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The present document, which refers to Cap Gemini Ernst & Young, was issued prior to our name change. It has not been modified since it is part of our archives.

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Merrill Lynch/Cap Gemini Ernst & Young

World Wealth Report 2003

Merrill Lynch

CAP GEMINI ERNST & YOUNG

Preface

Merrill Lynch and Cap Gemini Ernst & Young have worked together for nearly two decades to establish a deep understanding of the needs of high net worth individuals (HNWIs are individuals with more than $1 million in financial assets) and what it takes to successfully serve this market segment.

Our latest in-depth study examines and analyzes key trends and developments in the global HNWI market and highlights the implications for the wealth management industry.

In the seventh *World Wealth Report,* we

- explore the global HNWI market's performance over the past year;
- assess the effect of the challenges of 2002 on the financial markets and HNWIs; and
- discuss how HNWIs and wealth management specialists are enhancing financial assets.

We also spotlight the effect of the new market realities on HNWI needs, attitudes and demands toward financial products and services.

As part of our ongoing commitment to excellence, we are pleased to present this report, which we hope will assist wealth managers to better serve the needs of all investors globally.

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Merrill Lynch/Cap Gemini Ernst & Young *World Wealth Report 2003:* Key Findings

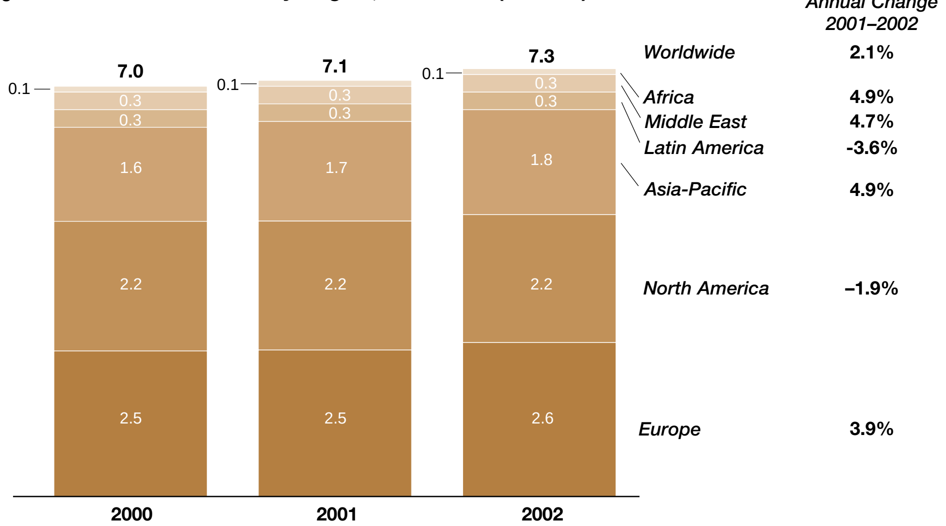
- The number of HNWIs edged up 2.1% to 7.3 million people in 2002, the lowest growth rate in the history of the *World Wealth Report .*
- HNWI financial wealth grew 3.6% to $27.2 trillion last year.
- Sluggish gross domestic product (GDP) growth and declining stock prices slowed HNWI wealth accumulation around the globe.
- North American (Canada, United States) HNWI wealth overall decreased 2.1%, undermined by a continuing decline in equity market indices in the United States in 2002.
- European HNWI wealth grew 4.8%, partially assisted by appreciation of the euro and British sterling against the U.S. dollar. The largest concentration of HNWIs around the world is in Europe.
- Despite Japan's economic woes, Asia-Pacific HNWI wealth jumped 10.7%, supported by relatively high savings rates and robust GDP growth in key regional economies, such as China, South Korea and Australia.
- Latin America's HNWI financial wealth increased 2.7%, with regional wealth generation primarily inhibited by economic and political problems in Venezuela and Argentina.
- Around the world, HNWIs continued to divert funds to fixed income, alternative investments, real estate and other investments less correlated to equities as they sought wealth preservation.
- The combination of corporate scandals, perceived conflicts of interest related to equity research, accounting irregularities and poor investment performance eroded HNWI confidence.
- Weakened personal financial confidence drove many HNWIs to increasingly turn to financial advisors for personalized advice and expert guidance, rather than opting for self-directed investment.
- Successful wealth management providers will have to further improve the client experience by providing greater integration of superior products and a wider spectrum of services through the use of enhanced capabilities and supporting technologies.
- Despite the poor performance in the past two years, we expect HNWI wealth to grow an average 7% a year during the next five years, reaching approximately $38 trillion by year-end 2007.

Market Size and Growth

Tough economic conditions continued in 2002 and had an adverse impact on wealth globally. However, in this economic environment the ranks of individuals with financial assets of more than $1 million grew by approximately a net 200,000 people globally. By year-end, the number of HNWIs had grown 2.1% to 7.3 million (see figure 1), and their financial assets had risen 3.6% to $27.2 trillion (see figure 2).

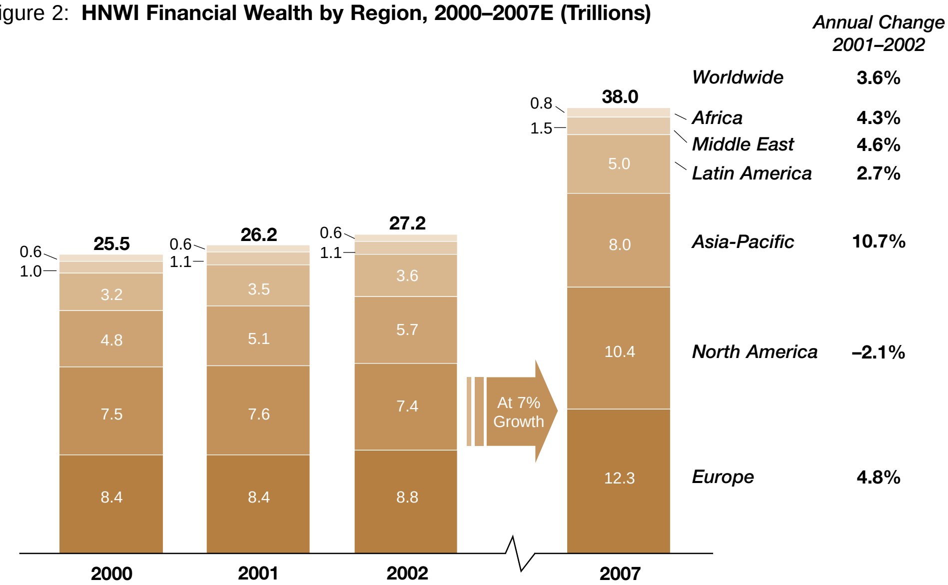
About 90% of HNWIs globally were in the $1 million to $5 million financial assets band, and less than 1% of HNWIs belonged to the ultra-HNWI wealth category (those with more than $30 million in financial assets).

