Watches, Especially in Middle East

Jewelry, gems and watches became the second-largest passion-investment category for HNWIs globally in 2009, overtaking Art. This robust demand continued the trend seen in 2008 when the financial crisis increased HNWI demand for more tangible assets expected to hold their long-term value. HNWIs from the Middle East and Asia excluding Japan were most heavily invested, at 35% and 31% respectively, and the Middle East share was up most sharply, from 29% in 2008.

The recovery in high-end retail was uneven, however. Jewelry sales were slow to rebound after a 12% drop in 2009 as many consumers bought less-showy pieces and switched to silver from gold<sup>64</sup>.

### Allocations to Other Collectibles Grew Slightly

The market for many 'Other Collectibles' (which includes e.g., wine, antiques, coins, memorabilia) also showed signs of recovery. For example, the Live-ex 100 Fine Wine Index, which tracks the price of 100 of the world's finest investment-grade wines, rose 15.7% during 2009. Fine Wine continues to be an easy entry point for new collectors as the price point is comparatively low, but serious investors also continue to expand their extensive wine collections<sup>65</sup>.

Sales of coins and memorabilia were also on a rise with some high-end items registering huge auction prices during late 2009. For example, a 1795 reeded-edged U.S. penny, one of only seven known to exist, sold for nearly US\$1.3 million at auction, the first time a 1-cent coin had cracked the million-dollar price barrier<sup>66</sup>.

'Other Collectibles' are favored by HNWIs second only to Art for their potential to return financial gains, and are more popular even than Jewelry, Gems, and Watches, or Luxury Collectibles among investor-collectors.

Sports Investments (e.g., in teams, race horses) saw an increase over 2008 in both the HNWI and Ultra-HNWI segments, though Ultra-HNWIs allocated proportionally more to the category (9%) than HNWIs as a whole (7%) in 2009.

### Lifestyle Spending Rose on Health/Wellness and Travel

HNWI spending increased again in the Health and Wellness category (which includes activities such as high-end spa visits, fitness-equipment installations, and preventative medical procedures), and was the top lifestyle spending category in 2009. Luxury travelers also returned to market in 2009, with increased spending on Luxury/Experiential travel.

HNWI purchases of luxury consumables, meanwhile, varied across the globe. In North America, HNWIs had reduced such spending, but in emerging markets such as China and Brazil, HNWI spending on luxury consumables was reportedly on the rise in the latter half of 2009. In fact, China reportedly now accounts for 49% of luxury-market growth as China's wealthy spend heavily on private jets, luxury cars, lavish homes and other luxury goods<sup>67</sup>. Notably, the cost of luxury goods and services edged up only slightly in 2009, according to the Forbes Cost of Living Extremely Well Index (CLEWI). The index, which tracks the cost of 42 goods and services, gained just 1% in 2009, reflecting widespread discounting to boost flagging sales.

### Demand for Passion Investments is Likely to Rise in 2010 as Wealth Levels Rebound

HNWIs' passion investments are likely to expand in 2010 as wealth begins to recover to pre-crisis levels.

Auction houses, luxury goods makers, and high-end service providers, which all reported signs of renewed demand later in 2009, expect spending to be more robust in 2010.

For instance, most premium car brands, including BMW and Audi, are forecasting strong growth in 2010<sup>68</sup>, particularly in emerging markets. Investments perceived to have tangible value are likely to remain the strongest. Art, for instance, will always be a valuable asset and a must-hold asset for both connoisseurs and investor-collectors<sup>69</sup>. In 2010, though, Art and Other Collectibles could also get a boost from HNWIs seeking a hedge against inflation<sup>70</sup>.

Further recovery in passion investments, however, is likely to be slow as investors weigh a wide variety of market and investing variables before starting to indulge again broadly in their passions.

<sup>64</sup> Matt Townsend, "'Luxury Is Not Dead' as Greubel Sells for US\$490,000 in Greenwich", Bloomberg Businessweek, March 31, 2010

<sup>65</sup> Mehmet Yorukoglu, House of Burgundy, interviewed by Capgemini, New York, April 2010

<sup>66</sup> Jeff D. Opydyke, "The Million-Dollar Penny", The Wall Street Journal, November 19, 2009

<sup>67</sup> Matthew Vincent, "A Return to Luxury", Financial Times, March 25, 2010

<sup>68</sup> Andreas Cremer, "VW, BMW Forecast Growth as German Carmakers Lead", Bloomberg Businessweek, March 11, 2010

<sup>69</sup> Michael Plummer and Jeff Rabin, "Could the Art Market be Undergoing a Fundamental Restructuring?", The Art Newspaper, January 29, 2010

<sup>70</sup> Ibid

# HNWIs Demand for Philanthropy-Related Advisory Services is Rising

HNWIs and Ultra-HNWIs have long been active in charitable giving, and HNWI allocations to philanthropic activities increased in all regions except North America in 2009. However, the increase followed a year in which philanthropy fell sharply, and the financial crisis has clearly reduced the outright level of donations.

While North Americans still have a strong culture of philanthropic giving, and donate more than \$200 billion a year to charities around the globe<sup>71</sup>, a smaller share of their assets was allocated to philanthropy in 2009 than in 2008. Among HNWIs in Europe, Asia-Pacific, Latin America and the Middle East, the philanthropic share of asset allocations was slightly larger in 2009 than 2008<sup>72</sup>. Since the crisis, donors have had fewer funds available for giving, so they are focusing on assessing the mission and effectiveness of charitable organizations to make sure their donations are really making a difference<sup>73</sup>.

Notably, while most HNWIs and Ultra-HNWIs give primarily for altruistic reasons, feelings of social responsibility<sup>74</sup>, social networking, and tax benefits are all reasons for philanthropic giving. Whatever the motivation, philanthropic choices are often inextricably linked to broader financial-planning initiatives, including tax strategies. As a result, the demand for philanthropic-related services offered by wealth management firms is also on the rise.

In fact, ‘advice on financial planning and tax’ aspects of philanthropy was the most demanded piece of philanthropic offerings in 2009 (see Figure 11). Additionally, nearly half of all Advisors said their HNW clients were asking for services related to philanthropic ‘project organization and selection’.

