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Merrill Lynch

World Wealth Report

2008

To Our Readers,

In our 12th year evaluating what are considered to be the key indicators impacting the global high net worth marketplace, we are pleased to present the 2008 *World Wealth Report*. Together, Capgemini and Merrill Lynch utilize more than 20 years of collaborative experience to analyze the macroeconomic factors that drive and inhibit wealth generation and to better understand how they influence high net worth individuals (HNWIs) around the world.

By most standards, 2007 was a very eventful year—for the wealth management industry, and the entire global economy. The first half of 2007 consisted of steady worldwide growth, while the second half was marked by a sharp divergence between mature and emerging economies. The U.S. economic slowdown weighed heavily on key mature regions. However, strong performances in emerging markets boosted HNWI gains around the globe. Although real GDP and market capitalization, the two key drivers of wealth creation, were weaker than in 2006, world growth was strong in 2007 and drove solid increases in both HNWI populations and overall wealth.

Our 2007 findings reveal that HNWIs assumed a more defensive approach to asset allocation in response to marked changes in economic environments. Steering away from some alternative investments, HNWIs favored safer options on more familiar grounds. As investor confidence rebounds, our expectation is that HNWIs will gravitate once again to less-conservative investments—particularly to the high returns and growth opportunities offered in emerging markets.

This year's Spotlight section focuses on the growing need for wealth management firms to create more customized infrastructure and service models to better target global HNWI growth markets. To meet the needs of increasingly diverse HNWI populations, leading firms are assessing their capabilities and tailoring key delivery models to ensure that service is aligned with the unique needs of clients in any given market.

We are pleased to present you with this year's Report and hope that you will find continued value in our latest insights.

Robert J. McCann
Vice Chairman and President
Global Wealth Management
Merrill Lynch & Co., Inc.

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Managing Director
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State of the World's Wealth

HNWI SECTOR GAINS IN 2007

- **10.1 million individuals worldwide held at least US$1 million in financial assets, an increase of 6.0% over 2006**
- **Global HNWI wealth totaled US$40.7 trillion, a 9.4% gain from 2006, with average HNWI wealth surpassing US$4 million for the first time**
- **The Ultra-HNWI "wealth band" experienced the strongest growth, gaining 8.8% in population size and 14.5% in accumulated wealth**
- **Emerging markets, especially those in the Middle East and Latin America, scored the greatest regional HNWI population gains**
- **India, China and Brazil had the highest HNWI population growth at the country level**
- **HNWI financial wealth is projected to reach US$59.1 trillion by 2012, advancing at an annual growth rate of 7.7%**

2007: A Story of Two Halves

For the global economy, 2007 was a transitional year that began and ended with sharply opposing macroeconomic environments: Momentum that was carried over from 2006 sustained unabated growth in the early months. By the latter end, heightened uncertainty and instability marked the deep change that was underway.

Overall, market performances were solid in 2007. However, closer analysis of the key drivers and inhibitors of wealth reveals how the many fundamental changes that took place over the course of the year led to deteriorating economic conditions in key markets, including the United States and several mature European nations. Evenly split, the two halves of the year tell very different stories: steady global growth in the first six months, followed by sharply diverging paths between mature and emerging economies in the second half.

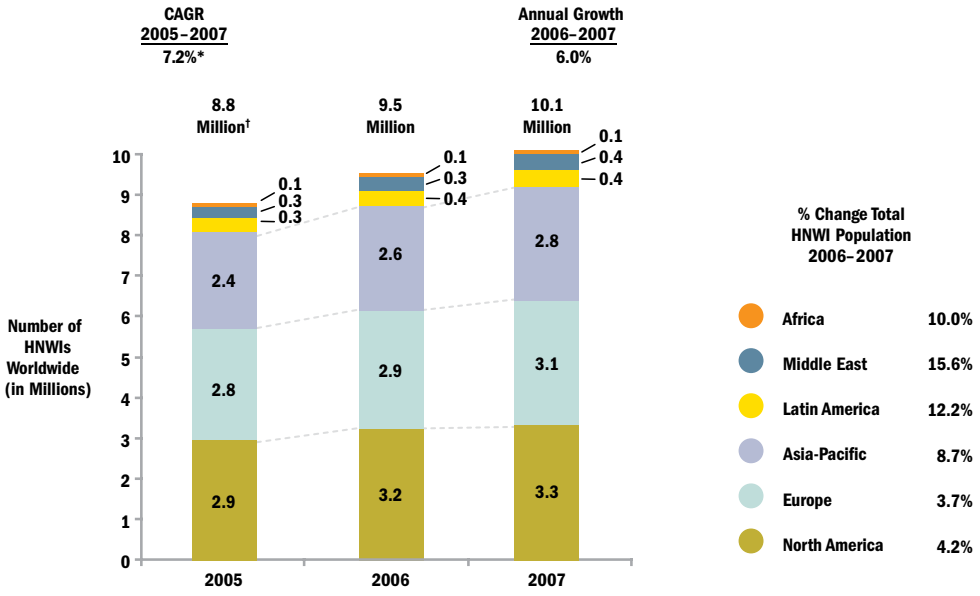
In early 2007, strong economic gains spurred impressive performances in equity markets and various investment products, reflecting high levels of investor confidence. Robust growth in emerging markets, driven by high commodity prices and rising domestic demands, supported solid growth in mature economies. Stock markets worldwide performed well into the summer, led by Latin America and Emerging Asia, which saw roughly 25% and 17% growth, respectively, through July.[1] A variety of investment products performed well during the first half of the year; for instance, total announced private equity deals worldwide were on pace to shatter their 2006 record.[2]

The second half of 2007, however, revealed a distinct and growing divergence between mature and emerging economies—with the advantage going to emerging nations. Whether hobbled by the downturn taking hold in the United States or challenged by the slowed growth of a major trading partner, with few exceptions, the performances of mature economies weakened significantly in the closing months of the year. In the European Union, for example, growth was dampened by a confluence of key market forces: slowing domestic consumer spending, a result of high levels of personal debt amid tightening credit conditions; a drop-off in exports brought on by easing demand in the United States, which received nearly 24% of E.U. goods and services shipped abroad; and an appreciating euro.[3] Growth slowed among other global powers as well: In Japan—the world's second-largest economy—a decline in housing investment and low levels of consumer confidence took their toll.[4] In essence, a long period of "easy money" in mature economies was routed by financial and credit market turmoil.

By contrast, emerging markets proved resilient and posted robust gains in the second half of 2007, even as uncertainty grew in mature markets. Building on their core competency, export-driven growth, many emerging economies converted sharp increases in energy and commodity prices into sources of high profitability and significant growth. Both GDP and market capitalization gains, particularly in Brazil, Russia, India and China—the BRIC nations—were strong, capping another impressive year for HNWI growth and investment opportunity. Given these nations' more stable consumption habits, rising domestic demand and healthy business environments, the slowing United States economy, which accounts for 21% of global GDP,[5] did not appear to significantly compromise their economic growth in 2007.

[1] Latin America and Asia MSCI Emerging Market Indexes, accessed March 6, 2008
[2] "For Deal-makers, Tale of Two Halves," Year-end Review of Markets & Finance, *The Wall Street Journal*, January 2, 2008
[3] The Economist Intelligence Unit, "European Union Regional Overview," January 2008
[4] The Economist Intelligence Unit, "Japan Country Report," January 2008
[5] Alex Patelis, "Global Macro Outlook for 2008," Merrill Lynch, March 5, 2008

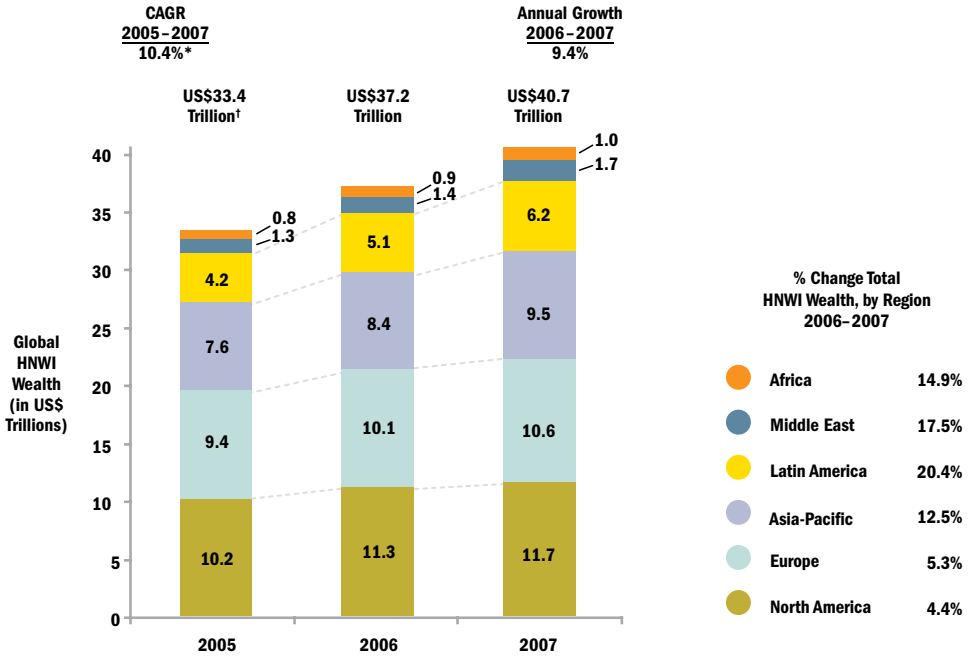
Figure 1. | **HNWI Population, 2005 – 2007 (by Region)**
(In Millions)



Note: High Net Worth Individuals (HNWIs) hold at least US$1 million in financial assets, excluding collectibles, consumables, consumer durables and primary residences

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

Figure 2. | **HNWI Wealth Distribution, 2005 – 2007 (by Region)**
(US$ Trillions)



† Bahrain and Qatar were added to model for years 2005 onward
* These CAGRs have been adjusted to account for the inclusion of Bahrain and Qatar in the model for years 2005 onward

Note: All chart numbers are rounded
Source: Capgemini Lorenz curve analysis, 2008

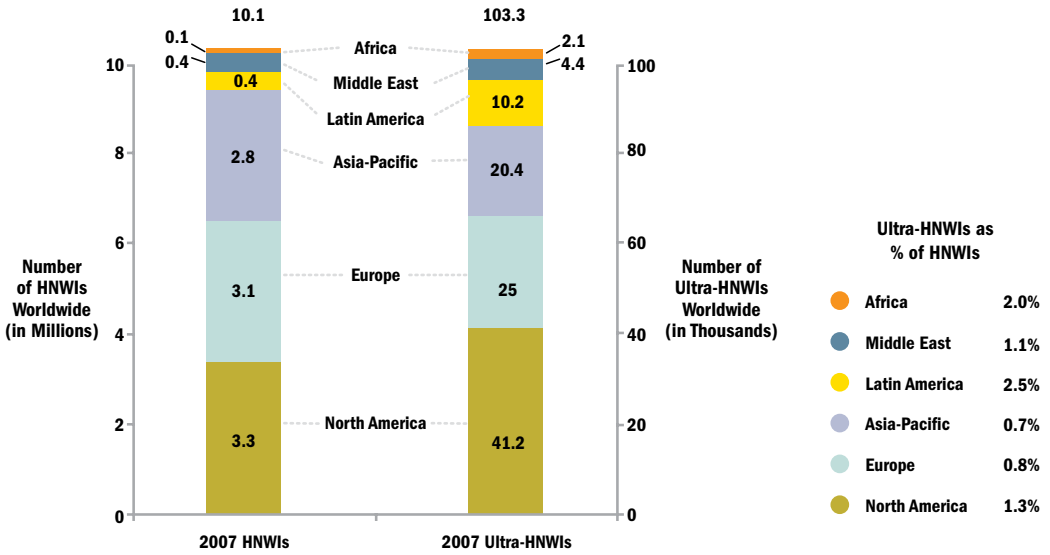
Despite these diverging trends, global growth remained solid for the year, in terms of both real GDP and market capitalization—two primary drivers of wealth generation. Strong worldwide gains in the first half of 2007 boosted HNWI growth across the globe; while in the second half, resilient emerging economies offset slowdowns in key mature economies.

Strong, yet Milder, Growth in 2007

Following the unprecedented level of world GDP growth in 2006, global performances in 2007, on average, decelerated slightly and returned to levels in line with those of 2005. The global HNWI population grew by 6.0%—to more than 10 million individuals for the first time—compared with 8.3% growth in 2006. HNWI population gains were highest in the Middle East, Eastern Europe[6] and Latin America, expanding by 15.6%, 14.3% and 12.2%, respectively. These growth rates far exceeded those of more mature economies, in large part stemming from impressive gains in commodity exports and growing international acceptance of emerging financial centers as global players.

In 2007, global wealth continued to consolidate among the world's HNWIs. Last year, total HNWI wealth grew by 9.4%, to US$40.7 trillion—a slight deceleration from the 11.4% growth witnessed in 2006—while the number of HNWIs themselves advanced by only 6.0%. The largest regional gains in wealth were in Latin America and the Middle East, up by 20.4% and 17.5%, respectively. For their part, Ultra-HNWIs posted the highest gains of any "wealth band," both in population, up 8.8%, and total assets, up 14.5%.

Figure 3. | **Geographic Distribution of HNWIs and Ultra-HNWIs, 2007 (by Region)**



Source: Capgemini Lorenz curve analysis, 2008

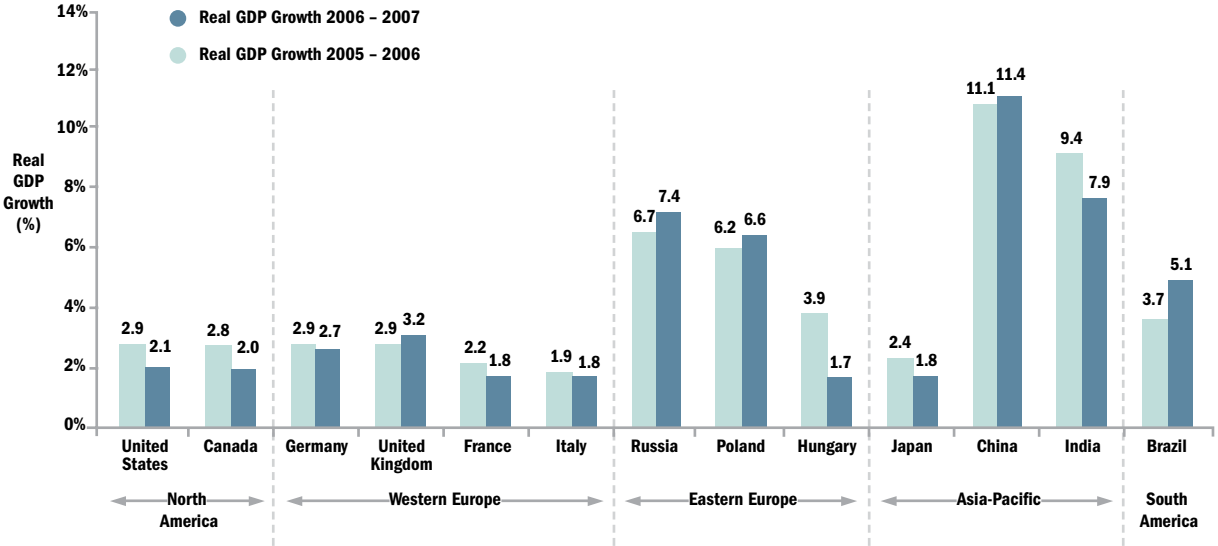
Emerging Markets Lead the Way

While many factors drive or inhibit HNWIs' financial prospects from year to year, the most significant levers are real GDP growth, domestic savings rates and market capitalization performances. In 2007, the global economy grew by 5.1%,[7] down slightly from the 5.3% global growth recorded in 2006. The highest-growth regions in 2007 included Eastern Europe, Latin America and Asia-Pacific—where gains in emerging nations were in marked contrast to the slowdowns taking place in more mature economies.

In the United States, real GDP growth in 2007 eased to 2.1%,[8] down from 2.9% in 2006. Although growth rates reached 3.8% and 4.9%, respectively, in the second and third quarters,[9] a slowdown in the fourth quarter weighed heavily on the yearly average—the compounded result of a cooling housing market, the destabilizing influence of losses from real estate-related securities and the tightening of credit conditions.

[6] Eastern Europe includes Czech Republic, Hungary, Poland, Romania, Russia, Slovak Republic, Slovenia, Turkey and Ukraine
[7] The Economist Intelligence Unit, Country Reports, January 2008
[8] The Economist Intelligence Unit, "United States Country Report," January 2008
[9] Bureau of Economic Analysis, National Economic Accounts, accessed February 21, 2008

Figure 4. | **Real GDP Growth in Select Economies, 2005 – 2007**



Note: 2005 – 2006 Real GDP Growth rates may vary from figures in the 2007 *World Wealth Report*, according to Economist Intelligence Unit updates
Source: The Economist Intelligence Unit, January 2008

In 2007, average real GDP growth rates for the member nations of the Organisation of Economic Cooperation & Development (OECD) and the European Union (EU-27) decelerated, although growth trends varied by country. Mature economies, such as those of Germany, France, Italy, Canada and Japan, experienced slower growth in 2007. The United Kingdom was a notable exception, with real GDP growth of 3.2%,[10] up from 2.9% in 2006. Despite widespread slowdowns in the fourth quarter, mature markets did lend support to the 5.1% global growth rate in 2007, given that average GDP growth in emerging markets was just under 6.0%.[11]

Most emerging economies continued to display impressive real GDP growth in 2007—boosted largely by thriving export sectors and heightened domestic demand. Despite weaker figures than in 2006, Argentina and Venezuela led Latin America with real GDP growth rates of 8.4% and 7.8%,[12] respectively, thanks to booming oil and commodity exports. Sharp increases in oil prices, highlighted by the 57.2% gain on crude oil futures,[13] greatly boosted growth in oil-exporting nations, especially those concentrated in the Middle East. In Asia-Pacific, growth in the Philippines accelerated to 6.9%,[14] as greater total consumption[15] aided a recovery of fixed capital investment. In Eastern Europe, Poland and the Czech Republic were among the top performers, with GDP gaining through strong private consumption.