Figure 1: **Number of HNWIs by Region, 2000–2002 (Millions)**



Source: Cap Gemini Ernst & Young Lorenz curve analysis; base data from multiple sources, including MSCI.
Note: Numbers in graph are rounded.

Figure 2: **HNWI Financial Wealth by Region, 2000–2007E (Trillions)**



Source: Cap Gemini Ernst & Young Lorenz curve analysis; base data from multiple sources, including MSCI.
Note: Numbers in graph are rounded. A more conservative growth estimate in line with world nominal growth and including risk would be at 6%. Our 7% growth estimate assumes no significant change in savings rates globally. Furthermore, we believe that HNWIs' global rebalancing of investment portfolios in 2001 and 2002 reduces risk levels and encourages higher wealth growth.

> "Overall, clients became more risk sensitive and realized that their overall risk propensity is much lower than initially thought."
>
> *Financial Advisor, North America*

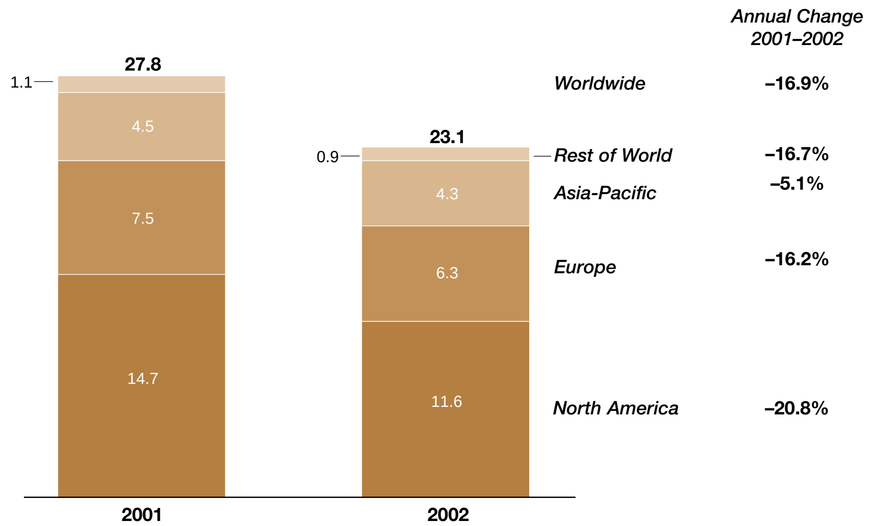
Growth in the two major traditional engines of wealth creation — global GDP and stock market capitalization — failed to pick up, resulting in continued anemic growth in 2002. For the second consecutive year, HNWI financial wealth grew at rates well below the zenith of wealth creation in 1999 and 2000, when wealth expanded at 18% and 6%, respectively.

According to the International Monetary Fund, worldwide real GDP growth remained soft, rising to 3% in 2002 from 2.3% in 2001. However, significant differences were observed among regions. In North America, real GDP grew at 2.3% compared with 0.3% the previous year. In the European Union, growth came in below forecasts, with the region registering a mere 0.9% increase in real GDP in 2002 compared with 1.5% in 2001, mainly due to the struggling economies of the more dominant countries, such as Germany and France. The Asia-Pacific region was mixed, with robust growth in key developing nations, such as China, contrasting with the continued recession in Japan.

Against this background, wealth creation suffered as national savings rates fell in 2002 in key economies where consumption growth outpaced growth in output (e.g., U.K. savings rates fell to 10.4% in 2002 from 12.2% in 2001). Government consumption, particularly in the U.S., was driven by defense and security-related spending associated with the post-September 11, 2001, environment. Private consumption, which recorded marginal growth in Europe and grew 4.5% in the U.S., was propped up by low interest rates. Most central banks continued to ease monetary policies, particularly in the latter half of 2002 when the fledgling recovery threatened to stall. In November, the U.S. Federal Reserve cut the federal funds rate 50 basis points to 1.25%, following a series of cuts in 2001. Between August and December, the European Central Bank cut its key rates a total of 175 basis points.

World stock markets, which fueled the the meteoric growth in financial wealth observed in years prior to 2001, registered dramatic declines in value (see figure 3). Aggregate market capitalization dropped

Figure 3: **Market Capitalization of Major Stock Exchanges by Region, Year-End 2001 and 2002 (Trillions)**



Source: Based on multiple sources including FIBV, World Bank, FEAS, FIAB and others.

Note: Market capitalization data reported for 2001 differs from the numbers reported in World Wealth Report 2002. Additional stock exchanges were added to this year's data.

16.9% in value in 2002, on top of a 13.9% decline in 2001. The market capitalization of the Standard & Poor's 500-stock index declined 22%, the market capitalization of the NASDAQ Composite index declined 32%, while that of the London FTSE index fell 27% and the Deutsche Bourse market capitalization declined 36%. In all, major indices ended 2002 close to their lows for the year. However, there were some notable exceptions: the capitalization of the Seoul and Johannesburg stock exchanges rose 11% and 23%, respectively. Investor confidence in equity markets suffered following a series of high-profile corporate scandals and restatements of financial results reported in previous years. Markets were further unnerved by bellwether companies that reported billion-dollar losses, and by talk of imminent military action in Iraq.

