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Merrill Lynch

World Wealth Report

2007

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To Our Readers,

On behalf of Merrill Lynch and Capgemini, we are pleased to present the *2007 World Wealth Report*. This is our 11th annual in-depth look at changes in the high net worth marketplace, which includes our read of macroeconomic factors shaping the behaviors of wealthy individuals around the globe, and our insight as to what is driving growth in the industry.

Our findings for 2006 show accelerated growth in terms of both GDP and market capitalization—the two key drivers of wealth creation. That growth led to an increase in the number of high net worth individuals (HNWIs) around the world, and an increase in the value of their assets. In regard to asset allocation, the Report found that in 2006, investors increased their allocations to real estate, capitalizing on the success of commercial real estate and real estate investment trusts (REITs).

This year's Spotlight section focuses on client service models and how they are changing from traditional models. As the needs of HNWIs become increasingly complex, and the choice of providers grows, wealth management firms are realizing that the quality of their service models is closely tied to their continued success. The relationship between an advisor and client is built on trust, integrity and results. But that is only part of the equation. For that relationship to work effectively, it must be backed by a quality service model. Leading firms understand this and are investing in platforms that give their advisors the best tools to serve the interests of their clients and allow them to adjust to the ever-changing marketplace.

In this year's Report we also take an in-depth look at HNWIs' investments of passion. We find that although art continues to be a favorite investment of this kind, luxury collectibles account for the largest spend.

We appreciate your interest in our findings, and we look forward to publishing our second annual *Asia-Pacific Wealth Report* later this year.

Robert J. McCann
Vice Chairman and President
Global Private Client Group
Merrill Lynch & Co., Inc.

Bertrand Lavayssiere
Managing Director,
Capgemini
Global Financial Services

State of the World's Wealth

HNWI SECTOR GAINS IN 2006

- **9.5 million people globally hold more than US$1 million in financial assets, an increase of 8.3% over 2005**
- **HNWI wealth totals US$37.2 trillion, representing an 11.4% gain since 2005**
- **Wealth generation was driven by real GDP gains and continued market capitalization growth**
- **Emerging markets registered strong advances in market capitalization, aiding wealth creation in regions such as Latin America, Eastern Europe and Asia-Pacific**
- **Singapore, India, Indonesia and Russia witnessed the highest growth in HNWI populations**
- **HNWI financial wealth is expected to reach US$51.6 trillion by 2011, growing at an annual rate of 6.8%**

A Return to Strong Performance Gains

The year 2006 marked a return to performance levels not seen in several years, a result of accelerating macroeconomic indicators and HNWI population growth. In 2003, stock markets were strong; 2004 recorded robust real GDP growth. Gains in 2006 advanced on a combination of these earlier trends, improving upon the decelerated growth witnessed in 2005.

Real GDP and market capitalization growth rates, two primary drivers of wealth generation, accelerated throughout 2006 — which helped to increase the total number of HNWIs around the world as well as the amount of wealth they control.

Globally, the HNWI population grew by 8.3% in 2006, to a total of 9.5 million individuals. HNWI population gains were particularly strong last year in Africa, the Middle East and Latin America, advancing by 12.5%, 11.9% and 10.2%, respectively, and outpacing more developed nations. These gains came amid these emerging markets' attempts to solidify their infrastructures and become more developed economies.

Global wealth continued to consolidate in 2006 — a trend we have reported for the past 11 years — with the assets of the world's wealthiest individuals accumulating at a faster rate than the growth of the overall HNWI population. The Middle East was the notable exception.

Total HNWI wealth in 2006 grew by 11.4% over the previous year, to US$37.2 trillion in financial assets, a significant gain over the 8.5% scored in 2005 and 7.8%[1] growth in 2004. Wealth growth in 2006 outpaced HNWI population growth by 3.1 percentage points. These gains were particularly strong in Latin America, Africa and Asia-Pacific, where 2006 HNWI wealth grew by 23.2%, 14.0% and 10.5%, respectively, thanks to record prices in the oil and metals industries that flourish in these regions. In the Middle East, total HNWI wealth grew by 11.7% in 2006, while the overall HNWI population grew by 11.9%, which suggests a dispersion of wealth in this part of the world.

In large measure, the continued growth of HNWI wealth has been driven by the world's wealthiest individuals — the Ultra-HNWIs: those whose financial assets exceed US$30 million. In 2006, the number of Ultra-HNWIs grew to 94,970, an 11.3% gain, up from a 10.2% gain in 2005. Total wealth accumulation for this elite group also grew last year, by an impressive 16.8%, to US$13.1 trillion — another sign that global wealth is rapidly consolidating among this ultra-wealthy segment.

Real GDP and Market Capitalization Drive HNWI Wealth

With economic gains returning to the levels last seen in 2003 and 2004, real GDP and market capitalization accelerated in most regions of the world. The rise of oil prices in the first half of last year helped bolster real GDP gains in oil-producing nations in 2006. The subsequent fall of oil prices, benefiting oil-importing nations, coupled with relatively low inflation, helped drive real GDP growth worldwide to 5.4%, compared with 5.0% gains posted in 2005[2]. Global GDP growth in 2006 was especially buoyed by continued strong performance in the Asia-Pacific and Eastern European regions.

While the accelerating pace of real GDP growth partially reflects steady performance of the world's most mature economies, emerging

[1] *World Wealth Report*, *2005* and *2006*, Capgemini and Merrill Lynch

[2] Economic data derived from the Economist Intelligence Unit, select countries, February 2007

Figure 1. | **HNWI Population, 2004 – 2006 (by Region)**
(In Millions)

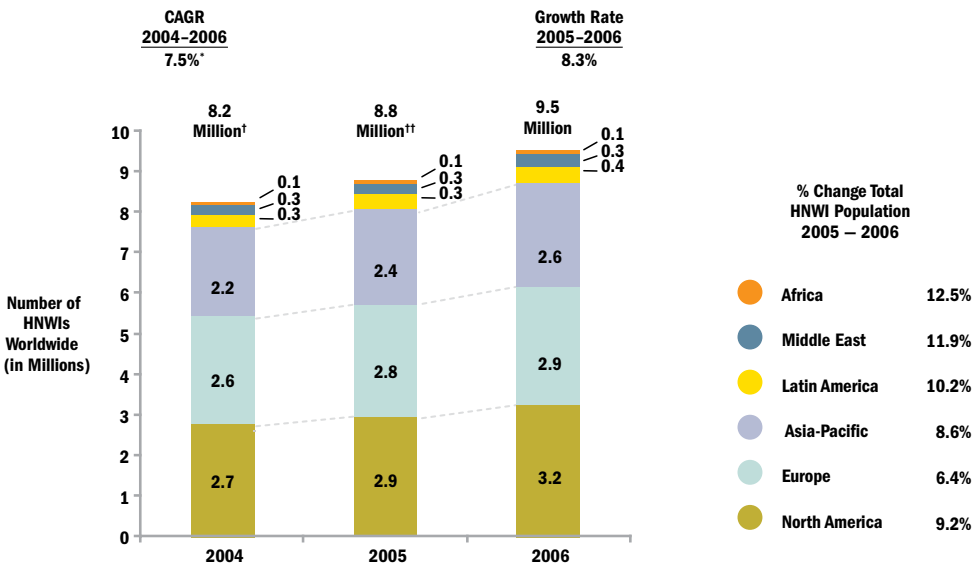
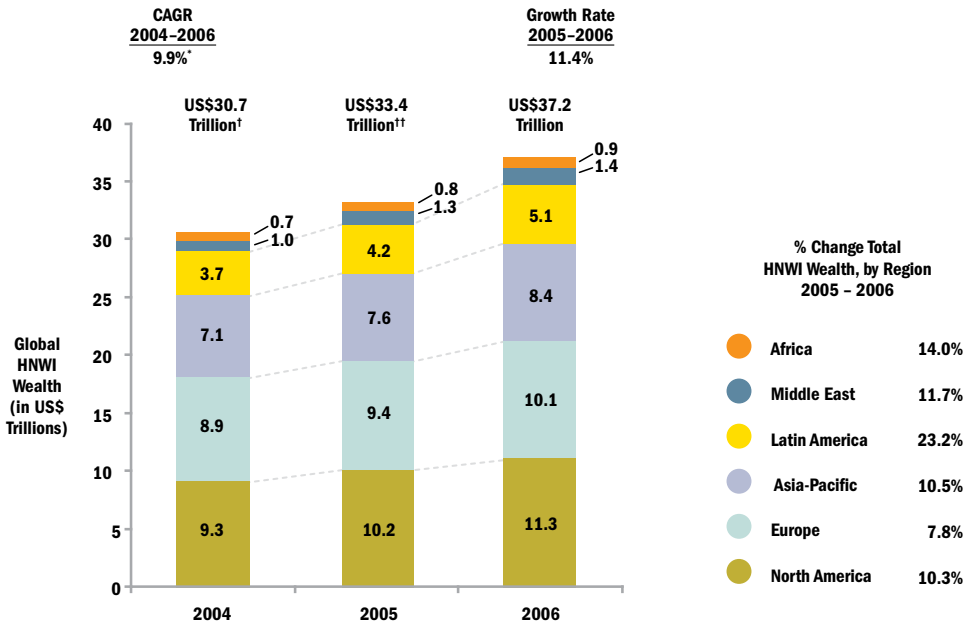
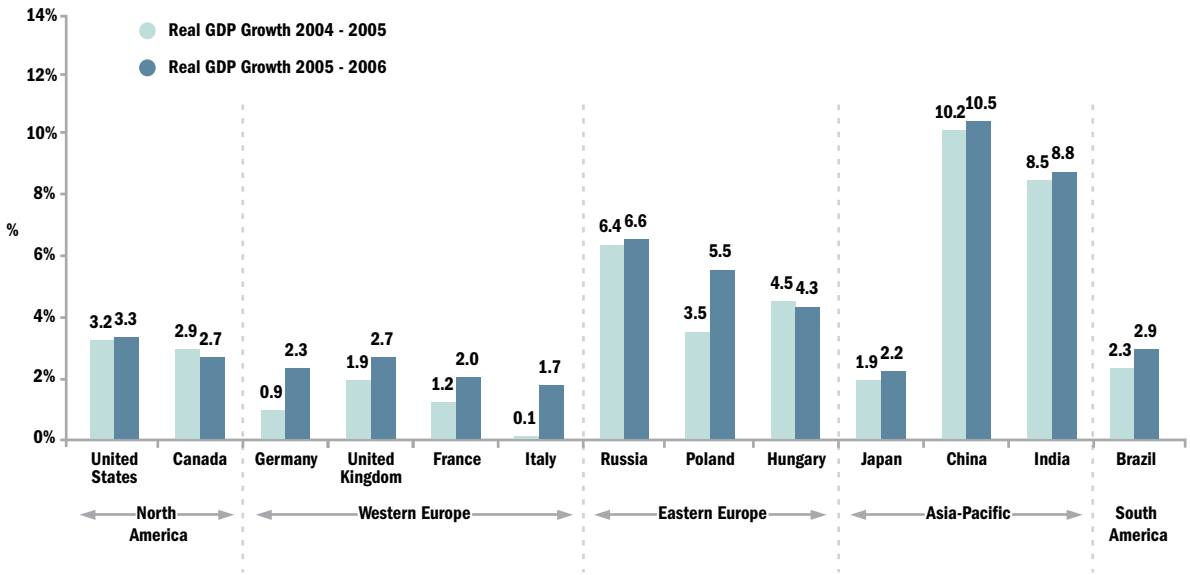


Figure 2. | **HNWI Wealth Distribution, 2004 – 2006 (by Region)**
(US$ Trillions)



† In 2004, the number of Asia-Pacific HNWIs (and thus Global HNWIs) was restated as a result of updated data becoming available
†† Bahrain and Qatar were added to the model for years 2005 onward. As a result, the number of HNWIs in 2005 is 8.8M instead of 8.7M (as stated in the *2006 WWR*)
* This CAGR has 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, 2007

Figure 3. | **Real GDP Growth in Select Economies**



Source: The Economist Intelligence Unit, February 2007

markets continued to outperform the rest of the world, which had a positive effect on wealth creation in those particular economies. In 2006, China and India, for example, sustained real GDP growth rates of 10.5% and 8.8%, respectively, among the highest of any economy in the world. Similarly, certain areas of Latin America and Eastern Europe also enjoyed real GDP growth rates that outperformed the global average of 5.4%. This was most evident in the oil-producing nations of Venezuela, with real GDP growth of 10.4%, and Russia, with 6.6% growth.

In July 2006, the United States Federal Reserve ended what had been a steady stream of interest rate increases, signaling that it felt it had successfully contained growth. This, in effect, kept real GDP growth almost constant, at 3.3%, in 2006, compared with 3.2% in 2005.

Market capitalizations grew rapidly in Europe, Asia-Pacific and Latin America, driven by strong corporate profits, IPO activity and ongoing foreign investment. For example, in Asia, the Shanghai/Shenzhen market capitalization grew by 220.6% in 2006, mainly on the strength of IPOs. Indeed, approximately 90% of the Industrial and Commercial Bank of China's (ICBC) IPO investments listed on the Hong Kong exchange came from global institutional investors[3]. Overall, we see HNWIs being interested in opportunities around the globe and moving quickly to take advantage of them.

In addition, HNWIs took advantage of opportunities in Latin America, Africa and Asia-Pacific. Here, rising oil revenues and commodity prices helped bolster economic growth.

Global Markets Post Robust Gains

Stabilizing market capitalization growth rates in 2005 set the stage for record stock market performance in 2006 and a return to the levels of 2003 and 2004. Although performance varied across the world, almost all indexes posted gains; some were rather substantial. For example, the Dow Jones World Stock Index grew by 16.4% in 2006, compared with 9.5% in 2005[4]. This increase was largely due to the performance of small- and mid-cap stocks, which boosted the Dow Jones World Small Cap Index's returns by 19.6% in 2006, compared with 11.4% in 2005, and the Dow Jones World Mid-Cap Index's returns of 17.3% in 2006, compared with 14.3% in 2005.

In the United States, 2006 market performance was robust: The Dow Jones Industrial Average, the S&P 500 and the NASDAQ advanced 16.3%, 13.6% and 9.5%, respectively. Growth was spurred by strong corporate profits, declining oil prices in the second half of the year, and increased investor and consumer confidence.

[3] "HK Beats New York on IPOs," China Knowledge Press, November 2, 2006

[4] Stock Index Performance, cited in "Year-End Review: Markets and Finance 2006," *The Wall Street Journal*, January 2, 2007, page R6. All index returns not quoted in *The Wall Street Journal* were calculated using the time period December 30, 2005 to December 29, 2006

Overall, however, markets outside the United States performed even better, with strong returns delivered by Europe, Asia-Pacific and Latin America. Record gains in these geographies in 2005 enticed foreign investors to invest even more heavily in these markets in 2006.

