Introduction, Market Size, & Economic Review

Capgemini
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Merrill Lynch
Wealth Management

World Wealth Report

2009

World Wealth Report

TO OUR READERS,

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

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

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

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

Dan Sontag
President
Global Wealth Management
Merrill Lynch & Co., Inc.

Bertrand Lavayssière
Managing Director
Global Financial Services
Capgemini

STATE OF THE WORLD'S WEALTH

HNWI POPULATION AND WEALTH CONTRACT SIGNIFICANTLY

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

HNWI POPULATION AND WEALTH SHRINK BELOW 2005 LEVELS

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

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

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

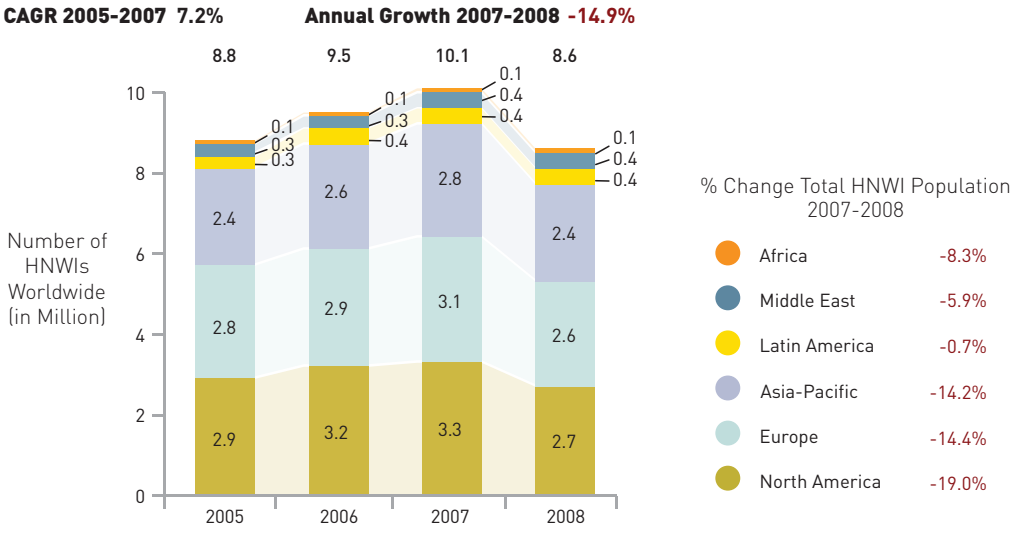
- The number of HNWIs in the U.S. fell 18.5% in 2008, but the U.S. remains the single largest home to HNWIs, with its 2.5 million HNWIs accounting for 28.7% of the global HNWI population.
- In Europe, the HNWI population decline varied widely by country. For example, the number of HNWIs shrank 26.3%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

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

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

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

(In Million)