Against this backdrop of economic, geopolitical and corporate uncertainties, volatility intensified across regions in 2002. Investors were particularly shaken by stock market volatility, which remained high throughout the year. For example, in 2002 the S&P 500 gyrated 2% or more on 52 days. In 1995, by comparison, the index made it through the entire year without such volatility. This volatility was not limited to U.S. markets: the German DAX fell to record lows only days after it had risen close to 8% in one session. Volatility in equity markets led to increased investor allocation of funds to bonds over equities. Specifically, in the U.S. investors pulled $27 billion from domestic equity funds and poured $124 billion into taxable bond funds.

Regional Outlook

Overall, Asia-Pacific saw the strongest growth among the major regions, while North America was the only major region to experience a decline in total financial wealth. North America and Latin America were the only two regions to suffer a decline in the number of HNWIs.

North America, for the first time in seven years, reported a 2.1% decline in wealth creation, dropping to $7.4 trillion in 2002 from $7.6 trillion in 2001, as well as a marginal decline in the number of HNWIs.

HNWIs were negatively affected by the steady declines in U.S. equity markets. Our analysis suggests U.S. HNWIs displayed greater faith in the market than their non-U.S. peers, retaining a comparatively large proportion of their financial assets in equities. In contrast, Canada outperformed the U.S. in HNWI growth by maintaining real GDP growth of 3.3% and suffered less significant equity market price declines: the TSE 300 stock index declined 13.5% in 2002. Overall, however, Canadian resilience could not offset the declines in the U.S., and North America ended the year with lower HNWI and financial wealth growth.

Overall, European HNWIs fared slightly better in 2002, recovering well from the previous year's stagnant growth. Their numbers grew approximately net 100,000 to 2.6 million in 2002, and wealth creation grew an impressive $400 billion to $8.8 trillion.

> "Clients kept their existing equity positions because they did not want to realize losses."
>
> *Financial Advisor, Europe*

In contrast to 2001, western European wealth benefited from the appreciation of British sterling and the euro against the U.S. dollar. By year-end 2002, the U.S. dollar had fallen 18% against the euro, enabling more western Europeans than ever before to break the $1 million financial assets threshold. Furthermore, the currency appreciation partially countered the weak performance of the major Western economies, such as Germany, France and the U.K., which saw relatively low GDP growth in 2002. To mitigate the decline in share prices on the leading exchanges, monetary policies continued to be eased in the 2002 second half, with the European Central Bank and the Bank of England cutting their key rates. Taking out the effect of currency appreciation, European HNWIs still saw wealth growth. The largest concentration of HNWIs was still in Europe, accounting for more than 32% of the world's HNWI wealth.

"Clients realize the risks more when the markets go down. Before, risk was non-existent!"

Financial Advisor, Europe

In central and eastern Europe, the economies of countries such as Hungary and the Czech Republic benefited greatly from an influx of foreign capital as the last hurdles to full membership of the European Union were removed. Real GDP in Hungary, for example, rose 3.1% from 2001. Simultaneously, Russia continued its impressive recovery from its late 1990's financial crisis, posting GDP growth of 4.3% and equity market increases of about 45% by year-end.

Furthermore, European HNWIs moved earlier than their international counterparts to diversify portfolios across major asset classes, insulating them against the worst of the downturn and enabling them to grow wealth.

In a difficult year, Latin America's HNWI financial assets showed an increase of 2.7%, far smaller than the growth of 2001. In 2002, wealth in the region increased $100 billion to $3.6 trillion. The number of Latin American HNWIs declined 10,000 to 270,000.

Real GDP growth in Mexico and Brazil, each at 1.5%, to a certain degree aided HNWI financial wealth in those countries. The oil crisis in Venezuela and the crash of the Argentinean peso sparked recessions that inhibited wealth generation there. Argentinean real GDP fell 10.9% in 2002 from a 4.4% decline in 2001. In general, the Argentinean economy never recovered in 2002 from the financial chaos into which it slid in 2001. Regionally, wealth growth was aided by Latin American investors' propensity for fixed income products over equity products.

Financial wealth in the Asia-Pacific region swelled 10.7% from the prior year to $5.7 trillion. HNWI numbers grew a moderate 4.9% to 1.8 million people in 2002. Asia-Pacific HNWIs responded quickly to shield their financial wealth against new market realities. They built diversified portfolios and pursued strategies that promoted modest wealth generation. Japanese HNWIs, for example, moved further into high-performing hedge funds that helped maintain steady returns in difficult conditions. This, coupled with the benefits of having a relatively high national savings rate of about 27% (compared with a U.S. savings rate of about 12%), enabled Japanese HNWIs to fare better than many observers expected.

Asia-Pacific's results in 2002 were also driven by local currency appreciation against the U.S. dollar and by robust GDP growth in regional economies, such as China, South Korea and Australia. In South Korea, the Seoul stock exchange showed an increase in market capitalization for the fourth consecutive year, and real GDP continued its steady recovery from the 1997 Asian financial crisis, rising to 6.1% in 2002 from 3% in 2001. However, key Asian financial centers such as Hong Kong and Singapore experienced market capitalization drops of 8.5% and 13.7%, respectively.

HNWI financial wealth for the Middle East grew 4.6% to $1.1 trillion in 2002, and the number of HNWIs grew approximately 4.7% in 2002. The oil-based economies of the Middle East, such as Saudi Arabia, benefited from buoyant demand for oil and the disruption in supply from Iraq and Venezuela. However, economic activity in the Middle East was kept in check by the impending threat of military action in Iraq.

Africa experienced a 4.3% HNWI wealth growth and a 4.9% growth in the number of HNWIs. Increases in HNWI financial wealth were primarily driven by robust GDP growth and the relatively strong performance of equity markets in South Africa. Specifically, the Johannesburg stock exchange appreciated more than 20%, the South African rand rose 25% against the U.S. dollar and global demand for South African–produced precious metals rose sharply.

Investor Behavior

Continuing the change in asset allocations witnessed in last year's *World Wealth Report,* HNWIs reduced their exposure to equities with greater vigor as the bear market took hold. By the end of 2002, HNWI confidence had fallen. Faced with soft economic growth, prominent corporate financial scandals and persistent index volatility, HNWIs increased holdings in investments such as fixed income and in cash. In 2002, the investor mantra became "cash (and fixed income) is king."