BRIC Nations Are at the Forefront of Global Growth

In 2007, the BRIC nations continued their roles as pivotal economies, building on relationships with their mature trading partners and capitalizing on the growth of their emerging counterparts. As mature economies slowed, the BRIC nations turned in particularly strong performances. They posted in aggregate the greatest gains in HNWI populations, 19.4%, and accumulated wealth, 25.1%, driven both by impressive economic gains and robust market capitalization growth. As a result of these record-setting performances, the BRIC nations are rapidly winning fiscal credibility and increasingly playing a central role on the world stage.

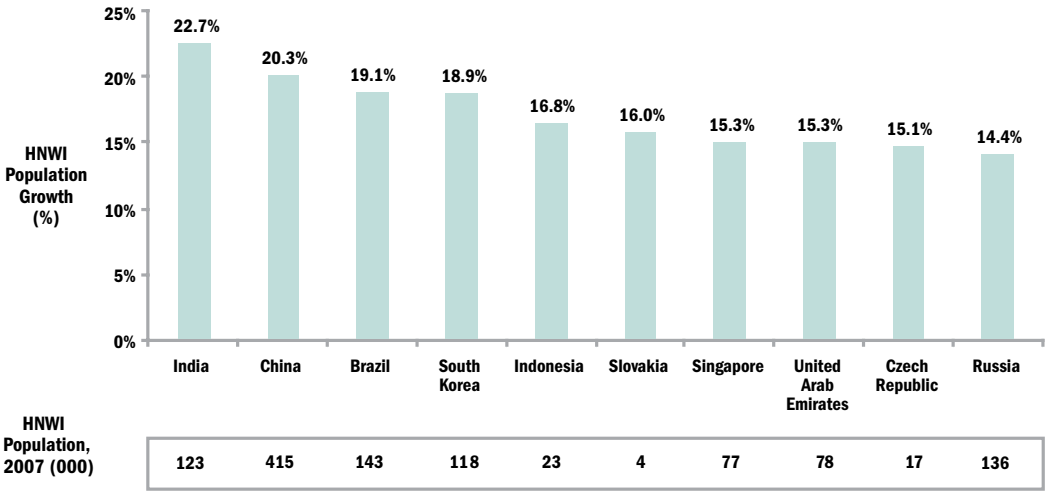
[10] The Economist Intelligence Unit, "United Kingdom Country Report," January 2008
[11] Capgemini analysis, "Emerging Markets" refers to those countries included in the MSCI Emerging Market Index
[12] The Economist Intelligence Unit, "Argentina and Venezuela Country Reports," January 2008
[13] "Year-end Review of Markets & Finance," *The Wall Street Journal*, January 2, 2008
[14] The Economist Intelligence Unit, "Philippines Country Report," January 2008
[15] Total Consumption = Private Consumption + Public (Government) Consumption

Today, the greatest single impediment to the BRIC nations' continued growth is the high level of inflation now sweeping the globe and most pronounced in emerging markets. In Russia, year-over-year money-supply growth in excess of 50% has kept inflation rates propped at around 12%.[16] Similar levels of excess liquidity are evident in China and across the Middle East. With BRIC nations' inflation rates averaging roughly 7.5% at year-end,[17] it is increasingly clear that this is the challenge most likely to shape 2008 outlooks.

In 2007, India led the world in HNWI population growth, rocketing ahead 22.7% and exceeding gains of 20.5% in 2006. Boosted by market capitalization growth of 118%[18] and real GDP growth of 7.9%, HNWI sector gains reached all-time highs. Although the country's real GDP growth decelerated from 9.4% in 2006, current growth levels are considered more stable and sustainable. Market capitalization growth more than doubled from roughly 50%, accounting for greater HNWI gains.[19] India's two largest exchanges, the Bombay Stock Exchange and the National Stock Exchange of India, benefited from rapidly expanding initial public offering (IPO) markets and heightened international interest; by the end of 2007, they ranked among the world's top-12 exchanges in total market capitalization terms.[20] Once recognized as a manufacturing superpower, characteristic of a more nascent market, much of India's recent growth has been driven by the technology, financial services, property, construction and infrastructure sectors. Growth in these arenas is indicative of the developing state of the Indian economy relative to other high-growth players.

China ranked second in HNWI population growth, advancing 20.3% in 2007, more than two-and-a-half times greater than its 2006 pace. Market capitalization and real GDP growth rates exploded last year, at 291%[21] and 11.4%, respectively. Fueled by impressive price increases and strong IPO activity, the Shanghai Exchange grew to be the sixth-largest exchange in the world in terms of total market capitalization.[22] Yet, despite rapid growth in its financial services sector, China's economy still is built on its manufacturing capacity. This helps explain why its HNWI population growth is slower than that of India—and why the gap continues to widen between China's richest citizens, a group with a particularly high concentration of wealth, and the middle-class, which continues to grow in size but remains largely unable to cross the HNWI threshold. Nonetheless, 2007 HNWI growth in China greatly exceeded its 2006 performance of 7.8% growth, reflecting strong economic fundamentals and great potential for future gains.

Figure 5. | **HNWI Population Growth, 2006 – 2007 (by Market)**



Note: Growth rates and absolute HNWI numbers are rounded
Source: Capgemini Lorenz curve analysis, 2008

[16] Bloomberg, accessed March 2008
[17] Capgemini analysis, data derived from Economist Unit Country reports, January 2008
[18] World Federation of Exchanges, "Focus Report," January 2008
[19] Capgemini/Merrill Lynch, 2007 *World Wealth Report*
[20] World Federation of Exchanges, "Focus Report," January 2008
[21] Ibid.
[22] Ibid.

The HNWI population in Brazil grew an impressive 19.1% last year, up significantly from 10.1% growth in 2006. Riding a wave of robust market capitalization growth of 93%[23] and real GDP growth of 5.1%, Brazil enjoyed the third-highest HNWI growth rate in 2007 among the countries analyzed. At the same time, net private capital flows to Latin America doubled in 2007, contributing to the Bovespa Stock Exchange's fourth-place ranking among the world's largest IPO markets and 7.2% market-share gain.[24] This lent support to the establishment and global integration of the Brazilian financial system. With well-developed agricultural, mining, manufacturing and service sectors, and as a major exporter of raw materials, energy products and other commodities, Brazil reaped the benefits of sharp increases in food and energy prices throughout last year. Further, Brazil is the world's largest exporter of ethanol,[25] giving it an important stake in the alternative energy market, which is gaining popularity as oil and conventional energy prices continue to rise around the world.

Russia was also home to one of the world's 10 fastest-growing HNWI populations, despite growth decelerating from 15.5% in 2006 to 14.4% in 2007. Solid gains in 2007 of 37.6%[26] in market capitalization and 7.4% in real GDP[27] were testaments to the growing international interest in the country as a global player. Indeed, despite serious problems, such as a critical lack of modern infrastructure, environmental degradation and a declining population, the ongoing development of external relationships is likely to improve the economy's fundamentals. Moscow is emerging as a respected and global financial center, highlighted by its playing host to the world's top-two IPOs in 2007. Notably, Russia is currently the world's largest exporter of gas and its second-largest producer of oil,[28] which allowed it to capitalize on sharp increases in energy prices through its exports of natural resources.

Domestic Savings Play Key Role in Wealth Accumulation

Domestic savings rates, important by-products of GDP and total consumption levels, are key drivers of wealth accumulation in a given year.

In 2007, most European nations saw domestic savings climb, a likely result of high and rising interest rates throughout 2006 and much of 2007. Among countries experiencing a drop-off in savings, most recorded greater decelerations in GDP growth than fluctuations in consumption behavior, underscoring the impact slowdowns had on mature markets. The United States had one of the world's lowest savings rates in 2007, at 10.9% of GDP, down from 11.4% in 2006, due to slowed GDP growth and increases in consumer and public spending. Also, the U.S. Federal Reserve held the target federal funds rate quite high, at 5.25%,[29] through July. However, indications of a slowing economy led to several sharp rate cuts during the remainder of 2007, further contributing to a decline in savings.

The characteristic rapid development of emerging economies goes hand in hand with very high levels of growth and consumption relative to their mature counterparts. In 2007, the savings rates of most emerging economies surpassed the benchmark average of the Group of Seven (G7) nations: 20.2% of GDP—a trend representative of the differences between emerging and mature economies.

Across the globe, key interest rates remained high through much of 2007. However, few central banks pursued rate cuts toward year-end. Given that monetary policy maintains the balance between growth and inflation, banks that cut rates in the second half of 2007, such as the U.S. Federal Reserve and the Bank of England, pursued economic stimulation as a priority, while most others were concerned with the inflationary pressures associated with rising food and energy prices.

Market Capitalization Growth Explodes in Emerging Markets

Given that HNWIs hold a significant portion of their wealth in stock markets, market capitalization performance is an important determinant of HNWI wealth generation. Representative of global market performances, the various Dow Jones World Indexes[30] experienced moderate returns in 2007, averaging 6.8%, well below the 17.3% average struck in 2006.[31] As a result, stock market gains did not have as positive an impact on HNWI wealth generation last year as they did in 2006.

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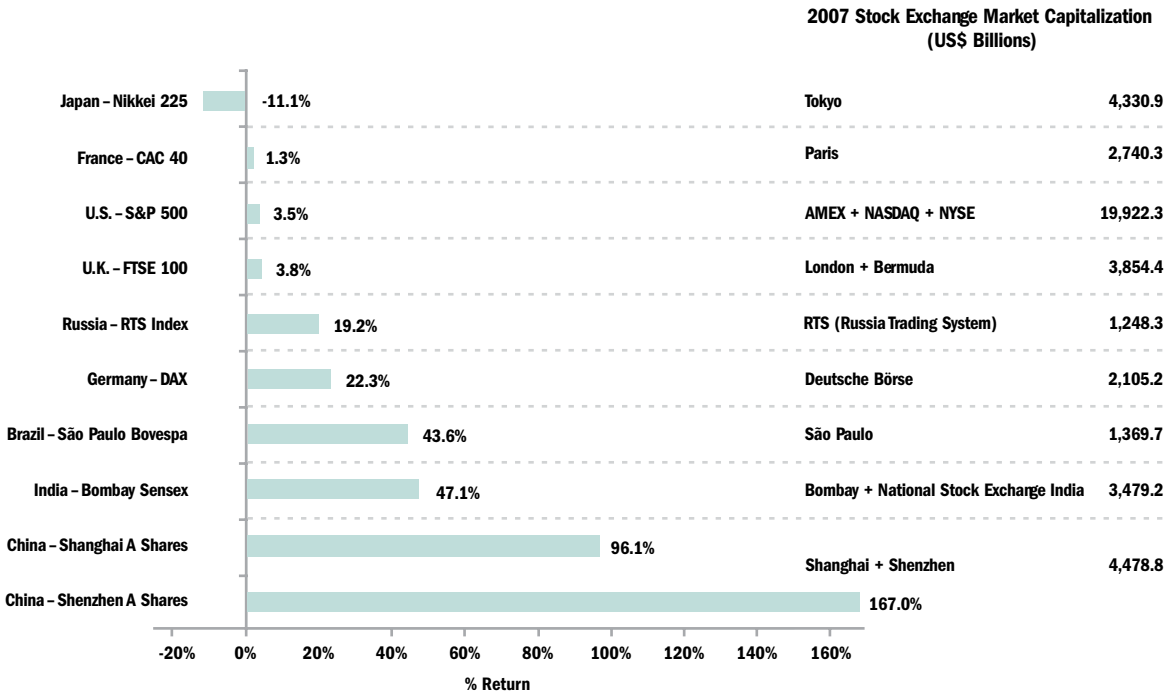
[23] World Federation of Exchanges, "Focus Report," January 2008
[24] "World's top IPO worth $8B," *Asia Pulse*, December 27, 2007
[25] "Brazil Foreign Min: Trade Deal for Environment Needs Ethanol," *Dow Jones International News*, January 26, 2008
[26] Russia Trading System, http://www.rts.ru/en, accessed April 2008
[27] The Economist Intelligence Unit, "Russia Country Report," January 2008
[28] "Gas version of OPEC fails to ignite," *The Australian*, February 4, 2008
[29] U.S. Federal Reserve, www.federalreserve.gov, accessed February 12, 2008
[30] The Dow Jones World Indexes consist of the large-cap, mid-cap and small-cap segments
[31] Capgemini analysis using reported figures of each Dow Jones World Index

Figure 6. | **Returns on Global Stock Market Indexes, 2007**



Note: Stock market capitalization values include all companies listed on the exchange
Source: "Year-End Review of Markets & Finance," *The Wall Street Journal*, January 2, 2008; Russia Trading System, http://www.rts.ru/en, accessed April 2008

In 2007, the divide between market capitalization growth in mature and emerging economies was significantly more pronounced than in previous years. Traditional United States, European and Asian stock indexes experienced moderate growth, while many emerging markets extended winning streaks of robust gains. In the United States, the Dow Jones Industrial Average and S&P 500 fell considerably, dropping from their respective growth rates of 16.3% and 13.6% in 2006 to 6.4% and 3.5% in 2007. Meanwhile, the NASDAQ saw its growth accelerate slightly, from 9.5% to 9.8%, supporting still-solid performances.[32]

At the same time, most major European and Asian indexes were contained to low-single-digit growth, with the world's worst performer, the Nikkei 225, contracting 11.1%.[33] The German DAX, Europe's best performer, was the only major traditional index to outpace its 2006 performance and sustain double-digit growth. Although market capitalization growth rates varied widely among the traditional exchanges of mature markets, from Hong Kong's 54.8% growth to Tokyo's 6.1% contraction,[34] 2007 performances across the board were consistently weaker than 2006 levels.

While growth among traditional stock exchanges slowed in 2007, it exploded in several emerging markets' exchanges and placed them among the largest in the world. The Shanghai and the Shenzhen Stock Exchanges experienced the highest growth worldwide, at 303% and 244%,[35] respectively. While they did host China's very active IPO market, raising US$64.5 billion in proceeds, growth in the two exchanges was mostly fueled by organic price increases. For example, new stock issues rose an average 191% on their first day of trading.[36] India's Bombay Exchange and the National Stock Exchange of India followed closely on China's heels, with respective growth rates of 122% and 115%.[37] Indian IPO activity in 2007 ranked fifth in the world in number of issues (95) and seventh in terms of total proceeds (US$8.3 billion). However, market capitalization growth was driven mostly by price increases in the very active financial services, property, construction and infrastructure sectors.[38]

[32] "Year-end Review of Markets & Finance," *The Wall Street Journal*, January 2, 2008; *Yahoo!Finance*, accessed February 13, 2008
[33] *Yahoo!Finance*, accessed February 13, 2008
[34] World Federation of Exchanges, "Focus Report," January 2008
[35] Ibid.
[36] "RMB 447 bln raised from IPOs on China's stock market in 2007," *Xinhua News Agency*, January 2, 2008
[37] World Federation of Exchanges, "Focus Report," January 2008
[38] "India's boom spawns new wealth," *The Australian*, February 8, 2008

Record Wave of IPOs, Other Investments Draw HNWIs to Emerging Markets

Emerging markets made significant contributions to record-level worldwide IPO activity in 2007. Overall, more than 1,300 IPOs raised roughly US$300 billion during the year,[39] with emerging markets capturing seven of the top-10 issues. The BRIC nations exhibited particular strength in this arena, accounting for 39% of global IPO volume in 2007, up from 32% in 2006.[40] Russian banks Sberbank and VTB raised nearly US$17 billion together and ranked first and second in the 2007 race for largest public offerings. Brazil's Bovespa, the largest exchange in Latin America, ranked fourth in IPO activity among global exchanges, riding a 7.2% gain in market share as the volume of IPOs in Brazil nearly tripled.[41] The 2007 offerings of China CITIC Bank and China Railway ranked among the world's largest, while PetroChina's Shanghai A-share offering, which raised US$8.94 billion, was the largest-ever issuance of its kind.[42] In India, IPO proceeds increased roughly 80% during the year, led by realty giant DLF's US$2.3 billion issue.[43]

Along with heightened market interest and activity, net private capital flows to emerging markets increased in 2007. While China attracted the largest absolute amount of private capital in 2007 at a country level, drawing in roughly US$55 billion, Emerging Europe was the most popular regional destination, attracting US$276 billion—enough to put it ahead of last year's leader, Emerging Asia.[44] The 20% drop in private capital flows experienced by Emerging Asia in 2007, in part, reflects that equity flows helped policymakers accumulate foreign exchange reserves, which reached roughly US$1 trillion in China alone.[45] Notably, private capital flows to Latin America more than doubled to US$106 billion in 2007, from US$52.6 billion a year earlier.[46] Financing needs are expected to grow in countries such as Russia, where current accounts will likely become deficits, despite limitations on foreign-financing and other inflow constraints.

Hedge funds also performed well in 2007—another investment arena that reflected the growing strength of emerging markets. Although down slightly from 2006, average hedge fund gains in 2007 reached 12.6%.[47] On average, hedge fund returns outperformed most traditional stock indexes in 2007, boosted by 20.3% average gains in emerging markets.[48] In recent years, an increasing proportion of hedge fund assets (estimated at US$1.7 trillion[49]) has come from institutional investors, who account for the majority of the nearly US$195 billion in net new money invested in 2007,[50] versus individual wealthy clients—shifting the main driver of the industry's growth.