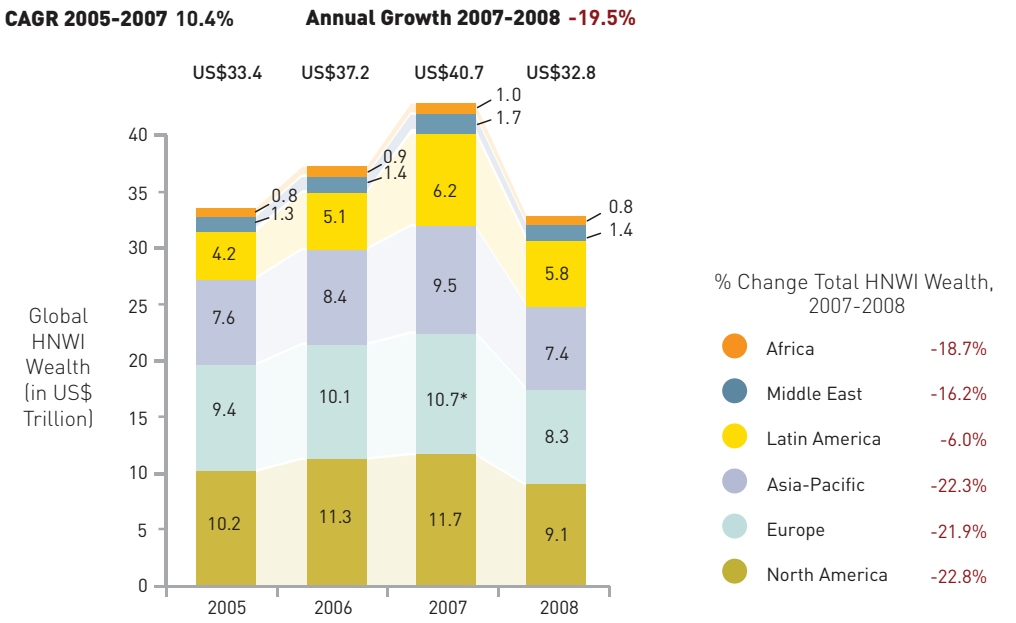


Note: High Net Worth Individuals (HNWIs) have at least US$1 million in investable assets, excluding primary residence, collectibles, consumables, and consumer durables.

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

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

(US$ Trillion)



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

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

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

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

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

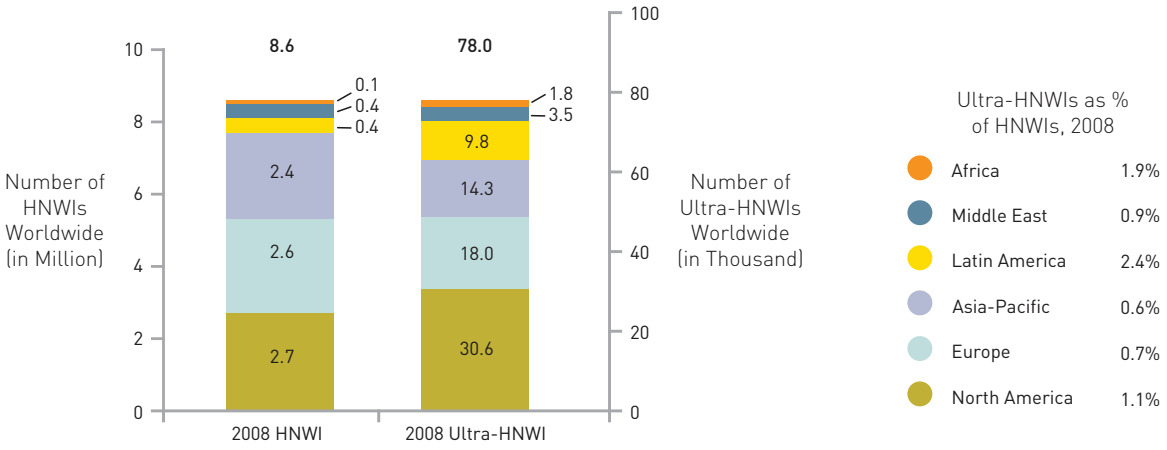
The U.S., Japan and Germany together accounted for 54.0% of the world's HNWI population in 2008, up very slightly from 53.3% in 2007 (see Figure 4), despite the substantial loss of wealth by HNWIs in those countries, particularly the United States. For example:

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

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

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

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



Source: Capgemini Lorenz curve analysis, 2009

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

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

HNWI WEALTH IS FORECAST TO RESUME GROWTH AS GLOBAL ECONOMY RECOVERS

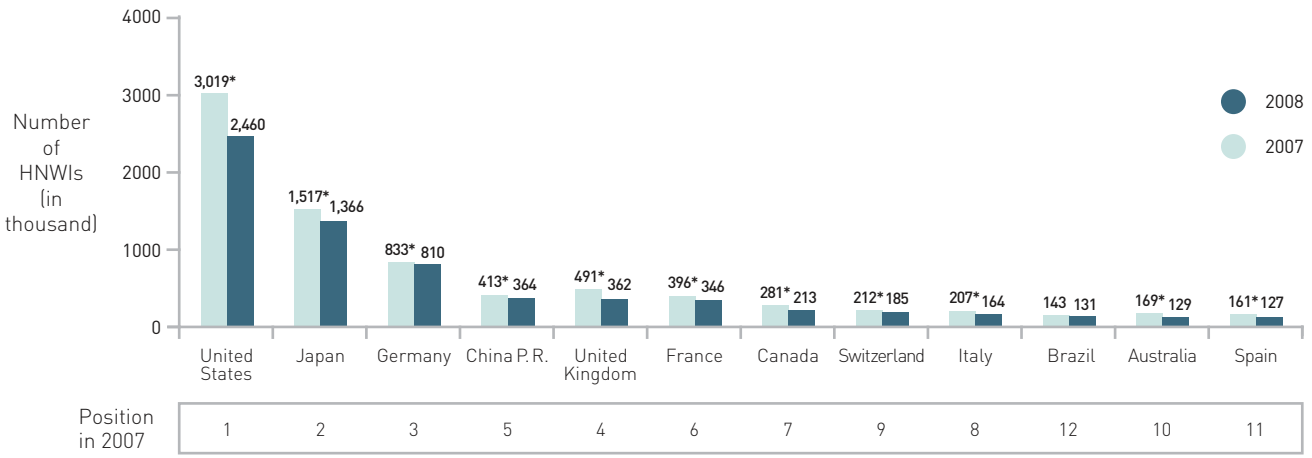
We forecast HNWI financial wealth will grow to $48.5 trillion by 2013, advancing at an annualized rate of 8.1% (see Figure 5). This growth will be driven by the recovery in asset prices as the global economy and financial system right themselves. Also, the 2008 flight-to-safety imperative is expected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

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

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

Figure 4. HNWI Population by Country, 2008

(in Thousand)



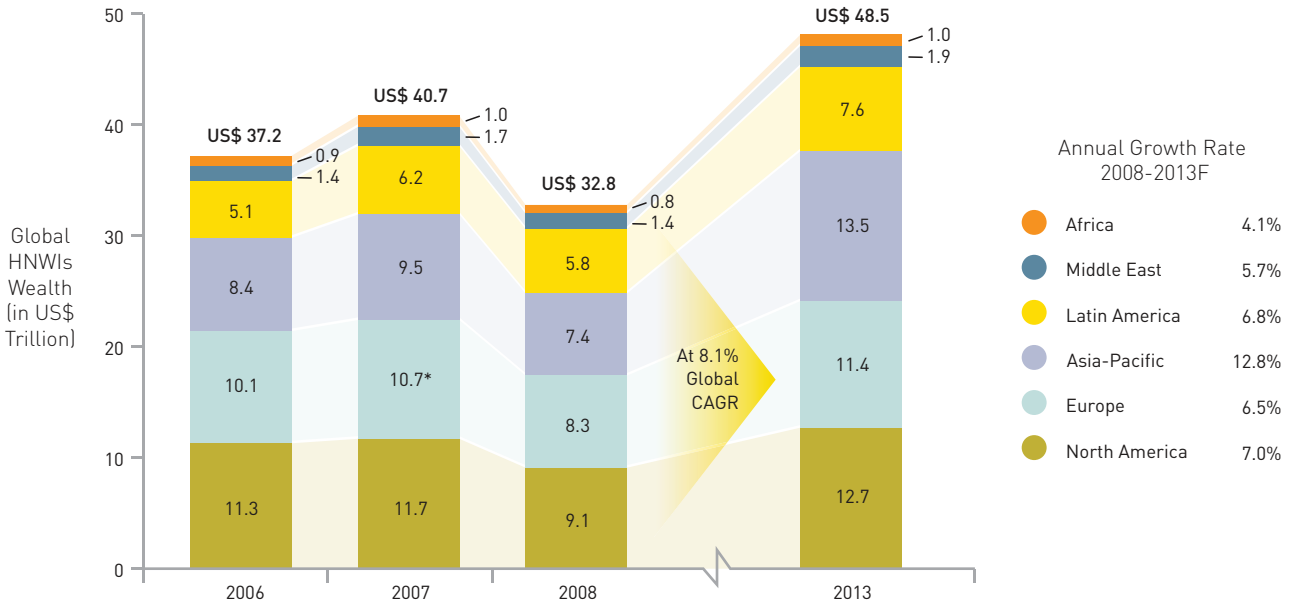
*2007 data has been revised
Source: Capgemini Lorenz curve analysis, 2009

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

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

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

(US$ Trillion)