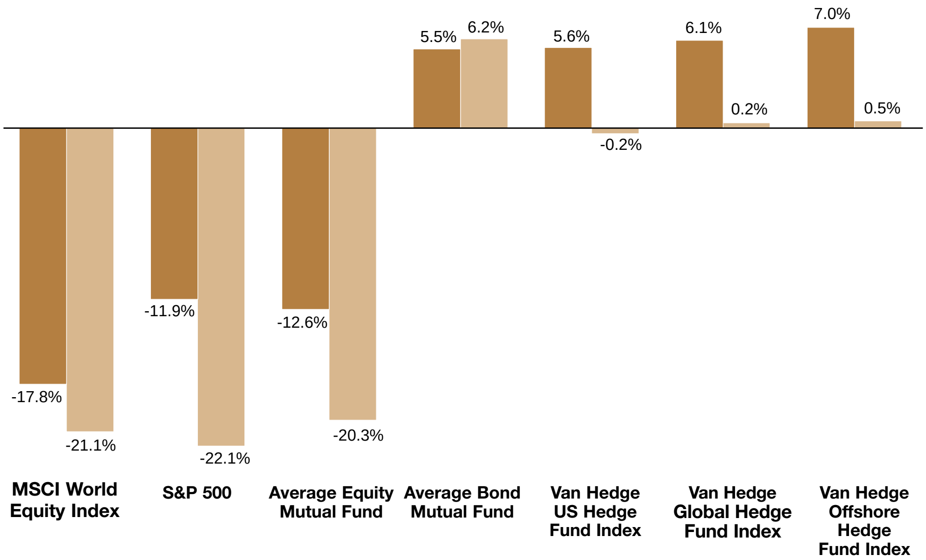
While many HNWIs held onto existing equity positions, they collectively avoided funneling new income into the stock market. The vast majority of HNWIs embarked on a balance sheet repair strategy to minimize risk and maximize fixed returns. Globally, HNWIs accepted the realities of the economic environment by insulating their existing financial assets and by pursuing more conservative wealth preservation objectives. Worldwide, HNWIs displayed a strong aversion to risk in 2002.

Alternative investments, such as real estate investment trusts and hedge funds, emerged as the main beneficiaries of the refocus on risk-balancing strategies. In the 2002 economic environment, alternative investments appeared to be increasingly viewed as a comparatively safe method of diversification because they are less correlated with stock market performance. In particular, real estate investment trusts (REITs) emerged as a universally popular investment vehicle for HNWIs.

"Clients are very cautious about their risk after three years of market decline. Capital preservation is their priority."

Financial Advisor, Asia-Pacific

Figure 4: **Percentage Change in Major Fund Indices, 2001–2002 (%)**



Source: Based on data in Van Hedge Fund Advisors International Van Hedge Fund Indices: U.S., offshore and global (March 2003).

"My clients across Southeast Asia have become risk averse to equities and are increasing exposure in principal protected notes."

Financial Advisor, Asia-Pacific

Hedge funds continued to enjoy popularity among HNWIs, partially because of the better performance of this product family. Van Hedge's Global Hedge Fund Index, for example, reported a slight 0.2% gain in 2002 compared with a bullish 6.1% in 2001. (See figure 4). Still, compared with the 22.1% decline of the S&P 500 index, hedge funds were a viable source for HNWIs seeking to diversify and spread risk.

As political tensions heightened globally in the latter part of the year, HNWIs diversified into precious metals, such as platinum and gold. The prospect of conflict in the Middle East sent gold prices to a six-year high at the beginning of 2003.

Amid challenging times in 2002, the more diversified HNWIs in general seemed better able to protect their wealth than the average investor. HNWIs continued to modify their investment strategies to safeguard their financial wealth by building a more balanced and sophisticated investment portfolio able to withstand the new market realities. HNWIs' use of expert financial advice and diversified products enabled them to rapidly and effectively prioritize strategic objectives — from new wealth creation to existing wealth preservation. The impact was striking. Growth in the number of HNWIs and financial wealth in 2002 outpaced the economy everywhere except the United States.

Looking ahead, the global economic projection for real GDP growth of 3.7% in 2003 offers some encouragement for HNWIs. In our opinion, such a prognosis will depend heavily on several issues: stability in the world oil supply; containing terrorism, minimizing the economic impact of Severe Acute Respiratory Syndrome (SARS), addressing economic deterioration in Japan, and speeding recovery in the U.S. and key European countries. We expect HNWI financial wealth to rise slowly during the next couple of years and to then increase to reach $38.0 trillion in 2007, an annual growth rate averaging 7% (see figure 2).

Spotlight: Understanding HNWI Needs, Behavior and Investment Attitudes

This year's spotlight section focuses on understanding the impact of new market realities on HNWI needs, demands, and attitudes toward financial products and services. The results summarized in this section indicate a change in the investment approach and attitudes of HNWIs, producing potentially significant repercussions for financial providers seeking to reposition themselves for successful differentiation under the new market realities.

New Market Realities

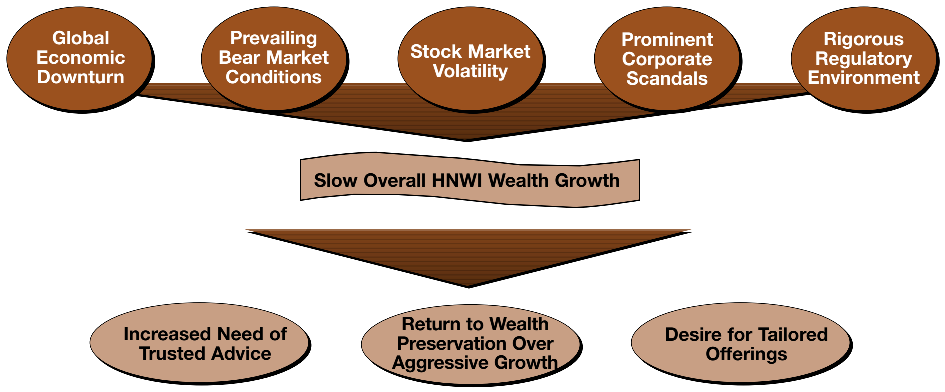
For the past few years, HNWIs have faced a dramatic change in market realities (figure 5). Since 2000, general economic indicators worldwide have not favored HNWI wealth growth. Unemployment rates, market capitalization, and GDP growth rates in many key countries continued to disappoint in 2002.