Last year, venture capitalist fundraising and investing reached their highest levels since 2001, fueled largely by the growth of capital-intensive sectors, such as life sciences and clean technology. In 2007, 235 funds raised nearly US$35 billion—only a 2.6% increase from 2006 in the number of funds, but a 9.4% increase in raised capital.[51] In targeting life sciences and clean technology, venture capitalists recognized a market opportunity with great potential—driven by high food and energy prices. In fact, the renewable energy sector hosted record IPO issuances last year, led by the US$6.5 billion IPO of a Spanish utilities group, Iberdrola Renovables, and the US$1.2 billion IPO of Brazilian sugar and ethanol producer Cosan.[52] Overall, total investment in clean technology increased 35%, to US$117 billion, in 2007, exceeding expectations and helping drive immense growth in the sector—illustrated by numerous clean technology benchmark indexes gaining more than 50% for the year.[53]

Mature Economies Slow as Market Volatility Rises, Credit Tightens

The downturn in the United States, whose effects, by and large, were limited to other mature economies—as evidenced by slowed GDP growth and weak equity market performances in parts of Europe and Asia—was fueled by three main factors: a cooling housing market, tightened credit availability, and greater volatility and price declines in equity markets. At the source of the problems, the negative wealth effect of falling home prices threatened to curtail consumers' spending and their ability to borrow against their homes' value. Meanwhile, declining home values also reduced banks' collateral and led to tighter lending standards—and, ultimately, to a rise in mortgage payment delinquency rates and, inevitably, home foreclosures. These, in turn, raised the level of risk associated with real estate-related

[39] "Year-end Review of Markets & Finance," *The Wall Street Journal*, January 2, 2008
[40] Rachel Morarjee, "Emerging markets push IPOs to record," *Financial Times*, December 21, 2007
[41] Ibid.
[42] Conrad Tan, "Global IPOs raise record US$," *The Business Times Singapore*, December 19, 2007
[43] Ibid.
[44] Institute of International Finance, "Capital Flows to Emerging Market Economies," October 21, 2007
[45] International Monetary Fund estimate as of December 2007
[46] Institute of International Finance, "Capital Flows to Emerging Market Economies," October 21, 2007
[47] Credit Suisse/Tremont Hedge Index, www.hedgeindex.com, accessed February 15, 2008
[48] Emerging Market Credit Suisse/Tremont Hedge Index, www.hedgeindex.com, accessed February 15, 2008
[49] Gregory Zuckerman, "Hedge funds weather stormy year," *The Wall Street Journal*, January 2, 2008
[50] Margot Patrick, "Hedge fund investors to shed light on industry in new guide," *Dow Jones International News*, January 30, 2008
[51] Thomson Financial & National Venture Capital Association, "2007 Venture Fundraising," January 14, 2008
[52] Rachel Morarjee,"Emerging markets push IPOs to record," *Financial Times*, December 21, 2007
[53] National Venture Capital Association and PricewaterhouseCoopers, "2007 Venture Capital Investing," January 21, 2008

loans, particularly in the subprime segment (loans made to borrowers with poorer credit ratings), and reduced the market values of mortgage-backed securities and other similar assets. As a result, investment institutions involved with the sector absorbed multibillion-dollar write-downs, heightening uncertainty among investors and leaving equity markets jittery. Liquidity constraints resulting from these losses were exacerbated by the tightening of credit markets, quickly evident among many financial products and asset types, such as collateralized debt and loan obligations, asset-backed commercial paper, auction rate securities, liquidity puts, financial insurers and structured investment vehicles.[54] Ultimately, this chain of events impacted both consumers and institutions, impeding their ability to maintain liquidity and operate businesses.

In line with housing market downturns, REIT indexes incurred significant losses globally in 2007 after posting robust gains in 2006. Relatively stagnant performances in the first half of the year were supported by privatization efforts, whereas tighter credit conditions weighed on activity in the second half. Both the Dow Jones Equity REIT Index (U.S.) and the Dow Jones Wilshire Global REIT Index lost approximately 25% over the course of 2007—illustrative of global declines in real estate prices and devaluations of mortgage-related securities.[55]

In the second half of 2007, worldwide equity market performances reflected the divergence between mature and emerging markets. The MSCI Global Indexes recorded 0.1% and 3.2% contractions in Europe and the United States, respectively, in the second half of the year, versus respective gains of 10.4% and 6.3% in the first half.[56] By contrast, the Emerging Market MSCI Global Indexes excelled—led by Latin America in the first half of 2007, which gained 25.3% through the end of June, and the BRIC nations in the second half, up an explosive 34.1% between July and December.[57]

The repercussions of equity market losses in mature economies reverberated throughout international credit markets in the second half of 2007. One U.S. Federal Reserve Board survey[58] indicated the extent of tightening lending practices: About 30% of respondents reported that credit standards "tightened somewhat" for firms of all sizes, while 40% of respondents claimed the cost of credit lines and the premiums charged on riskier loans did so as well. Roughly 8% of respondents felt premiums charged on riskier loans "tightened considerably."

The economic slowdown in the United States drove a severe depreciation of the U.S. dollar against most major currencies worldwide. Notably, the dollar fell 10.5%, 15.8% and 17.0%, respectively, relative to the euro, the Canadian dollar and the Brazilian real.[59] A combination of levers—including foreign players' loss of confidence in both the value of the U.S. dollar and the country's overall economic strength, rising concerns of inflationary pressures, and the U.S. Federal Reserve's decision to stimulate economic growth rather than contain inflation—all put sustained downward pressure on the U.S. dollar's value.

Fundamental Problems Spur the U.S. Downturn

By general consensus, August 2007 marked the beginning of the economic slowdown in the United States. However, several fundamental problems, which originated years earlier, exacerbated the downturn's impact. For instance, markets were seriously jolted by the collapse of several hedge funds; efforts by Countrywide Financial Corp.—the country's top mortgage lender—to avoid insolvency by drawing down US$11.5 billion from credit lines; and coast-to-coast home foreclosures, up by a staggering 93% year-over-year in July.[60] Yet, it seems likely that better control of issues such as the overextension of consumers and housing markets, as well as high levels of securitization, could have mitigated some of the repercussions of a downturn.

While most pronounced in the United States, unsustainable spending behavior was also evident in several other mature economies in 2007, namely in Australia, the United Kingdom and several other European nations, including Finland and Norway. Near-zero household savings rates in each of these countries, in comparison with the healthier savings rates in other economies, such as France (13.1%), Germany (11.1%) and Italy (6.8%),[61] that also experienced slowed GDP growth, in part, highlight the evident consumer overextension.

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[54] Allan Sloan, "On the brink of disaster," www.cnnmoney.com, March 31, 2008
[55] Dow Jones REIT Indexes, www.djindexes.com, accessed February 15, 2008
[56] USA and Europe MSCI Global Indexes, www.msci.com, accessed March 5, 2008
[57] Latin America and BRIC Emerging Market MSCI Global Indexes, www.msci.com, accessed March 5, 2008
[58] U.S. Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices," January 2008
[59] www.ozforex.com, accessed February 2008
[60] "The US Credit Crunch Timeline," *The Toronto Star*, December 16, 2007
[61] Organization of Economic Cooperation & Development (OECD), "Economic Outlook No. 82," accessed April 2008

Debt levels have a high correlation with savings rates. Not surprisingly, the United States, along with other nations that have low savings rates, has comparatively high levels of debt.[62] In these countries, debt-ridden households allocate a much greater portion of disposable income to mortgages and long-term loans, further challenging overextended consumers in the wake of both slowing wealth growth and a higher dependency on home equity. Compared with international and historical trends, the U.S. consumer has long been overextended, particularly since 2001. In the recent turn of events, as market enthusiasm subsided, the discrepancy between perceived and actual wealth levels was realigned, curtailing consumption and investment perhaps more sharply than likely would have occurred in a downturn.

The motors driving the booming but overextended U.S. housing markets in recent years also intensified the downturn's impact. Over the past decade, strong economic growth, low interest rates and high levels of confidence, coupled with consumers' pronounced willingness to incur debt, all fueled housing markets' growth. Meanwhile, loose lending standards compromised the appropriateness of loan sizes and candidate eligibility, effectively raising the associated risk of each loan. When runaway real estate prices began to subside, as early as in 2006, the ensuing negative wealth effects were exacerbated by the overextension of the housing markets, illustrated by mortgage payment delinquency rates and home foreclosures increasing at a much greater rate than otherwise would have been expected, especially among subprime borrowers. In fact, while the subprime adjustable-rate-mortgage segment accounted for only 6.8% of outstanding loans, it represented roughly 43% of total home foreclosures.[63]

Finally, the extensive use of securitization in the United States greatly magnified the consequences of a housing market downturn, as is evident in the industry-wide losses on real estate-related securities. The United States accounts for roughly 79% of global securitization issuances,[64] highlighting the immense investment opportunities in most sectors and the high dependency, in this case, on real estate performance. Ultimately, a wide array of investment products was revalued at lower market prices, resulting in industry-wide write-downs of more than US$150 billion—with some projections calling for significantly greater credit-related losses before reaching bottom.[65]

2008 Updates

A flurry of developments in international credit and equity markets, all stemming from the U.S. economic slowdown, shaped the opening months of 2008. Early on, greater downside risks to growth in the United States, along with the far-reaching implications of tightening international credit markets, weighed heavily on equity markets around the globe. By mid-January, losses incurred in virtually all geographic markets exceeded 10%.[66] Since then, however, mature markets have stabilized somewhat, bringing average 2008 losses down to roughly 4%, and emerging markets have actually reclaimed and exceeded incurred losses, generating an average net gain by mid-April.[67]

Since the close of 2007, economic indicators in the United States have deteriorated further; notably: slowing consumer spending, cooling housing markets and softening labor market conditions. U.S. consumer confidence reached a 16-year low in March, falling from 70.8 to 69.5,[68] weighed down by record-level food and energy prices and significant financial market turmoil. In fact, the U.S. Department of Agriculture reported that domestic food prices rose 4% in 2007, a 17-year high that is significantly greater than the 2.5% average annual increase recorded over the previous 15 years. Further compounding U.S. economic difficulties, crude oil prices climbed persistently higher in the opening months of 2008, setting new records well above US$120 per barrel. Also, reduced demand for housing depressed new home sales to a 13-year low in February.[69] Finally, jobless claims rose to a two-year high in early April,[70] after employers cut 80,000 jobs in March—the largest cut in five years.[71]

Although research may suggest that the fundamental challenges faced by major financial systems are contained within the United States, the global reach of securitization has hurt many international banks heavily invested in U.S. markets, particularly in real estate-related positions. Credit constraints and widespread unease culminated in the near-collapse of Bear Stearns, the fifth-largest U.S. investment bank. In the nine months leading to April 2008,

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[62] Organization of Economic Cooperation & Development (OECD), "Economic Outlook No. 80," estimates as of 2005
[63] Mortgage Bankers Association of America, "Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey," December 6, 2007
[64] International Financial Services, London, "2006 Annual Issuance"
[65] "Goldman sees $1.2 trillion global credit loss," Yahoo!News, March 25, 2008
[66] Dow Jones World Indexes, SunGard PowerData, accessed April 18, 2008
[67] Capgemini analysis, data derived from Dow Jones World Indexes and MSCI regional indexes
[68] Reuters/University of Michigan Surveys of Consumers, March 2008
[69] U.S. Department of Housing and Urban Development, "New residential sales in February 2008," *U.S. Census Bureau News*, March 26, 2008
[70] Jeannine Aversa, "Jobless claims shoot up to 2-year high," *Yahoo!Finance*, April 3, 2008
[71] "Employers slashed 80,000 jobs in March," *Yahoo!Finance*, April 4, 2008

UBS, Switzerland's largest bank, reported total write-downs of US$40 billion from exposure to the U.S. subprime market, the largest of any bank. In the first quarter of 2008 alone, UBS absorbed US$19 billion in write-downs and a US$12.1 billion net loss.[72] Due to the lack of transparency in troubled asset classes, financial institutions around the world are acting aggressively to strengthen their capital bases and stave off any potential for collapse. Ultimately, business fundamentals are strong in the Euro Area and most emerging markets, making it unclear to what extent credit constraints will continue to threaten growth outside of the United States.

Equity markets, including the strong-performing emerging markets, tumbled worldwide in the early months of 2008, weighed down by weak U.S. growth prospects and the global impact of tightening credit. Representative of emerging markets, the MSCI Emerging Market Indexes for the BRIC nations, the Middle East and Asia fell sharply in the month of January, by 15.5%, 14.8% and 14.5%, respectively.[73] While the heightened volatility of equity markets around the world should not undermine the fundamental strength and growth potential of emerging markets, the extent and severity of the situation leaves authoritative powers in extremely delicate situations, attempting to stabilize troubled equity markets that appear to be as much a source of the problems as a by-product—a key factor in distinguishing the current situation from typical economic slowdowns.

In some cases, authorities have responded with aggressive and unconventional solutions to match the complex nature of the problems that surfaced. The U.S. Federal Reserve cut its target interest rate by 225 basis points in the first four months of the year,[74] aiming to stimulate economic growth and mitigate downside risks. Through April, other major central banks hesitated to follow suit and lower their target rates, largely due to concerns over historically high food and energy prices boosting inflation. Building on its initial responses, the Fed next created three mediums by which to inject markets with short-term money: the Term Auction Facility, the Primary-Deal Credit Facility and the Term Securities Lending Facility. These offerings, totaling more than a half trillion U.S. dollars, have been made widely available—including to investment banks, which are not typically granted access to the Fed's funding.[75]

Amid heightened liquidity pressures and dwindling investor confidence, more than 20 hedge funds have frozen invested assets since November 2007 in order to avoid bank runs—preventing mass sell-offs, asset devaluations and margin calls.[76] These actions convey both the extreme measures financial institutions are willing to take to protect their portfolios and the widespread unease of investors.

To date, numerous financial institutions have obtained additional funding from foreign investors—specifically, sovereign wealth funds—to ease liquidity concerns. These sovereign wealth funds are state-owned investment vehicles that often disclose little information about their transactions. As a result, they have attracted significant media attention by purchasing minority stakes in leading financial institutions around the world. In the United States alone, such investments totaled more than US$100 billion through February 2008.[77] However, given the lack of information transparency, published reports put the worldwide number of sovereign wealth funds between 30 and 40 and cite them as having control of an estimated US$2 trillion to US$3 trillion—a figure that may have quadrupled between 2003 and 2007.[78] These funds are playing an increasingly significant role in global markets. Nevertheless, like many other investment vehicles, sovereign wealth funds have generally infused capital at levels below thresholds that would trigger review and approval by federal banking agencies (typically, less than 10% of voting shares).

Conclusion

The early months of 2008 revealed further complications to the conditions facing the global economy at the end of 2007, heightening uncertainty among investors regarding the near-term global outlook. Deepening credit market woes threaten growth prospects in key mature markets. However, still-strong fundamentals in emerging markets are likely to sustain high levels of growth—a divergence that will likely impact consumer and business segments and shape policy choices. The balance between emerging market strength and mature market recovery is likely to persist through 2008, with the short-term outlook subject to variability given that aspects of potential risk may still be unknown.

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[72] "UBS writes off $19 billion," *Yahoo!Finance*, April 1, 2008
[73] Select Emerging Market MSCI Global Indexes, www.msci.com, accessed March 5, 2008
[74] The Federal Reserve Board–Open Market Operations, www.federalreserve.gov/fomc, January 2008
[75] Allan Sloan, "On the brink of disaster," www.cnnmoney.com, March 31, 2008
[76] Matthew Goldstein, "Hedge funds frozen shut," *BusinessWeek*, March 17, 2008
[77] Bob Davis, "U.S. pushes sovereign funds to open to outside scrutiny," *The Wall Street Journal*, February 26, 2008
[78] Scott G. Alvarez, U.S. General Counsel, "Sovereign Wealth Funds," www.federalreserve.gov/newsevents/testimony/alvarez20080305a.htm, March 5, 2008

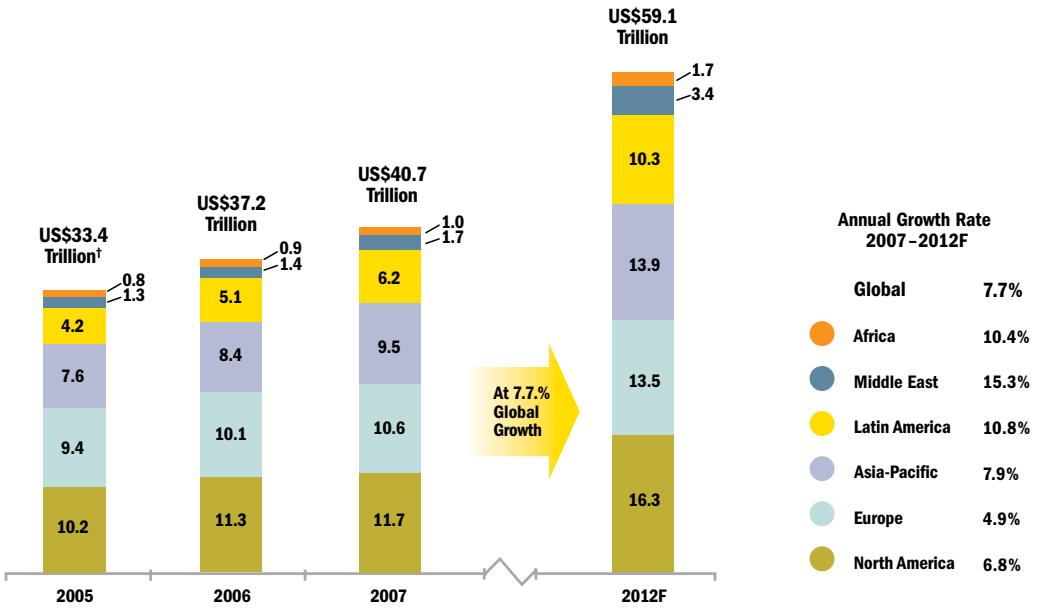
By and large, the global economy has two distinctive obstacles to overcome: inhibitors to growth in mature markets and high risks of inflation in emerging markets. How well these challenges are met will shape global HNWI growth prospects going forward.