FIGURE 11. Client Demand for Philanthropic Offerings of Wealth Management Firms

(%)



Note: Total for each philanthropic offering in the chart may not add to 100% as the percentage of respondents with neutral answers have been excluded

Source: Capgemini/Merrill Lynch Wealth Management Financial Advisor Survey, March 2010

<sup>71</sup> Amy Feldman, "Rethinking How to Give", Bloomberg Businessweek, February 1 & 8, 2010, page 72

<sup>72</sup> Capgemini/Merrill Lynch Financial Advisor Survey, March 2010

<sup>73</sup> Amy Feldman, "Rethinking How to Give", Bloomberg Businessweek, February 1 & 8, 2010, page 72

<sup>74</sup> Capgemini/Merrill Lynch Financial Advisor Survey, March 2010; 83% of Advisors say HNWIs are driven to give by a sense of social responsibility

Tax considerations are certainly a reality for philanthropists. After all, when tax policies change, HNWI's may want to make philanthropic decisions in line with other wealth and finance strategies being employed to optimize the tax efficiency of their portfolios. Moreover, as global media make world crises more visible, HNWI's are increasingly likely to give to causes beyond their own tax jurisdictions. Britain's Treasury has extended the country's "gift aid" tax break to charitable donations headed to other European Union nations, lifting a bureaucratic burden on cross-border giving<sup>75</sup>. HNWI's will certainly need specialized advice to navigate these kinds of rules and regulations in line with their other holdings and finance decisions, and increasingly, they expect that advice from their wealth management advisors.

In addition, today's philanthropists generally want to make sure their giving actually makes a difference, and are likely to demand the same kind of professional advice in making these types of investments as they do when considering investments designed to meet other financial and lifestyle objectives<sup>76</sup>. Some philanthropists, for

example, are starting to employ more sophisticated financial vehicles and options once used only by the larger institutions and Foundations<sup>77</sup>.

All of these developments are consistent with the increasing trend in modern philanthropy toward more so-called 'giving while living,' in which philanthropists are incorporating their giving strategies into their ongoing wealth accumulation and capital-preservation plans<sup>78</sup>. This shifts charitable-giving considerations farther into the purview of wealth managers and potentially away from estate planners that typically manage bequests.

As demand from HNWI's continues to increase, wealth management firms and Advisors will need to understand a wide array of issues related to philanthropy in order to provide relevant solutions. Indeed, several wealth management firms are already beginning to build expertise in-house or leverage third-party ventures more extensively, and offer these capabilities to their clients to aid in their continuing philanthropic efforts.

<sup>75</sup> The Chronicle of Philanthropy, "British Decision on Tax Break Could Ease Cross-Border Giving", <http://philanthropy.com>, March 25, 2010

<sup>76</sup> Sean Stannard-Stockton, "Philanthropy: Tax Planning and Beyond", *Wealth Manager* Web, September 21, 2009

<sup>77</sup> Shelly Banjo, "Consider It an Investment", *Wall Street Journal*, November 09, 2009

<sup>78</sup> Sean Stannard-Stockton, "The Next Wave of Philanthropy and Wealth Management", *Planned Giving Design Center*, December 2008



# Spotlight:

## CRISIS HAS CLEARLY SHIFTED INVESTOR PSYCHE, AND WEALTH MANAGEMENT FIRMS ARE RESPONDING

- **Post-crisis, most HNW clients have yet to regain their trust in the regulatory bodies and institutions that are meant to oversee markets and protect investor interests.** Coupled with ongoing concerns around financial markets, this lack of confidence has long-term implications for investing behavior.
- **Shifts in asset allocation mirror investor caution.** HNWI are favoring predictable forms of cash flow like those in fixed-income products, and are seeking protection against downside risk, and their search for returns takes place within the broader context of portfolio risks and goals.
- **HNWIs have seized a more hands-on role in their finances.** Above all, they want specialized and independent advice, transparency and simplicity, and effective portfolio and risk management, and are looking for wealth management provider relationships that can clearly demonstrate a more integrated approach to meeting their needs.
- **Emotional factors are a prominent feature of the HNWI psyche today,** and wealth management firms and Advisors must incorporate those emotional factors into stronger portfolio management and risk capabilities so as to properly support client goals and needs.
- With billions of assets still in motion post-crisis, **wealth management firms are embracing change, leveraging key tenets of behavioral finance** to rebuild investor trust and confidence and drive further innovation into their offerings and service models.

### POST-CRISIS, CLIENT EXPECTATIONS HAVE CLEARLY SHIFTED; FIRMS ARE ADAPTING

Undeniably, the global financial crisis was a watershed event that deeply affected the psychology of HNWI—more so than many might have anticipated. In spite of stock market rebounds and early signs of recovery in various economic indicators, wealthy investors have not rushed to chase performance or seize risky market opportunities. Rather, HNWIs have remained cautious and have asked much more of their Advisors and Firms—in particular demanding more information, transparency, and risk-adjusted portfolio management to manage their downside risk. We expect this change in behavior to endure for the foreseeable future.

While 59% of HNWIs indicated they had regained trust in their Advisor over the past year, and 56% had regained trust in their wealth management firm, a striking 71% of HNWI have yet to regain trust in the regulatory bodies that were supposed to be monitoring the markets, and ultimately protecting investors (see Figure 12). They also continue to have ongoing concerns regarding the direction of the financial markets. Given the depth of this distrust, wealth management firms and Advisors will be further challenged to overcome investor hesitation and caution as they encourage the kind of investing that is needed to recoup losses.

## Emotional Factors Clearly Emerge in HNWI Investing Behavior

HNW clients are not just investing on intellectual information and news, but are being driven by emotions when making investment decisions post-crisis. Again, the trend is hardly surprising. After all, the crisis hit investors at every level of wealth—and impacted investors on a very personal and emotional level: Retirees saw their portfolios and nest eggs dwindle; those wanting to bequeath money to heirs and charities have to reevaluate what is possible, and those counting on assets for a new business venture were challenged to find available cash.