As a result of the global economic downturn and new market constraints, HNWIs experienced soft overall wealth growth. Consequently, they dramatically altered their expectations regarding personal wealth management.

HNWI Quest for Personalized Advice

Over the past few decades, HNWI needs, demands, and attitudes toward investing have grown increasingly complex and,

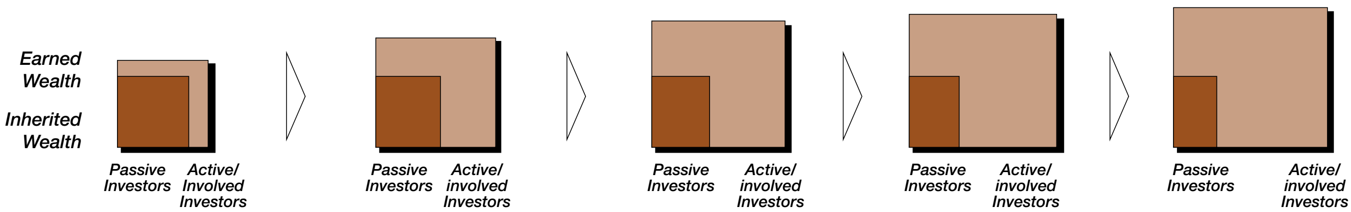
Figure 5: **New Market Realities**



At the same time, declining market indices created a bear market that negatively affected investors worldwide, as high market volatility continued to hamper investing conditions. Investor confidence was eroded by concerns about accounting, Wall Street practices, and corporate collapses around the globe. Moreover, evolving regulatory environments also continued to impact HNWI attitudes and behavior. For example, government amnesties on repatriated money resulted in assets flowing from offshore banking centers to onshore in some European countries. In Italy, the first to offer amnesty, repatriated offshore assets totaling about 78 billion euros.

consequently, more difficult to serve and satisfy. (see figure 6). The proportion of inherited wealth continued to decline as new wealth was created. Infused with confidence during the 1990's bull market, many investors evolved from being passive investment overseers to active self-directed investors. In the wake of dramatic portfolio losses, 2002 saw a return to conservatism and to an advice-seeking approach to investment management. The fear of navigating alone compelled HNWIs to build upon their basic investment knowledge with additional professional guidance and expertise.

Figure 6: **HNW Investor Trends, 1960–2002**



	1960s	1990s	1999	2000/2001	2002
Source	• Inherited wealth	• Increased new wealth	• Overnight wealth	• Less new wealth	• Less new wealth
Style	• Wealth confidentiality • Discretionary asset management — passive investors	• More educated from greater access to financial information — more active	• Self-directed investors — very active	• More involved, sophisticated and savvy investors, but less self-directed	• Involved, sophisticated and savvy investors, but even more doubtful of self-investment abilities — guidance seeking
Risk	• Risk averse	• Less risk averse	• Increased risk taking	• Increased risk aversion	• High risk aversion
Focus	• Wealth preservation • Personalized advice	• Wealth creation	• Aggressive wealth creation • Investment performance	• Wealth preservation and diversification	• Aggressive wealth preservation and diversification • Personalized and comprehensive advice

Note: Size of box represents total HNW investors.

"Clients feel lost in a very complex and changing environment. They look for smart, wise, original and well-organized products adapted to their needs,"

Financial Advisor, Europe

Although HNWIs, in general, grew more investment savvy, the 1990–2002 period was marked by dramatic fluctuations in investment returns. During the bull market of the 1990s, a high percentage of general investors and HNWIs developed an inflated sense of investor self-confidence that led to self-directed, high-risk investment choices. When the market fell in 2000 and 2001, HNWIs became increasingly conservative and risk averse and began to seek wealth preservation through strategic asset allocation and diversification. Through demand fueled by the more financially educated HNWIs, structured and alternative investment products proliferated dramatically, leading to an increased demand for third-party financial products.

In 2002, the combination of corporate scandals, perceived conflicts of interest related to equity research, accounting irregularities, and poor investment performance further rattled HNWI self-confidence. Investor paralysis became the norm, and HNWIs renewed their demand for expert guidance from financial advisors. Market data indicated that the likelihood for HNWIs to make an investment-related decision without consulting professionals declined to 45% in 2002, from 55% in 2000.

However, the change in demand for increased guidance was not indicative of a return to the pre-1990's "manage it for me" approach. Rather, HNWIs looked for advisors who took a "manage it with me" approach characterized by collaboration, transparency, reliability, and high service levels. As a result, investors consolidated assets with advisors offering this approach.

Other market data indicated that HNWIs who engaged "counselor-like" advisors were more satisfied than those with "information-focused" advisors, revealing 85% versus 75% advisor satisfaction rates, respectively.

Increased concern and skepticism over the securities industry as a whole propelled investors to look for transparency in fee structures, reliable research, and advice. Service quality, personal relationships, valued advice, and investment performance ranked as top priorities in provider selection criteria, indicating a renewed demand for strong service focus after years of emphasis on investment performance focus.

In fact, lack of proactive advice, poor customer service, investment errors, and inadequate communication were identified as the top four reasons why HNWIs disengaged from a financial advisory organization. Some market observers suggested that the renewed focus on customer service was in response to the diminished levels of service provided by financial advisory companies during the performance-driven bull market. Despite lower levels of client satisfaction, we found little evidence of an increase in HNWIs switching providers. But HNWIs generally are prone to increasing balances with advisors providing the best service, without ending less satisfactory relationships.

Another important development in 2002 was the extent to which HNWIs looked for providers who offered comprehensive financial planning and advice across all financial products. Our research indicates that in general up to 85% of HNWIs demand comprehensive financial planning and advisory capabilities from their providers, a notable increase from previous years.

Interestingly, HNWIs without a financial plan were, in general, less satisfied with services they received and indicated a higher tendency to switch providers.

Moreover, as HNWI needs grew in complexity, HNWIs expected their providers to comprehensively address a wide spectrum of wealth management services. HNWIs often face the challenge of asset transfer beyond the typical distribution of wealth to family members. An increased desire for philanthropy and "to give back to society" is a key driver. However, in many cases HNWIs lack the means for effective execution.