Given 2007 performances and taking into consideration recent developments in world markets, we project that global HNWI wealth will grow to US$59.1 trillion by 2012, advancing at a rate of 7.7% per year.

This upward revision of last year's *World Wealth Report* projections is based on several factors: Recent economic downturns in the United States have been shorter by historical comparison attributed, in part, to increasingly effective monetary policy. Therefore, the current complications are not expected to weigh on growth prospects as heavily as they may have in the past. Similarly, research suggests that emerging markets' recoveries have outpaced analysts' expectations.

Moreover, as HNWI portfolios continue to grow more diversified over the long term, spread across international boundaries and asset classes, their investments become increasingly mobile. Thus, as growth in one region or market slows, HNWIs can move freely, reallocating their funds to other areas, often more quickly than the troubled market itself can react and recover. Ultimately, this evolution will make HNWI investments less vulnerable to market downturns.

Figure 7. | **HNWI Financial Wealth Forecast, 2005 – 2012F (by Region)**
(US$ Trillions)



† Bahrain and Qatar were added to the model for years 2005 onward
Note: All chart numbers are rounded
Source: Capgemini Lorenz curve analysis, 2008

HNWIs Retrench to Safer, More Familiar Investments

- **HNWIs moved to safer investment categories, with cash/deposits and fixed-income securities accounting for 44% of HNWI financial assets, up 9 percentage points from 2006**
- **Fixed-Income Securities saw a 6 percentage-point increase in asset allocation, accounting for 27% of holdings, up from 21% in 2006**
- **Globally, HNWIs continued to decrease their holdings in North America**
- **HNWIs showed greater interest in domestic market investments, preferring more familiar grounds amid heightened levels of economic uncertainty**

The diverging macroeconomic environments in the two halves of 2007 helped define HNWIs' asset allocation strategies last year. Building on the optimism of 2006, the early months of 2007 showed HNWIs betting heavily on riskier asset classes. However, as the year wore on and financial market turmoil and economic uncertainty intensified, HNWIs began to retrench, shifting their investments to safer, less volatile asset classes. By year-end, HNWIs were moving in favor of cash/deposits and fixed-income securities in an effort to mitigate their risk exposure in increasingly uncertain economic times. HNWIs also increased allocations to domestic products over the course of the year, a scenario consistent with an increasing desire to invest in more familiar grounds.

HNWIs Seek Refuge in Lower-Risk Assets

In 2007, HNWIs sought refuge in safer, more traditional investment vehicles, increasing their overall portfolio allocations to cash/deposits and fixed-income securities by 9 percentage points, to 44% of their holdings.[79] Of this amount, fixed-income securities accounted for 27%, up from 21% a year earlier, and cash/deposits rose to 17%, from a 14% share in 2006.[80]

Latin American and North American HNWIs allocated more of their holdings to fixed-income securities than any of their peers, at 39% and 29%, respectively.[81] Given the slowing economy in the United States and the currency value erosion, HNWIs increasingly invested in non-U.S.dollar-denominated bonds and stocks, hedging against growing risks in the United States by anchoring their investments to stronger-performing economies—and their respective currencies.[82]

HNWI investors in Asia and Europe led in allocations to cash/deposits, setting aside 25% and 21%, respectively.[83] This is consistent with Asia's historical tendency toward high personal savings rates relative to other regions. In 2006, for instance, Asian HNWIs allocated 24% of their financial assets to cash/deposits, compared with only 14% by their European peers.[84]

Overall macroeconomic indicators weakened in Europe in 2007: GDP growth slowed in most of the continent's major economies and investor confidence receded, especially towards the end of the year. Additionally, European stock markets, with the exception of Germany's, performed relatively poorly during 2007 compared with the previous year. As a result, European HNWIs shifted their allocations to cash/deposits, from 14% in 2006 to 21% in 2007.[85] Given that European HNWIs already had a relatively high allocation to fixed income, many of them reallocated assets to cash/deposits in order to maintain a diversified portfolio while minimizing risks.

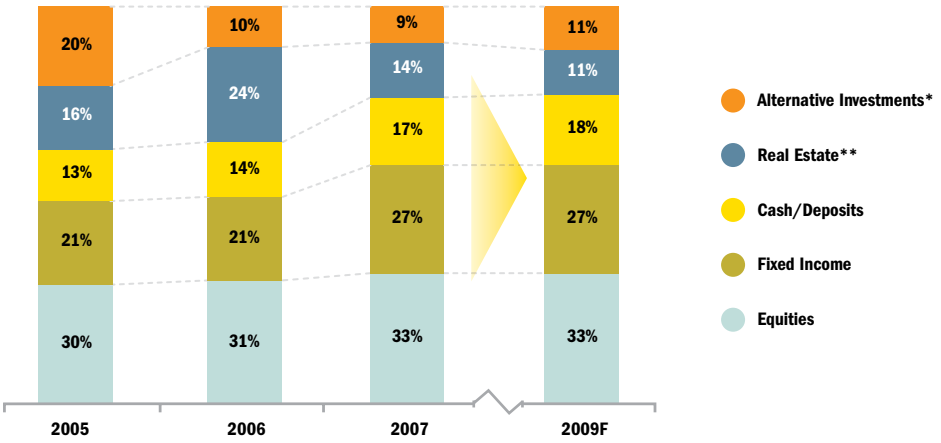
Alternative Investments' Popularity Eases

The economic downturn, and the heightened levels of uncertainty it created for investors in the second half of the year, deterred HNWIs from increasing their allocations to alternative investment vehicles. HNWI allocations to alternative investments were shaped by the balance between the uncertainty spurred by the economic turmoil and the strong performances of select products within that asset class. Ultimately, HNWIs trimmed their allocations to alternative investments by a single percentage point, from 10% of their financial assets in 2006 to 9% in 2007.[86]

Counterbalancing HNWI concerns, growth opportunities developed as a result of shifting economic strengths. For instance, gold, among other commodities, gained popularity as a hedge against inflation and the sliding U.S. dollar, boosting gold futures by 31.4% in 2007.[87] Additionally, various hedge funds froze client withdrawals starting in late 2007, which helped minimize reductions in allocations to alternative investments.

[79] Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008
[80] Ibid.
[81] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[82] George Mannes, "The Best Ways to Protect Your Money Today," *Money*, May 1, 2008
[83] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[84] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007
[85] Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008
[86] Ibid.
[87] "Year-end Review of Markets & Finance," *The Wall Street Journal*, January 2, 2008

Figure 8. | **HNWIs' Allocation of Financial Assets, 2005 – 2009F (by Category)**



* Includes: Structured products, hedge funds, derivatives, foreign currencies, commodities, private equity, venture capital, other (may include: structured credit, managed futures, investments of passion, etc.)
** Includes: Commercial real estate, REITs and other investment properties

Source: Capgemini/Merrill Lynch Financial Advisor Surveys, March 2006, March 2007, April 2008

Globally, hedge funds represented the largest portion—over 30%—of alternative investments.[88] During the course of the year, HNWIs seemed to grow more distrustful of hedge funds as subprime mortgage-related turmoil intensified. The collapse of two Bear Stearns hedge funds, resulting from losses stemming from highly leveraged mortgage-backed security positions, deepened investors' concerns over participation in hedge funds, limited pricing transparency and the investment vehicles they were likely to impact.[89] Ultimately, however, hedge funds' average gains of 12.6% in 2007 were enough to outweigh HNWIs' worries.[90] Consequently, HNWIs made only slight adjustments to their overall allocations to alternative investments.

Real Estate Loses Momentum

In 2006, real estate experienced record returns across various categories. Many HNWIs took profits from these increased values during 2007, and moved their money into other asset classes. However, HNWIs across the globe pulled out of real estate investments earlier and more significantly than anticipated, finishing 2007 with only 14% of their financial assets allocated to real estate, a 10 percentage-point drop from 2006 levels.[91]

REITs Fail to Meet High Expectations

While 2006 was a year of impressive returns for REITs, results in 2007 fell short of high expectations. REIT performances were split by the two halves of the year, scoring mild gains in the first half of 2007 and pulled down by tightening credit markets and deteriorating economic conditions in the second. However, REIT performances varied widely across regions, with differences most widely seen across Asia and North America.

Asian REITs performed particularly well in the first half of 2007, during which time 11 new REITs were listed—more than in any other region.[92] This brought REIT market capitalization to more than US$80 billion, roughly twice the size attained by the end of 2005.[93] While evidence suggested that Asia was becoming the new "REIT Tiger,"[94] the unfolding credit crisis in the second half of the year led many investors in the region to adopt a more cautious approach. The unsettled economic climate and significant market corrections caused the Asian REIT market capitalization to contract to US$ 78.7 billion, producing an overall negative sentiment and undermining annual market results.[95] The year closed with only 18 new REITs introduced, compared with 35 in 2006.[96]

[88] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[89] "The US Credit Crunch Timeline," *The Toronto Star*, December 16, 2007
[90] Credit Suisse/Tremont Hedge Index, www.hedgeindex.com, accessed February 15, 2008
[91] Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008
[92] CB Richard Ellis, "REITs Around Asia, 1H 2007"
[93] Ibid.
[94] Ernst & Young, "Global REIT Report, REIT Market Overview," October 2007
[95] CB Richard Ellis, "REITs Around Asia, 2H 2007"
[96] Ibid.

In the United States, 2007 marked the end of seven consecutive years of positive returns for REITs. According to various indexes, U.S. REITs reported net losses of up to 26.2% in 2007, down significantly from the 30.8% average gains posted in 2006.[97] Even when many regional markets performed well, the first six months' results in North America were lackluster. The number of listed REITs contracted by 23%, to 169 (down from 220), in large part due to private equity deals taking REITs out of the listed markets.[98]

Tightening credit markets added to other deteriorating economic conditions in the second half of 2007, with significant worldwide impact. Indeed, the United States accounted for 5.7 percentage points of the 14.7% contraction in the 2007 S&P/Citigroup World REIT Index.[99] Amid these global conditions, REITs lost ground with HNWIs, accounting for 17% of their real estate asset allocations in 2007, down from 22% in 2006.[100]

Global Direct Commercial Real Estate Performs Well

Globally, direct commercial real estate investments rose 8.4% (US$59 billion), during 2007, amounting to US$759 billion.[101] During the first six months of 2007, high levels of investor confidence and healthy deal-making environments drove record transaction volumes to US$394 billion.[102] However, as credit markets tightened and real estate valuations deteriorated, transaction volumes steadily declined over the second half of the year.

In Europe, transaction volumes increased only 1.9% from 2006 to 2007, whereas in the Americas, they rose about 10%, to US$312 billion.[103] For its part, the United States netted US$291 billion.[104] Likewise, investments in the Asia-Pacific region increased by 27.4%, led by Japan, owner of approximately 50% of regional volumes.[105] Consistent with these trends, HNWIs in North America and Asia increased their exposure to commercial real estate in 2007, while globally, the portion of HNWIs' financial assets allocated to commercial real estate remained unchanged.

The Middle East remained the region with the most exposure to commercial real estate, with 33% of HNWI real estate investments allocated to this asset.[106] The Dubai emirate, for instance, is undergoing massive construction projects, both commercial and residential, and offering incentives, such as tax-free property sales, to boost transactions. While these investment vehicles are not readily accessible to overseas investors, local HNWIs are able to leverage their domestic-market knowledge to generate profitable returns on such investments.[107]

HNWIs Retrench to More Familiar Domestic Markets

At the regional level, the geographic distribution of HNWI investments underwent significant changes in 2007, with allocations to domestic markets gaining strong favor. We view this as a temporary, tactical move dictated by caution, as investors across all regions await further developments in the global markets.

HNWIs outside the United States moved to diminish their exposure to U.S. markets, the primary victims of the subprime and credit market turmoil. For instance, HNWIs in the Middle East and Latin America, who, among non-U.S. investors, traditionally have had the highest proportion of their financial assets allocated to North American markets, decreased their exposure to this part of the world by five and nine percentage points, respectively.[108] Globally, HNWI allocations to North America accounted for 42% in 2007, but have been decreasing in recent years.[109]

Globally, the geographic distribution of HNWIs' investments changed only slightly from 2006 to 2007. Allocations to North America, Asia-Pacific and Africa decreased by a single percentage point, while those to Europe remained unchanged. Meanwhile, allocations to Latin America and the Middle East increased by two and one percentage points, respectively.[110]

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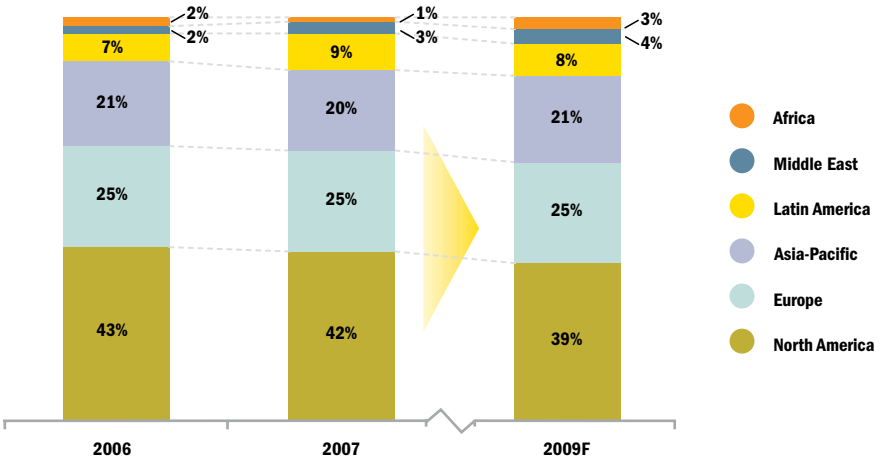
[97] Dow Jones Equity REIT Index, www.djindexes.com, accessed February 15, 2008
[98] Ernst and Young, "Global REIT Report, REIT Market Overview," October 2007
[99] S&P/Citigroup Global Equity Indexes, www.globalindices.standardandpoors.com, accessed February 26, 2008
[100] Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008
[101] Jones Lang LaSalle, "Global Direct Commercial Real Estate Investment Reaches Record Levels in 2007 Despite Credit Crunch," New Global Capital Flows Research, January 31, 2008
[102] Ibid.
[103] Ibid.
[104] Ibid.
[105] Ibid.
[106] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[107] Tom Burroughes, "Wealth Management," *The Business*, August 4, 2007
[108] Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008
[109] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[110] Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008

Figure 9. | **Geographic Distribution of HNWIs' Financial Assets, 2006 – 2009F (by Region)**



Source: Capgemini/Merrill Lynch Financial Advisor Surveys, March 2007, April 2008

Looking Ahead

As HNWIs across all regions regain confidence in financial markets, they will move from cash/deposits and fixed-income securities back into less risk-averse investments. Globally, we forecast the portion of HNWI assets invested in alternative investments will increase by two percentage points through 2009.[111] Asia-Pacific will likely lead the way, with a projected three percentage-point increase.[112]

Global allocation of HNWI investments to North America is expected to continue to erode, from 42% in 2007 to 39% by 2009.[113] Additionally, as HNWIs shift away from a "retrenching-to-domestic-markets" strategy, they are likely to favor the higher-risk/higher-return investments of fast-growing markets. The BRIC nations, as well as North Africa and Latin America, will continue to benefit from the rising prices of commodities and natural resources. Additionally, HNWI allocations to Eastern Europe should continue to increase as it further benefits from strengthening relations with members of the European Union.

As signs of financial market recovery appear, we project that HNWIs will likely return to their pursuit of high returns, particularly in emerging and frontier markets—such as Bangladesh, Jamaica, Slovenia, and many other countries in Africa, South Asia, Eastern Europe, and the Caribbean—and alternative investments.

[111] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[112] Ibid.
[113] Ibid.

Green Investing Gains Traction in 2007

As the world community has grown more attentive to environmental concerns, such as global warming and climate change, the presence of related investment opportunities has greatly increased, driving robust growth of green investing in 2007. Whether perceived as an investment opportunity or a responsibility of global citizenship, overall participation in green initiatives has risen rapidly in recent years due to the fundamental need for sustainable development, and, as a result, the undeniable growth potential of the green sector. Furthermore, it seems the era of economically viable green power has finally arrived, as the impact of soaring oil prices on consumer attitudes and the widespread acceptance of global warming implications converge. Individuals, businesses and governments alike are actively pursuing the integration of green initiatives into everyday systems and investment strategies, adapting to and preparing for what is quickly becoming the way of the future. Capitalizing on the fundamental strength of demand for green initiatives, the investment community has been particularly invigorated by the attractive financial returns of green investments that have accompanied the already appealing environmental and social benefits generated.

More Investors Bet on Green

In much greater size and proportion than in recent years, investors have been supporting innovative research and development initiatives in search of alternative fuels, renewable energy and other advanced technologies. Today, investors are presented with many vehicles through which to back green initiatives, such as mutual funds, ETFs and other pooled products or alternative investments. In 2007, these investment vehicles drove robust growth in green sectors. For example, total investment in the clean technology sector increased to US$117 billion in 2007, up 41% from 2005,[114] with particular strength in the wind and solar segments. In fact, in the three years ending November 2007, gains in the wind segment exceeded 300%, while solar posted the highest growth in 2007, roughly 150%.[115] Furthermore, the solar segment produced the highest proportion of IPOs of any green sector over the course of last year, including the Merrill Lynch-led US$6.5 billion issuance of Iberdrola Renovables, the world's largest renewable energy company.[116] Despite being burdened by poor overall market conditions in late 2007 and early 2008, green investing trends have been driven by an underlying commitment to sustainable development, which takes profit incentives into consideration alongside social responsibilities. As a result, the sector will likely weather short-term fluctuations and deliver strong returns in the long run.