And investor wariness is certainly pervasive. For instance, many wealth management executives are especially surprised at the degree to which younger investors (those under 50) around the globe remain cautious despite rebounding markets. While these

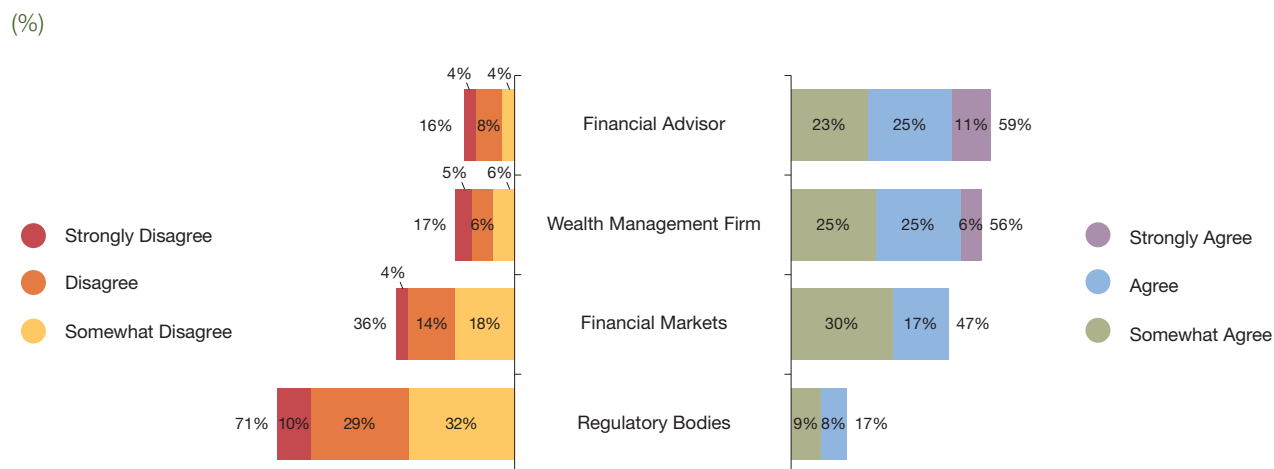
investors were encouraged to be aggressive in the markets in their 30s, some 40-50-year-old investors have experienced a ‘lost decade’ in terms of gains, and are questioning whether they still have the “stomach” to ride out possible market swings again.

As all this uncertainty persists, wealth management firms and Advisors will need to engage in much more dialogue with clients to address their ongoing concerns.

## HNWIs, Confidence Shaken, Seize a More Active Role in Investing

Post financial crisis, HNW investors are now much more engaged in their financial affairs. HNW clients are re-evaluating their current wealth management provider relationships and moving assets to firms that can clearly demonstrate a more integrated approach to meeting their needs.

FIGURE 12. Level of Agreement that HNW Clients are Regaining Trust and Confidence in Financial-Market Entities



Note: 1) Total for each category may not add to 100% as the percentage of respondents with neutral answers has been excluded

Note: 2) Survey asked, 'To what extent do you agree or disagree with the following statements?'

Source: Capgemini/Merrill Lynch Client Survey 2010

Three unequivocal demands HNWI's are making of their wealth management firms today (see Figure 13) are:

■ **SPECIALIZED ADVICE:**

As clients become more educated about their own investment choices, they increasingly expect 'Specialized' or 'Independent' investment advice, and are re-validating advice from their Advisors/Firms through other sources, including peers, the Internet, and other research alternatives. They also expect the advice to be aligned with realistic and appropriate goal-setting, based on their actual risk profile.

■ **TRANSPARENCY AND SIMPLICITY:**

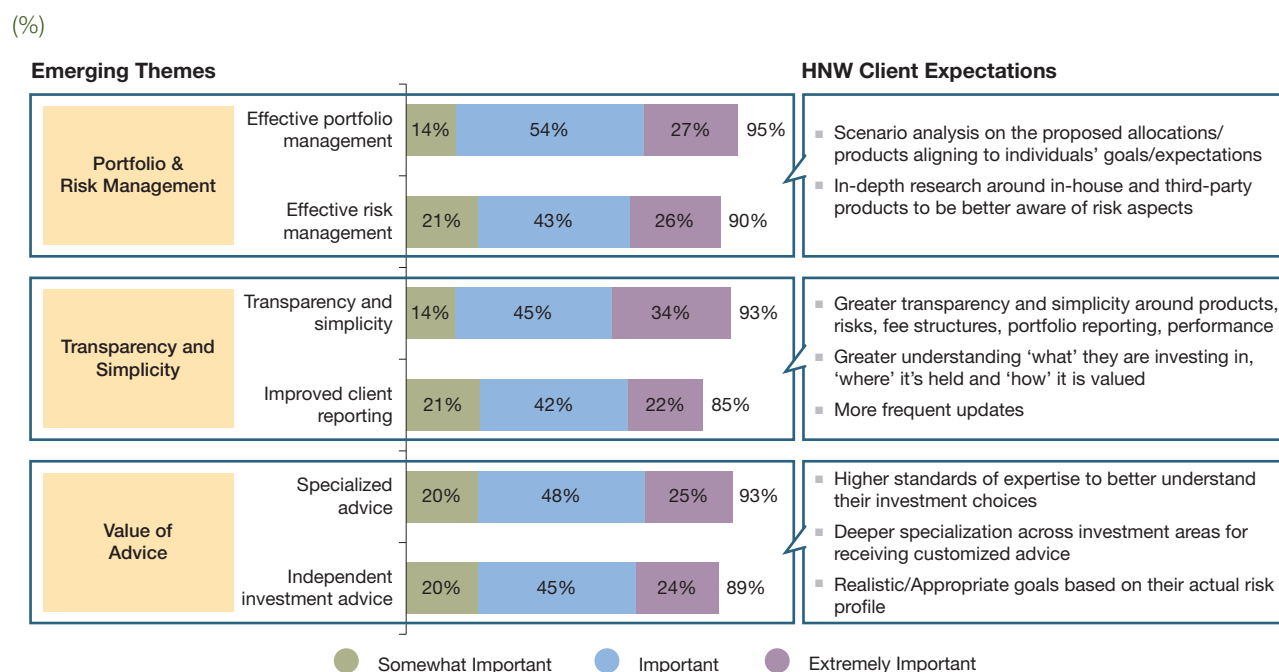
HNW clients want increased 'Transparency and Simplicity' and 'Improved Client Reporting' so they can better understand products, valuations, risks, performance, and fee structures. HNWI's are reviewing product disclosure statements and investment risks before even conferring with their Advisors. They also value better reporting and more frequent updates after being blind-sided during the crisis, when they lacked a

real-time view of what was happening to the value of their investments. And increasingly, the type of products they seek out are the ones they can understand.