Risk Management and Wealth Preservation

In 2002, HNWIs' attitudes toward risk and investment objectives also changed. As a result of slow investable financial asset growth, HNWIs focused on wealth preservation to fulfill retirement and wealth transfer goals, in strong contrast to the 1990s focus on wealth generation. We found strong evidence that the primary financial decisions for HNWI households in 2002 were

- Wealth Preservation/Risk Management
- Estate Planning
- Tax Planning
- Retirement Planning
- Stock Purchases

This increased focus on wealth preservation and risk management directly impacted HNWI asset allocation strategies. With thousands of different funds to choose from, determining the best mix of investments is daunting. More funds does not always mean better funds, making investment selection and strategic allocation increasingly challenging. During the bull market, the concept of strategic asset allocation became unfashionable, as equities produced record returns. However, during this bear market period HNWIs sought to allocate their

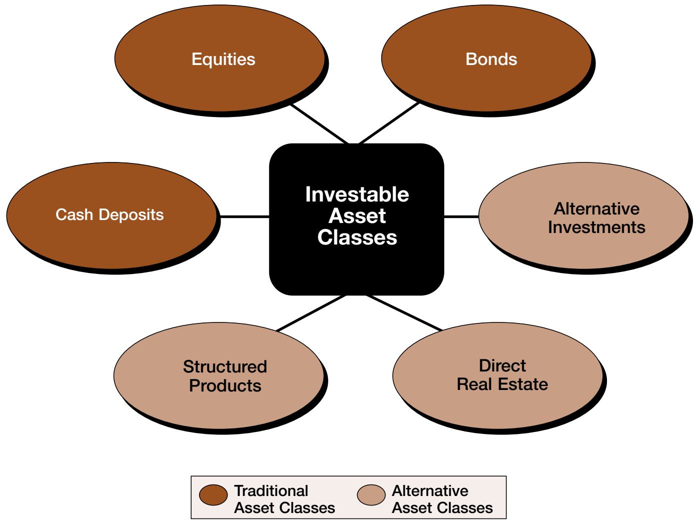
"HNWIs need and demand more attention from our side. Control the risk. Protect the wealth."

Financial Advisor, Europe

wealth into a greater variety of asset classes (see figure 7). Consequently, the average HNWI financial asset investment portfolio grew more complex. The 2002 average HNWI investment portfolio reflected the need for well-designed asset allocation strategies with a clear set of investment objectives (see figure 8).

HNWIs continued to allocate a small, but growing, percentage to alternative investment classes. The average HNWI invested approximately 10% of assets in alternative investments in 2002. However, the higher the wealth band the greater the proportion of alternative investment products in the portfolio. HNWIs' interest

Figure 7: **Asset Class Overview**

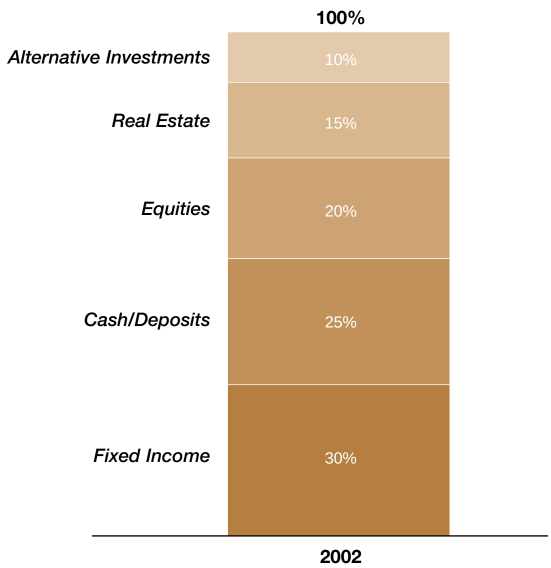


Note: Real estate investment trusts (REITs) are included in alternative investments and not direct real estate.

"Clients demand to have information, to be contacted and to have a close relationship with the financial advisor."

Financial Advisor, Latin America

Figure 8: **Average HNWI Financial Asset Breakdown, 2002 (%)**



Note: Alternative Investments include structured products, luxury valuables and collectibles, hedge funds, managed futures, and precious metals.

Source: Merrill Lynch and Cap Gemini Ernst & Young analysis.

in hedge funds and real estate appeared to grow in 2002 from 2001, while interest in market-linked private equity fell. Hedge funds assets under management increased 8% in 2002 from 2001, bringing the total to approximately $650 billion globally in 2002 and a projected total of approximately $1.5 trillion in 2010. It is our estimate that HNWIs currently account for approximately 60% of total hedge fund assets under management. However, this percentage is likely to decline as institutional investors are expected to continue to increase hedge fund allocation.

Enthusiasm for diversification also fueled a universal increase in real estate investment, both in direct ownership and indirect ownership through real estate trust funds. Low interest rates and solid returns of 6-8% in all major commercial and residential property markets attracted capital. Private equities suffered from adverse market conditions in 2002, but a market still exists for investors who consider these assets as one of the better alternative investment opportunities.

Additionally, some HNWIs also diversified into luxury collectibles and explored new products. Across the globe in 2002, auction houses saw increased interest and sales in art and wine collections as attractive investment options. A wine index, compiled by Fine Wine Management, outperformed equities by 97% in the 2000–2002 period. Furthermore, fund of funds and products providing principal protection were also considered viable portfolio choices for HNWIs.

HNWIs increasingly demanded greater product accessibility, specifically best-of-breed products. Open architecture, the ability to access products from multiple financial institutions through a single point of contact, held enormous appeal for wealthy clients.

Consequently, HNWIs' desire for appropriate wealth preservation strategies, effective risk management and monitoring set an even higher bar for providers.