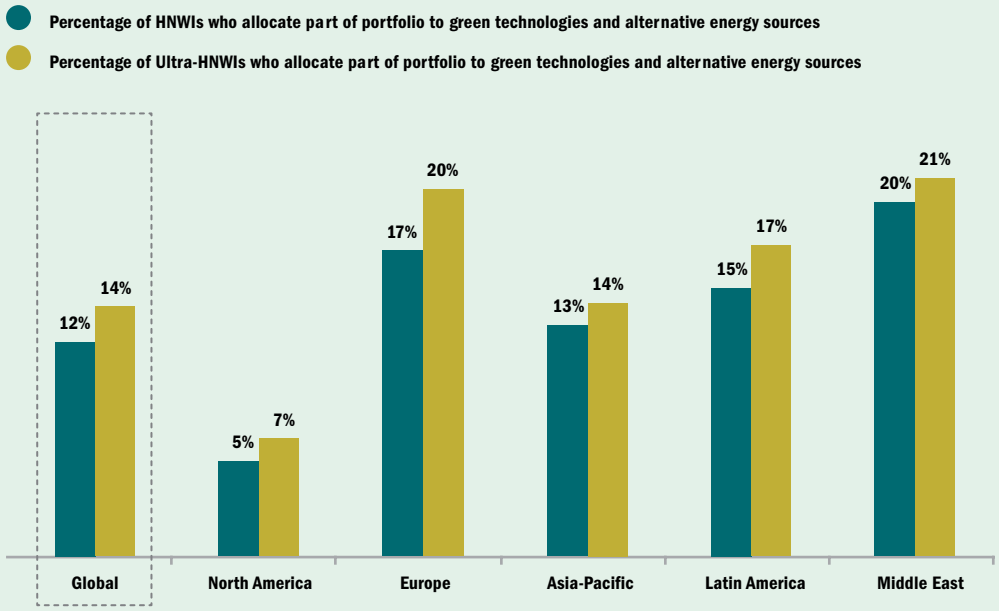
Venture capital has played a leading role in green investing throughout North America and Europe, as investments in the sector reached nearly US$5.2 billion in 2007, up from US$3.6 billion in 2006 and only US$714 million in 2001.[117] In 2007, US$3.9 billion of venture capital was invested in the United States in green technology, of which roughly US$1.8 billion was invested in California alone—accounting for approximately 45% of all green investments in North America.[118] Given the greater freedom with which individuals, relative to institutions, can allocate their assets, venture capital has flowed largely from wealthy private clients as opposed to stringently controlled institutional investors. In addition, private equity firms will likely play an increasingly active role and represent another important investing outlet as innovative technologies continue to emerge. Also, many top-tier banks showed heightened involvement in green stock market listings in 2007—Credit Suisse, Merrill Lynch and Morgan Stanley set the pace, handling deals worth US$2.8 billion, US$2.4 billion and US$2.3 billion, respectively.[119] Financial institutions of all classes are quickly realizing the growth potential of the green sector and are acting accordingly to secure an early stake in the market.

Heightened Interest Drives New Market Opportunities

Scientific evidence today overwhelmingly points to a massive expansion in greenhouse gases as the foremost consequence of rapid industrialization and driver of climate change. The widespread acceptance of such theories has warmed the international political climate to broader environmental issues and, as a result, has encouraged the general public to integrate green standards into their personal and professional lives. Informational broadcasts by the mass media and documentaries, such as Al Gore's *An Inconvenient Truth*, have raised public awareness of the global impact of everyday activities and habits and driven greater appreciation of the need for green initiatives. As a result, heightened public awareness has reshaped business dynamics and raised expectations for government and business endeavors, creating significant opportunities for future growth.

[114] "Folding green: the investment boom," *The Observer*, February 24, 2008
[115] "Green Light for Renewable Energy," *Davy Research Report*, November 2007
[116] "Is 'green' power money misguided? Market is booming, but dot-com memories make some worry business of green," *International Herald Tribune*, March 1, 2008
[117] "Green tech investments growing fast," *The San Francisco Chronicle*, January 17, 2008
[118] Ibid.
[119] "Is 'green' power money misguided? Market is booming, but dot-com memories make some worry business of green," *International Herald Tribune*, March 1, 2008

Figure 10. | **HNWIs' and Ultra-HNWIs' Interest in Green Investing, 2007 (by Region)**



Source: Capgemini/Merrill Lynch Financial Advisor Survey, April 2008

Governments across the globe have played an active role in stimulating the growth of green initiatives, paving the way for lucrative market opportunities. Depleting fossil fuel reserves, volatile fuel prices, energy security worries and emission concerns are some of the key factors that convey the international nature of the issues at hand and, to date, have driven aggressive government advocacy of green initiatives.[120] European powers have been long-standing leaders and pioneers of green initiatives. In January 2008, Norway made an extraordinary pledge to be "carbon neutral" by 2030, such that it would generate no net greenhouse gases into the air.[121] Despite concerns regarding carbon neutrality and the practice of offsetting domestic emissions with contributions to emission-reduction schemes abroad, Norway represents the high ambition necessary to bring about meaningful change. Britain may become the first country in the world to introduce legally binding CO_2 reduction targets if a climate change bill, aimed at reducing the country's emissions 20% by 2010, is passed, as expected, in summer 2008.[122] In the United States, state-level policies, tax credits and cost-recovery systems are among the incentives that have been offered to encourage innovation. However, Abu Dhabi is exploring, arguably, the most ambitious plan of all: to create the world's first carbon-neutral metropolis.[123] Intended to host 100,000 inhabitants and likely to absorb billions of investment dollars in clean technology initiatives, this futuristic project illustrates Abu Dhabi's resolve to be a pioneer of post-oil alternatives, and is drawing significant global media attention. As climate change and other environmental concerns take center stage in the global arena, government bodies have demonstrated a keen interest in advancing even the most daring green initiatives in order to induce meaningful change and secure future economic and political stability.

Businesses "go green" in an effort to adapt to changing market dynamics and capitalize on growth opportunities, as heightened public interest redefines the rubrics by which companies are evaluated and governments raise the incentives to participate in environmentally conscious endeavors. A flurry of start-ups has sprouted in search of innovative technologies and other alternative solutions they hope will meet the fundamental needs critical for sustainable economic growth. Developing anything from online dashboards that monitor environmental activity in buildings (e.g., energy and water usage) to real-time tracking of transportation systems through GPS and mobile phone networks to improve efficiency and cut fuel costs, to thin-film solar panels that boast longer lifetimes at lower costs,[124] businesses are devoting resources to bring about improvements in all facets of daily life. Even the construction industry has fostered pioneering green initiatives that have altered the landscape of international building standards. For instance, the Leadership in Energy and Environmental Design (LEED) Green Building Rating System is a third-party certification program that has become an international benchmark for high-performance green building standards; it is currently being utilized in 41 countries, representing both mature and emerging ations.[125]

[120] HSBC, "The US Market, Global Natural Resources & Energy," December 3, 2007
[121] "Lofty pledge to cut emissions comes with caveat in Norway," *The New York Times*, March 22, 2008
[122] Heather Green and Kerry Capell, "Carbon Confusion," *BusinessWeek*, March 17, 2008
[123] Stanley Reed, "Guess who's building a green city," *BusinessWeek*, December 24, 2007
[124] "The most promising green tech startups," *Green Wombat*, October 30, 2007
[125] U.S. Green Building Council, "LEED Rating Systems," www.usgbc.org, accessed April 28, 2008

Around the world, scientists and entrepreneurs have been fusing creativity with abundant resources to extend green initiatives beyond their current reach. Business mogul and social activist Richard Branson hosted a private conference in early 2008 on his remote Caribbean island, Necker Island, to discuss with world leaders and other business executives possible green initiatives that would bring about both meaningful change and lucrative returns.[126] Efforts aimed at expanding the scope of alternative solutions are quickly increasing in number as individuals and companies of all backgrounds have been converting environmental and social concerns into actionable business opportunities in new and innovative ways.

Globally, consumers increasingly favor "environmentally friendly" products and more prudent green standards, putting pressure on businesses to meet new market demands. Even traditional industries have realigned their strategies to incorporate green initiatives in recognition of more sophisticated consumer expectations. Among others, the likes of Siemens, Wal-Mart and GE have executed mergers and acquisitions of green pure-plays to augment their own internal environmental-sustainability initiatives. Introducing environmental considerations to business decision processes has become increasingly important and, as a result, businesses across the globe have demonstrated concerted efforts to adapt to a changing global environment.

HNWIs Attracted to Growth in Green Investing

Green investing encompasses a wide range of industries, making the classification of applicable investment products quite subjective. Furthermore, green investments often match very different criteria and include anything from "best-in-class" oil rigs to true pioneers of clean technology. As a result, the green investing market is difficult to size. However, trends evident in the broader Socially Responsible Investing (SRI) category—which encompasses environmentally and socially screened assets—provide useful insight into the narrower green universe. Institutional investors and HNWIs held more than 70% of the US$2.71 trillion SRI assets under management in 2007, representing an increasingly attractive target for financial institutions and advisors. Given the high development risk associated with the sector, green investing caters largely to institutions and HNWIs—more sophisticated investors willing to assume greater financial risk in hopes of high returns.

Roughly 12% of HNWIs and 14% of Ultra-HNWIs around the world allocate part of their investment portfolio to green technologies and alternative energy sources.[127] Regionally, the most environmentally attuned HNWI and Ultra-HNWI populations, as measured by the percentage of affluent investors allocating to green investing, were found in the Middle East and Europe—with participation rates ranging from around 17% to 21% in 2007, all exceeding global averages. By comparison, only 5% of HNWIs and 7% of Ultra-HNWIs in North America allocated part of their portfolio holdings to green investing. It is interesting to note that North America was the only region in which social responsibility was the primary driver of HNWIs' green investing. Among all HNWIs worldwide, approximately half pointed to financial returns as the primary reason for their allocations to green investing. The combination of lucrative returns and social responsibility underpin the rising popularity of green investing among HNWIs across the globe.

With Future Sustainability at Stake, Green Investing Will Grow

Investors, businesses and governments can no longer ignore the realities of climate change and other environmental risks. Therefore, all are looking for ways to systematically integrate eco- and sustainable investing into their moneymaking decisions.[128] Amid government efforts to promote and reward the pursuit of green initiatives, and the increasing dependence of corporate profitability on sustainable development, green products will be more commonly incorporated in households and businesses on the premise of practicality and efficiency gains. Furthermore, the sheer size of the energy market, estimated at US$6 trillion,[129] coupled with the fundamental need for energy to drive economic growth, underpins the long-term, global security of green investing, even though higher levels of risk are often associated with nascent marketplaces, such as the green sector. Ultimately, the unilateral pursuit of economic progress against a backdrop of sustainability will be driven by consciously aligning investment choices with values and concern for the environment.

[126] "On an island paradise, talking about global warming's silver lining," *The New York Times*, March 22, 2008
[127] 2008 Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[128] "Personal wealth: Profiting from climate change," *The Edge–Singapore*, July 16, 2007
[129] "Environment–Where the money is," *The Wall Street Journal*, March 24, 2008

HNWIs' Pursuit of "Passion Investments" Is Not Deterred by Economic Volatility

HNWIs and Ultra-HNWIs allocate and spend a significant portion of their wealth on investments of passion: art collections, luxury autos, yachts, sports teams, memorabilia, wine collections, luxury travel and health/wellness, for example. However, allocations vary considerably from region to region, and between mature and emerging economies. Further differences emerge when allocations are studied in terms of whether they are tangible passion investments, such as art collections, or luxury expenditures, such as high-end travel, which are more experiential in nature.

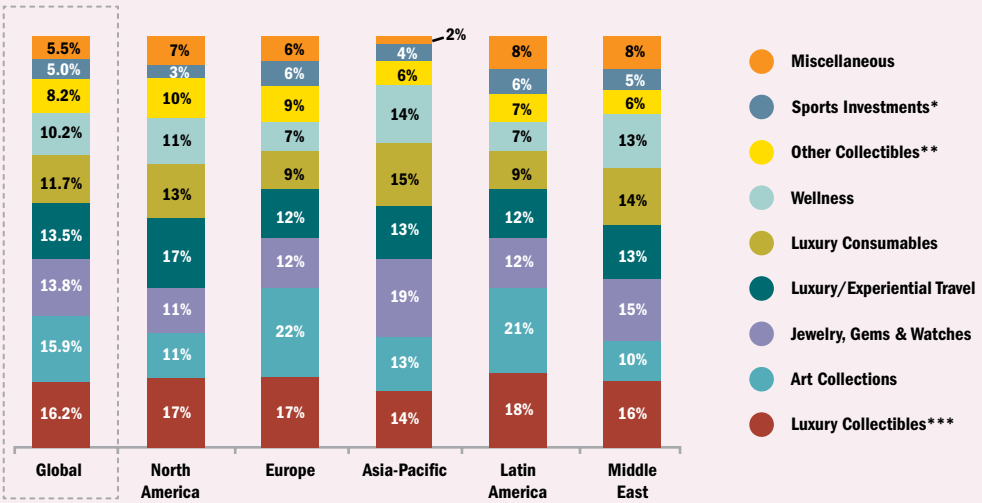
In 2007, luxury collectibles, accounting for 16.2% of passion investments, and fine art, representing 15.9%, continued to be the most popular choices of HNWIs worldwide.[130] Jewelry held third place, with 13.8%, and luxury/experiential travel ranked fourth, with 13.5%.[131] These four categories are the most expensive of the passion investments studied, and together account for over half of all HNWIs' expenditures on luxury items.[132]

Despite Rising Costs and Financial Market Turmoil, HNWIs Did Not Give Up Expensive Purchases

The Forbes' Cost of Living Extremely Well Index (CLEWI), which tracks the year-over-year cost of a basket of luxury goods, rose 6.2% from 2006 to 2007, more than double the rate of inflation.[133] Despite these significant price increases, various luxury segments reported record sales figures in 2007, testifying to the unquenchable appetite of HNWIs for luxury items.

Over the course of the past year, wealthy individuals from emerging markets demonstrated significant influence in the global luxury marketplace. Thus, even as financial market turmoil impacted the United States during the second half of 2007, luxury goods makers, high-end services providers and auction houses all found ready clients in the emerging markets of the world—most notably China, India, Russia and the Middle East—thereby sustaining their own growth. "We used to think in terms of hedge funds when targeting new customers," says David Norman, worldwide cochair of Sotheby's Impressionist and Modern Art Department. "Now, we look for barrels of oil."[134]

Figure 11. | **HNWIs' Investment-of-Passion Dollars, 2007 (by Region)**



* "Sports Investments" represents sports teams, sailing, race horses, etc.
** "Other Collectibles" represents coins, wine, antiques, etc.
*** "Luxury Collectibles" represents automobiles, boats, jets, etc.
Source: Capgemini/Merrill Lynch Financial Advisor Survey, April 2008.