■ **EFFECTIVE PORTFOLIO AND RISK MANAGEMENT:**

The vast majority of clients see 'Effective Portfolio Management' and 'Effective Risk Management' as important after the crisis. As a result, they increasingly want and expect scenario analysis on proposed allocations and products that is aligned to their individual goals and expectations, and in-depth research around all types of products so they can better understand the risks. For instance, many wealthy clients are very concerned about their exposure to markets and want to limit their downside risk. At the same time, they know they need to diversify and have global exposure, particularly to fast-growing markets. As a result, they want evidence through risk-scenario analysis to facilitate investment decisions that meet their goals while remaining aligned with broader volatility and risk-appetite limits.

FIGURE 13. Importance of Client Priorities Post-Financial Crisis



Note: 1) Total for each category may not add to 100% as the percentage of respondents with neutral and negative answers has been excluded

Note: 2) Survey asked, 'After the financial crisis, how important are the following to your clients?'

Source: Capgemini/Merrill Lynch Financial Advisor Survey 2010

## DEVELOPING A DEEPER UNDERSTANDING OF INVESTOR PSYCHOLOGY WILL HELP FIRMS AND ADVISORS DEAL WITH A MORE VOLATILE AND LESS CERTAIN ENVIRONMENT

In the aftermath of the financial crisis, “emotional” investing may not seem surprising, but research has long shown that psychology and emotion prompt investors to behave in ways that are inconsistent with what is deemed rational in modern portfolio theory. These concepts form the basis of behavioral finance.

More specifically, behavioral-finance research in recent years has actually demonstrated that investors are often driven emotionally, not just intellectually, to buy and sell on market information. Investor biases, overconfidence and loss aversion lead to investing that doesn’t correlate to “efficient market theory,” and actually causes a “disposition effect” in which individual investors are twice as likely to sell winning positions, and hold on to losing investments<sup>79</sup>.

Research also suggests a substantial number of investors actually forego holistic portfolio optimization, and rather select stocks sequentially, evaluating holdings based on their overall risk attitude, while disregarding overall portfolio volatility<sup>80</sup>. The irony is, in this crisis at least, HNW investors who had bought into traditional managed accounts wouldn’t necessarily have been protected from large portfolio losses as risk models weren’t always optimized for the downturn.

While behavioral finance has not been widely integrated into wealth management to date, it is gaining momentum as Firms seek to navigate the new challenges in the investing environment.

### Firms Can Differentiate Themselves by Integrating Behavioral Finance as They Strengthen Portfolio Management and Risk Models and Capabilities

Among wealth management firms, early adopters are incorporating and applying behavioral finance into their advisory processes to capture and translate investor behavior into a more robust advisory process—so as to facilitate the kind of financial strategies clients really want and need.

As part of this approach, wealth management firms are also looking to help clients identify their true risk tolerance by not just looking at their life-stage, potential wealth, etc., but more importantly, understanding a

client’s overall goals, understanding what principal must be protected (house, business, college fund), what portion of the assets can be exposed to market risk—as well as what assets might be set aside for aspirational risk (see Figure 14).

**Risk and Scenario Analysis** is now being used more extensively to help HNW clients understand the extremes, with risk positioned as a series of ups and downs not an average. Firms are extending the possible extremes (increasing the standard deviations) in their models of ‘what could happen?’, as many pre-crisis models did not account for the extremes that ultimately occurred.

But more importantly, risk analysis is being revamped to include a more thorough client goal assessment. Previously, clients may have been simplistically assigned the typical labels (conservative/moderate/aggressive), and consequently provided the appropriate models in which to invest, based on a very basic outline of their objectives. That label served as a proxy for risk tolerance—categorizing the client’s willingness to pursue or avoid risk, while often using simple volatility to quantify that risk. The crisis proved the flaws in that approach since strategies to avoid volatility, for example, did not necessarily limit downside risk. The more sophisticated scenario approaches, beginning with client goals rather than just a risk ‘label’, assist in identifying the emotional triggers that could ultimately help to better optimize a client portfolio for risk.

Firms are also making sure the risk-scenario results are reflected in portfolio models and **comprehensive asset-allocation models**, which ensure the underlying needs are met, and gauge what the portfolio would do cohesively—ensuring the client’s overall risk and volatility concerns are addressed.

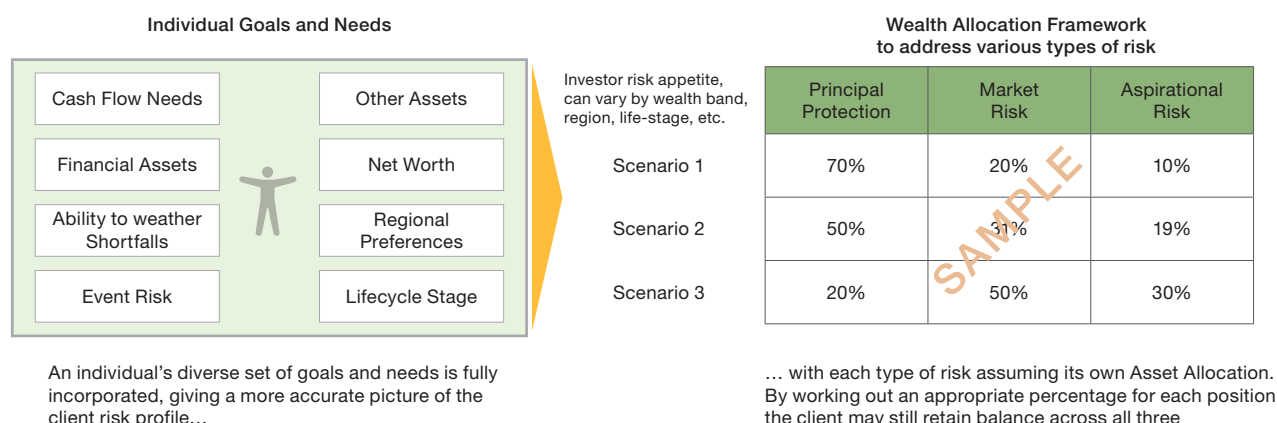
Comprehensive asset-allocation models are therefore becoming more client-driven, and better aligned to the client’s true appetite for risk than the traditional, often product-based solutions, which so often focused on returns in the past. A comprehensive asset-allocation approach is better able to integrate degrees of client risk across an entire portfolio, facilitate true diversification and provide more systematic protection against market swings—while preserving the integrity of the client’s financial and lifestyle objectives.