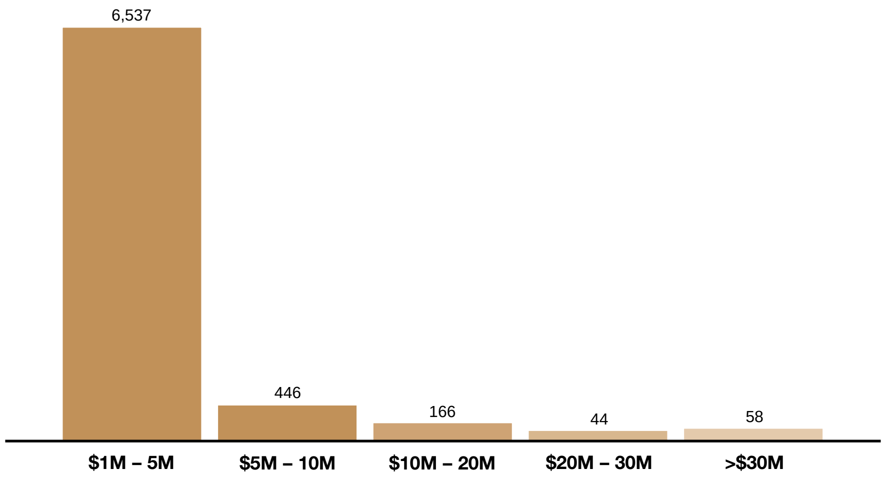
Tailored Segment-Specific Offerings

Although overall products and services demands are similar, segment-specific HNWIs needs and behavior may differ. Serving HNWIs today requires detailed segmentation, or in the case of ultra-HNWI one-to-one segmentation. "Old money" tends to be more risk averse than "new money," and European HNWIs are more inclined to invest a greater proportion of assets across borders than North American HNWIs.

"HNWIs expect proactive monitoring of their portfolios instead of a fixed asset allocation plan."

Financial Advisor, North America

Figure 9: **Number of HNWIs Bby Wealth Band, 2002 (Thousands)**



Note: US$30 million is threshold for the ultra-HNWI (U-HNWI) bracket.
Source: Cap Gemini Ernst & Young Lorenz curve analysis; base data from multiple sources.

"HNWIs want a one stop-shop but don't want to put all their eggs in a single basket."
Financial Advisor, North America

For the most part, HNWIs are traditionally segmented by size of current assets. However, insights into the size of their wealth do not always lead to a better understanding of segment-specific needs or profitability. Many HNWIs insist on being served by advisors who understand and can provide products that address their needs as well as individual attitudes toward risk and diversification.

The segment of 58,000 ultra-HNWIs around the world (see figure 9), a particular and exclusive segment, illustrates the importance of segmentation. To serve this group, providers have traditionally formed exclusive multi-disciplinary teams armed with a diverse set of capabilities to serve an individual's needs. Typically, ultra-HNWIs are a leading indicator of emerging HNWI needs and demands. Consequently, providers are increasingly facing the challenge of balancing client expectations for tailored offerings with economic sustainability and effectiveness.

Another example illustrating the importance of understanding segment-specific needs is highlighted in box 1, where we spotlight some distinct differences between two cultural HNWI segments.

Box 1:
Asian-Americans and Hispanic-Americans are the two fastest-growing populations in the U.S., yet with divergent investment approaches. Generally, Asian-American HNWIs embrace a more "do-it-myself" attitude with investment. Conversely, Hispanic-Americans are more inclined to solicit counsel from financial advisors. We found that only 52% of Asian-American HNWIs used a primary advisor compared with 67% of Hispanic-Americans. This attitude also is reflected in Hispanic-American HNWIs' greater use of financial plans: 33% compared with 24% of Asian-Americans. This behavioral difference is not based on different levels of investment knowledge, as both groups view themselves as fairly educated in financial matters concerning traditional products, such as stocks and bonds. More likely, differences may be attributed to varying cultural backgrounds. Also, when choosing an advisor Asian-American HNWIs put a much greater emphasis on advisor personality compared with Hispanics.

Confidence in their knowledge about traditional financial products and services may also explain why approximately 24% of Asian-American and 31% of Hispanic-American HNWIs increased their holdings in stocks and mutual funds amid the volatile equities landscape of 2002. Following the general wealth preservation trend, nearly half of each group also increased allocation in real estate and cash holdings. Hispanic-American HNWIs had a greater increase in real estate holdings, or 42% compared with 33% of Asian-American HNWIs.

For Asian-American and Hispanic-American HNWIs, wealth growth and preservation are both key financial goals. The difference is in the motivations behind these two goals. When asked about the primary goal of estate planning, supporting family and spouse were two of the top goals for Hispanic-Americans. Conversely, a majority of both Asian-American and general U.S. HNWIs saw tax planning as their primary estate planning goal. It should be noted that almost half of affluent Asian-Americans and more than 40% of affluent Hispanic-Americans did not have an estate plan.

Source: Hispanic/Asian Affluent Study, conducted by IPSOS and Merrill Lynch in April/May 2003.

These examples highlight the importance for advisors to understand clients' investment styles and motivations. By having a clear segmentation framework that looks at and reviews factors such as wealth band, culture, source of wealth, needs and geography, advisors can further provide HNWIs with products and services tailored to their specific needs.

Repositioning for New Market Realities

Success in serving HNWIs' quest for tailored advice and products and service needs is dependent on providers' ability to reposition in the current market. Focusing on selected critical elements of the client experience will be essential for providers to differentiate themselves and increase profitability (see figure 10).

The client experience framework is founded on the provider's ability to offer services and products supported by a strong element of personal interaction. Providers must be able to build a comprehensive portfolio of services beyond stock selection and market timing to build a customized financial plan that encompasses elements such as financial goals, risk portfolio, asset allocation, and ongoing portfolio rebalancing upon deviation from goals. In addition, providers must address HNWIs' desire for a range of additional advisory services, from basic banking services to sophisticated tax planning and trust and estate planning. However, to tailor these services to build trust providers must have an intimate knowledge of client characteristics. In the end, HNWIs are looking for close advisor contact characterized by two-way communication and rapid task management.

Although financial products are increasingly becoming commodities, providing an attractive product portfolio is still essential. Open architecture enables providers to include third-party products in their offerings, leading the way to a broader and deeper product and service base, regardless of institutional origin. As open architecture has proliferated over the years, the key to success is not basic product access, but "smarter access". Today, successful providers of third-party products will implement open architecture, perform due diligence of investment managers, provide a wide array of portfolio opportunities, create comprehensive investment processes, and implement sophisticated support infrastructure.