[130] Capgemini/Merrill Lynch Financial Advisor Survey, 2008
[131] Ibid.
[132] Ibid.
[133] Forbes CLEWI, updated September 20, 2007
[134] Kelly Crow, "Art Auctions Look Abroad," *The Wall Street Journal*, November 2, 2007

Luxury Collectibles

Private jets, yachts, high-end automobiles and other luxury collectibles again accounted for HNWIs' largest investments of passion, with wealthy Latin Americans at the forefront of this trend. While North Americans traditionally have been the largest purchasers of private jets, their position was eclipsed in 2007—the first year that orders for Gulfstream jets from overseas buyers surpassed those from North Americans, according to U.S.-based General Dynamics.[135]

Luxury automobile makers reported similar trends for 2007. Ferrari recorded unprecedented growth in emerging markets. Its sales to Asia-Pacific rose by 47.2%, while the Middle East grew by 32.3%. This compared with strong—but single-digit—growth in the United States and Germany, historically Ferrari's largest markets.[136] Limited-edition and classic car prices remained immune to the economic downturn, and custom-built motorcycles experienced a boom in demand, with aficionados paying more than US$300,000 for some of these one-of-a-kind "works of art."[137]

The yacht market, long dominated by HNWIs from the Middle East, has been taken by storm by Russian buyers in recent years—further evidence of a surge in demand from emerging market buyers. The "Eclipse," perhaps the largest privately owned yacht in the world and still under construction, is believed to be the property of one of Russia's oil billionaires. Meanwhile, yacht brokers report that "at least 20% of the business for new vessels longer than 200 feet is coming from Russia—more than from any other country, including the United States."[138]

Fine Art

Globally, fine art retained its position as one of the most popular investments of passion. Demand was greatest for contemporary and iconic art in mature and emerging markets alike. Similar to previous years, more European (22%) and Latin American (21%) HNWIs invested in fine art than did their North American (11%), Middle Eastern (10%) or Asian counterparts (13%) in 2007.[139]

Newly minted millionaires from Moscow, to Mumbai, many of whom have made fortunes in the global commodities boom, were active auction participants.[140] Christie's International and Sotheby's both profited from the expanding Russian economy. Their combined 2007 Russian sales totaled US$324.9 million, up 45% from US$223.6 million in 2006.[141] Accordingly, Christie's plans to open a showroom in Moscow in 2008 to better serve its Russian client base, which has grown significantly over the years.[142]

While some critics suggest that U.S. HNWIs' driving role in the global art market has weakened after several decades of influence, auction houses have found that art sales have not been impacted by the tumultuous economy. In fact, during Christie's November 2007 auction of post-war and contemporary paintings, 50.8% of the presented items were bought by HNWIs from the United States, up from a reported 48.5% in 2006.[143]

2007 also saw two growing trends within the art market: online auctions and private sales. Christie's online auction sales did particularly well during the year, with buyers comfortably bidding up to US$1 million over the Internet for items that they couldn't view firsthand.[144] Private sales at auction houses, too, were on the rise during 2007, as more Ultra-HNWIs chose to avoid being named in the press on select purchases.[145]

Jewelry, Gems and Watches

Jewelry, gems and watches attracted the largest share of passion investment allocations in the Middle East and Asia, while ranking third on a global basis. Wealthy collectors avidly pursued "fancy or colored diamonds," causing prices to soar last year.[146] In October 2007, Sotheby's sold a 6.04-carat emerald-cut blue diamond for a record US$1.32 million per carat.[147] Although market watchers speculate about a "bubble," prices are expected to climb even higher in 2008 because of the growing demand. Men's luxury watches, too, were highly prized by collectors from around the world, with exclusive and limited-edition models from Patek Phillippe, Franck Mueller and other watchmakers viewed as enduring "collection" pieces.[148]

[135] Stephen Manning, "Private Jet Sales Up, Fueled by Overseas Buyers," *The Post and Courier*, March 16, 2008
[136] Fiat Group, Annual Report, December 31, 2007
[137] "2008 Collectors Guide," *Forbes*, December 24, 2007
[138] Robert Frank, "The Wealth Report: The Russians Are Coming...," *The Wall Street Journal*, January 12, 2007
[139] Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[140] Kelly Crow, "Art Auctions Look Abroad," *The Wall Street Journal*, November 2, 2007
[141] John Varoli, "Sotheby's, Christie's Report Record Russian Art Sales in 2007," Bloomberg.com, January 11, 2008
[142] Interview with Toby Usnik, Christie's, New York, April 25, 2008
[143] Ibid.
[144] Ibid.
[145] Ibid.
[146] "A Dazzling Palette," *Worth*, January/February 2008
[147] Ibid.
[148] "2008 Collectors Guide," *Forbes*, December 24, 2007

Luxury/Experiential Travel

With luxury goods increasingly within the reach of the upper-middle-class, especially in more mature markets, HNWIs continued to purchase "exclusive experiences" as a way to differentiate themselves. According to the founder of the travel firm DreamMaker International, HNWIs are "fixated on the story—and [want to] tell their friends what they did."[149] Whether it's an impromptu trip to Italy to race a Ferrari, Lamborghini and several Porsches from Florence to Portofino, or a three-week adventure across the world, with brief stops in some of the world's most exotic locales—from Africa's Serengeti to Peru's Machu Picchu—Ultra-HNWIs are ready to spend large sums of money to "live the dream" in the most luxurious conditions.[150]

HNWIs also are seeking out philanthropic trips that give them the opportunity to do charitable work, while still enjoying luxurious accommodations. Tour operators arrange for wealthy clients to visit schools, health clinics and poor neighborhoods to see firsthand how financial donations might be implemented. HNWI demand for such trips has grown 15% over the past two years, according to luxury tour operator Artisans of Leisure.[151]

Other Luxury Categories

Luxury goods makers also reported strong growth in 2007. Richemont, the world's second-largest such firm after LVMH Group, reported that its sales rose 14% in the last three months of 2007, to 1.7 billion euros.[152] Wealthy consumers in the Middle East, Asia-Pacific and North America showed the highest level of spending on Luxury Consumables (clothing, designer apparel and accessories, etc.).

Globally, HNWIs and Ultra-HNWIs allocated 10.2% to Health and Wellness spending, which included visits to high-end spas, investments in personal fitness facilities, as well as full body scans. At the regional level, HNWIs from the Middle East, Asia-Pacific and North America allocated the most to this particular category of passion investments.

Sports Investments, Club Memberships, Wine Collections and other personal interests rounded out the remaining categories for investments of passion. Wine distributors in Europe and the United States reported that sales of mid-priced wines slowed during the latter half of 2007 and the early months of 2008, while those of "good value" and expensive wines increased[153]—in part, due to stepped-up interest from emerging market buyers from China and Russia investing their new wealth in wine collections.

While, globally, investment-of-passion interests were weighted more heavily toward tangible items, such as art collections, yachts, personal jets and the like, regional differences could be discerned. Asian HNWIs allocated the most to "intangible categories," such as luxury and experiential travel, health and wellness, and luxury consumables.[154] Luxury expenditures by Middle Eastern and North American HNWIs also exceeded global averages.[155] Compared with Ultra-HNWIs, who favored more tangible investments, such as art collections, HNWIs, in general, were more likely to spend on "intangibles."[156]

Looking Ahead

The global art market and luxury industry segments tend to be "latecomers to economic downturns." Accordingly, some industry analysts have voiced concern that these sectors may yet be impacted by the financial market turmoil of late 2007.[157] However, historically, investments in fine art, private planes, luxury automobiles and other high-priced collectibles have been more immune to economic downturns, as their Ultra-HNW buyers tend to be less adversely affected by such trends. "Affordable (and aspirational) luxury goods,"[158] which are more accessible to HNWIs as well as to less affluent individuals, may suffer more of an impact if the downturn is sustained.

Despite these concerns, analysis suggests that new wealth and growing consumer demand in Asia-Pacific, Eastern Europe and the Middle East will continue to outweigh the pressures of an economic slump in Western markets.[159]

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149 Dan Wilchins, "What the Rich Want; The Trip Is Nothing without a Story to Tell Your Friends," *Reuters*, November 3, 2007
150 Gene Sloan, "For $100,000, See the World from a Richly Detailed 757," *USA Today*, March 28, 2008
151 Jennifer Alsever, "When a Luxury Vacation Cultivates Philanthropy," *The New York Times*, December 9, 2007
152 "Swiss Luxury Goods Still Sparkle Thanks to Eastern Promise," *Agence France Presse*, February 4, 2008
153 Interview with Mehmet Yorukoglu, House of Burgundy, Inc., New York, April 2008
154 Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
155 Ibid.
156 Ibid.
157 "Swiss Luxury Goods Still Sparkle Thanks to Eastern Promise," *Agence France Presse*, February 4, 2008
158 Aaron Pressman, "Low Expectations for the High End," *BusinessWeek*, May 5, 2008,
159 "Swiss Luxury Goods Still Sparkle Thanks to Eastern Promise," *Agence France Presse*, February 4, 2008

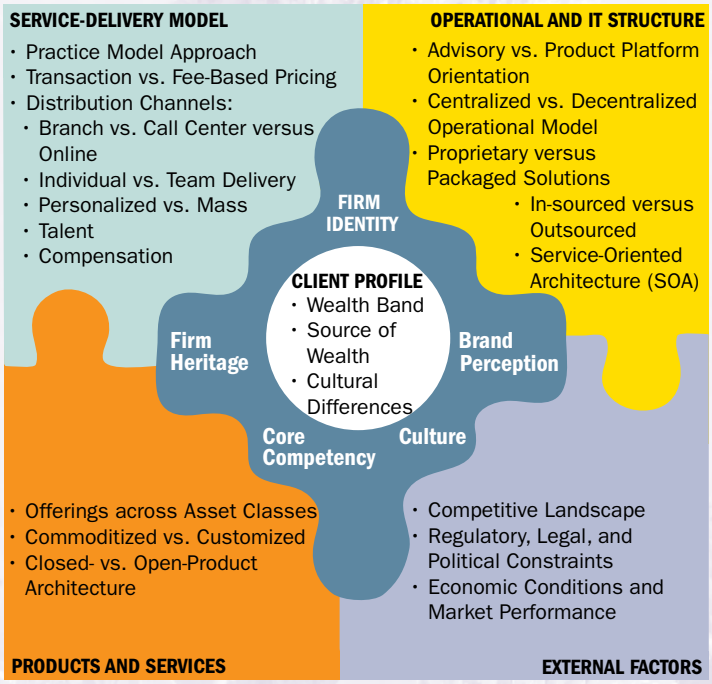
Spotlight: Wealth Management Firms Adapt to Meet Unique Needs of Growth Markets

The global pool of HNWIs is shifting in a way that presents enormous potential for wealth management firms. World wealth continues to grow broadly, despite fluctuations in markets and economic conditions, and global demographic and economic trends are bringing entirely new segments of clients into the HNW band all the time.

Some firms have already begun to grow and transition successfully into new markets, despite the volatile times, but the task is not an easy one. It requires firms to assess their own capabilities, strengths and limitations, and, most importantly, adapt existing go-to-market strategies to the unique needs of growth markets, both at home and abroad.

Not all firms will find the transition easy, or even viable, given their existing service models and information technology (IT) and operations structures. Fundamentally, the cost/benefit analysis of a short-term approach versus a long-term growth strategy for each market is needed. The question is: How much transformation will be required—and what specific issues of execution are involved to deliver a service proposition that clients demand and deserve, especially when those clients hail from unfamiliar territory?

Figure 12. | **Wealth Management Strategy: The Sum of Many Parts**



In reality, designing a winning strategy, particularly for growth, means defining an effective model that incorporates a host of complex factors. While these factors are obviously interrelated, each must be resolved to pursue growth rationally—while taking into account what the firm is, and what it wants to be.

In designing a winning growth strategy, firms particularly need to look at six key dimensions. (See Figure 12.)

- Target-client needs
- Firm identity
- Service-delivery model
- Operations and technology
- External environment and factors
- Products and services

Client needs are the nucleus of any wealth management solution, so firms have to understand and respond to those needs first. However, they also have an opportunity to influence many of the other dimensions of the strategic equation—albeit some more than others.

Above All, Growth Depends on Winning Over the Client

HNW clients are demanding comprehensive and tailored services from the multiple firms with whom they do business; wealth managers are waging an impressive response to differentiate themselves. In the ensuing competition, however, different types of wealth management firms have begun to vie for the same clients—as well as for those they traditionally have not served.

Wealth management firms are making strategic investments to differentiate themselves in the eyes of existing and would-be HNW and Ultra-HNW clients. For example, retail banks and insurance firms are investing in advisory services to become wealth managers of choice for the burgeoning retirement segment, and to establish links with those in younger generations who will be beneficiaries of intergenerational wealth transfer. This move has taken them into territory once dominated by private banks and trusts—forcing those players to look at how best to differentiate their own propositions for their HNW and Ultra-HNW clients. Some private banks and trusts are looking to institutional capabilities, such as overlay management tools (once reserved just for fund managers), to offer clients more comprehensive asset allocation, rebalancing and portfolio oversight. Investments in reporting capabilities, which offer clients more detail and analysis of their comprehensive holdings, are on the rise. Other wealth management firms are investing in "client experience" initiatives to bring a more personalized, family office-like service to HNW delivery, or introducing customizable client solutions to respond to

the growing demands of clients, who want improved visibility into embedded risk, holistic analysis of their assets and other benefits. These strategies all complement retention, while offering the potential for organic growth, but only if firms can execute them effectively.

Some leading firms have adopted more qualitative traits to define their HNWIs, such as demographics, investing behavior, geographic scope and source of wealth, since clients can no longer be segmented simply by their level of wealth. This approach helps them to distinguish and better serve clients—even among those in the same wealth band. For instance, comparing investing approaches and goals may reveal significant differences among a wealthy entrepreneur, a HNWI whose wealth is inherited, an affluent entertainer or sports figure and a baby boomer who has just cashed out a hefty retirement-savings account. By recognizing such distinctions, firms can tailor their approach—and some are going so far as to deploy teams of specialists dedicated to individual micro-segments.

Cultural factors are another variable when expanding into new regions. Consider, for example, the differences between wealthy individuals in Asia-Pacific and those in the Middle East—two fast-growing HNW sectors. In the Asia-Pacific region, many HNWIs are first-generation, self-made entrepreneurs, with limited access to sophisticated wealth management services. In the Middle East, most wealth is inherited, and cultural and religious constraints mean Sharia-compliant products and services are a must to meet client needs and expectations.

Clearly, then, as wealth management firms increasingly compete for the same HNW clients, and the clients themselves become more demanding, the pressure is on firms to understand the essence of client needs in existing and growth markets, even if they have already developed an accurate read on HNWIs in their established markets. Without this insight, firms will find it difficult to develop a distinguishing proposition.

Growth Can Elude Firms that Aim to Be What They Are Not

In seeking to capture a new market, firms also can hone their growth strategy and more easily differentiate themselves by looking first at who they are in the context of the wealth management process—their history, core competencies and brand identity. While many firms purport to be capable in all aspects of wealth management—from the advisory component to trading and execution—firms tend to excel in one area or the other, based on their history.

In short, if a firm's identity and capabilities do not align well with the needs of the target market, it will need to bolster its position—either by developing the missing capabilities or acquiring them via a joint venture or other partnership. A self-diagnosis is therefore needed before deciding which tactics to deploy to attain growth. It is especially important for firms to acknowledge and account for their roots. After all, different wealth management firms develop their value proposition from polar positions. (See Figure 13.)

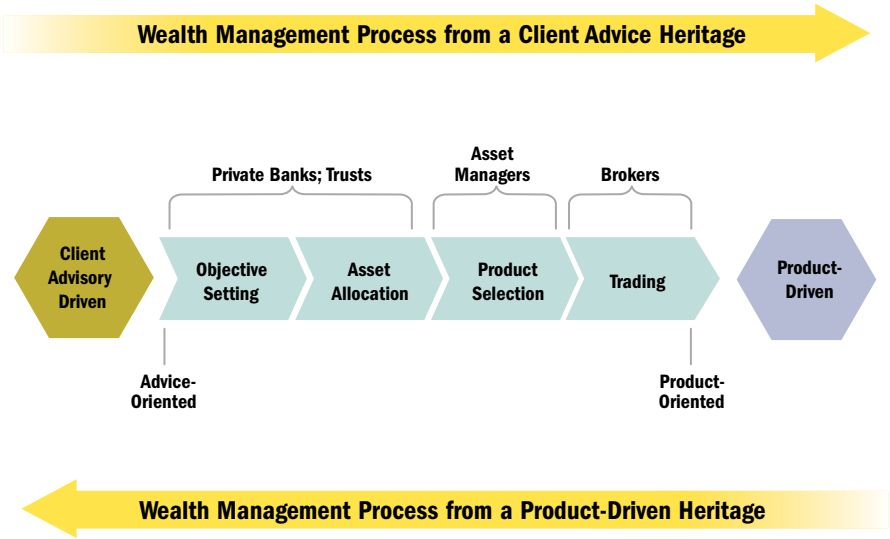
Firms with an advisory-centric approach focus on holistic client needs, develop a strategy to meet clients' financial objectives and execute against those needs with the product mix at their disposal. In essence, they are focused on the art of translating client needs into financial objectives. At the other end of the spectrum, firms with a product-centric approach excel in understanding market opportunities around specific products and how best to bring these products to clients. Both approaches combine the science of execution with the art of delivery—an "art" at which some are better than others, due largely to their respective heritages.

A firm's self-assessment also takes place, of course, against a backdrop of evolving client, market and competitive trends. These shifts are transforming the way clients perceive value in wealth management firms, and the way in which different wealth managers are positioned to deliver that value back to their clients. As a result, the approaches and models that have driven success in one market may not form the best basis for an appropriate and effective strategy for targeting growth in new markets. So, firms looking to develop winning value propositions for both existing and target growth markets need to resolve whether those propositions can comfortably coexist in the firm.

External Factors and Products/Services Need Attention, but May Not Be Big Growth Levers

When firms seek to develop an effective organizational model for growth, they consider external factors, a dimension in which they may find they have relatively little influence. For example, the regulatory environment and privacy laws may dictate or restrict what types of products can be sold to certain clients and limit the ability of "foreign" firms to serve local-market clients without investment in local infrastructure. In such circumstances, firms may have to reach clients

Figure 13. | **Wealth Management Value Chain**



through a partnership or joint venture. Economic conditions, market stability, political factors and the competition of local financial institutions are other contributing factors. Brand is another issue: A firm's brand may be perceived in a positive light in their local market, but acquire negative connotations in other markets—sometimes compounded by political, economic or popular sentiment. These issues all impact the go-to-market strategy.

Meanwhile, as the wealth management market continues to mature, and becomes more global, products and services are becoming more commoditized, making it more difficult to differentiate on product. As a result, firms need to make strategic decisions as to whether they will simply provide commoditized products, or focus on unique, customized product solutions. They also need to decide whether to restrict their offering to proprietary products, or embrace an open-architecture model. In some markets, private banks are partnering with the institutional side of their businesses to find unique private equity placements or IPO participation for their HNW and Ultra-HNW clients—i.e., one-off opportunities that are hard to match. In new markets, some firms have taken the lead from the results of their self-assessments and focused on products or advice, depending on their innate strengths and weaknesses.