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

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

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

THE ECONOMIC FALLOUT WAS TEN YEARS IN THE MAKING

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

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

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

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

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

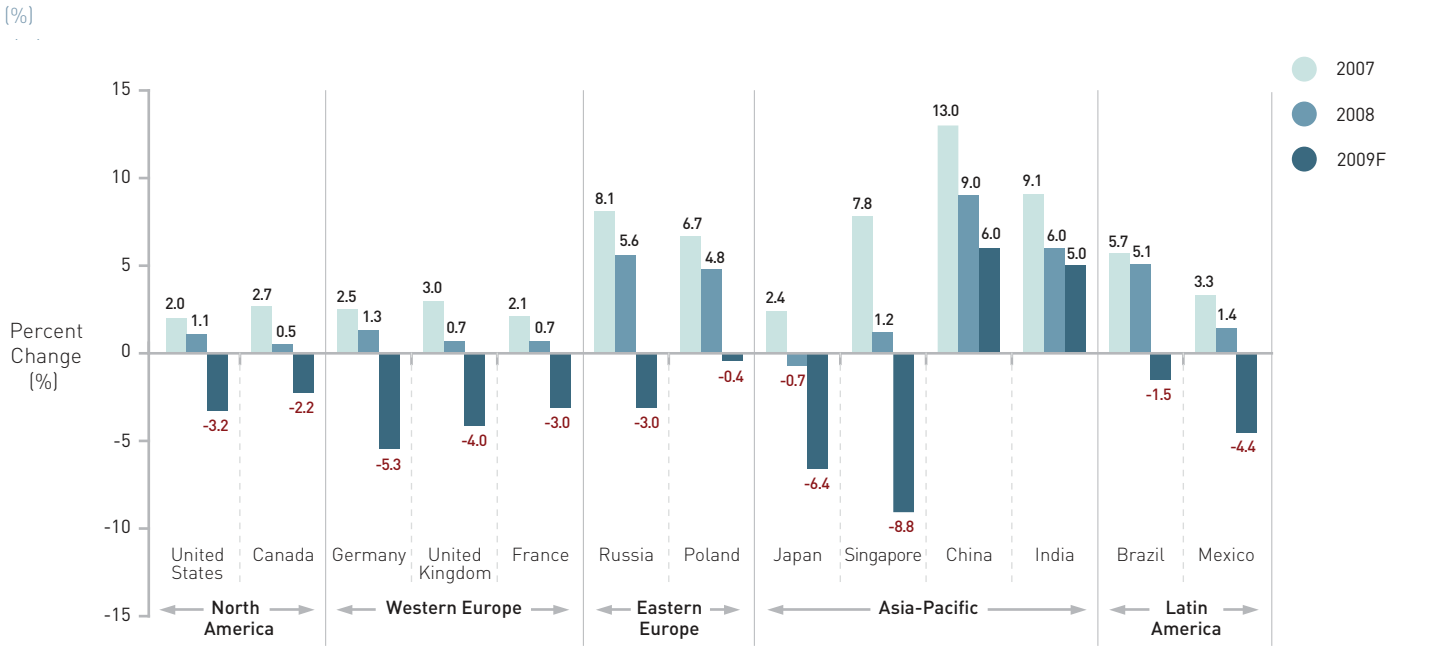
The financial crisis that started in 2007 and continued into 2008 rapidly escalated and expanded into the general economy in mature markets, and culminated in a steep, global economic downturn, particularly in the last quarter of 2008. Export-driven countries were hit hardest, particularly in Asia, as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