In Europe, markets rose in response to corporate restructurings, technology investments and a range of cost-cutting moves in 2006. In Germany, the DAX gained 22.0% for the year, albeit a decline from the 27.1% gains posted in 2005. France's CAC 40 and the London FTSE 100, too, were up, by 17.5% and 10.7%, respectively, for the year.

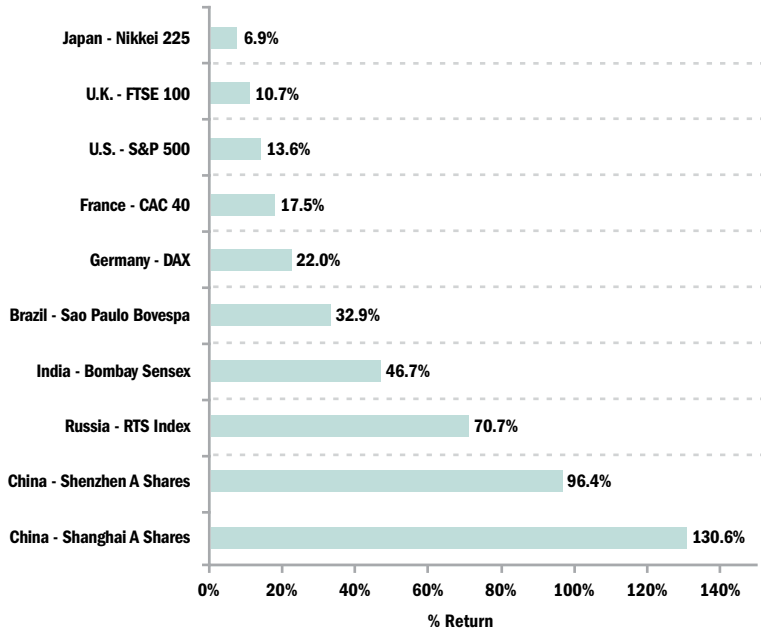
Asia-Pacific markets — with the exception of Japan — remained particularly strong in 2006. Most notably, the Dow Jones China/Shanghai Index returned 130.6%. Also, smaller Asian markets did well in 2006, including Indonesia and the Philippines, where Dow Jones Indexes returned 62.0% and 49.5%, respectively, on the back of strong economic fundamentals. This provided still more opportunities for HNWIs to cultivate their wealth. South Africa, Venezuela and China/Shanghai also were among the best performers in 2006; strong economic growth in China and high commodity and oil prices in Venezuela strengthened corporate profits and helped push gains in their respective stock markets. The Morgan Stanley Capital International (MSCI) Emerging Markets Index returned 29.2% in 2006. Commodities, too, did particularly well in 2006, bolstering gains in commodity-producing nations such as Brazil and Mexico, which export soybean and crude oils.

Still, not every market advanced as much. The Swiss Market Index, for example, recorded a sharp decline in growth, from a 33.2% gain in 2005 to 15.8% in 2006. Japanese markets, too, slowed significantly, with the Nikkei 225 dropping from a 40.2% gain in 2005 to a modest 6.9% upturn in 2006. Along with signs of profit-taking from investors, Japan's consumer confidence continued to drift below 50 points, as it has for the past several years, reflecting a negative domestic outlook for the Japanese economy[5]. Proposed legislation seeking to put a 20% cap on consumer loan rates inside the country added to the market pressure, forcing down the share prices of leading consumer lenders[6].

Savings and Interest Rates Climb

Monetary policy was tight in most regions of the world, with the exception of the United States and South Korea. While these two nations stopped raising interest rates in mid-summer, most central banks, including the European Central Bank, raised rates throughout 2006 in the hope of containing inflation. As a result of higher interest rates, private consumption in

Figure 4. | **Returns on Global Stock Market Indexes, 2006**



2006 Stock Exchange Market Capitalization (US$ Billions)

Tokyo	4,614.1
London + Bermuda	3,797.0
AMEX + NASDAQ + NYSE	19,569.0
Paris	1862.5
Deutsche Börse	1637.6
Sao Paulo	710.3
Bombay + National Stock Exchange India	1593.0
RTS (Russia Stock Exchange)	965.2
Shanghai + Schenzhen	1145.5

Note: Stock market capitalization values include all companies listed on exchange
Source: "Year-End Review of Markets & Finance," *The Wall Street Journal*, January 2, 2007; Russian Stock Exchange, *http://www.rts.ru/en*, accessed April 2007

[5] Japan's Cabinet Office, *http://www.esri.cao.go.jp/en/stat/shouhi/0702shouhi-e.html*, accessed April 3, 2007
[6] Jamie Miyazaki, "Tokyo Shares End Lower As Financial Stocks Retrench," *Dow Jones Asian Equities Report*, October 25, 2006

the United States decelerated, from 3.5% growth in 2005 to 3.2% in 2006. At the same time, the country's savings rate, as a percentage of GDP, rose slightly, to 11.6%, up from 11.3%.

Elsewhere in the world, savings rates rose slightly in 2006, a result of higher interest rates and strong corporate profits. In emerging markets, consumer savings rates were higher than in more mature economies, helping to raise local wealth accumulation. For example, South Korea had a 38.4% savings rate, while in China, savings climbed to 50.1% of GDP, primarily due to corporate savings and families conserving income to cover unforeseen events[7].

Much of this increase in savings around the world can be attributed to strong corporate profits and savings. In the mid-to-late 1990s, increased investment by businesses around the world was fueled by debt. The stock market crash in the early 2000s and the accounting scandals that followed have helped drive up recent savings rates. Globally, businesses now are attempting to clean up their balance sheets by saving to pay down debt and create future investment opportunities [8].

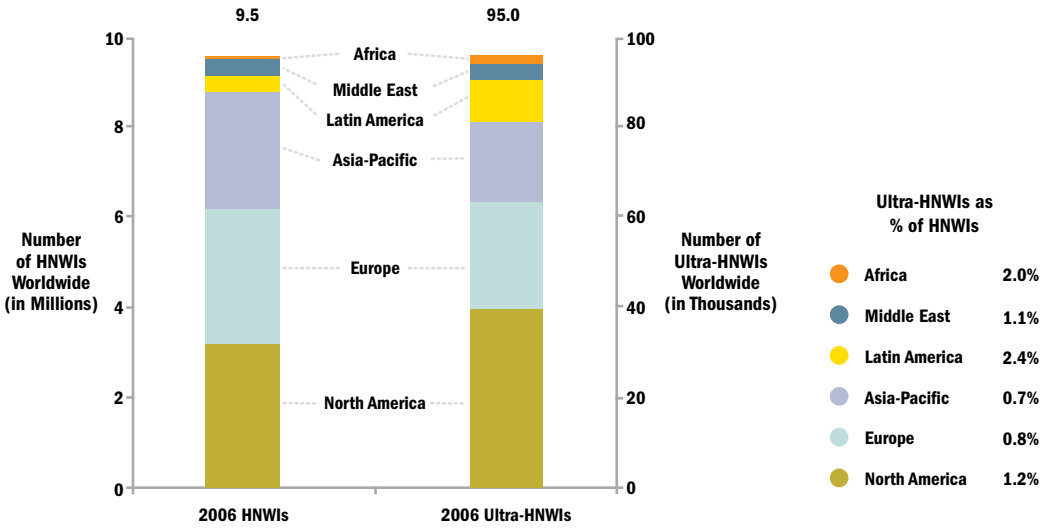
HNWIs Show Regional Gains

As expected, regions experiencing strong real GDP growth and above-average stock market returns showed an increase in wealth creation. At the same time, international diversification continued as investors flush with cash sought higher returns in riskier corners of the market. This reflects individual investors' growing confidence with the exposure levels typically associated with less familiar markets[9]. Exchange rates were also an influencing factor as the U.S. dollar depreciated in value, particularly against the euro, British pound and Brazilian real[10]. The U.S. dollar gained against the Japanese yen, albeit slightly, as well as against the Mexican peso and South African rand.

North American HNWIs Grow Their Ranks and Wealth

The ranks of North American HNWIs swelled by 9.2% in 2006, compared with 6.9% in 2005. This growth helped solidify North America's first-place ranking in both the number of resident HNWIs and the size of their accumulated assets.

Figure 5. | **Geographic Distribution of Ultra-HNWIs, 2006**



Note: Ultra-HNWI is defined as an individual with more than US$30 million in financial assets
Source: Capgemini Lorenz curve analysis, 2007

[7] "Policy Changes Provide Keys to Trade Imbalance," Industry Updates, China Daily Information Company, March 2, 2007
[8] Raghuram G. Rajan, "Investment Restraint, The Liquidity Glut, and Global Imbalances," comments at Conference on Global Imbalances, International Monetary Fund, November 16, 2006
[9] Nisha Gopalan, "Mideast Investors Tap Asia Growth," *The Wall Street Journal*, February 2, 2007; Ian Salibury, "For U.S. Investors, The World is Flattening," *The Wall Street Journal*, March 8, 2007
[10] Given exchange rate fluctuations over the past years, especially with respect to the U.S. dollar, we have specifically assessed the impact of currency fluctuations on our results. The conversion to U.S. dollars is made using a yearly average exchange rate, which adjusts for sharp currency fluctuations. 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 on our HNWI sizing.

These gains were seeded by the United States' real GDP growth, which totaled 3.3% in 2006, up slightly from 3.2% a year earlier. The main driver was government consumption, which grew at an overall rate of 2.1% in 2006, up from 0.9% in 2005, and at the state and local level by 2.1%, up from 0.5% in 2005.

In the United States, the HNWI population expanded by 9.4% in 2006, up from 6.8% in 2005. This more than compensated for the deceleration in HNWI growth in Canada, which fell from 7.2% in 2005 to 6.9% in 2006. Canada's consumption levels grew faster than real GDP growth, leading to a decrease in the savings rate and hence a drop-off in wealth accumulation. Nevertheless, western Canada's oil-producing strength helped bolster the nation's economic growth.

Europe Enjoys Strongest Growth Since 2000

Several years of healthy market capitalization growth helped Europe's HNWIs grow both in number and accumulated wealth. Real GDP growth among EU-27 nations was 2.7% in 2006, up from 1.7% in 2005. The HNWI population grew by 6.4% in 2006, building on the 4.5% gains logged in 2005, a result of such factors as robust GDP growth, strong market capitalization in Eastern Europe's emerging markets and strong market capitalization growth by the region's more developed nations, mainly in Western Europe, where merger and acquisition activity was strong. Business investment and labor markets also have been strong in Western Europe, which has helped buoy private consumption. In fact, private consumption grew 2.1% in 2006, up from 1.4% in that region[11]. Equally telling, economic sentiment, which reflects the views of various economic players, reached 112.6 in November 2006, its highest level since January 2001[12]. In 2006, total HNWI wealth in Europe grew to US$10 trillion, a 7.8% gain, compared with 4.9% growth in 2005.

In 2005, we observed a moderate concentration of wealth in Europe. This trend continued in 2006, in part, as a result of growing wealth in Russia. In 2006, Russia's RTS Index continued to display strong growth rates on the back of its primary exports: oil and natural gas. Consequently, financial wealth grew faster than the European HNWI growth rate, concentrating wealth in the region.

Germany's real GDP growth rate rebounded in 2006, advancing 2.3%, up from 0.9% in 2005; this helped bolster wealth creation within its borders. This accelerated growth rate can be attributed, in large measure, to private consumption and an upswing in gross fixed investments, which grew by 5.8% in 2006, up from 0.8% in 2005. Adding luster to this growth, the country's IFO Business Climate Index hit 108.7 in December 2006, its highest level since it was re-based in 2000[13]. This led to a healthy increase in the Deutsche Börse's market capitalization as IPO activity intensified. Germany's HNWI population grew by 4.1% in 2006, a substantial increase from 0.9% in 2005, one of the slowest growth rates in the world that year.

Real GDP growth also surged in France, moving ahead by 2.0% in 2006, up from 1.2% in 2005. A strong housing market, falling unemployment and an appreciating euro all helped drive this growth. During the year, the France-based CAC 40 gained 17.5%, well below its 23.4% gain in 2005, but still relatively healthy. In the end, wealth creation was positive in France in 2006, with the total HNWI population climbing by 6.0%.

France's gains paralleled developments in the United Kingdom, where real GDP grew by 2.7% in 2006, up from 1.9% a year earlier. London's FTSE 100 gained 10.7% in 2006, albeit a decline from the 16.7% advance seen in 2005. Business confidence, however, remains high as corporate balance sheets are strong, profits continue to grow and borrowing costs remain low by historical comparison. Overall, Britain's HNWI population grew by 8.1% in 2006, substantially higher than the 7.3% growth seen in 2005.

In Eastern Europe, Latvia, Slovakia and Lithuania led the region with real GDP growth of 11.6%, 7.5% and 7.3%, respectively. Other recent entrants to the European Union also witnessed healthy real GDP growth coupled with strong gains in market performance and capitalization. Much of this can be attributed to strong growth in Western Europe, which accounts for a large portion of Eastern Europe's exports, and which was a strong performer in 2006. More economically mature countries, such as the Czech Republic and Poland, also posted strong real GDP growth of 5.9% and 5.5%, respectively, in 2006, both above the worldwide average of 5.4%. Market capitalization in Poland raced ahead by 58.9% in 2006. With few exceptions, Eastern Europe showed substantial gains in both the number of HNWIs and the size of their accumulated wealth.

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[11] Western Europe: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom

[12] European Commission Website, Europa, Business and Consumer Surveys

[13] The IFO Business Climate Index is based on approximately 7,000 monthly survey responses of firms in manufacturing, construction, wholesaling and retailing. IFO Institute webpage, *http://www.cesifo-group.de*, accessed April 10, 2007

Overall, as the newest members of the European Union gain economic traction, we expect to see a slowdown in their real GDP growth, bringing them in line with the established members' more mature economies. While in the near-term this may have a negative impact on HNWI wealth accumulation, over time it will have a positive effect, as the Eastern-bloc economies mature and become more competitive.

Emerging Economies Gain HNWIs and Personal Wealth

In Asia-Pacific, the overall HNWI population grew by 8.6% in 2006, up from 7.3% in 2005. The region's wealth grew by 10.5% in the same period. The HNWI populations of Singapore, Indonesia and Taiwan all enjoyed double-digit growth in 2006; India and China also posted significant gains. Market capitalization grew in select geographies — in China, for example. However, Japan's growth, despite being home to the second-largest HNWI population in the world, was more anemic. Australia, one of Asia-Pacific's largest economies, experienced real GDP growth of 2.5% in 2006, down from 2.8% growth in 2005 — gains that were tempered by a drought that significantly affected the nation's agricultural sector.

