Introduction,
& Asset Allocation

Capgemini
CONSULTING TECHNOLOGY OUTSOURCING

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.

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

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

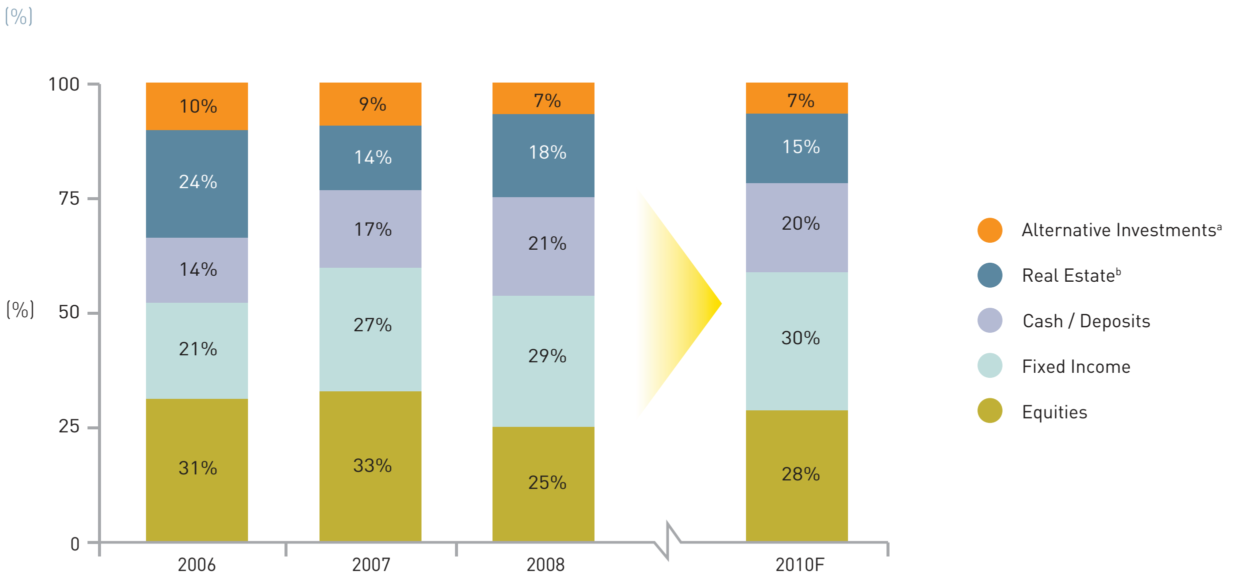
HNWIs REDUCED EXPOSURE TO EQUITIES IN 2008 AMID SHIFT TO SAFETY, SIMPLICITY

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

HNWIs REDUCED THEIR HOLDINGS OF ALTERNATIVE INVESTMENTS

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

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

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

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

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

HNWIs SOUGHT REFUGE IN INVESTMENTS CLOSE TO HOME

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

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

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

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

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

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

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

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

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

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

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

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

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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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