<sup>79</sup> Brad Barber and Terrance Odean, “Do Investors Trade Too Much?” *American Economic Review*, 1999

<sup>80</sup> Gur Huberman with Daniel Dorn, “Preferred Risk Habitat of Individual Investors”, *Journal of Financial Economics*, 97 (2010), p. 155-173



FIGURE 14. An Integrated Investment Advisory Process and Wealth Allocation Framework



Source: Capgemini analysis; Ashvin B. Chhabra "Beyond Markowitz – A comprehensive Wealth Allocation Framework for Individual Investors", Merrill Lynch, 2005

## MORE MAINSTREAM USE OF BEHAVIORAL FINANCE APPROACHES WILL HAVE A SIGNIFICANT IMPACT ACROSS SERVICE DELIVERY MODELS AND PLATFORMS

### Challenge Lies in 'Mainstreaming' Approaches Once Reserved for Ultra-HNWIs

Wealth management firms of all types (large, small, boutique) are deciding to what degree they should adapt to a paradigm that integrates behavioral factors, but many face a dilemma when looking at the options for delivering such an approach across multiple wealth bands and age segments for the long term.

What, they might ask, does the investment advisory approach look like in the coming months and years, given the evolution in investing behaviors? Is the model they have used up until now sufficient? Do they need to build out their offerings? And if so, how? If not, will they be able to satisfy investor demand arising from the crisis? What impact will this have on the service model? And what systems and technologies need to be updated as a result?

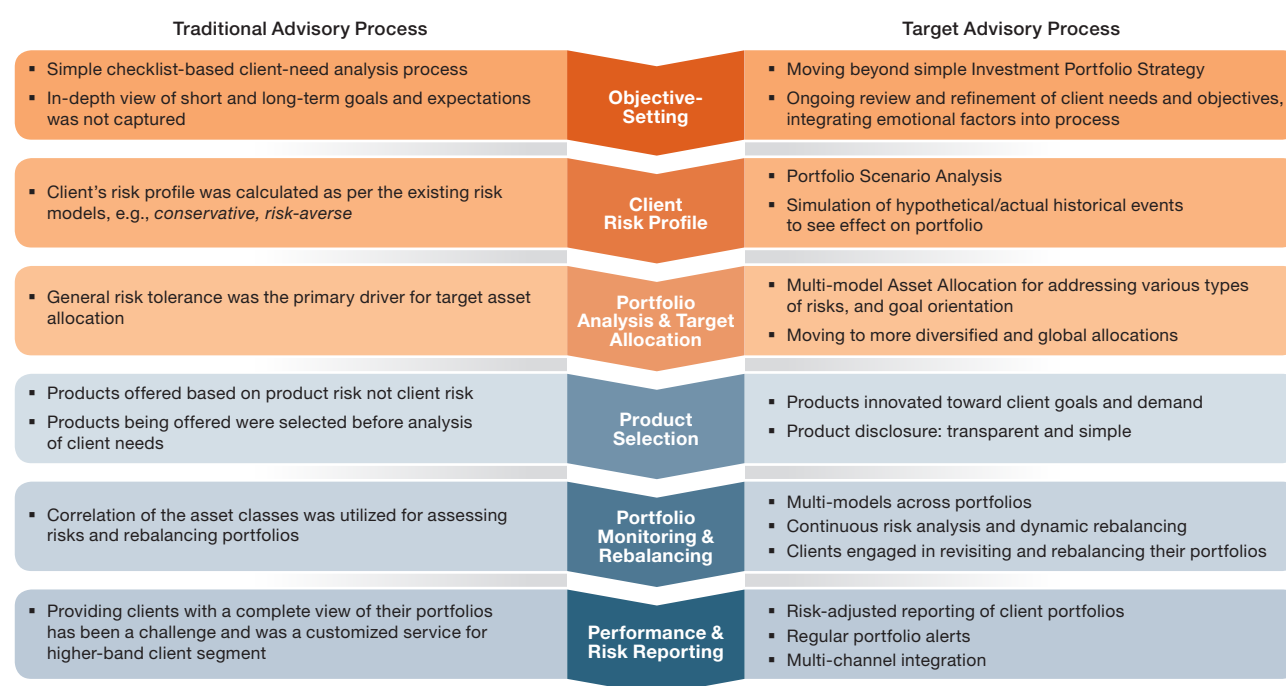
Many Firms already incorporate elements of behavioral finance into offerings for the ultra-wealthy, but extending those practices to the broader HNWI population is challenging. In fact, taking behavioral finance concepts mainstream could result in fundamental changes to the wealth management service delivery model.

### Key Sticking Points are Scalability and Efficiency across Wealth Bands and Segments

'Operationalizing' behavioral finance on a large scale raises many questions for Firms in regards to products, processes, platforms, and service models, and potentially represents a significant transformation for many Firms. We see broad-based applicability for Firms to deliver to clients across wealth bands, but the most challenging issue will be the need to address scalability and efficiency.

Consider, for example, how the HNWI advisory process might evolve to incorporate behavioral finance (see Figure 15). The evolution potentially affects all aspects of the operating model—products, processes and platforms, and service model—though the specific adaptations each Firm ultimately makes will depend on the Firm, its size, focus, specialization and its vision for its future, as well as its desire and ability to adapt and lead.