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

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

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

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



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

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

NATIONAL SAVINGS DECREASED IN 2008, AND SO DID PERSONAL SPENDING

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

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

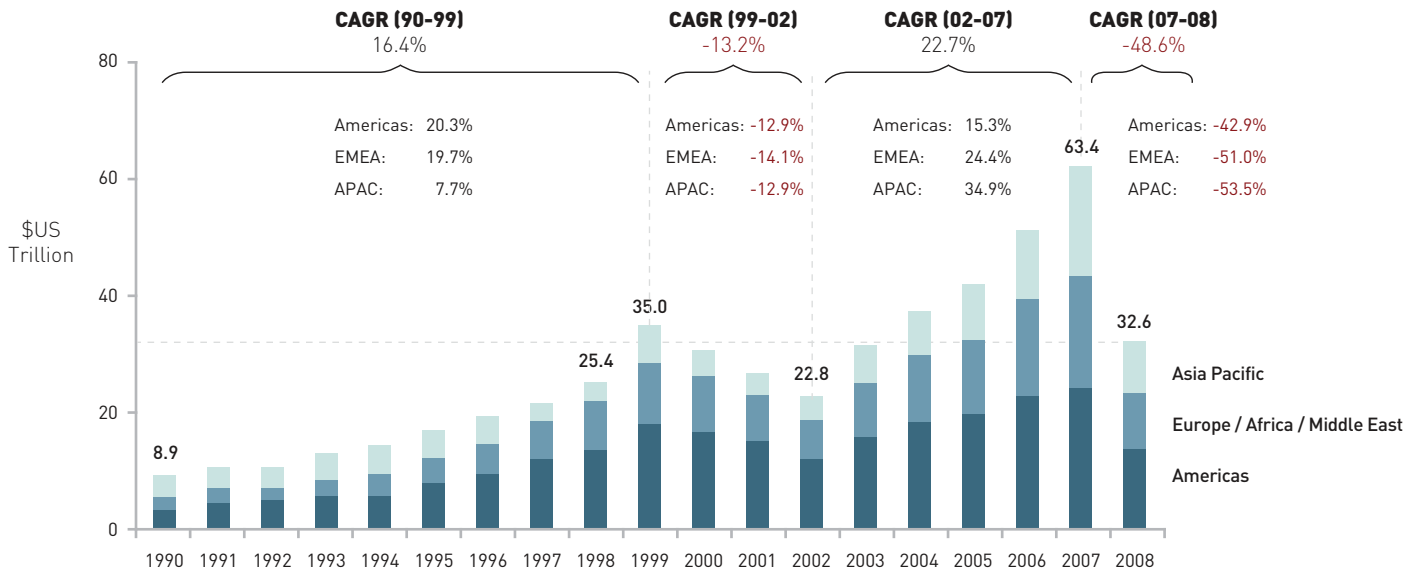
However, 2008 saw a global slowdown in consumer spending, as eroded consumer confidence and scarce credit prompted widespread thrift. The most salient example of this trend was in the U.S., where consumer spending grew just 0.2% in 2008, after a gain of 2.8% in 2007—while the fourth-quarter personal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

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

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

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

Figure 7. Market Capitalization by Region, 1990 - 2008



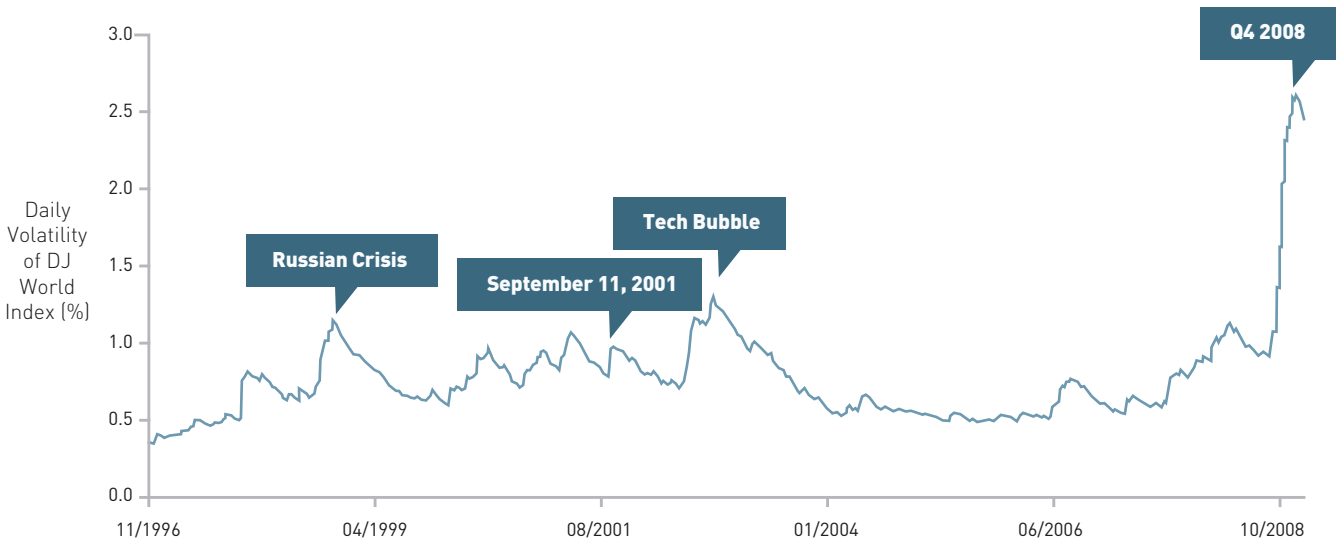
Source: World Federation of Exchanges, April 2009