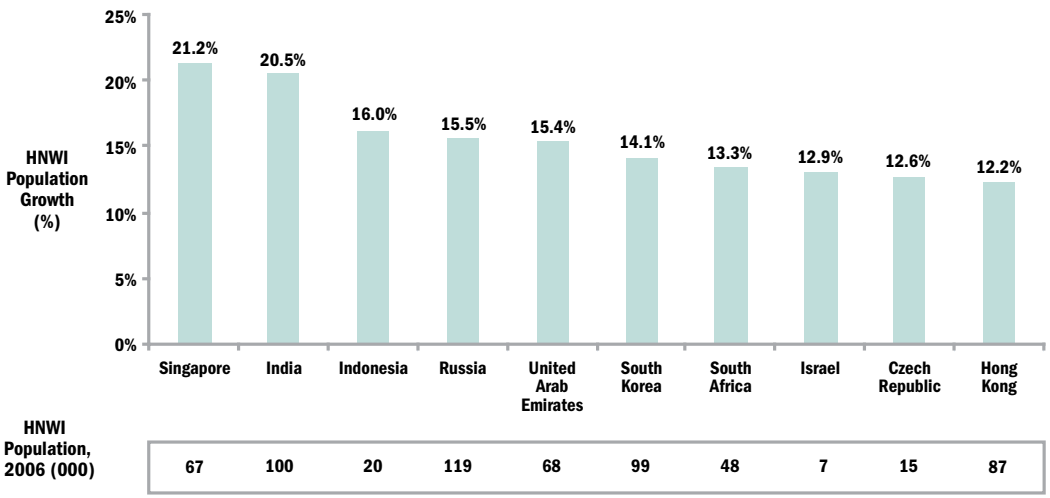
Latin America continued to add to its HNWI population, with Argentina, Brazil, Peru and Chile leading the way. Real GDP growth in the region was 4.8% in 2006, reflecting China's growing demand for local commodities as well as its mounting direct investments in the region, which accounted for roughly 16% of all foreign direct investment there by 2006[14], up from 2.9% in 2000. As we saw in last year's *World Wealth Report*, Latin America's HNWI population grew faster than the global average, expanding by 10.2% in 2006, up from 9.7% in 2005. Wealth in the region grew by 23.2% in 2006.

The Middle East continued to benefit from relatively high oil prices and developed nations' heavy dependence on fossil fuels. Even though oil prices eased somewhat during the second half of the year, they remained at historically high levels. At the same time, global demand increased by 0.9%[15], a trend that helped bolster current-account surpluses in the region. The Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) continued to drive wealth creation throughout the region.

Healthy real GDP growth rates helped expand the ranks of the Middle East's HNWI population — by 11.9% in 2006, up from a 9.8% growth rate in 2005 — while negative market capitalization rates helped decelerate their total wealth accumulation. Total HNWI wealth grew by 11.7% in 2006, down from a 19.7% advance in 2005, suggesting a dispersion of wealth among the region's wealthiest individuals.

On the back of high commodity prices worldwide, Africa's real GDP surged 5.1% in 2006. This, in turn, led to increased interest in foreign direct investment, particularly in the mining and exploration sectors. A lot of this interest has centered on South Africa and its gold-mining activities. Also, as in Latin America, China has been an active player in Africa,

Figure 6. | **HNWI Population Growth, 2005 – 2006 (by Market)**



Note: Growth rates and absolute HNWI numbers are rounded
Source: Capgemini Lorenz curve analysis, 2007

[14] Lawrence Brainard, "Chinese Takeout," *The Wall Street Journal*, February 20, 2007
[15] International Energy Agency, *Oil Market Report*, January 2007

investing heavily in various sectors, and showing particular interest in mining. Taken together, these factors bolstered the continent's HNWI population, helping it grow by 12.5% in 2006, and increasing its wealth by 14.0%.

The BRIC Nations See Continued Economic Growth

The BRIC nations (Brazil, Russia, India and China) are playing increasingly important roles in the global economy. Two of these four countries made their way onto the list of the 10 fastest-growing HNWI populations in 2006. MSCI's BRIC Index gained 52.9% for the year, outpacing MSCI's G7 Index, which gained 15.7% in 2006. The Organisation for Economic Co-operation and Development predicts continued growth for China, but sees a slowdown for Brazil and India. In 2006, the HNWI populations in the BRIC nations grew in number and accumulated wealth. China's HNWI population, for example, grew by 7.8% in 2006, while India's expanded by 20.5%.

Several events contributed to China's 2006 gains. For example, a flurry of IPO activity on the Shanghai/Shenzhen Stock Exchanges raised 45.0 billion in primary offerings, an amount second only to that raised in the United Kingdom[16]. China also converted two thirds of its non-tradable shares into tradable shares, creating liquidity in its markets. The effects of unpegging the yuan from the U.S. dollar also began to take hold as the year wore on, helping the currency to slowly appreciate over the course of the year. However, this appreciation was not enough to significantly slow export growth and total output.

Russia's market capitalization took off in 2006, on the heels of several IPOs and the liberalization of the country's banking market. Shares of several Russian banks experienced triple-digit performance growth in 2006[17], benefiting the country's wealthiest individuals and swelling their ranks by 15.5%.

Brazil saw an increase in private consumption and investment along with a decline in inflation in 2006. At the same time, commodity prices were relatively high — factors that helped drive up the total number of HNWIs in Brazil by 10.1%.

Meanwhile, India continued its strong expansion, with real GDP growth of 8.8% in 2006, thanks to increased private consumption — 9.1% in 2006, up from 6.6% in 2005 — and strong manufacturing and service sectors. Manufacturing led the way with 11.9% growth in 2006. Overall, the country's HNWI population increased by 20.5% in 2006.

2007 Growth to Temper as Mature Economies Grow More Moderately

Following the stock market recovery of 2003, and the resurgence of real GDP growth a year later, 2005 turned in stable performance on the key drivers of wealth. The year 2006 built on earlier gains and reaped the benefits of both market capitalization and real GDP growth. Looking ahead, however, the Economist Intelligence Unit forecasts a slowdown in the real GDP global growth rate, to 4.8%, in 2007 and 2008, down from 5.4% growth in 2006. As more mature markets, such as the United States, enter a period of more moderate expansion after several years of vigorous growth, the effects will be felt throughout the world. Also, with many central banks outside the United States tightening their monetary policies, the period of high liquidity that has so stimulated recent growth may soon come to an end[18].

The decline in certain housing markets and downturn of the sub-prime mortgage sector is expected to slow the United States economy in 2007. Further, the country's high consumer debt level has helped fuel a negative household savings rate; although, we are beginning to see a reversal of this trend, albeit a slow one. In the words of U.S. Federal Reserve Chairman Ben S. Bernanke, "Overall, the economy appears likely to expand at a moderate pace over coming quarters"[19].

While real GDP growth in Europe was weak compared with other regions of the world, in 2006 it enjoyed its largest upswing since 2000, driven by strong economic sentiment, which promoted consumption. This, in turn, drove up corporate profits and investment within Western Europe. As monetary and fiscal policies tighten, this growth is likely to slow. As the appreciating euro erodes trade competitiveness, growth within the European Union is likely to decelerate. However, with the rise of consumer and business confidence numbers in the latter half of 2006, it suggests a more tempered deceleration of growth. Current projections call for EU-27 growth to slow to 2.2% in 2007 and 2008, down from 2.7% in 2006.

The Asia-Pacific market has experienced strong gains in recent years and should continue to do so in 2007, though at a decelerating rate. As we've come to expect, this growth should be fueled by China and India as their economies continue to race ahead. However, as consumption moderates in the United States, a market on which China is very dependent, Asian

[16] "China Becomes World's 2nd Largest IPO Destination," *Asia Pulse*, December 29, 2006
[17] "Quite a Few Actively Traded Stocks of Russian Banks Were Expected to Enter the Market in 2006," WPS: Banking and Stock Exchange, WPS Russian Media Monitoring Agency, September 12, 2006
[18] The Economist Intelligence Unit, Regional Overviews, January 2007
[19] Ben S. Bernanke, "Testimony of Chairman Ben S. Bernanke: The Economic Outlook," appearing before the Joint Economic Committee, U.S. Congress, March 28, 2007

growth should be a bit slower than in the past. Real GDP growth in Japan is expected to remain stable, at around 2% for the next several years, as the United States and China continue to grow, although at a slower pace. China and the United States account for nearly 40% of Japanese export revenue. One possible bright spot: land prices increased in 2006, for the first time in 16 years, pointing to a possible recovery of the Japanese housing market[20].

The countries of Latin America have been experiencing a boom related to rising commodity prices and the rapid economic expansion of trading partners, such as China. However, commodity prices are expected to decrease in 2007 and 2008 as global demand slows and output increases. On the other hand, oil prices are expected to remain at their historically high levels, which should help offset the decline in commodity prices. Overall, the Economist Intelligence Unit predicts Latin American real GDP growth will edge back to 4% in 2007 and 3.8% in 2008.

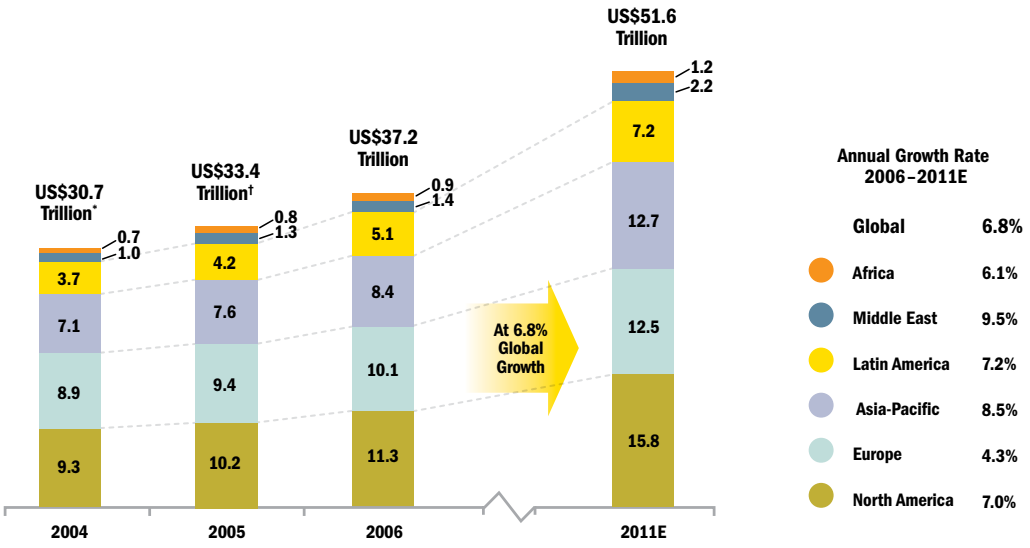
Over the past several years, we have seen record revenues in oil-producing nations, many of which are located in the Middle East. With oil prices predicted to remain high by historical standards for the near future, the region is likely to continue growing at a rather robust rate. Also, this trend is likely to benefit non-oil-producing nations, as oil-rich countries look to diversify their investments beyond their own borders. Forecasters expect the Middle East to experience 5.7% real GDP growth in 2007, and 5.2% in 2008, a slight deceleration from 5.7% real GDP growth in 2006.

As in Latin America, the oil-producing nations of Africa are likely to enjoy increased revenue from historically high petroleum prices — and increased interest from China, both in terms of its importing African commodities and making direct investments there. These trends should help offset the decline in commodity prices that is expected in the near future. However, the World Bank has stated that it would like to tackle government corruption, which seems likely to put at risk various loans it has made across Africa. In spite of that, Africa's real GDP is expected to continue growing, by 5.2% in 2007 and 5.6% in 2008.

While economic growth in select countries may accelerate through 2008, many economies are likely to decelerate in terms of real GDP growth. The dual risks of rising energy prices and geopolitical conflicts are a continued threat, adding a level of uncertainty to our current forecast. Additionally, the question of growth in the United States, China and Japan, which accounts for a large portion of global GDP, factors into the variability of our projections.

Given this, we forecast that global HNWI financial wealth will grow to US$51.6 trillion by 2011, at an annual rate of 6.8%.

Figure 7. | **HNWI Financial Wealth Forecast, 2004 – 2011E (by Region)**
(US$ Trillions)



* In 2004, HNWI wealth figures were restated as a result of updated data becoming available
† Bahrain and Qatar were added to the model for years 2005 onward
Note: All chart numbers are rounded
Source: Capgemini Lorenz curve analysis, 2007

[20] Andrew Morse, "Japanese Land Prices Rise For First Time in 16 Years," *The Wall Street Journal*, March 22, 2007

THE HIGH COST OF LUXURY LIVING — AND COLLECTING — ESCALATES

Each year the *World Wealth Report* examines Forbes' Cost of Living Extremely Well Index (CLEWI), which was established in 1976. It compares the price inflation of luxury goods[21] against that of everyday consumer items[22]. In 2006 we found the cost of luxury goods and services rose nearly twice as fast as the cost of everyday consumer products. The cost of the luxury items tracked by the CLEWI rose 7.0% while the cost of consumer goods and services, as monitored by the Consumer Price Index (CPI), rose 4.0%[23]. This represents a larger increase over 2005, when the CLEWI rose 4.0% and the CPI by 3.6%. All else kept constant, the higher price increases reported in the most recent CLEWI signals that demand for luxury goods is outpacing demand for everyday consumables. In a year of worldwide economic growth, expanding emerging markets and an increasing number of HNWIs around the world, the demand for luxury consumables has grown along with their cost.

This year, we took a detailed look[24] at HNWIs' portfolio allocations in "investments of passion." These include: luxury collectibles (automobiles, boats, airplanes, etc.), jewelry, art, sports-related investments (such as professional teams, sailing, race horses) and other collectibles (wines, antiques, coins, etc.) categories. The results revealed that luxury collectibles ranked first, accounting for over 26% of all HNWIs' investments-of-passion dollars in 2006; art followed, with 20%; and jewelry, with 18%. The pattern was slightly different for Ultra-HNWIs, who allocated 25% to luxury collectibles, 25% to art and 16% to jewelry. HNWIs allocated 14% of their investments-of-passion dollars to the "other collectibles" category while Ultra-HNWIs allocated 13%. HNWIs and Ultra-HNWIs earmarked only 6% and 8%, respectively, to sports investments.

Luxury Collectibles

Aficionados willingly pay top dollar for luxury collectibles — including vintage yachts, luxury automobiles selling for hundreds of thousands of dollars[25] and private airplanes. So it follows that such items accounted for the largest percentage of HNWI outlays to investments of passion in 2006 amid signs that the global audience for these goods is expanding.