FIGURE 15. Evolving Advisory Process



Source: Capgemini Research 2010

## MANY FIRMS ARE ALREADY ADAPTING ADVISORY PROCESSES AND OPERATING MODELS TO INTEGRATE BEHAVIOR INTO HNWI INVESTING STRATEGIES

### Early Focus is on Risk and Asset-Allocation Models that Fell Short during the Crisis

Most Firms are focusing first on integrating behavioral finance by building room for emotional triggers into risk scenario analysis and comprehensive asset-allocation models. Prioritizing these elements of the advisory process is an astute move as these are two key areas in which wealthy investors perceive the pre-crisis approaches served them poorly when it came to meeting their risk and portfolio goals. Also, HNWIs understand they now need to view their portfolios through the dimensions of risk, versus just a diversified sector asset allocation or performance lens.

### Firms are Responding to Client Demands, but Still Need to Scale for the Long Term

In the short term, wealth management firms are generally responding to the increased client demands by bringing more product and risk specialists into client meetings to demonstrate their commitment to providing transparency, and to address head-on the emotional triggers that are causing clients to remain cautious about investing. (One firm, which typically deployed a specialist to 10% of HNW client meetings, is now using a specialist in 50% of such meetings.) Many Firms are also hiring additional risk analysts to run more advanced portfolio scenarios and to back-test various products and investment strategies.

Further, some wealth management firms are investing in deeper and more specialized Advisor training around goal/risk-adjusted approaches so as to integrate behavioral-finance tenets into modeling, and better address clients' risk concerns.

Product groups are also adjusting to the new market realities and changing their product development cycles. They are focusing on providing products the market will bear, and on innovations that are being driven directly by client demand. Product groups are also working to better educate clients and Advisors about the detailed risks and rewards of the products and the details of the disclosure statements.

In the longer term, though, Firms and Advisors understand that integrating clients' emotional biases into the advisory process means consistently capturing information that can drive a deeper, goal-oriented conversation with clients, and result in more effective investing strategies and long-term trust and confidence. Nevertheless, Firms that incorporate 'behavioral finance' more deeply into processes and organizational models will need to do so in a standardized, scalable and efficient way or the approach won't be sustainable or profitable.

For now, though, wealth management firms are making in-roads into incorporating behavioral finance into their products and processes.

## PRODUCTS

- One large global institution has offered behavioral-based fund products into its offering for several years. Investment managers model and analyze stocks based on behavioral biases that could potentially create opportunities for investment, and the Firm's client portfolio managers—who are well versed in the mechanics of behavioral finance strategies—communicate this information to its wealthier clients<sup>81</sup>. The Firm is now evolving the use of behavior-based investing to infuse emotional triggers more deeply into its own broader advisory process<sup>82</sup>.

- While target-date funds have been around for some time, and are frequently offered as retirement-product options for mass-affluent clients, these funds are getting a new look from wealth management product groups. The funds are being repurposed for the HNWI segment with the use of enhanced risk models to more specifically account for the client's time- and goal-driven demands and principal-protection needs. Fund managers reallocate the holdings to reduce risk exposure as the target-date nears, while still growing the portfolio. More innovation around these products is likely as goal-oriented investing gathers momentum.
- One small firm that had relied heavily on modeling for the client even before the crisis nevertheless saw its clients' portfolios plummet during the crisis. Those risk models have been reevaluated to integrate behavior biases, and the Firm has "re-modeled" its product offering approach accordingly to integrate recent historical returns. The Firm has also assured its investors it will adjust these models with more frequency, seeking to protect against downturns in the future.

## PROCESSES – Client Segmentation

- One large global wealth management firm has adopted a client segmentation process that looks at clients based on behavior, life outlook and goals, and not just assets, source of wealth or age. This involves an extensive client questionnaire that incorporates not just the client's risk appetite, but other non-financial preferences and emotive values. The advisory and service approach is then customized, shaping how Advisors speak to clients, and defining strategies that best address clients' motivations. The process ultimately determines how wealthy clients will be provided with service<sup>83</sup>.
- Another U.S.-based wealth management firm is adjusting its client segmentation approach to identify and better understand the investing behaviors of the existing client base (frequency of trades, deposits, etc.) so as to tailor offerings that correspond to clients' behavioral preferences and needs.

<sup>81</sup> Capgemini Executive Interviews, March 2010

<sup>82</sup> Ibid

<sup>83</sup> Ibid

## WHILE BEHAVIORAL FINANCE IS RELEVANT FOR ALL FIRMS, THE DEGREE TO WHICH FIRMS SEEK TO TRANSFORM WILL VARY

When it comes to integrating behavioral finance into the wealth management offering, the universe of Firms currently breaks down into three main segments (see Figure 16):

- “Staying With Tried and True”
- “Breakthrough Visionaries”
- “Tactical Movers”

### “Staying With Tried and True”

Some wealth management firms are already focused on delivering tailored advisory offerings to specific client segments, usually Ultra-HNWIs, and on customizing their messaging and advice to specific client needs. For these firms, their approach will continue to:

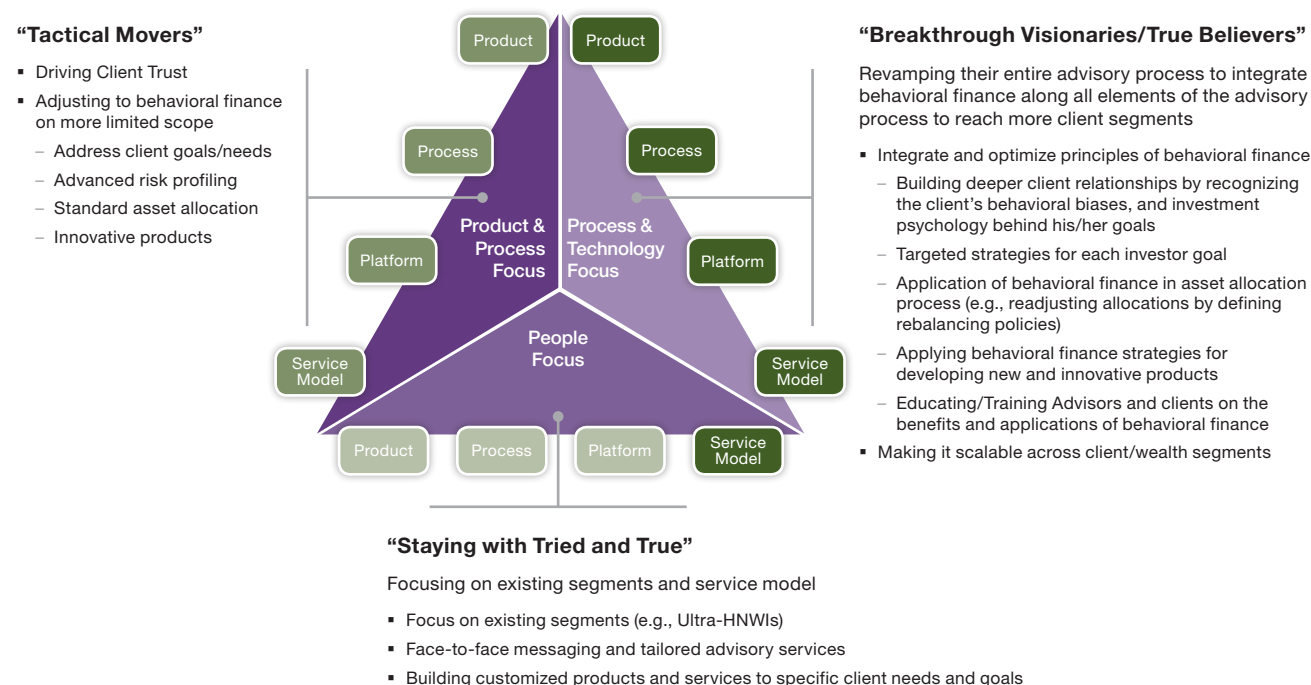
- Focus on existing segments, primarily Ultra-HNWIs.
- Provide face-to-face messaging and tailored advisory services.
- Build customized products and services specific to client needs and goals.

These Firms don’t plan to mainstream behavioral finance, and will keep their investment advisory process focused on a narrower segment of clients, continuing to address their clients’ needs on a dynamic basis. They will primarily address emotive client factors and increased demand for risk analysis by utilizing more specialists in their existing processes and service model approach to meet the increased client demands.

### “True Believers” / “Breakthrough Visionaries”

These Firms believe the tenets of behavioral finance will have an enduring impact on the investment process moving forward. They are looking for ways to best analyze emotional triggers and build them into the individual components of the advisory process, so as to capitalize on, and annuitize, a model that works effectively. They are optimizing across the firm’s levers to make the behavioral-finance integration scalable across multiple wealth bands and client segments, including front-office processes, as well as back-office and desktop tools.

FIGURE 16. Transformation End-States



Source: Capgemini Research 2010



These key transformational changes include:

- **Organizational**
  - Integrate and optimize the principles of behavioral finance throughout the advisory process.
  - Educate/Train Advisors and clients on the benefits and applications of behavioral finance.
- **Client Analysis & Segmentation**
  - Build deeper client relationships by recognizing the client's behavioral biases and the investment psychology behind his or her financial goals.
  - Segment clients based on behavioral characteristics as well as life goals to drive deeper understanding and serve clients better.
  - Provide service by client behavioral groupings.
- **Portfolio Analysis: Risk-Based Asset Allocation**
  - Target strategies and various but integrated risk parameters for each investor goal.
  - Deepen the application of behavioral finance in asset-allocation processes and the selection of products as a solution for addressing overall risk and volatility.
- **Products: Provide innovations that address client concerns about principal protection and risk-adjusted returns and are targeted to client goals, and not just optimized for the product itself. For existing products, greater emphasis is placed on demonstrating clearly why products are suitable for a given client, and showing how these products behave amid market volatility.**
- **Reporting:**
  - Provide transparency not just up-front in the process, but through clear reporting that makes risk and exposure more apparent to clients.

These Firms are examining how best to change underlying **processes** and embed a more complex risk-analysis assessment into Advisor **platforms** and desktops and reconfigure their advisory **service model**. **Product** and investment groups are supporting the change, and moving from supporting single-model asset allocation to a multi-model approach that better meets the needs of individual clients in a scalable fashion—all while addressing a client's overall investment objectives, desire for principal protection, and overall risk tolerance. This requires underlying systems to be adapted accordingly.

### ***“Tactical Movers”***

While these Firms might recognize that integrating a behavioral finance framework into the wealth management process is valuable, their response is largely dictated by factors such as size and firm focus. As a result, some changes may be limited to individual components of the advisory process, whether it be process, product, platform or service model. However, even on a limited basis, these firms are not just asking themselves what processes need to be changed in the front office, they are exploring what systems and platforms need to be modified and updated to account for the deeper analysis needed to meet client demands.

**Process and Technology:** For example, one boutique wealth management firm, which does not develop its own products, is focusing more on enhancing its current risk and asset-allocation models, with technology investments for broader accessibility to Advisors and product groups. These Firms expect the overall client experience to benefit, with more consistency in approach and less variability among Advisors.

**Product and Process:** One large U.S. firm is investing further in product offerings that integrate behavioral finance tenets into its analyses, and is also adjusting its asset-allocation models to synthesize multi-model approaches. Additionally, the firm is extending its client segmentation model to better identify clients based on their emotional biases, and approach them with the appropriate service model.

**Service Model:** One large European bank has decided to modify its service model by introducing a new “solutions architect” role to interact with clients—a person who will help the primary relationship manager deliver a highly customized investment-management and risk-mitigation strategy, which incorporates the individual client's risk parameters and the product solutions set. This solutions architect works closely alongside the Advisor and team to provide a balanced and effective client portfolio solutions set.

Ultimately, then, wealth management firms are integrating behavioral finance frameworks into their overall advisory process, understanding the need to demonstrate deeper analysis and more customization per client. The way in which Firms execute and enable transformation may vary, depending on firm strategy and positioning, but every firm knows investor demands and behaviors have changed.

## A PATH FORWARD FOR THE INDUSTRY

HNW investors will remain more cautious, conservative and engaged going forward, but with so many clients remaining conservatively allocated to cash and more liquid investments, a lot of investable assets are still in play. The situation therefore represents both a challenge and an opportunity for Firms and Advisors.