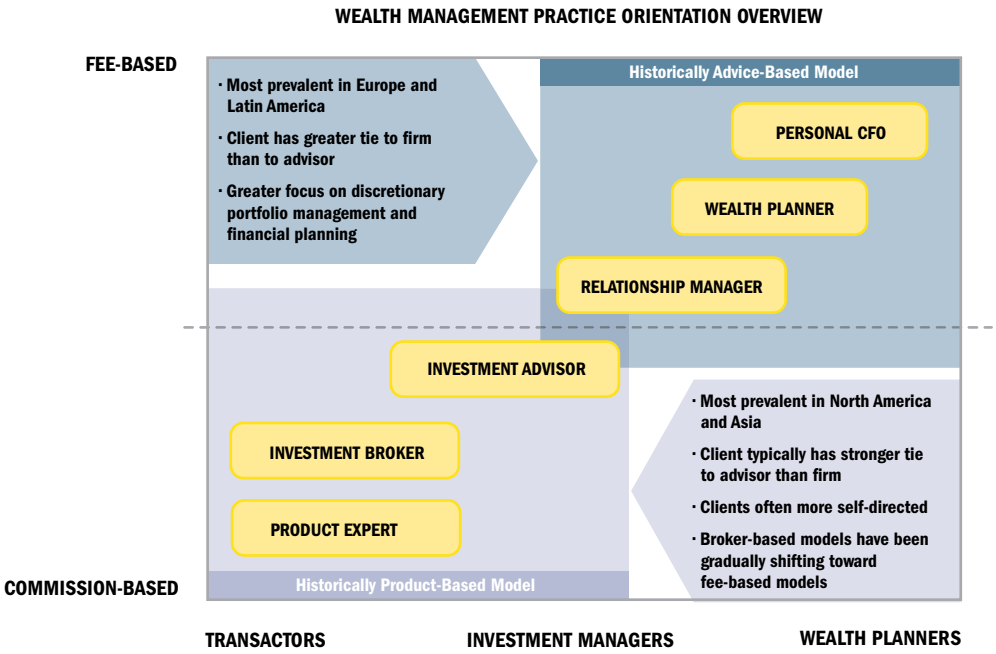
Aligned Service-Delivery Models Can Drive Significant Value

In contrast to external factors and products/services, service-delivery models can be directly influenced—and they offer significant potential for driving value in new markets. Leading wealth management firms have always known one-size-does-not-fit-all in the HNW segment, but the imperative when targeting new markets is to design a service-delivery model that is flexible enough in its architecture to accommodate diverse client needs and the diverse advisors serving them—even for firms that are not able or keen to invest heavily in the underlying technology.

Over time, many firms have acquired or developed a full spectrum of services through mergers and acquisitions or organic growth strategies, but the root of their service models often lies in their heritage, affecting key variables—from advisor talent to distribution channels, practice models and pricing structures. Successfully deploying the right type and combination of solutions is as much art as science, and may prove to be the critical differentiator—or the critical flaw—for a firm moving from one market to another.

A closer look at the typical wealth management practice models highlights how firms operate and deliver value. Practice models generally fall into three major categories: Transactors, Investment Managers and Wealth Planners. Each has a direct correlation to the preferred pricing structure—i.e., fee- versus commission-based. (See Figure 14.)

Figure 14. | **Wealth Management Practice Orientation Overview**



Transactors:

- Product Expert: Handles high-volume transactions involving sophisticated products or asset classes, such as foreign exchange derivatives
- Investment Broker: Handles transactions involving basic asset classes, such as equities, fixed income and options

Investment Managers:

- Investment Advisor: Offers strategic investment planning, as well as playing a hands-on role in constructing, reviewing and rebalancing client portfolios
- Relationship Manager: Establishes and nurtures client relationships, delegating portfolio management to internal or external managers

Wealth Planners:

- Wealth Planner: Offers holistic advice in accordance with client's finances and short-/long-term goals, such as real estate, retirement and generational wealth transfer
- Personal CFO: Aspires to provide quasi family-office services, often acting in a lead discretionary role coordinating with the client's other trusted advisors

The significance of these practice-model categories is that each reflects a different advisory approach, borne of a different perspective. While some firms claim to have a single practice orientation, many actually use multiple models in and across regions—and often leverage different models within their core markets to capitalize on the strengths of individual advisors. As they move into new markets, firms can create or exacerbate friction among the different advisory approaches they use. Importantly, practice orientations need not be mutually exclusive, but the mix of intra-firm practice models does need to be consciously managed.

When firms move into new markets and need to adapt existing service models or deploy new ones, management of coexisting service models can help them to flourish. This dynamic is also a factor for firms that consider partnering with or acquiring a local firm, or simply hiring local talent. For instance, a failure to understand the implications of prevalent practice models and those followed by new rainmakers can cripple the best-formulated strategy.

Locally dominant wealth management players are already testing their approach to service models by straying from what was once their base market to pursue opportunities. Most, however, still have a lot of work to do on the "art" facet of service delivery—the dimension in which leading firms are rallying their talent, organizational culture and distribution models to pursue new markets. In the successful pursuit of growth, however, it's incumbent upon firms to fill any critical gaps between the identity and strengths they have and those they need to deliver service excellence in a new market.

A Rightly-Sized and Executed IT Strategy Can Reduce Risks of Entering a New Growth Market

New service-delivery models also pose a challenge for operations and IT because they add complexity and stress to the already complex task of supporting core wealth management activities, and meeting associated demands of risk, compliance and data management. For instance, middle-office staff, and integrated workflows and tools, are especially critical in cementing new-client relationships. During the relationship's "on-boarding" stage, firms must be able to execute key middle-office activities effectively, such as setting up new-client portfolios and establishing initial statement cycles, to support both advisors and clients during the transition.

Simply stated, the imperative for firms is to develop from the outset an IT strategy that meets their operational objectives for new markets. Accordingly, leading firms are already assessing their existing operations and IT structures to gauge the degree to which they can be applied to other markets. In the process, it is not unusual to find strategic "blind spots," especially when planning to serve a global constituency of HNWIs, advisors and operations personnel.

After all, globally relevant and effective platforms can deliver myriad capabilities, from integrated front, middle and back offices, and multicurrency and multijurisdictional transactions, accounting and reporting, to full tax optimization, business-rules automation, straight-through processing and personalized user experiences.

However, to support new service models, it is imperative to discern and plan which capabilities are critical to success, and what options IT has for delivering them. Moreover, those plans must be executed to full effect—which can be tough in practice. In theory, for example, firms often plan to pursue global scope, scale and governance through an incremental expansion of existing platforms into new markets. Then, however, they allow one-off IT decisions for individual new markets—decisions that seem more expedient at the time, and for which there is a more tangible business case in the near term. As a result, though, the initially well-conceived service model and IT strategy are compromised—potentially constraining the effectiveness of advisors and the entire operation, and posing significant risks to the brand as it seeks to establish a place in the new market.

By contrast, an IT strategy that is aligned to the growth strategy and is well defined and executed—leveraging core business platforms and enhancing operational capabilities—can substantially reduce the risks of entering a new growth market. However, no single technology, product or sourcing strategy offers the complete solution; so, given the array of IT options, how do wealth management firms pursue a strategically sound path forward, attaining scalable operational best practices?

Heritage, it turns out, plays an important part in a firm's existing operations and IT structures as well as its service model—and therefore affects its attempts to achieve global scale and effectiveness. The differentiation among firms is not absolute, but, in general:

- "Transactors" typically have invested in large proprietary end-to-end IT systems, optimized for capturing economies of scale in execution volumes, and they usually have mature, differentiated wealth management processes and robust front- and middle-office IT capabilities.

- "Wealth Planners" have typically sought to capitalize on high-touch relationship management and specialized wealth management processes, so they leverage boutique front-office IT capabilities and back-office and execution platforms, based on application service providers (ASP) or commercial off-the-shelf (COTS) solutions.

Like the service models themselves, IT and operations structures have typically grown out of the firm's historical needs and approaches, potentially leaving a gap between the existing structure and the one needed to support the firm's growth strategy. To fill that gap, wealth management firms of all types have a range of go-to-market options—from installing quick-hit information-sharing systems that augment manual processes and workflows, and running regional operational and technology centers, to establishing robust service-oriented architectures (SOAs) with fully integrated transaction, accounting and reporting platforms.

For example, firms entering a new geographic market may not have a clearly defined operating or practice model, so investing in an overly integrated IT structure is neither appropriate nor necessary—and could end up constraining the practice model as it evolves. In such cases, it is rational and viable—and relatively quick—for the firm to move forward with a set of manual processes and limited information-sharing (e.g., via manual data entry). In effect, this approach focuses on defining the required processes, then automating and optimizing them—and that may be all that is required to execute transactions effectively (e.g., in the local currency), meet local compliance mandates and fulfill a high-touch service pledge to clients. As the new market's business scale grows over time and the business case is proven, firms can undertake the next stage of IT/operations evolution.

Similarly, some firms have a siloed approach in existing operations—perhaps as a result of acquiring firms with different systems in the past, or reflecting some legal need to hive off certain activities—and it may be senseless to deconstruct those silos simply to enter a new market. In fact, firms may be able to operate quite effectively with a technology silo, a middle-office silo, and so on, overlaying requisite capabilities and reconciling across the silos to meet operational and service-model objectives like achieving a top-down view of a business line. These silos may or may not converge at some point on a single processing site or technology platform, but firms nevertheless can achieve some standardization of processes—providing standards around risk and compliance, how customers are serviced, the look and feel of reports, and so on—across the different silos.

Another option is to adopt a service-oriented architecture (SOA) approach: A business-driven paradigm that injects operational flexibility through a framework of business activities, services, policies, practices and software. SOAs are a pragmatic choice in cases where core IT platform capabilities and operational scale are fundamental to business-case realization, and SOA adoption is viable for all firm types, large and small. The SOA approach:

- Provides a standard way of representing and interacting with software assets.
- Supports the creation of new internal applications from existing components.
- Simplifies the integration of core functions and third parties in legacy applications and elsewhere.

As such, SOA allows for judicious incremental IT investments, which can unlock value embedded in mature legacy platforms, while providing contemporary capabilities, such as fluid workflows, improved straight-through processing, business-rules automation and business-activity monitoring.

Clearly, there is no universal remedy for structuring IT and operations in existing or new growth markets; the solution depends in large part on the business case—and the state of the existing model. To select the most appropriate and viable path forward, firms must iterate around some key considerations, including:

- Stability and efficacy of the existing IT capabilities and operating model, and their applicability to target markets
- Scale of the target market
- Sophistication of required capabilities
- Level of integration needed in IT/operations
- Availability and maturity of industry utilities, components and service providers

Wealth Management Firms Encounter New Challenges When Addressing Growth-Market Needs

Figure 15A. | Global Private Bank Uses Advice to Target Lower Wealth Tier in Emerging Markets

Situation

This private bank successfully serves both HNW and Ultra-HNW clients in its home market. As part of a broader growth strategy, it had invested heavily in a comprehensive reporting platform that allowed advisors to view clients' relationship holdings and serve them across regions. It rolled out the same advisory model and platform around the globe, differentiating itself by using a holistic advisory approach.

Growth Strategy

The bank was able to expand into emerging wealth markets in Asia by configuring the existing platform and limiting the functionality and complexity for a more-simplified advisory approach, in line with a tiered service model approach.

Lessons Learned

By utilizing an existing platform, and understanding local-market needs and expectations, the bank successfully differentiated itself by delivering sought-after advice to a lower-tier wealth segment.

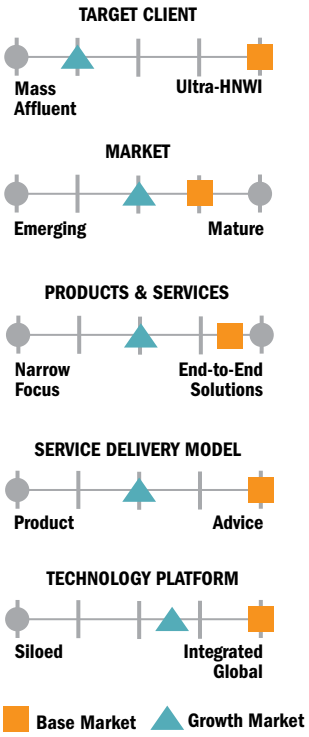


Figure 15B. | European Private Bank Struggles to Extend Offering Overseas

Situation

In its home market, the bank serves HNW and Ultra-HNW clients from all over the world, providing a breadth of services to clients, including advisory and concierge services, but limited in the way of innovative products.

Growth Strategy

In both mature and emerging markets, the firm has led with the brand cache, but limited its service offerings and advice, instead looking to attract various wealth segments with some unique product propositions, but limited. The organizational model retained domestic orientation, and each market deployed their own siloed technology platform.

Lessons Learned

While enjoying moderate success, the firm has struggled to gain top billing in many markets. The siloed technology platform has inhibited the firm's effectiveness in growth markets by limiting access to home-market assets. Additionally, while struggling to gain traction, the private bank remains committed to its heritage domestic model, having strong convictions it will significantly differentiate them in their growth markets. As a result they have conceded convergence with the target market objectives will exceed originally forecasted timelines.

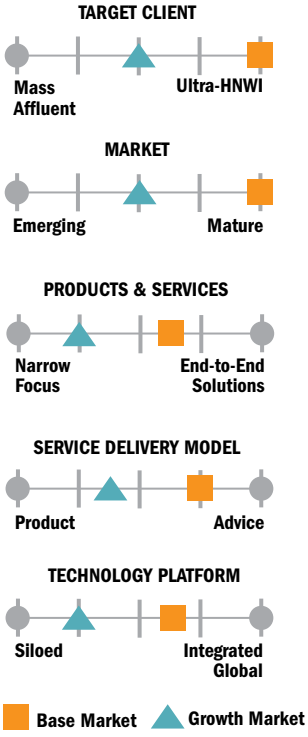


Figure 15C. | Brokerage Firm Overcomes Technology Constraints to Capture Emerging Market Ultra-HNW Clients

Situation

In its home market, the firm focuses heavily on its advisory process, and has invested in an extensible platform that serves Mass Affluent and HNW clients. However, because the platform was only U.S. dollar-based, it was difficult to extend the platform for global scale without major overhaul and investment.

Growth Strategy

Instead, for its international growth strategy, it focused on the Ultra-HNW client segment, which it believed was looking primarily for unique product propositions—such as structured products and unique private equity participation.

Lessons Learned

Despite a U.S. dollar-based technology platform, the firm understood the needs of targeted Ultra-HNW clients, and paid much attention to cultural differences. It has succeeded with the product approach in emerging Europe and Russia, as well as in the Middle East with its Sharia products.

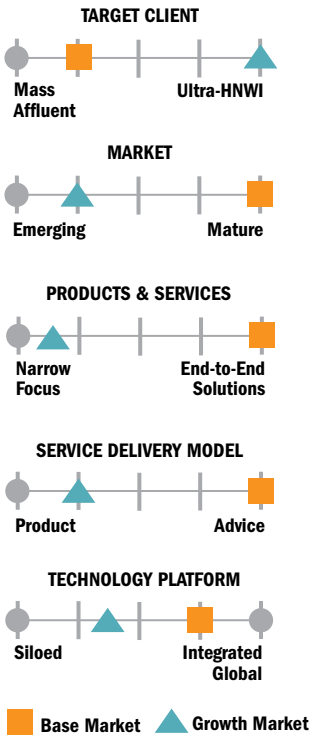


Figure 15D. | Boutique Bank, Misreading Needs, Fails in Bid for New Latin American HNW Clients

Situation

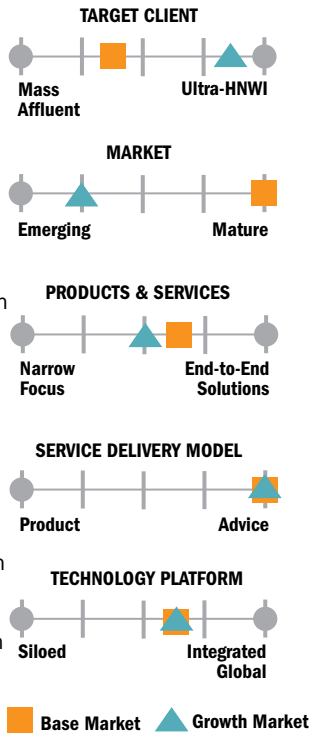
A small boutique private bank, serving HNW clients in its home market with advisory services, had a limited technology platform, but had access to a wide array of products for its clients with an open-architecture.

Growth Strategy

The firm decided to target the growing Latin American base of millionaires by locating itself in Miami, Florida, a travel and business hub for many Latin American clients. The firm assumed it would also gain some U.S. HNW market share as a secondary target due to the location. It hoped to gain market share with its highly personalized approach, advice, and the open-architecture.

Lessons Learned

The boutique bank did not succeed with its plan, assuming that the Latin American clients needed the same products as U.S. HNW clients. It failed to offer the products and services that Latin American clients needed when offshoring their money to the United States, with requisite tax advice.



Conclusion

The hallmarks of wealth management—sophisticated, discerning clients; complex services; and stiff competition—are all compounded in the HNW segment, where firms have long deployed superior talent, expertise and technology to differentiate themselves. The stakes are rising anew, as global economic and demographic trends produce new growth opportunities, forcing firms to search for go-to-market strategies able to attract new client segments through organic growth. In the process, firms are tackling an eternal dilemma: How to execute successfully to capture growth opportunities, differentiate themselves among target clients, and—ideally—become a firm of choice for the HNW and Ultra-HNW clients they serve.

When seeking to enter new markets, wealth management firms inevitably encounter challenges they do not face in their established markets. To define and execute a successful growth strategy, firms will need to respond to all the forces described, and ask and answer serious questions around the key dimensions of strategy. For example:

- Do we have a comprehensive understanding of client needs in our new target markets?
- Have we made an honest assessment of who we are and who we aspire to be?
- What are our long- and short-term growth strategies?
- How do we best leverage our existing capabilities and strengths to determine the most pragmatic and effective service-delivery model and operational/IT capabilities for enabling success in new markets?
- How can we improve speed to market entry, and what strategic sourcing options make the most sense?

Ultimately, the greatest success will be realized by those firms that comprehensively understand their clients, and are able to leverage their existing strengths to transform and adapt their service delivery and technology to cater effectively to client needs in their target growth markets.