In the case of privately owned jets (totaling an estimated 10,000 planes in the United States alone), the ultra-wealthy are transforming what was once viewed as a more comfortable mode of travel into a sizeable component of their total financial worth. Boeing reportedly has taken orders for 11 wide-body private jets that are being customized and outfitted as "mobile mansions." The price tag: about US$150 million each. Clearly, today's buyers are after more than convenience. According to Boeing, the majority of these individual buyers are from the Middle East, but Americans, Europeans, Russians and Asians are starting to place orders as well[26].

Art

The art market spotlights two trends discussed in the *2006 World Wealth Report*: globalization and increased access to information. As HNWIs' personal wealth has increased so has their interest in fine art. Once viewed almost exclusively as the pastime of connoisseurs, art collecting is increasingly seen as an investment. This, in turn, is helping fuel a large international art market that has been setting record prices not just for the scarce work of old masters but also for the creative output of popular contemporary artists.

The art market has drawn such wide interest that today many wealthy investors, even those without a particular passion for collecting, now see paintings, drawings and sculpture as viable vehicles for diversifying their portfolios given the low correlation between art prices and the market cyclicality of stocks, bonds and real estate. While auction houses, private galleries and others are big beneficiaries of this trend, they generally encourage buyers to invest in art and other collectibles because they like the work. Others, as reflected in the Mei Moses Art Index, which tracks the performance and financial return of art purchases, promote the idea that art purchased for investment purposes is a profitable long-term asset alternative to traditional financial holdings[27].

This trend is gathering steam around the world, in emerging economies as well as in more developed ones, and is one more reason why the luxury-item prices reported in the CLEWI are on the rise. Survey data revealed that the BRIC nations and other emerging markets not only are setting the pace for global economic growth but that their wealthiest citizens are becoming enthusiastic collectors, especially for artwork and objects that reflect their cultural identities. Many Western collectors are favoring art from emerging markets such as India, Russia,

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[21] The CLEWI is made up of 42 luxury items, including designer handbags, watches, clothing, high-end spa services, tuition at Harvard University, a case of Dom Perignon, seven pounds of filet mignon, and the price of yachts and helicopters
[22] Price inflation of general everyday goods is calculated using the Consumer Price Index (CPI)
[23] The Cost of Living Extremely Well Index, *Forbes*, October 2006
[24] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007
[25] "Showroom Showdown, Koenigseg CCR Vs. Spyker C8 Double 12 S," *Forbes*, March 22, 2007
[26] Robert Frank and Daniel Michaels, "One 'World's Biggest Jet,' Please," *The Wall Street Journal*, February 16, 2007
[27] "Going, going, up: Easy money is pouring into the modern art world," *The Economist*, January 11, 2007

Poland, Cuba and China, as it does not have the same export restrictions that some countries place on more historic pieces[28]. To support this rising interest, international auction houses that once confined their operations to the United States and Europe have begun opening showrooms in other parts of the world. Christie's, for example, recently established an office in Dubai[29], while Sotheby's is opening branches in Moscow and Beijing[30]. Both auction houses are seeking to meet the demands of a globalizing and growing art market.

As with jewelry and other high-end collectibles, our survey analysis found geographic differences among art investors. For instance, Latin Americans and Europeans allocated more to art than North Americans or Asians. On average, art investments comprised 20% of HNWIs' investments of passion — outlays that were dwarfed by the huge prices paid for private aircraft and yachts and which, necessarily, accounted for a larger percentage of HNWIs' assets.

Jewelry

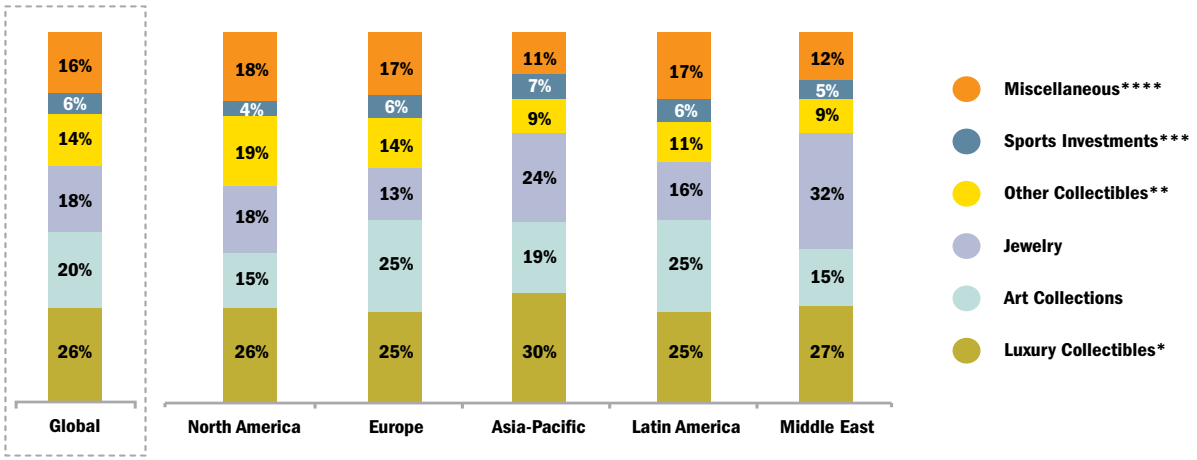
Jewelry showed greater geographic variations than other investments of passion. In 2006, this category was most popular with Middle Easterners, who directed 32% of their investments of passion into jewelry purchases; in contrast, Europeans, Latin Americans and North Americans each gave it less than 20%. For their part, Ultra-HNWIs devoted a smaller percentage of their passion-investment dollars to jewelry than HNWIs, which suggests that HNWIs' choice of jewelry as an investment vehicle — relative to other categories — declines as their wealth grows.

This may be because in the secondary market jewelry typically garners only about a third of its original price[31]. However, some buyers are willing to pay a significant premium for select jewelry items. For example, in October 2006, a private collector paid US$1.8 million at auction for a 22.76-carat diamond ring that was expected to fetch between US$800,000 and US$1.2 million[32].

Sports Investments and Other Collectibles

Sports investments tend to be less popular than other investments of passion, attracting just 6% of all HNWIs' investments in this area. However, as a category, sports investments continue to receive a significant amount of media attention due to the depth of interest of average consumers.

Figure 8. | **HNWIs' Investment-of-Passion Dollars, 2006 (by Region)**



**** Miscellaneous represents club memberships, travel, apparel, etc.
*** 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, March 2007

[28] "Art's New Frame of Reference: India, China, Russia...Collecting is going global, and prices have room to run," *BusinessWeek*, December 25, 2006
[29] Christie's Annual Global Art Sales, Press Release, January 11, 2007
[30] Sotheby's 2006 Fourth Quarter and Full Year Results, Press Release, March 1, 2007
[31] Susan Adams, "Barkin Bling Brings Big Bucks," *Forbes.com*, October 11, 2006
[32] Ibid.

By contrast, HNWIs allocated 14% to "other collectibles," such as wines, antiques and coins, in 2006, according to our survey. Some of this can be attributed to these categories having a lower cost of entry, which makes building a collection easier than for items with higher price points. Still, the influx of new investors, including those from emerging markets, is steadily driving up prices for these goods as well.

Increased HNWI interest in wine has led to the creation of wine funds, and in 2006 resulted in higher prices on the futures market for French Bordeaux and record price levels for many of the most "investment-worthy" brands: Mouton-Rothschild, Lafitte-Rothschild, Le Pin, Margaux and Petrus. A new index of investment-grade wines — the Liv-ex 100, which tracks top Bordeaux vintages — recently joined the list of indexes that Bloomberg uses to track traditional assets, such as stocks, bonds and commodities[33].

Conclusion

Although a select number of wealth management firms provide advisory services for investments of passion (those that do exist cater most often to art), the growth and investment potential of these items will likely draw increased focus from advisors in the future. Partnerships between advisors and firms that currently specialize in passion-investment advice may also increase.

According to Merrill Lynch analysts, the growing buying power of emerging market HNWIs will continue to drive demand for lifestyle and luxury brands[34], and regional preferences will continue to appear. However, this upturn carries with it the risk that as the number of HNWIs interested in investments of passion primarily for purposes of financial gain increases, so does the possibility that these items will become overvalued. If speculative forces bid up auction prices to irrational levels and, ultimately, lessen demand, the likelihood of a price correction in a historically cyclical market increases.

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[33] Jeff D. Opdyke, "Fine Wines No Longer Just Tempt Collectors," *The Wall Street Journal*, February 24, 2007
[34] "Launching the ML Lifestyle Index," Merrill Lynch, April 12, 2007

HNWIs Increase Their Allocation to Real Estate

- **Global HNWIs' allocations favored real estate in 2006**
- **Europe's HNWIs had the most balanced portfolios of any region**
- **HNWIs increased investments in European markets**

Real Estate's Allure Deepens

As we have reported in the past, HNWIs are well-informed of present and approaching economic conditions and quickly reallocate their portfolios to capitalize on market trends. This year, globally, HNWIs liquidated some of their alternative investments to realize significant returns from real estate investments. We see this as a temporary tactical move rather than a long-term asset allocation shift. Therefore, we project a greater allocation to alternative investments in 2008.

Last year, we saw a significant increase in HNWIs' allocations to real estate, driven primarily by commercial real estate and real estate investment trusts (REITs). As the global real estate market has increased transparency and improved liquidity, it has become a less risky investment[35]. Global direct real-estate transaction volumes reached US$682 billion in 2006, up 38% from 2005[36]. Global real estate investment (including direct real estate and REITs) totaled US$900 billion in 2006 — the strongest-ever performance by global real estate markets[37].

To better understand these investment patterns, this year we analyzed three categories of real estate: commercial real estate, REITs and other investment properties.

Commercial Real Estate

In 2006, commercial real estate sales prices shattered market records. A surge in mergers and acquisitions among real estate companies culminated in a bidding war between U.S.-based Vornado Realty Trust and international private equity giant Blackstone Group for Equity Office Properties Trust. Blackstone Group's bid of US$39 billion proved to be the largest private equity buyout to date[38].

Global investors, attracted to income-earning investments in the form of rent or dividends, fueled the demand for commercial property. Pension funds, foreign investors, REITs and private equity funds, all bidding for the same real estate properties, drove prices skyward. In addition, while demand for commercial real estate remained strong, supply was constrained. Global construction costs increased during the year under study[39], further driving up prices and increasing the return on investment of commercial real estate.

REITs

The year 2006 was a year of great returns for REITs — corporations or trusts that use a pool of capital to purchase and manage income property. REITs, often traded like equities on major exchanges, are relatively liquid and, therefore, are an attractive real estate investment option for investors across all wealth bands. For the seventh year in a row, the FTSE National Association of Real Estate Investment Trusts (NAREITS) U.S. Real Estate Index outperformed major market indexes, with 34.4% gains in the FTSE NAREIT ALL REITs Index, up from 8.3% returns in 2005. The S&P REIT Composite index rose 35.4% in 2006, compared with a return of 15.8% for the S&P 500 index[40].

Further, the global number of REITs is increasing as governments around the world allow for the establishment of REIT-type investment vehicles. Italy joined the United Kingdom and Germany (both governments have recently allowed for REITs) when, at the close of 2006, its government announced plans to introduce legislation for a REIT-like investment vehicle[41]. REITs have become more popular in the Asia-Pacific region as well. The first Japanese REIT was launched in 2001; as of June 2006, there were 36 Japanese REITs with an aggregate market capitalization of US$30 billion[42]. Further, in 2006 the FTSE EPRA/NAREIT Global Real Estate Index Series gained 42.35%[43].

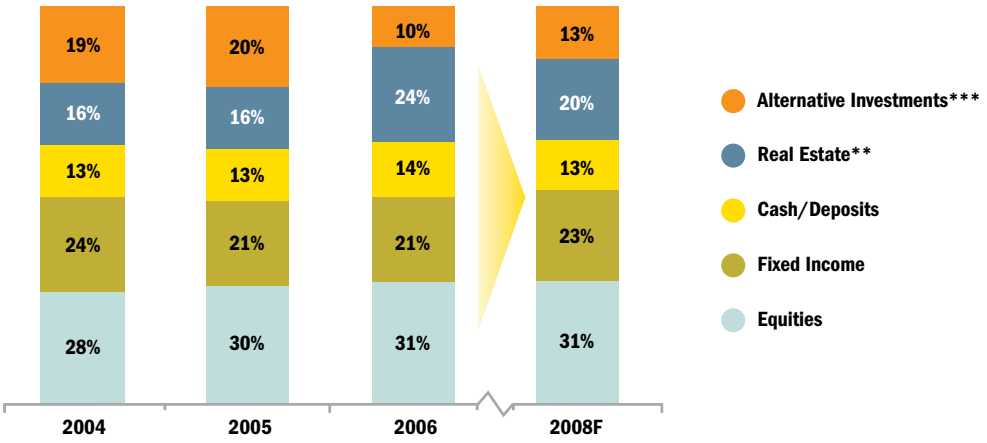
It is not surprising then, as our financial advisor survey found, that, in 2006, HNWIs around the world increased their allocation to real estate from 16% to 24% of their portfolios[44].