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

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

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

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



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

[15] World Federation of Exchanges, 2007-2008 market capitalization statistics.(http://www.world-exchanges.org/statistics)
[16] MSCI Barra. Equity Indexes for select regions. (http://www.mscibarra.com/products/indices/index.jsp). Capgemini Analysis.
[17] Liz Rappaport and Serena Ng, "Bonds on Leading Edge of Crisis; 'Not a Single Place to Hide'", *Wall Street Journal*, Jan. 2, 2009
[18] Dow Jones. Historical Dow Jones – AIG commodities benchmark. (www.djindexes.com)

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

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

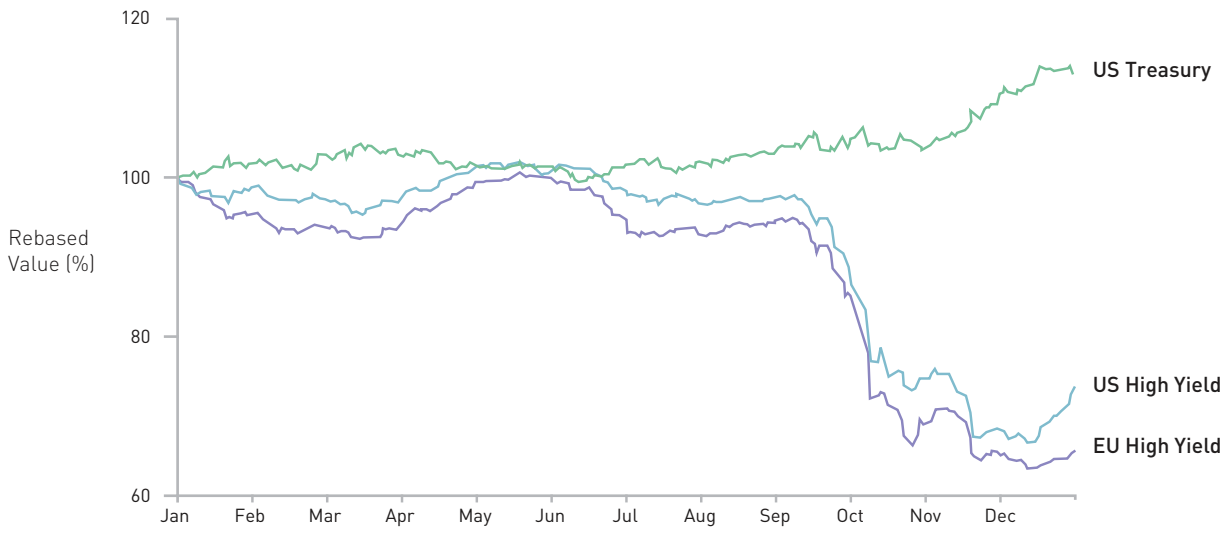
  REIT prices also ended the year sharply lower. After peaking at 1,574.9 at the end of February 2007, the Dow Jones Global REIT benchmark index declined steadily, to around 1,000 (base value) in July 2008, where it held until mid-September 2008. Thereafter, however, a heavy sell-off pushed the index down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

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

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

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

(1/2/2008=100)



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

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

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

WATCHING THE ECONOMIC HORIZON

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

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

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

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For more information, please contact: wealth@capgemini.com

For Capgemini press inquiries, please contact:
Lisa Desmond at +1-786-251-8413 (North America) or
Karen Cohen at +1-516-607-9652 (Global)

For Merrill Lynch press inquiries, please contact:
Selena Morris at +1-212-449-7283

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

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