During the crisis, there was a ‘flight to safety’ windfall for many of the well-capitalized national and regional banks as clients temporarily moved assets into cash at those institutions. That shift is starting to unwind and HNW clients are broadly and actively testing the value delivered by existing providers. We expect them to keep exploring their provider options over the next couple of years.

Clients are demanding fundamental changes in how they are served, and are rewarding Firms that can clearly demonstrate a sharper understanding of their needs and objectives, and deliver risk-adjusted portfolios, increased transparency and simplicity, and specialized advice.

We believe behavioral-driven investing represents a major global socio-economic trend that will create significant opportunities for industry growth and transformation. We believe behavioral finance can serve as a potential differentiator for Firms and Advisors to truly understand the emotional aspects of client behavior as a lever in rebuilding trust and confidence.

While the level of industry adoption will probably vary, there are significant opportunities for leaders to reposition their Firms and drive further innovation, including the way in which:

- advice is delivered
- existing products are positioned
- new products are developed and delivered
- the service delivery model is tailored to reach more focused customer segments and behavior styles
- the desktop tools for advisors, investment specialists, and clients takes client behavior into account.

Adapting to the new market realities and client behaviors will require different degrees of transformation and change. For some, it will be incremental—especially for Firms that have excelled in delivering tailored advisory solutions for Ultra-HNW clients. For others, with a heritage of being more product-centric or investment returns-oriented, adapting the service delivery model may represent a more significant change. This may force some providers to question how they remain relevant in serving clients moving forward. We expect some Firms to choose to excel on integrated service delivery, while others will retrench and focus more on product innovation and rely on other partners for distribution.

The investor’s psyche has been changed radically by the crisis, and now reflects deep-seated emotional biases. That shift applies to clients across all wealth bands—from mass affluent to Ultra-HNWI—so for Firms and Advisors, it will be critical to deliver the right level of high-touch advice and market-relevant product and service innovation to meet the needs of all clients in a scalable way.

# 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 include 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 account for undeclared savings in the report.

Given exchange rate fluctuations over recent 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 the impact of a sharp currency appreciation for a year or two has a negligible impact.

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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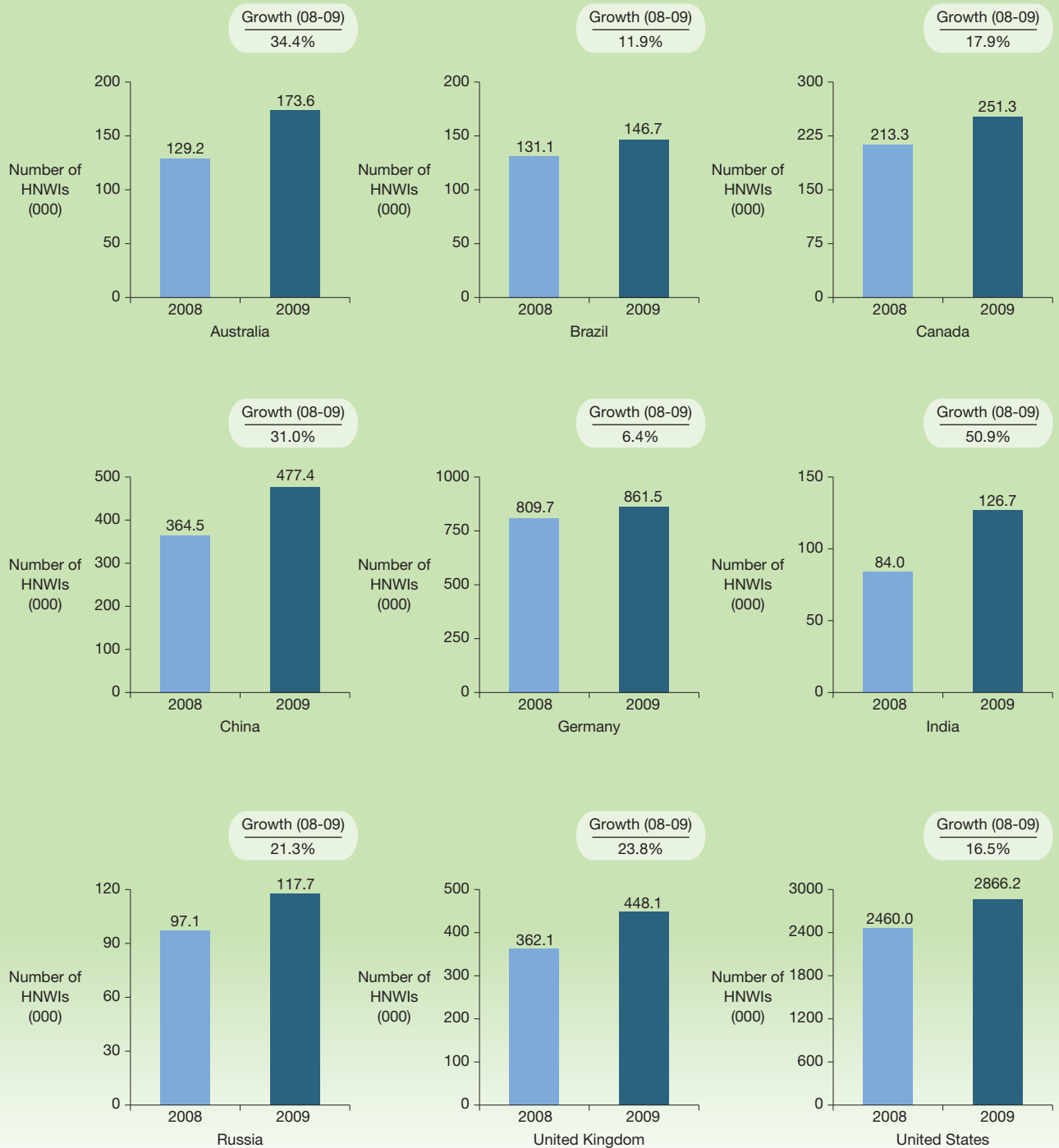
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# Select Country Breakdown



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