Other Investment Properties

While some U.S. housing markets experienced a deceleration in 2006 and into the beginning of 2007, examination of HNWI investing

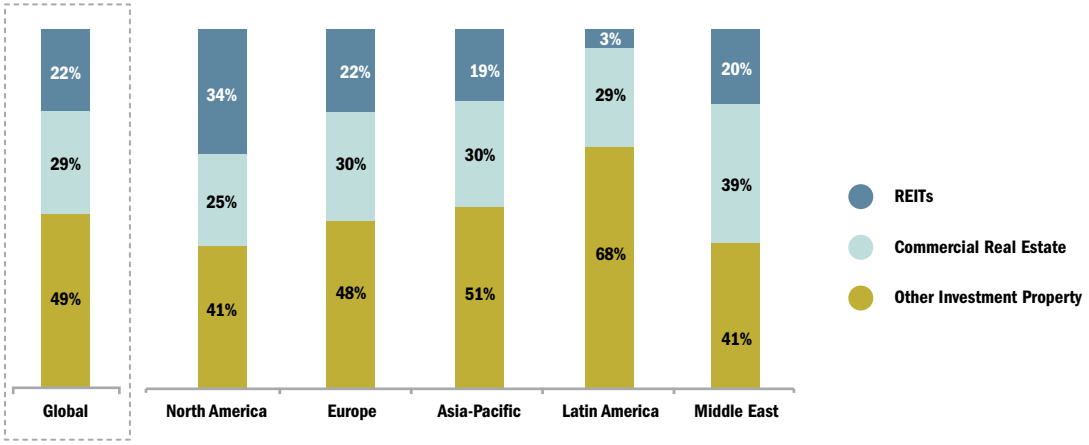
[35] ING Real Estate Investment Management Research & Strategy, 2006
[36] "Global Real Estate Capital – Moving Further and Faster," Jones Lang LaSalle
[37] Ibid.
[38] Ryan Chittum and Alex Frangos, "Year-End Review of Markets & Finance 2006 – Commercial Deals Shatter Records; Housing Sales Slow," *The Wall Street Journal*, January 2, 2007
[39] Dees Stribling, "Stellar Performance," *Real Estate Portfolio*, March/April 2007
[40] *Standard & Poors Industry Surveys: Real Estate Investment Trusts*, February 15, 2007
[41] "Ciao REITs," *Real Estate Portfolio*, March/April 2007
[42] *Standard & Poors Industry Surveys: Real Estate Investment Trusts*, February 15, 2007
[43] Dees Stribling, "Stellar Performance," *Real Estate Portfolio*, March/April 2007
[44] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007

Figure 9. | **HNWIs' Allocation of Financial Assets, 2004 – 2008F (%) (by Category)**



*** Includes: Structured products, hedge funds, derivatives, foreign currencies, commodities, private equity/venture capital, investments of passion, other (may include: structured credit, managed futures, etc.)
** Includes: Commercial real estate, REITs and other investment properties
Source: Capgemini/Merrill Lynch Financial Advisor Surveys, March 2006, March 2007

Figure 10. | **HNWIs' Real Estate Investments, 2006 (by Region)**



Source: Capgemini/Merrill Lynch Financial Advisor Survey, March 2007

patterns reveals wealthy investors have been less affected by this downturn. HNWIs hold nearly half of their real estate dollars in second and vacation homes[45], which typically aren't financed through mortgage debt. Therefore, sales of these homes are less dependent on market cycles and mortgage rates. Furthermore, many second-home buyers make purchases when they find property that suits the multigenerational needs of their families rather than timing cycles in the real estate market. These factors tend to shield HNWIs from upturns in 30-year mortgage rates, a recent trend, thereby creating a softer landing for HNWIs' "other investment properties"[46].

Alternative Investments Lose Some Appeal

In 2006, HNWIs, overall, shifted their allocations from "alternative investments," which includes hedge funds, structured products, foreign currencies, commodities, private equity/venture capital and derivatives, to seek high returns from real estate opportunities.

Within this very broad and varied asset class, specific alternative investments respond differently to prevailing market conditions. Certain alternative investments capitalize on volatile markets; that is, investors hedge that the prices of certain equities or goods will go up or down. In highly volatile markets, more investments are hedged, as there is more potential for profitability. The year 2006 proved to be an unfavorable year for structured products and hedge funds as market volatility subsided. The Volatility Index (VIX), which tracks market volatility over time, hovered around 11% for the majority of the year with a mid-year spike to 22%[47]; overall, well below the 15-year average of 19%.

Highly volatile markets are favorable to trading structured products as they allow investors to hedge against risk and capitalize on the fluctuations in value of the underlying asset. The low volatility of 2006 combined with a significant spike of volatility in the middle of the year made it difficult to price structured products and lessened the need to hedge against the risk in a volatile market. Hedge funds, too, are most profitable in highly volatile or trending markets. The year 2006 experienced low volatility; thus, market conditions were largely unfavorable for this investment vehicle.

Although certain alternative investments were susceptible to unfavorable market conditions, private equity enjoyed another year of growth, with the sector raising a record US$432 billion globally in 2006[48]. While our analysis reveals the private equity boom is far from over, we found that it is largely institutional investors with large pools of capital that are driving the surge.

While HNWI allocations to alternative investments dipped in 2006, we do not interpret this as a sign that this investment class is falling out of favor. We believe that this dip is a temporary tactical move by investors pursuing the higher performance currently yielded by real estate. We project an increased allocation to alternative investments in the coming year.

Regional Patterns Show More Global Allocations

A look at past *World Wealth Reports* reveals that the investing behaviors of HNWIs have become more global, driven by an expanded awareness of international developments, better portfolio performance and risk mitigation.

North Americans historically have held the largest portion of their assets in domestic markets. For example, in 2005, 78% of HNWI assets were held domestically[49]. In 2006, that number dropped to 73%, as wealthy North Americans increased their allocations to overseas investments in Europe, Asia-Pacific and Latin America[50] — signs both of their growing confidence in the strength of the euro and greater appetite for the higher returns of emerging markets.

In 2006, as in previous years, North Americans held the most unbalanced portfolios, with 41% allocated to equities[51], a slight decrease from 43% in 2005[52]. As members of a developed market comprised of enterprising individuals, North American HNWIs typically have aggressive investing strategies that tend to favor equities. Yet in 2006, North Americans reduced their allocations to alternative investments and shifted more of their investments into real estate. With the vacancy rate for office space at its lowest since the third quarter of 2001 — 13.5%[53] — it is not surprising that North Americans increased their real estate allocations from 12% to 20% of their portfolios[54].

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[45] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007
[46] Elizabeth Harris, "Luxury Real Estate Investment," *Worth Magazine*, April 2007
[47] CBOE Volatility Index, *Yahoo! Finance*, 1/1/06-12/31/06
[48] Lori McLeod, "Global Private Equity Firms Aim to Raise US$500B," *Financial Post*, January 26, 2007
[49] Capgemini/Merrill Lynch Financial Advisor Survey, March 2006
[50] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007
[51] Ibid.
[52] Capgemini/Merrill Lynch Financial Advisor Survey, March 2006
[53] "Year-End Review," *The Wall Street Journal*, January 2, 2007
[54] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007

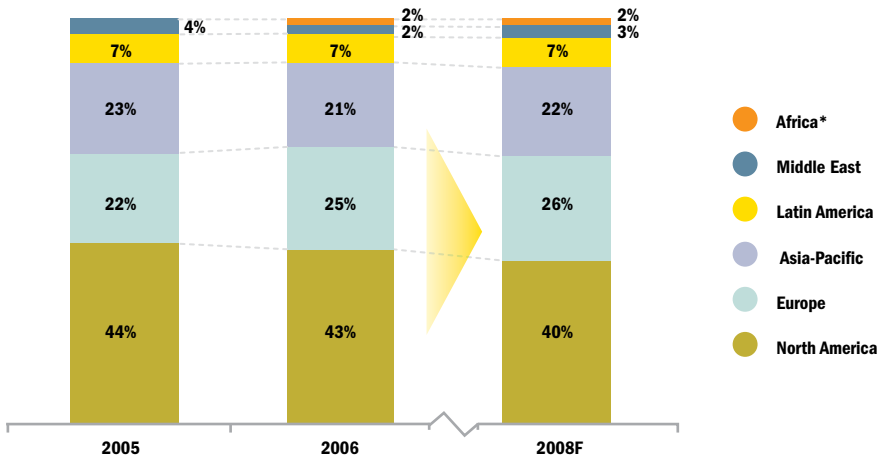
By and large, HNWIs around the world slightly decreased their allocations to North America and increased investments in Europe. Stocks in this part of the world enjoyed healthy growth in 2006, and GDP growth in the EU-27 was up 2.7% for the year, compared with 1.8% growth in 2005. Additionally, Europe became the world's most active real estate investment market with direct commercial real estate investment reaching US$305 billion, up 44% from 2005[55]. European growth was led by Germany, where real estate transactions totaled US$62 billion, up 140% over 2005[56]. Additionally, the French real estate market was also up 70%, and the Russian real estate market was up 700% from 2005[57].

Europeans were the only ones to increase domestic and regional allocations — from 48% in 2005 to 52% in 2006 — while HNWIs in all other regions added to their international allocations. From 2005 to 2006, Europeans invested more heavily in equities, expanding their allocations from 27% to 30% of their portfolios. This coincides with the European stock markets' strong growth during 2006. The Dow Jones Stoxx 60 Index, which tracks Europe's 600 largest publicly traded companies, was up 17.8% for the year[58]. Britain's blue-chip FTSE 100 was up 10.7% in 2006, Germany's DAX index of 30 blue-chip stocks rose 22%, and the French CAC 40 index climbed 17.5%[59].

HNWIs in Asia-Pacific nearly doubled their allocations to real estate, from 16% in 2005 to 29% in 2006[60]. Consistent with the investor behavior often seen in emerging economies, HNWIs in Asia-Pacific tended to invest in tangible assets. Direct commercial real estate investment in Asia-Pacific was US$94 billion in 2006, up 42% from 2005[61]. In Australia, investors looked to the United States' real estate sector to provide stability[62]. Elsewhere in the region, with business expansion still healthy, office space prices continued to climb in Beijing and Shanghai in 2006.

For their part, Latin Americans historically have allocated a majority of their assets to foreign markets. In 2006, they were the only group to increase their investments in North America. Latin American investors also increased their allocations to real estate — from 11% to 25% of their portfolios[63]. Middle Easterners followed the same course and continued to make significant investments in Europe and the Americas, spending US$5.29 billion on commercial property in the United States alone in 2006[64].

Figure 11. | **HNWI Assets, 2005-2008F (by Region)**



Source: Capgemini/Merrill Lynch Financial Advisor Surveys, March 2006, March 2007
* In 2005, investments in Africa were less than 0.4%

[55] "Global Real Estate Capital – Moving Further and Faster," Jones Lang LaSalle, 2007
[56] Ibid.
[57] Ibid.
[58] Alistair MacDonald, "Year-End Review of Markets & Finance 2006 --- Investors Place Bets Globally – and Reap the Rewards --- Corporate Profits and Mergers Propel European Shares," *The Wall Street Journal*, January 2, 2007
[59] Ibid.
[60] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007
[61] "Global Real Estate Capital – Moving Further and Faster," Jones Lang LaSalle, 2007
[62] Maya Roney, "Overseas Investors Still Find U.S. Property Hot...," *BusinessWeek*, February 14, 2007
[63] Capgemini/Merrill Lynch Financial Advisor Survey, March 2007
[64] Maya Roney, "Overseas Investors Still Find U.S. Property Hot...," *BusinessWeek*, February 14, 2007

Looking Ahead

Our research shows that, globally, HNWIs will continue to decrease their allocations to North America in favor of moving more of their wealth to Europe. This reflects the strengthening of the euro and European markets as well as the potential for growth in emerging and developing markets in Eastern Europe. Further, we project that HNWIs will slightly reduce their investments in Asia-Pacific in favor of investments in the Middle East, while their investments in Latin America will remain static.

Also, we project that as HNWIs around the world realize profits from their real estate investments, they will increase their allocations to alternative investments. In the near term, however, as REITs continue to generate high returns and become more established in European and Asian markets, we expect HNWIs to show continued interest in this investment class.

DEMAND GROWS FOR ENVIRONMENTAL AND SOCIALLY RESPONSIBLE INVESTING

Environmental and socially responsible investing (SRI) are no longer niche categories. As HNW investors are becoming increasingly conscious of social and environmental concerns, they are looking to invest in companies and financial products that share their concerns. By 2006, over 160 investors, investment managers and corporations — representing more than US$5 trillion in assets — had signed onto the "Principles for Responsible Investment" (PRI) group, a project coordinated by the United Nations and aimed at bringing greater environmental, social and governance awareness to the mainstream investment community. Also, there are other signs that this trend is gaining support. According to a recent survey conducted by the UK Social Investment Forum and Thomson Extel, last year 49.8% of buy-side firms applied socially responsible criteria to more than 10% of their total assets — a 20% increase over 2004 levels.

Socially Responsible Investing Defined

Around the world, various terms are used to describe SRI — the name most typically used in North America. In Europe, it is sometimes referred to as Ethical Investing. Other locales refer to the concept as Environmental, Social and Governance (ESG) investing. While these varying labels and the underlying initiatives that they embrace make it difficult to size the market, there are certain shared strategies that form the foundation of SRI.

Screening for Social Responsibility

SRI strategies assess securities using a variety of measures to test a company's demonstrated awareness of environmental, social and governance issues. A company found to be socially irresponsible, or one that is involved in the production of alcohol, tobacco or firearms, for example, may be "screened out." That is, its shares passed over, while another business may be "screened in" and purchased for a portfolio based upon its mission or exemplary record. The strategy aims to raise social, environmental or governance criteria high enough so that only top-performing companies in this area are chosen to be part of a portfolio.

Shareholder Advocacy

Shareholder advocacy is not exclusive to SRI. Today, a growing number of socially responsible investors are actively seeking ways to leverage their ownership of publicly traded equities to influence passage of measures that will improve a company's environmental, social and/or governance record. Sometimes the spotlighted issues are never even brought to a shareholder vote. Management often is persuaded to become more proactive after holding dialogues with activist investors.

Community Investing

Investors can support development initiatives in low-income communities around the world by working through one of many institutions: community banks, community credit unions, community loan funds and microenterprise lenders. This last group includes the Grameen Bank (Bank of the Villages), founded and directed by Dr. Muhammad Yunus, who along with the bank, won a Nobel Peace Prize in 2006 for groundbreaking work on microfinance.

To some, the 1928 establishment of the Pioneer Fund, which excluded "sin" stocks, such as those of alcohol, tobacco and gambling firms, from its investments, marks the beginning of SRI[65]. The movement took deeper root several decades later as growing numbers of United States investors sought to keep their investment dollars away from

[65] "Social Investment Timeline," *socialfunds.com*, accessed April 6, 2007, *http://www.socialfunds.com/media/timeline.cgi*

companies supporting the Vietnam War. Later, many divested equities with ties to South Africa to support the growing anti-apartheid movement. By the late 1980s, support for SRI began to globalize, drawing the interest of investors in Germany, France and Switzerland[66], among other countries.

Today, individual investors have many options for participating in SRI, including mutual funds and ETFs. Wealthy investors can turn to large global financial services firms and asset management companies that specialize in SRI strategies for help in incorporating these strategies as a part of their portfolios.