Focusing on the Financial Advisor

Building a superior client experience also depends on effectively leveraging several key enablers, advisor capability enhancements, adaptive processes and efficient work flows, and the next-generation advisor technology.

To succeed, advisor attraction, retention, and capability enhancement must become a priority. New market realities require providers to rejuvenate and enhance advisor skills and performance through improved training (e.g., new products, financial modeling tools, regulatory updates, etc.). Attracting new hires with various skill sets and diverse backgrounds to match clients' needs for more sophisticated financial planning will also become increasingly critical.

"Total financial planning is nothing without access to third-party products."

Senior Vice President, North America

"Open architecture for fixed income trading provides clients with more choices in bonds. This is key in a capital preservation environment."

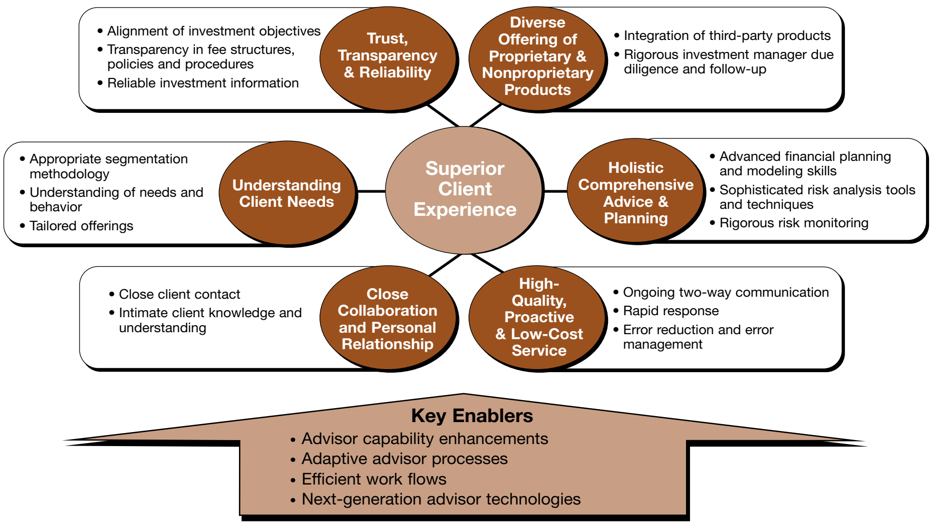
Financial Advisor, Asia

As the search for new talents and capabilities becomes more demanding, providers may want to look outside their organization for additional resources. Currently, only large providers have the economies of scale to match all client needs with in-house capabilities. As mentioned in last year's report, to remain competitive most providers will have to gain access to skills from other providers and integrate these resources seamlessly into existing processes to better serve client needs.

To reduce costs and to improve profitability, transforming processes and work flows should become a priority. Best practices include organizing the talent into multidisciplinary teams, establishing consistent service levels across the organization, implementing a standard wealth management process, and measuring client profitability.

The next-generation advisor workstation also is a critical enabler for improving capabilities and efficiencies of processes. The workstation must facilitate the complete relationship with clients, from acquisition to development to retention. It provides the financial advisor with a substantial platform (workstation and on-line) of functionality to support all aspects of comprehensive wealth management. The next-generation wealth advisor workstations build a holistic client view around advisor work flows and integrate previously stand-alone applications. Thus client service is improved, while assets under management and advisor efficiency are increased. Moreover, fixed technology related costs are reduced and made increasingly variable.

Figure 10: **Superior Client Experience Framework**



In addition, some firms will have to improve their current on-line offerings to build a more complete full-service experience. Full-service on-line solutions will provide clients with the right balance of self-service access and collaboration with their financial advisor. At the same time, they must provide advisors with more opportunities to interact with clients on substantive matters through enhanced functionality, planning, transaction and information sharing, and other collaborative efforts. The right on-line solution can improve profitability by reducing costs and improving advisor productivity, while increasing client satisfaction.

Future Prospects

This year's analysis has led to several observations on the future of the wealth management market. As market performance improves and as HNWIs become more accustomed to new market realities, investment skepticism will decrease. For example, Americans tend to react quickly to market rebounds. As equity markets improve, U.S. HNWIs are likely to be the first to accelerate activities in equities. However, in the near term better performance will not lead to the majority of HNWIs returning to self-directed investing. HNWIs will continue to seek guidance across all financial facets as their financial needs and opportunities become increasingly complex.

Furthermore, passive HNW investors will become more actively involved in their financial decisions as they seek personalized advice, in essence a superior client experience tailored to their needs.

To secure HNWI retention and attraction, providers will need to create and implement a superior client experience covering a wide spectrum of sophisticated HNWI service and product needs. Providers failing to do so will struggle to survive the new market realities.

Appendix: Methodology

The *World Wealth Report* covers 59 countries, accounting for 96% of world GDP and 98% of world stock market capitalization.

We have estimated the size and growth of wealth in various regions using the Cap Gemini Ernst & Young Lorenz curve methodology. This was originally developed during consulting engagements with Merrill Lynch in the 1980s and is updated on an annual basis to calculate at a macrolevel the value of HNWI financial wealth. Again this year, we have updated distribution data for several countries based on new research.

The model is built in two stages: first, the estimation of total wealth by country, and second, the distribution of this wealth across the population. Total wealth levels by country are estimated using national account statistics from 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, an adjustment is made based on world stock market indices so that the final figures reflect the market value of the equity portion of HNWI wealth.

The wealth distribution of each country is based on known relationships between wealth and income (in countries where the necessary information exists). Data on income distribution is provided by the World Bank. We use the resulting Lorenz curves to distribute wealth across the owners of wealth, whom we assume to be the adult population in each case. Of course, the distribution of wealth varies for each country.

To arrive at financial asset wealth as a proportion of total wealth, we have used statistics for countries with available data to calculate their financial wealth figures and extrapolated these results 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, and funds and the usual money market and cash deposits. It excludes ownership of collectibles and real estate used for personal residences. Offshore investments are theoretically accounted for, but in practice 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 figures.

We would like to thank the following people for helping to compile this report:
Petrina Dolby, Robert Low, Valerie McCabe, Catherine Ng and Sohil Parekh.

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