The War for Talent Intensifies

More HNWIs Seek "Trusted Advisors"

The "trusted advisor" relationship is the cornerstone to long-term relationships between clients and advisors, as well as wealth management firms. While most HNWIs and UHNWIs have relationships with multiple wealth management firms,[160] many clients seek long-term "trusted advisors" who can help them navigate complex topics and strategies. HNWIs are becoming increasingly "hands-on" and sophisticated in their financial needs and investment behaviors. As a result, these wealthy individuals seek advisors they can trust for comprehensive wealth management services, not only guidance on investments. Clients expect advisors to understand them in the context of a larger relationship that encompasses personal and family finances as well as business partnerships or estate planning.

However, as HNWI population and wealth continue to climb, so does the number of clients seeking private bankers and wealth managers. Since 2002, total wealth held by HNWIs has grown by more than 50%, from US$26.7 trillion to US$40.7 trillion. During the same period, the number of HNWIs worldwide has increased by nearly three million individuals.[161] This has compounded the demand for talented advisors from wealth management firms. Yet, the expectations of advisors may differ from one market to another. In many mature markets, for example, large retiree populations seek advice on how to draw steady income from their retirement assets. But in several emerging markets, HNW clients seek advisors who understand both the global financial markets and nuances of the local culture, as they desire to capture more sophisticated products as their wealth grows. Wealth management firms have adapted in response to the changes in their client base, shifting the industry from a transaction-driven business to an advice-oriented and fee-based business.

[160] Capgemini/Merrill Lynch Financial Advisor Survey, 2008
[161] Capgemini analysis, 2008

In mature markets advisor talent is increasingly in demand by HNW clients and in emerging markets even more so. The challenge remains, however, in matching each client with their specific needs with the appropriate advisor. Client demand for a "trusted advisor" further exacerbates this trend as HNWIs tend to favor older—and, presumably, more experienced, dedicated and talented – private bankers and wealth managers. The average advisor in North America is now 52 years old, and industry experts estimate that, within five years, 42% of the advisors now practicing will pass 60 years of age and near retirement.[162] Similar age trends among advisors exist globally. Some analysts speculate that if more advisors retire than enter the sector, the demand for talent will sharply increase. However, wealth management firms globally are actively hiring the next generation of advisors.

Developing and Attracting Top Talent Is a Major Investment

A decade or two ago, traditional firms had relatively linear tracks for recruiting and training future advisors. Today, however, wealth management firms have broadened the spectrum from which they seek out new talent. Before becoming an advisor, new recruits may be placed in different tracks to learn about the business, and conversely, firms learn about them before placing them in appropriate roles helping them build their client base. Attracting advisors involves recognizing the desired mix of personality and skill. Equally important for meeting the needs of HNW clients and earning their trust are relationship management skills as well as technical skills. And so, executives and recruiters attempting to tip the outcome of "the war for talent" in their firm's favor have tried innovative spins on current strategies to grow, including looking for successful executives outside wealth management with similar skills, for new hires. Some firms have sought out successful lawyers, accountants, educators, consultants and salespeople to join their ranks.[163,164] While new to wealth management, these hires from other industries making a mid-career switch often relate well to a wealthy clientele that may prefer older, or "life-experienced" advisors. Yet, as wealth transfer and estate planning becomes more important to HNW clients, firms are still seeking hires that can relate to and earn the trust of a younger generation.

However, given the increased costs of educating, training, and grooming talent to become future advisors, many wealth management firms have had to balance their programs with situational acquisitions that make sense. Despite the intensity of effort, capital, and resource on the part of firms, attrition among advisors is still high, as the job of an advisor is rigorous, demands discipline, as well as strong relationship and technical skills. Interviewing 15 to 20 candidates for every individual that eventually becomes an advisor is not unusual.[165] Some firms have reported drop-out rates in training programs between 40% and 60% over a five-year period.[166] Not that the acquisition of talent is necessarily an easier option. To acquire talent, firms find themselves balancing opportunity costs of promising upfront and guaranteed bonuses and capital firms could use instead to develop new and less experienced advisors, who are likely to have a greater loyalty as they mature and prosper.[167] The competition for talent has risen to an extent that bidding wars among firms for top advisors are not uncommon, with promised bonuses equaling two or three times the payouts from just a few years ago.[168] In many instances, firms need years to recoup recruitment costs for highly experienced financial advisors.

Strategies for Motivating Talent to Stay for the Long Haul

Advisor turnover and retirement—and the attendant impact on clients—is a constant concern for wealth management firms. While turnover rates can vary by firm size and location, many firms face rising attrition. To combat this trend, some of the industry's innovative firms have experimented with novel ways to reward performance and loyalty. For example, firms are increasingly using the promise of a career path to aid advisor retention. Other wealth management firms are using more traditional tactics such as equity, as well as defined percentage payouts on new assets they bring to the firm.[169] Firms have reengineered compensation packages, revising voluntary deferred compensation and additional retirement options. In the past, firms used voluntary deferred compensation and longer vesting periods to compensate financial advisors and increase retention. Indeed, vesting periods in wealth management tend to be longer than for other sectors in the finance industry as relationships between client and advisor can take years to establish. But today, several firms have rethought their arrangements and have adjusted the defined vesting periods to incent advisors to behave strategically in the client's and the firm's long-term interests. For example, before advisors retire, wealth management firms have arranged a compensation plan that extends income into retirement, which works well for the client, the advisor and the firm. The advisor, reaching retirement, can carefully transition clients to colleagues, ensuring key relationships are maintained, while remaining a mentor/consultant for the firm/client relationship. The transition for clients is thus evolutionary and easier.

Time is increasingly becoming an important factor in the acquisition and retention of talent, as advisors weigh the advantages of the short- and long-term implications of their compensation packages. Several innovative wealth management firms have looked outside the sector

[162] Helen Kearney and Lee Conrad, "The War For Talent," *On Wall Street*, March 1, 2008
[163] Jane Croft, "War for Talent Fuels Pay Rises for Recruits," *Financial Times*, June 20, 2007
[164] Capgemini research, 2008
[165] Interview with Phil Sieg, Merrill Lynch, April 2008
[166] Dennis Gallant, "The Top Producer Syndrome," *Registered Rep*, September 1, 2007
[167] Capgemini analysis, 2008
[168] Halah Touryalai, "Independent Together," *Registered Rep*, March 1, 2008
[169] Joseph Giannone, "UBS sets awards plan to boost assets, keep brokers," *Reuters*, May 22, 2008

for competitive compensation structures. For example, using a model frequently used in real estate investment firms,[170] wealth management executives and recruiters combine upfront and guaranteed bonuses into a multi-year compensation package and significant carried interest. Spreading out compensation, for example, from a four-year to a nine-year vesting period, allows a firm to pay more over the long term, and less upfront, as well as help keep the talent investment with the firm. From both the advisor and firm perspective, multi-year bonuses, together with voluntary deferred compensation and retirement plans, complete a competitive compensation package. And spreading a bonus over several years benefits executives concerned with the retention of talent, as it lessens the temptation for advisors to leave, and frees capital for firms to use elsewhere until the payout date.

Advisor Retention Correlates with Quality of Support

While compensation levels contribute to advisor satisfaction and retention, the quality of support a wealth management firm provides to its advisors is also a driver of advisor and client satisfaction.[171] Because HNW clients tend to follow their "trusted advisors" when the advisors switch firms, both advisor retention and client retention correlate with the quality of support. As a way to enhance advisor and client retention, many firms invest in operational support and client-experience initiatives to deliver not just a "trusted advisor" but a "trusted firm" to the client. Thus, when advisors retire or switch firms, the clients are likely to trust the firm despite the change. Many firms now focus on enabling advisors to meet their clients' needs more effectively as a way to lessen a clients' desire to switch firms. Investments are being made in front-office operations and support as well as specialized technology so advisors cannot easily replicate the advisor-client relationship and related services if they go elsewhere.

Leading firms are investing in analytic tools that all advisors can use as training or coaching tools to provide them with a better understanding of the client needs. By providing advisors with real-time, detailed analytics to identify which clients are underserved and offer actionable recommendations, more advisors are likely to support clients effectively and holistically. Firm executives also are studying these "needs-based" analytics to pinpoint best practices unique to their organization and business models that are experiencing the most success. These analytic tools can help to identify advisors with the greatest retention-risk factors, and therefore, can help firms assess what impact their attrition could have on client satisfaction. Such warning allows executives to engage these at-risk advisors proactively.

In recent years, firms also have begun to place greater value on team-based models over individual advisors. Team models enable a firm to provide their clients with access to specialists, whose collective expertise covers the full spectrum of wealth management needs services to meet their growing demands and expectations. Firms too benefit from "team financial advisors" in the form of greater performance—10% to 20% over individual financial advisors—and higher retention rates.[172] Additionally, convincing HNW clients to leave a firm is more difficult when more than one "trusted advisor" is integral to the long-term relationship. For those firms embracing a team-based model, a retiring advisor is not as daunting, as maturing advisors transition the client to other "trusted" team members. Team models enable strategies to develop talent, allowing firms to develop promising advisors with senior colleagues while enhancing the trust between advisors and clients.

Several leading firms have also developed in-house practice management consulting groups focused on maximizing the effectiveness of financial advisors in supporting their clients' needs. These groups provide advisors teams with training on best practices, global perspectives, and objective evaluations with attendant recommendations to advise a client better. The support from the consulting groups range from individual consulting engagements (both short- and long-term) to one-on-one coaching, and may even include access to a best practice knowledge base. By investing in these in-house practice consulting groups, firms demonstrate their commitment to advisor satisfaction and success. Such investments and support can distinguish a firm in the recruiting and retention of talented advisors while enhancing the firm's ability to earn the trust of its clients.

The competition for talent has led to firms taking more innovative approaches to invest in their wealth advisors. These strategies, including attracting individuals from outside the sector and enhancing the quality of support for current advisors, have not only facilitated firms to better support their advisors, but have also enabled them to more effectively meet their growing HNW client needs.

[170] Russell Reynolds Associates, "2007 Recruiting Trends: Asset and Wealth Management"
[171] J.D. Power and Associates, "2007 Financial Advisor Satisfaction Study," May 2, 2007
[172] Interview with Richard Orlando, Merrill Lynch, April 11, 2008

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 have estimated 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 reported in the 2008 *World Wealth Report* have been updated since publication in previous reports).

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 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 have used statistics from countries with available data to calculate their financial wealth figures and extrapolated these findings to the rest of the world.

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

In response to industry and media requests, in 2005, we revised the methodology to move from reporting our annual findings at a regional to a country level. In addition to applying up-to-date annual statistics, we made adjustments to estimate the number of HNWIs and their financials more precisely at a country level. We have continued with this approach in this year's report.

This year, we continued to enhance our macroeconomic model with increased analysis of domestic economic factors that influence wealth creation. We have worked, for example, with colleagues from Capgemini and Merrill Lynch in over 30 countries to best account for the impact of domestic, fiscal and monetary policies over time on HNWI wealth generation.

Given exchange rate fluctuations over the past years, especially with respect to the U.S. dollar, we again assessed 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 our results.

The translation to U.S. dollars is made using a yearly average exchange rate. Wealth is calculated in the *WWR* model by first calculating cumulative savings at a country level, going back about 100 years. As our model calculates cumulative wealth in U.S. dollar terms using a time series of data going back over 100 years, the impact of a sharp currency appreciation for a year or two has a negligible effect. For example, our analysis shows that if exchange rates in 2007 had remained at the same level as in 2006, global HNWI wealth in 2007 would have been only 0.2% lower than our reported figure of US$40.7 trillion.

We would like to thank the following people for helping to compile this report:

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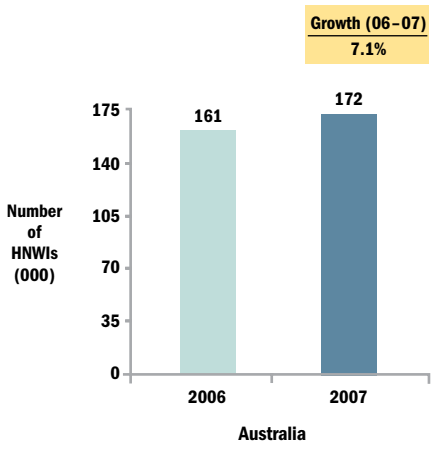
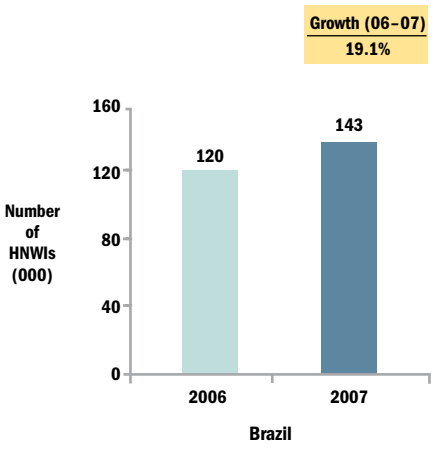
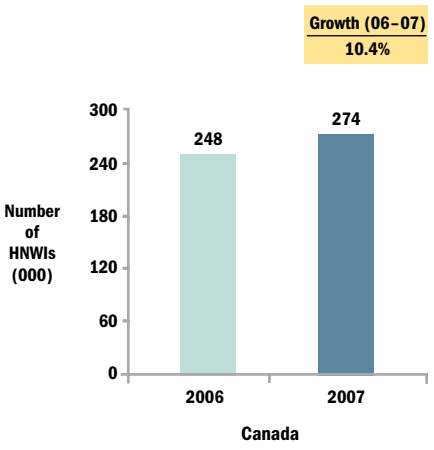
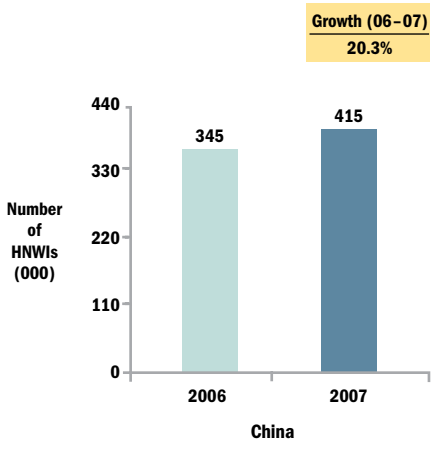
We extend a special thanks to those firms that gave us insights into events that are impacting the Wealth Industry on a global basis as well as those participating in this year's Financial Advisor Survey: ABN AMRO Private Banking; ANZ Private Bank; Banco Urquijo; BBVA Patrimonios; Citigroup Private Bank and Smith Barney; Christie's; Credit Suisse; Morgan Stanley; Marshall & Ilsley Wealth Management; Popular Banca Privada; Santander Banca Privada; Schretlen & Co.; and Van Lanschot.

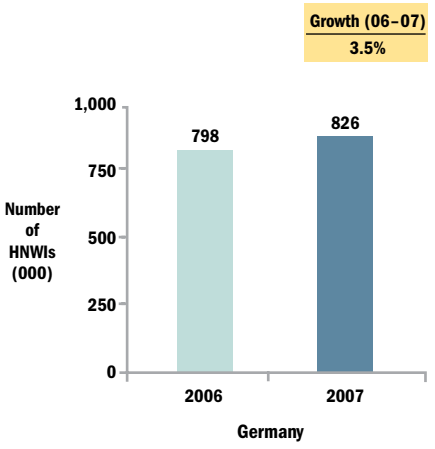
Appendix B: Select Country Breakdown

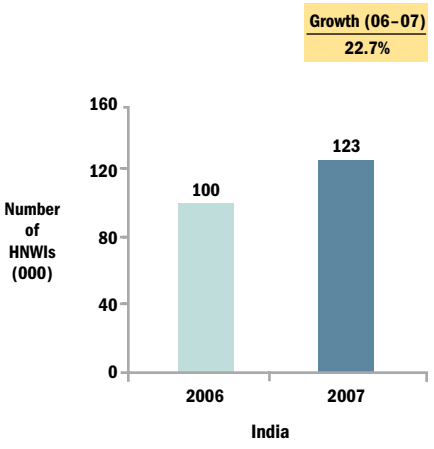


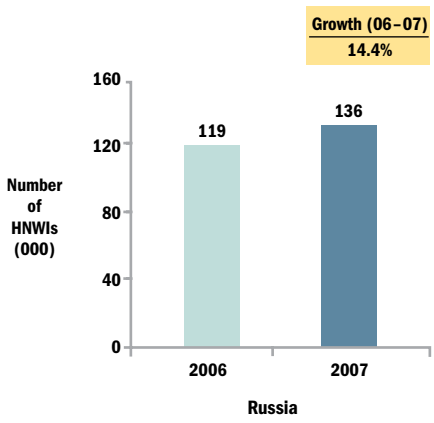


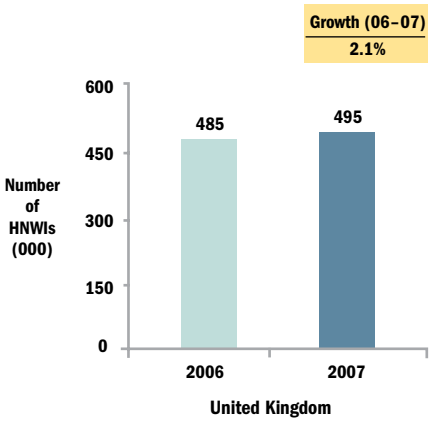


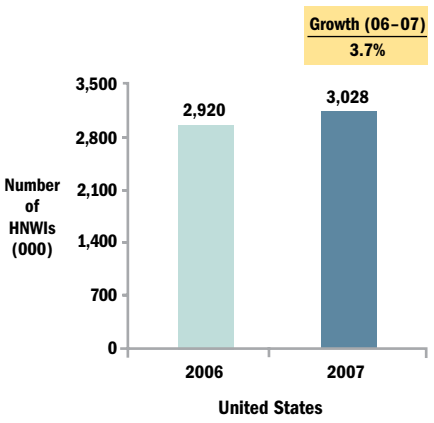












Source: Capgemini Lorenz curve analysis, 2008

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