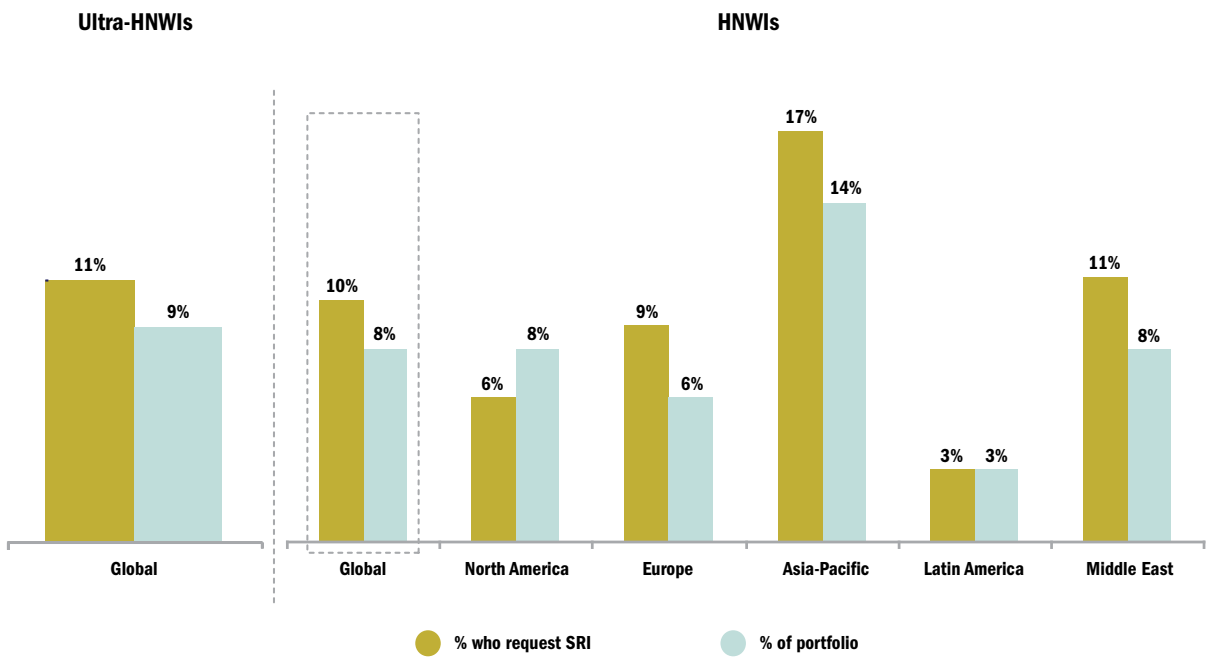
Worldwide SRI Assets Continue to Grow

In 2005, SRI assets under management (AUM) totaled US$2.29 trillion — or roughly one out of every ten dollars invested in public equities in the United States, according to Nelson Information's *Directory of Investment Managers*. Socially screened separate accounts have increased ten-fold since 1995, reaching US$1.5 trillion in 2005, including US$17.3 billion in separately managed accounts for individuals and US$1.49 trillion in institutional funds. At the retail level, by 2005 the number of SRI mutual funds had climbed to 201, up from 55 in 1995. In the same period, AUM increased from US$12 billion to US$179 billion[67].

In Europe, AUM guided by SRI principles increased to US$1.29[68] trillion in 2005, up from US$380.73 billion in 2003[69]. In Australia and New Zealand, managed SRI portfolios grew by 56% during 2006, to US$9.03 billion[70]. Another US$100 billion is invested in a dozen SRI funds in Japan.

To gain more insight, in this year's financial advisor survey we asked respondents to tell us how often their clients request SRI screens and how much of their current portfolios are dedicated to this strategy. The results from our respondents illuminated significant differences across geographies. Roughly 6% of North American HNWI clients and 8% of North American Ultra-HNWI clients have requested socially responsible investments, compared with nearly twice as many Asian investors — approximately 17% of both HNWI and Ultra-HNWI clients. Wealthy Middle Easterners were the second-most likely group to request SRIs, with 11% of HNWIs and 17% of Ultra-HNWIs represented by the survey seeking such investments. Europeans ranked third, with SRIs requested by 9% of HNWIs and 10% of Ultra-HNWIs.

Figure 12. | **HNWIs and Ultra-HNWIs' Interest in Socially Responsible Investments, 2006 (%) (by Region)**



Source: Capgemini/Merrill Lynch Financial Advisor Survey, March 2007

[66] "A Brief History of Socially Responsible Investing," *www.goodmoney.com*
[67] "2005 Report on Socially Responsible Investing Trends in the United States: Ten Year Review," *Social Investment Forum*, January 24, 2006
[68] All currencies were converted to U.S. dollars using the average exchange rate for the year in question
[69] "European SRI Study: 2006," the European Social Investment Forum (Eurosif), with support of the European Commission, 2006
[70] "Sustainable Responsible Investment in Australia – 2006," The Ethical Investment Association and Corporate Monitor, September 2006

Wealthy Asian investors also led in allocating a greater portion of their portfolios to SRI strategies than HNWIs in other regions, earmarking 10% to 15% of their portfolios for these investments. By contrast, investors in other geographies requesting SRIs apportioned only 6% to 8% of their portfolios to these holdings.

Green Investing and Alternative Fuels

Investors and corporations alike are looking at ways to invest in greener technologies, not just for socially responsible reasons, but also because these financial vehicles are providing returns. Critics of SRI argue that taking non-financial data into account and, thereby, possibly limiting the pool of acceptable securities to invest in, curtails the possibility of making a profit. Yet, the Domini 400 Social Index, which is based on the S&P 500 with applicable social screens, has returned 12.71% annually from 1990, the year of its inception, through 2005. During this period, the S&P 500 returned 11.49%[71] annually. Thus, many view SRI as another strategy for diversification.

Also, with global concern mounting over climate change, society is likely to reward companies that are proactive in cleaning up the environment through technology or alternative fuels. In the United States, for example, Texas Pacific Group and Kohlberg Kravis Roberts & Co.'s (KKR) 2007 buyout bid for energy giant TXU was negotiated with the approval of pro-environment groups that have strong ties to Texas Pacific Group and KKR's management. The proposed deal included an understanding that plans to build up to 12 coal-fired power plants would be significantly curtailed.

Overall, investors are backing explorations into new fuels, such as ethanol, fuel cells and advanced battery technology, along with new ways of using biotechnology as a power source. In fact, more than US$70 billion was invested globally in clean energy and clean technology markets in 2006, a 43% increase over 2005[72]. At the same time, the number of indexes following this sector doubled from five in 2005 to 11 in 2006. One sign that alternative fuels are catching on: The Dow Jones Commodity Index reported a 40% increase in 2006 in the price of corn, a staple for ethanol, a gasoline substitute. Wind and solar power, two more mature forms of alternative energy, are expected to grow. According to Robin Batchelor, co-manager, Merrill Lynch New Energy Technology Trust plc: "Demand still outstrips supply in this area and the global wind market grew by 21% last year and solar by 25%. We expect visibility of the entire market will continue to grow as politicians compete to show their environmental and energy security credentials"[73].

Investors aren't the only ones who see the possibility of healthy financial returns in this market. Companies, too, are attempting to map and reduce their carbon footprints for economic gain. In Europe and Asia, governments and investors alike are asking corporations to provide evidence of carbon neutrality. This can happen in several ways. A company can assess its operations and supply chain to find ways to reduce carbon emissions. Or, it can participate in cap-and-trade systems, allowing a central authority (usually a government) to set limits on the amount of a given pollutant it can emit. This system became prevalent in Europe with the commencement of the European Union Greenhouse Gas Emission Trading Scheme in January 2005[74]. Under this framework, participating companies are issued credits that allow them to emit a certain amount of pollutants, trade any unused credits or buy credits from other companies when they exceed their own designated cap.

Governments are taking climate change seriously. The Kyoto Protocol, an agreement made under the United Nations Framework Convention on Climate Change, seeks to reduce collective developed-country emissions by an average of 5% between 2008 and 2012, compared with 1990 levels. This agreement has been signed by more than 60 countries. For their part, a growing number of businesses no longer view non-governmental organizations (NGOs), such as Greenpeace, as a hindrance to their operations. Rather, they are seeking ways to work collaboratively with them to ensure their own alignment with the development of new, eco-friendly technologies and investments. As environmental regulations around the world grow tighter, more and more businesses will find that they must invest in green technologies, cut toxic emissions, create eco-friendly products and cooperate with NGOs. According to Pete Engardio of *BusinessWeek* magazine, "Now there's a more sophisticated understanding that environmental and social practices can yield strategic advantages in an interconnected world of shifting customer loyalties and regulatory regimes"[75].

As climate change and its detrimental impact on the environment and global economy continue to gain attention, we expect to see increasing interest in these issues from investors, businesses, governments and NGOs.

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[71] James Spellman, "Let's Improve Social Investing and Its Returns," *The Financial Times*, March 5, 2007
Note: The broadest definition of SRI was used to define market sizes in the United States, Europe, Australia and New Zealand
[72] Fiona Harvey, "Renewables Gather Investment Power," *The Financial Times*, January 3, 2007
[73] Elaine Moore, "Merrill LIIF New Energy Fund," *The Financial Times*, April 3, 2007
[74] Emission Trading Scheme, Europa website, *http://ec.europa.eu/environment/climat/emission.htm*, accessed April 10, 2007
[75] Pete Engardio, "Beyond the Green Corporation," *BusinessWeek*, January 29, 2007, page 52

HNWI PHILANTHROPY GROWS MORE STRATEGIC AND GLOBAL

Led by the ranks of the ultra-wealthy, HNWIs are increasing the financial resources, time and thought that they donate to philanthropic causes. Philanthropy is increasingly being used to provide HNWIs with a social return on their investments, rather than to just leave a legacy for future generations. The way in which HNWIs give also is evolving due to an increasingly global perspective combined with an increase in the availability of investment approaches that enable support of a broader range of causes.

Private Giving Represents Significant Proportion of HNWI Wealth

According to our survey, in 2006, the 11% of HNW investors worldwide that contributed to philanthropic causes devoted over 7% of their wealth to philanthropic giving. Ultra-HNWIs gave even more: The 17% of Ultra-HNW investors that gave to philanthropy contributed over 10% of their wealth. In total, this equates to more than US$285 billion globally. By comparison, less affluent individuals donate less than 1.5% of their earnings each year[76].

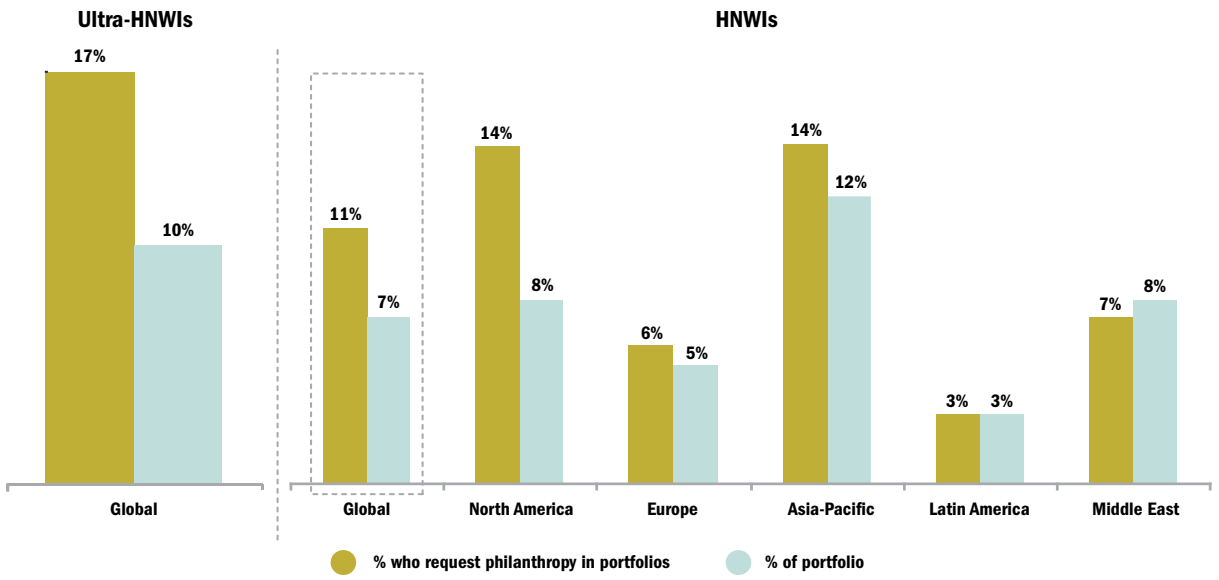
Geographical and wealth-band differences were notable. Thirteen percent to 14% of North American and Asia-Pacific HNWIs (and 26% and 16% of Ultra-HNWIs, respectively) requested philanthropic offerings compared with only 6% to 7% of HNWIs (and 10% of Ultra-HNWIs) in Europe and the Middle East. In Latin America, where philanthropy is less developed, only 3% of HNWIs and Ultra-HNWIs sought philanthropic allocations in their portfolios.

Contribution levels also varied by region. North Americans gave 7.6% of their portfolios, more than a 20% increase from 2005 levels (largely attributed to a heightened sense of social responsibility among North American HNWIs)[77], while HNWI philanthropists in Asia-Pacific and the Middle East devoted approximately 11.8% and 7.7%, respectively, to philanthropic giving. In Europe, HNW philanthropists allocated 4.6% of their wealth to charitable donations. In Latin America, contributions were approximately 3%.

HNWI Giving Grows More Strategic and Investment-Like

Many new HNWIs have built their wealth through income, business ownership and other proactive activities as opposed to passively inheriting wealth. This new generation of HNW philanthropists is looking to give back to society through a much broader range of activities than was previously the case. The correlation between active wealth generation and philanthropic giving is particularly pronounced in the United States,

Figure 13. | **HNWIs and Ultra-HNWIs' Philanthropic Involvement, 2006 (%) (by Region)**



Source: Capgemini/Merrill Lynch Financial Advisor Survey, March 2007

[76] Giving USA Foundation, 2006
[77] "Wealth in America 2007," Northern Trust, January 2007; Capgemini Analysis

where HNW entrepreneurs donate significantly more than HNWIs inheriting wealth: an average of US$232,206 in giving by wealthy entrepreneurs in 2005 versus US$109,745 for those inheriting wealth[78].

This new generation of HNWIs is increasingly seeking to strategically manage the wealth and personal resources they allocate to philanthropy in order to maximize its impact. To this end, HNW philanthropists are leveraging tactics that are quite similar to those utilized and proven successful in their business ventures and personal investing. This is resulting in a growing trend toward strategic "investment-like" giving aimed at maximizing societal return on investment. HNWIs are also investing significant personal time and energy toward attaining their specific philanthropic goals.

One manifestation of this trend is the substantial growth in popularity of donor-advised funds during 2005 and 2006. These funds allow individuals to grow a philanthropic investment tax-free and then recommend the timing, amount and recipient of subsequent distributions from the fund in order to maximize impact. Assets held at four of the largest commercial funds soared 50%, from US$3.26 billion in fiscal 2003 to US$4.9 billion in fiscal 2005, according to Giving USA.

"Donor consulting" firms are also playing an increasingly important role in advising wealthy clients on philanthropic investments that maximize social return on investment, with leading firms increasing their market penetration by more than 45% per year from 2002 to 2006[79]. While the United States accounts for the majority of growth in donor-advised funds and donor consulting, globally, private banks are expanding beyond their traditional range of services to advise HNW philanthropists.

HNWI Giving Becomes More Global as Perceived Sphere of Influence Expands

Many HNWIs and Ultra-HNWIs are focused on giving back to society. This is particularly true in Europe and Asia, where our survey data indicated that, for 60% of philanthropists, a sense of social responsibility is the number one reason why they contribute to philanthropic causes. Forty-seven percent of North Americans give primarily due to a sense of social responsibility, while in the Middle East a combination of social responsibility and religious obligation drives giving.

HNWIs and Ultra-HNWIs are using their financial resources and personal energy to create significant societal change within an ever-growing sphere of influence. Rather than focusing solely on preservation and transfer of wealth within the family or donating primarily to local causes (e.g., to local religious institutions, community groups, arts foundations, etc.), many HNW and Ultra-HNW philanthropists now look to leverage their philanthropic investments to affect change on an international level.

Several high-profile donations announced in 2006 provide examples of Ultra-HNWIs strategically leveraging their financial resources, business savvy and entrepreneurial energy to create positive global change. Philanthropic initiatives of Warren Buffet (projected to donate approximately US$37 billion to five foundations), Bill and Melinda Gates (who created the US$33-billion-plus Bill and Melinda Gates Foundation to address global health and development issues) and Richard Branson, who, in late 2006, publicly committed to spending all the profits from his airline and rail businesses (an estimated US$3 billion over the next 10 years) on combating global warming, are leading a trend toward strategic results-oriented philanthropic investments aimed at affecting change on a global level[80].

Improved healthcare and support for eradicating poverty on an international scale has been an area of particular philanthropic focus for HNWIs. Individuals, such as rock star Bono, the lead singer of U2, are focusing on the urgent need for health care in Africa, particularly the need to address malaria and AIDS on the sub-continent. Former politicians and business people also are stepping onto the philanthropic stage by donating not just money but also time and influence to bring attention to diplomacy and peace initiatives, as well as relief to impoverished disaster-struck areas, whose media images enter homes around the world.

Giving Back Remains an Important Driver of HNWI Philanthropy

The increased emphasis on global and more-focused causes does not mean that traditional causes are being neglected. One area where major contributions have been made in the past few years is in academia. In early 2007, New York's Columbia University announced a gift of US$400 million to US$600 million from an Ultra-HNW alumnus, one of the largest donations ever made to an American university[81]. In China, Harvard mathematician Shing-Tung Yau has taken an active role in building advanced math institutes, which have trained hundreds of China's top math minds, enlisting the financial support of several Asian billionaires[82].

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[78] "Study of High Net Worth Philanthropy," The Center on Philanthropy at Indiana University, October, 2006
[79] "Paying Money to Donate Money," *The Wall Street Journal*, March 9, 2007; Capgemini Analysis
[80] "Branson Pledges Billions to Fight Global Warming," *The New York Times*, September 21, 2006
[81] "Kluge to Give Up to $600M to Columbia University," *CNBC.com*, April 11, 2007
[82] "Plugging a Math Gap," *Forbes.com*, March, 12, 2007

While the causes that attract HNWI interest vary greatly, wealthy donors have one attribute in common: a desire to maximize the impact that their personal contributions have on achieving a preferred societal outcome. As the number of HNWIs increases and their interests continue to broaden, they likely will continue to expect higher returns on their investments. Although HNW philanthropists continue to donate financial resources for tax benefits and legacy building, they also expect substantial positive social impact. Successful giving, more than ever, will be defined by the results generated by a given investment. From financial advisers to non-profit organizations, entities that can meet these expectations will be rewarded handsomely.

Nevertheless, irrespective of wealth band, philanthropic giving will continue to be driven not by corporations, governments or foundations but by the generosity and intent of individuals.

Spotlight

Adopting a New Service Model for HNW Clients

- **As HNWIs' needs become increasingly complex, new client service models are emerging**
- **Leading firms are taking a new approach to client service to provide the most appropriate products and services and unlock potential value for their clients**
- **Firms must provide wealth management advisors with improved client segmentation, more advanced tools and a sophisticated technology platform that supports knowledge gathering, analysis and delivery to ensure long-term relationships with HNW clients**

The Need for Dynamic, Needs-Based Services

This year, we take a closer look at how HNW clients' changing needs impact wealth management firms and their service approaches. Given HNW clients' increasing demands for specialized products and services, the effects of globalization and impending wealth transfer trends, new dynamic, needs-based services are becoming essential.

Service Models Move beyond AUM

Historically, wealth management firms have used AUM to determine which products and services will be offered to individual clients, believing that it was a good indicator of client needs. Advisors tend to focus their time and energy on clients with the most sophisticated needs — usually those with the most AUM. However, this process of estimating client needs based on AUM may preclude further probing to gain deeper insight into a given client's particular wealth management requirements.

Typically, new clients at a wealth management firm are placed in one of three basic (and static) types of practice models, based on the assets they bring to the firm:

- Brokerages (product experts; investment brokers)
- Investment managers (investment advisors; relationship managers)
- Wealth planners (personal CFOs; financial planners; wealth strategists)

While AUM will always be a starting point for predicting client needs, this year's financial advisor survey found that clients within the same wealth band can have very different requirements and expectations.

Our research revealed that clients' service-level expectations are not only based on the wealth they bring to a firm but also on a variety of factors determined well before a client opens an account; these include source of wealth and level of financial involvement, among other attributes[83]. Additionally, demographics, life events and risk appetite all play important roles in shaping the optimal product and service bundle for any one given client. For HNWIs and Ultra-HNWIs alike, there are a core group of basic products and services — investment advisory, for example — that are widely expected. Other services, our research revealed, such as online access and alternative investments, are in higher demand in some regions than in others. For example, in Latin America and parts of Asia, security concerns drive many HNWIs to online channels for account information[84].

Not surprisingly, a client's specific needs change significantly over the course of his or her relationship with a provider, and must be continuously monitored if the full potential value of that relationship is to be unlocked. By taking a more client-focused approach to client servicing, wealth management firms can deepen their relationships with their clients.

For instance, one advisor we surveyed described a scenario in which a dynamic client-focused service approach was utilized. A HNW client maintained a relatively constant level of assets with the firm over several years and met regularly with advisors in his given practice model to review investment performance, goals and the standard product array the firm offered. During one of these client reviews, the client expressed interest in investments beyond this standard array. Using a traditional approach, the advisor might not have probed the client to better understand his needs, with the likely result that the client would not have been offered other investments. However, with the use of a dynamic service model, the advisor was able to make a deeper assessment of the client's background and behavioral history. Based on this analysis, the firm decided to offer their client a co-investment opportunity in an emerging market in the field in which his family had made their fortune (retail supermarkets). The client knew the critical underlying qualities and success metrics of this co-investment opportunity and, thus, gladly became more involved with the venture. The client eventually transferred significant funds from another firm to fund the co-investment opportunity[85] — evidence that the client's willingness to invest further with the wealth management firm had increased.

[83] Capgemini/Merrill Lynch *World Wealth Report* Industry Interviews, February 2007

[84] Capgemini/Merrill Lynch *World Wealth Report* Advisor Survey, April 2007

[85] Capgemini/Merrill Lynch *World Wealth Report* Industry Interviews, February 2007

Leading Firms Adopt a Dynamic Needs-Based Approach to Increasing Client Satisfaction

Across various wealth bands, affluent clients cited *service quality* as the most important factor in their staying with a wealth management firm[86]. Furthermore, when they chose a firm, most HNWIs and Ultra-HNWIs relied more heavily on referrals from friends, family and business relationships than on any firm's traditional marketing efforts to make their selection[87]. This suggests that service quality and satisfying client needs are paramount to attracting and retaining HNW clientele. Taking a needs-based approach allows firms to better satisfy client needs, thus increasing client satisfaction, retention and acquisition.

To optimize service quality, firms first must understand and anticipate their clients' needs. Second, they must continuously monitor these needs as they inevitably will change over the course of the relationship. Understanding the client at a static level will not suffice.

Leading wealth management firms are addressing this issue by moving to a more dynamic model that assesses clients using a more fluid, in-depth and iterative needs-based approach. Some leading wealth management institutions are taking a more holistic approach to reexamining their servicing models and frameworks, drawing lessons from successful service leaders in hospitality, entertainment, retailing and other industries. For example, some innovative financial services firms are building on approaches used by high-touch service providers, such as the Ritz-Carlton, that continuously capture, monitor and analyze their customers' preferences and previous consumption patterns to anticipate and meet their guests' needs.

Creating the Right Service Model for Each Client

Using static segmentation criteria to offer increasingly commoditized wealth management products and services is becoming outdated. The new models that firms are adopting take a multifaceted and dynamic approach to client service. These models put client needs first, taking into account a multitude of behavioral, demographic and investment characteristics that describe each client's wealth management requirements.

Leading wealth management firms are looking carefully at their future clients in an effort to understand their needs beyond just products and services. By closely polling new and existing clients about what drives their investment decisions, and what they expect from their financial managers, these firms can structure a more holistic servicing approach.

Adopting a more dynamic servicing model puts clients on the receiving end of services that will satisfy their needs — and increase their lifetime value to the financial services provider — rather than those simply suggested by their AUM profile. Advisor practice models, service approaches and product offerings can be tailored to meet client needs and continuously refreshed as firms identify changes in client behavior. In this enhanced model, both clients and wealth management firms benefit from the optimization of initial pairing and reevaluation of client needs with firm offerings.

There are several key success factors to consider when incorporating a dynamic needs-based approach. (See Figure 14.)

- **Segmenting and Determining Client Needs beyond AUM**

  In addition to considering AUM, leading firms are segmenting clients according to their interests, cultural backgrounds, frequency of interactions with the firm, communication preferences (which can differ for each family member) and financial-behavioral attributes. These help to align product and service offers to specific client needs.

- **Using Firm Strategy and Client Lifetime Value to Determine Products and Services**

  Once their needs are pinpointed, it is important to understand which products and services are most likely to satisfy clients and support a longer-term relationship with them. Firms assess their core competencies and overarching strategy to determine the segments on which they wish to focus. If there are gaps between their clients' needs and their own product and service offerings, a firm must decide whether to build additional capabilities, partner with a third party or decline certain business opportunities to ensure consistency with their overall strategy. Finally, evaluating the costs along with the potential profitability of additional services and delivery channels will serve as guiding principles for new product and service selection.

- **Selecting a Service Approach and Practice Model**

  Determining the most appropriate service approach means selecting a combination of appropriate delivery channels and practice models that best serve a client's needs. Practice models can be modified or combined to meet specific client needs.

[86] Capgemini/Merrill Lynch *World Wealth Report* Advisor Survey, April 2007
[87] Ibid.

Figure 14. | **Traditional vs. Needs-Based Approach to Client Servicing**

	Traditional Approach	Needs-Based Approach
Client-Needs Determination & Segmentation	Clients segmented by: ▪ Assets under management (AUM) ▪ Risk profile ▪ Other demographic characteristics ▪ Client needs are not proactively reviewed prior to firm strategy determination	Clients segmented by criteria beyond AUM and demographics: ▪ Current and future investment objectives ▪ Behavioral characteristics ▪ Aspirational models ▪ External interests ▪ Preferred communication style/desired level of interaction ▪ Client needs determined based on product, service and investment criteria ▪ Needs drive firm strategy and service offering
Product & Service Alignment	▪ Strategy and product offers determined prior to analysis of client needs ▪ Marketing primarily based on AUM and risk profile ▪ Clients offered products based on wealth band	▪ Firm looks at book of business, and existing and targeted clients to assess its own core competencies and offerings ▪ Clients offered products on a needs-based approach. Anticipated client profitability drives level of service
Practice Model & Service Approach Determination	▪ Clients placed into practice model based on AUM ▪ Service approach driven by practice model	▪ Practice model and service approach tailored to client needs ▪ Multiple delivery channels and practice models used as necessary
Service Review	Once clients are assigned to a model, service approach is static unless significant changes in AUM occur	Ongoing reviews to uncover opportunities for products, services and investments based on behavioral dynamics, valuation analytics and other criteria

For example, some clients may require only a single advisor or relationship manager; others may need a team or private wealth advisor. Some clients may prefer to manage most of their activities online, while still others want service-center support — preferences that do not have a direct correlation with a client's wealth. Alternatively, hybrid solutions can be employed to help a firm exceed a client's service expectations.

▪ Staying Current with Client Needs

To effectively address and anticipate ever-changing client needs, firms should continuously monitor and update their clients' profiles and behavior patterns (e.g., asset allocation and fund-flow patterns, transaction and communication frequencies, online usage, etc.). This information then can be used to update and tailor practice models and advisor approaches.

Together, these success factors support a dynamic and needs-based approach to HNWI and Ultra-HNWI servicing that meets and exceeds client expectations.

A Technology Framework to Support Dynamic Service Delivery

To adopt a dynamic client-servicing model, financial service providers first must improve their ability to understand more about their clients' evolving needs. Information technology (IT) is a key enabling factor — with sophisticated data-gathering and analysis as the primary components of the required technology infrastructure.

Having rich client profile information is a core requirement for implementing a dynamic client-servicing model. This demands that the IT framework be flexible enough to permit capture of a broad range of client profile attributes, data management processes, and procedures for sourcing, maintaining and cleansing the data. The closer a firm can come to creating a single client record and associated profile for each unique individual, the easier it will be to consolidate and mine the data. This will require:

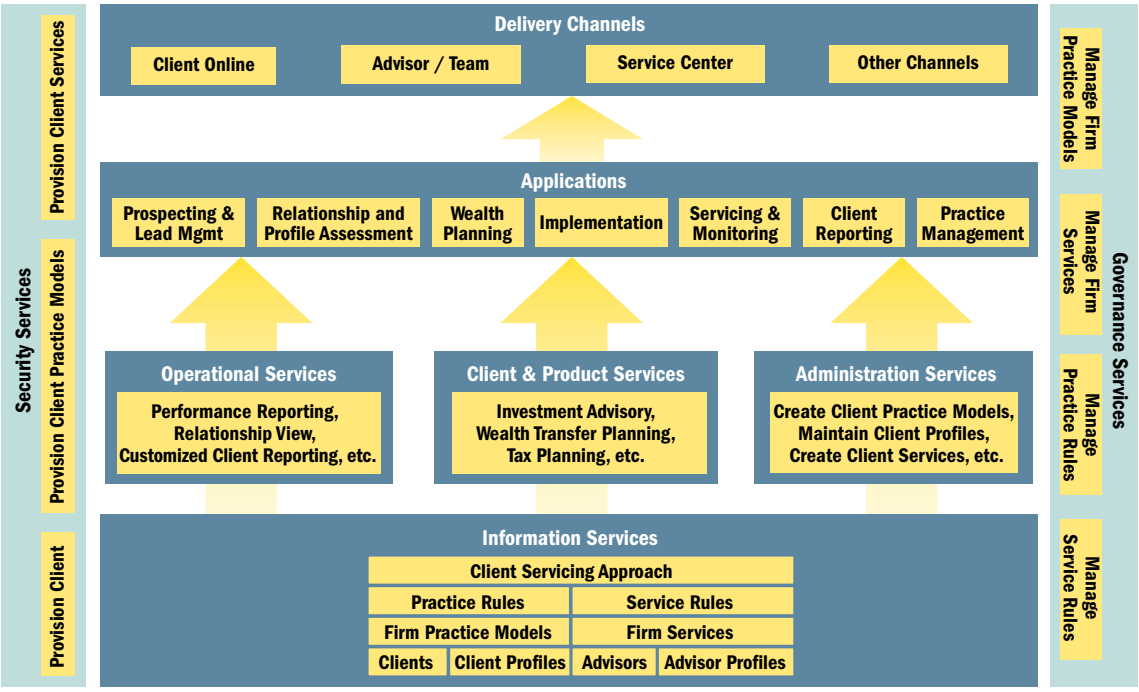
- Client, product and operational services that correspond to firm services;
- Managing various aspects of information services — such as maintaining service definitions and policies;
- Applications to provide information, alerts and workflows to a target set of users (the term "composite application" is commonly used here);
- Delivery channels to guide applications to the appropriate end-users;
- Security to assure secure access to the service-delivery platform and to associate clients with the appropriate service approach;
- Governance to assure that policies are being closely followed.

Technical Challenges and Implications

Implementing the technology framework described above poses certain challenges and implications:

- *A service-oriented architecture is the direction for agile businesses:* Designing the business and technology architecture around the concept of services can improve business agility;
- *Single-client repository*: Aggregation of client databases into a single client repository can simplify the creation of client profile-driven delivery architecture;
- *Aligning service delivery to client needs requires more than simple business rules:* A sophisticated business-rules engine or repository allows for specification and easier maintenance of rules that support complex combinations of client profile attributes;
- *Delivery channels should be containers for composite applications:* Different channels need the flexibility to integrate a range of client applications. In-depth knowledge of policies and preferences is required to provide the right environment for the applications. Commercial software packages must be evaluated to determine the extent to which they can be policy- and preference-driven;
- *Business rules must be adjusted from existing manual procedures and automated systems:* Business rules may not be explicit but, rather, implicitly embedded in manual procedures or automated systems. An exercise in business process transformation will allow a firm to bring to life the new service-oriented architecture;
- *Continuous monitoring of client satisfaction and retention:* Business intelligence dashboards allow firms to monitor how well they are meeting their business goals and finding untapped client potential. Analysis of this information will enable a continuous improvement program.

Figure 15. | **Technology Architecture for a Needs-Based Approach to Client Servicing**



Dynamic Needs-Based Service Models in Today's Global Environment

Several leading firms are already instituting these dynamic, clients' needs-based approaches to serve individuals across multiple wealth bands. The impact of these changes can be seen around the world.

In Asia-Pacific, the non-resident Indian (NRI) community is a key market segment. Successful NRI business owners and professionals are of great interest to wealth management institutions, as they tend to be global in outlook, savvy about the markets in which they live and well-informed about international affairs. Theirs is a close-knit community; members openly discuss investments and provide an excellent base for referrals. Almost all international private banks (and many domestic ones) have identified this rapidly growing segment's need for specific products and services and have created practice models and advisor teams that specialize in servicing NRIs. Firms closely monitor changes in this community to continuously refine and enhance their NRI practices as they learn more about their client base and as the NRI community matures.

In the Middle East, it is incumbent upon advisors to understand *Sharia* (the Islamic law) and its implications for investing and finance. While many firms now provide *Sharia*-compliant products, success in this region requires a deeper level of client knowledge, such as an understanding of women's rights under *Sharia*. As such, firms are making sure that their *Sharia*-compliant advisor practice models have both male and female team members to address the financial needs of both sexes in an Islamic household. In addition, as Middle Eastern cities such as Dubai continue to transform themselves into regional financial and cultural centers, the interests of Middle-Eastern clients also are changing. With the acceptance of *Sharia*-compliant products increasing among the Islamic population in recent years, leading firms have adjusted their models to accommodate the needs of a more globally aware and financially sophisticated clientele.

Within Europe, providers historically have relied on a more uniform client service model in their day-to-day practices across the continent, albeit with more of a global focus. However, leading wealth management providers now are being forced to consider how best to serve an increasingly diverse client base. In the United Kingdom, for example, some advisors report that 25% of their clients come from Emerging Europe and 75% are from the Middle East and India.

Additionally, European clients are becoming more global in their outlook as they increasingly support families who live in more than one country — and conduct banking activities in multiple geographies. Thus, here too, the services being provided have to take into account more than just AUM if a firm wants to maintain a good client relationship over the long term. Advisors who have not recognized this significant shift to a broader geographic client base will have missed an enormous opportunity.

Conclusion

By broadening their perspective to understand their client base, leading firms are reshaping HNWI and Ultra-HNWI expectations of client service. By determining the practice model along with the advisor approach *after* client needs are fully understood, wealth management firms can individualize their service approaches to meet individual client service needs and expectations. This shift enhances the interaction between the client and the firm: optimizing value, profitability and the overall wealth management experience.

Some wealth management firms determine the practice model and advisor approach *before* clients ever solicit advice. They maintain a static service model based on AUM but never understand why certain clients leave while others stay. Only by understanding the needs of each individual wealth management client within a fluid and dynamic model can firms determine the most-effective practice model and service approach. By tailoring their service approach prior to or at the start of the relationship, and by keeping it dynamic and continuous, firms can have a better long-term relationship with their clients. As a model for the future, financial services providers can hope to strengthen client relationships, increase client investment activity and, ultimately, build a richer bond with their HNW clients.

Appendix A: Methodology

The *World Wealth Report* covers 71 countries in the market-sizing model, accounting for over 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 market indexes to reflect the market value of the equity portion of HNWI wealth.

The wealth distribution, which differs by country, is based on known 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 figure 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 the up-to-date annual statistics, we made adjustments to more precisely estimate the number of HNWIs and their financial wealth at a country level. We have continued with this approach in this year's report. Additionally, we have added Bahrain and Qatar to our model 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 20 countries to best account for the impact of domestic fiscal and monetary policies over time on HNWI wealth generation.

Given the exchange rate fluctuations over the past years, especially with respect to the U.S. dollar, we specifically 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 in time. 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 2006 had remained at the same level as in 2005, global HNWI wealth in 2006 would have been only 0.06% lower than our reported figure of US$37.2 trillion.

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

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

Michael Angelicola, Benjamin Beauvalot, Ellyn Charters, Swati Chaturvedi, Katherine Hoffman, Patrick McLaughlin and Andrew Moschetti from the Strategic Research Group for researching, compiling and writing the findings, and providing in-depth market analysis.

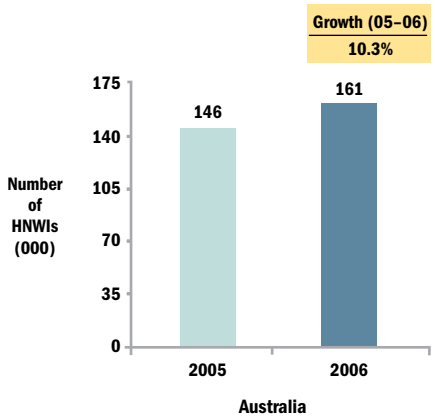
Ileana van der Linde from Capgemini, for her overall leadership for this year's report; Robert Crespi, Stephen Ray and Donie Lochan from the Capgemini Wealth Management Practice, for their guidance and their industry knowledge in creating this year's spotlight section.

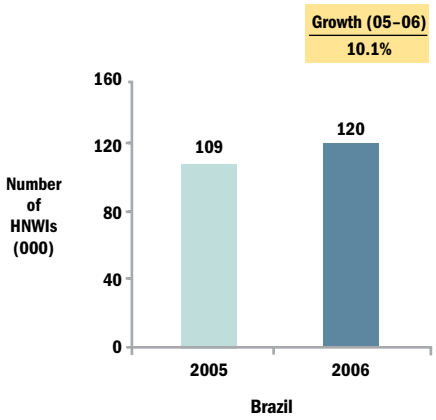
Erik Hendrickson, Michael O'Looney and Tricia Nestfield from Merrill Lynch, who provided industry perspective and research to ensure development of topical issues being addressed in the Financial Services industry; Kathy Bostjancic, Martin Mauro and Christopher Wolfe from Merrill Lynch, who provided expert advice on current trends.

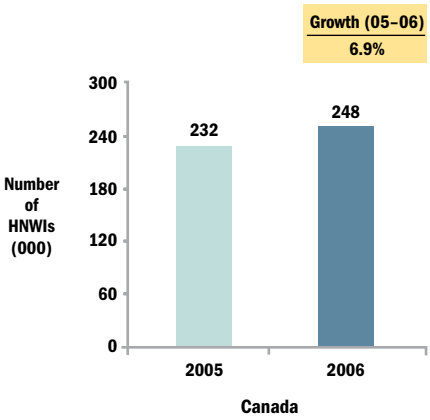
We also would like to thank the hundreds of Financial Advisors and regional experts from Capgemini, Merrill Lynch and other institutions who participated in surveys and interviews to validate findings and add depth to the analysis.

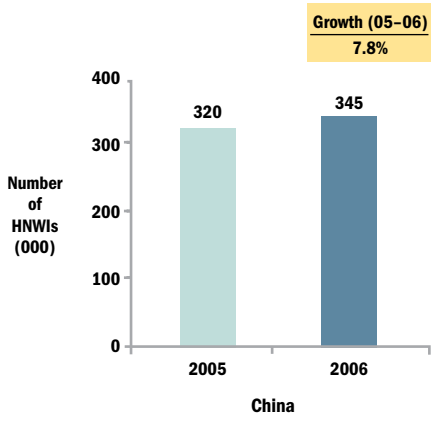
We extend a special thanks to our extended WWR Advisory Council, who gave us insights into events that are impacting the Wealth Industry on a global basis: ABN AMRO Private Clients, AIG Private Bank, Barclays Wealth Management, Capital Asset Management, Christie's, Citigroup Private Bank, Clariden Leu, Coutts & Co., Credit Suisse, Lloyds TSB, Morgan Stanley, Rothschild Private Management, Schretlen & Co., Schroders Private Bank, SG Hambros Private Banking, UBS and Vontobel.

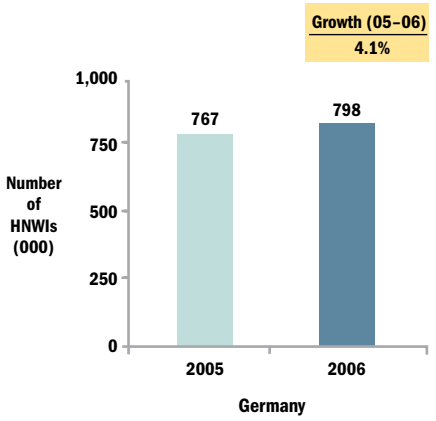
Appendix B: Select Country Breakdown

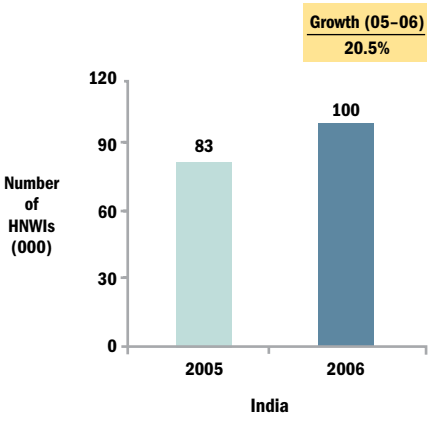


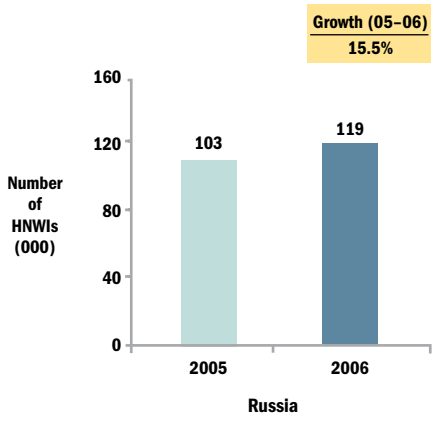


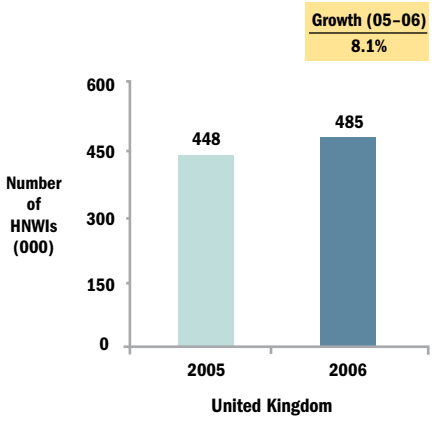


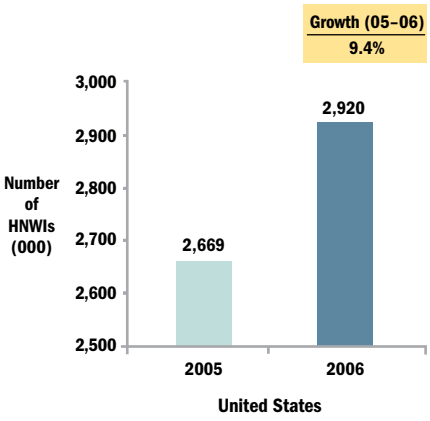












Source: Capgemini Lorenz curve analysis, 2006

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Tel Aviv	+972 3 607 2000
Tokyo	+81 3 6225 8300
Washington, D.C.	+1 202 659 7478
Zurich	+41 1 289 48 00

For more information, please contact
Swati Chaturvedi at Capgemini on +1-617-768-5504

For Capgemini press inquiries, please contact
Jonathan Blank on +1-917-936-8842 (North America) or
Karen Cohen on +1-631-757-5895 (Global)

For Merrill Lynch press inquiries, please call
Erik Hendrickson on +1-212-449-7293

Design/Editorial: Andy Jacobson Design
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