

How the World's High-Net-Worth  
Grow, Sustain, and Manage Their Fortunes



# WEALTH



Associates of  
Merrill Lynch and Capgemini

*Foreword by Robert J. McCann, Merrill Lynch  
and Bertrand Lavayssière, Capgemini*



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***Library and Archives Canada Cataloguing in Publication Data***

Wealth : how the world's high-net-worth grow, sustain and manage their fortunes / by associates of Merrill Lynch and Capgemini

Includes index.

eISBN : 978-0-470-67511-3

1. Finance, Personal. 2. Wealth. 3. Investments. 4. Rich people—Finance, Personal. I. Merrill Lynch & Co. (1973- ) II. Capgemini (Firm)

HG179.W.024'01 C2008-900607-0

**Production Credits**

Cover design: Michael Freeland

Interior text design: Adrian So

Printer: Friesens

John Wiley & Sons Canada, Ltd.

6045 Freemont Blvd.

Mississauga, Ontario

L5R 4J3

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To Our Clients and Our Colleagues

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## ACKNOWLEDGMENTS

While the idea for *WEALTH* was inspired by the tenth anniversary of the *World Wealth Report*, quickly took on a life of its own. This deeply collaborative effort has evolved over the past two years, and we hope, provide a richer view of the world of wealth.

First and foremost, we would like to thank the management of Merrill Lynch and Capgemini for their support in agreeing to support this effort amidst multiple priorities, as well as the many thought leaders who graciously agreed to share their views, insights and lessons learned about wealth and its preservation. Of these, we are particularly grateful for the expertise and guidance of Bob McCann, Vice Chairman and President of Global Wealth Management at Merrill Lynch, and Bertrand Lavayssière, Managing Director of Global Financial Services for the Capgemini Group. If not for their steadfast support and deep industry knowledge, the storyline could not have matured.

Secondly, we would like to thank the management of Merrill Lynch and Capgemini for their support in agreeing to support this effort amidst multiple priorities, as well as the many executives at both firms who invested considerable time and effort in reflecting and commenting on the points of view expressed in this book. The ability of both organizations to reach out to a global network of economists, academics and experts in the field for validation and support was a key factor in broadening the scope of the work.

Thirdly, Capgemini and Merrill Lynch would like to thank Michael Sisk of Hamilton, Bridge & Co. Media Inc., for the numerous interviews he conducted across the globe, and for his skillful organization of the many stories and ensuing research into a commendable first draft. In the process of guiding our manuscript to completion, Stephen Fenichell of Merrill Lynch's Executive Communications group provided color, texture and a narrative framework, in addition to conducting further interviews and research.

We would also like to extend our sincere appreciation to Petrina Dolby of SECOR Consulting for her insight, creativity and tenacity in overseeing this complex and collaborative process.

On the Capgemini team, we would like to acknowledge the key contributions of William Sullivan, Manager of Capgemini's Global Wealth Management Center of Excellence, for his leadership in the book's development; Scott Becchi, Karen Cohen, Chris Gant, Andres Guibert, Bob McGraw, Patricia Neuwirth, Eric Rajendra, Stephen Ray, Ileana van der Linde, Liz Witt, and Alan Young from Capgemini's Financial Services practice for providing industry insights and expertise; and Capgemini's Strategic Research Group for providing research and in-depth market analysis. We would also like to thank Capgemini's Group management for supporting this endeavor.

At Merrill Lynch, Erik Hendrickson, Michael O'Looney and Tricia Nestfield provided industry perspective and oversight of the editorial and research process.

We would additionally like to recognize the contributions of a number of senior executives at Merrill Lynch, including: Stacy Allred, Sameer Aurora, John Barrett, Nancy Bello, Richard Bernstein, Stephen Bodurtha, Candace Browning, Darcie Burk, August Cennamo, Daniel Dunn, John Hogarty, Richard Jones, Karen Klein, Joseph Lam, Albert Lee, Rahul Malhotra, Patricia McLaughlin, Marc

Mitchell, Alyssa Moeder, former CEO Stan O'Neal, Paula Polito, David Ratcliffe, Diane Schueneman, Raj Sharma, Dan Sontag, Ed Specter, Michael Sullivan, Tom Sweeney, Victor Tan, John Thiel, Kevin Waldron, and Ken Winch.

We would like to express our appreciation to our colleagues at Wiley for adeptly steering *WEALTH* through the publishing process and for their collective commitment to editorial excellence. A special thank you goes to Karen Milner, Elizabeth McCurdy, Pamela Vokey, Peter Knapp and Lucas Wilk.

Finally, we have benefited enormously from the many industry authorities and clients who have been so generous with their time in granting extensive interviews for this book. Namely: Antoine van Agtmael of Emerging Markets Management, LLC, Patricia Angus of Shelterwood Financial Services, Jacques Attali of PlaNet Finance, Edward Bernard and James A.C. Kennedy of T. Rowe Price, David James Canton, Jon Carroll of Family Office Metrics, Charles Collier of Harvard University, Larry Fink and Ralph Schlosstein of BlackRock, Doug Freeman and Lee Hausner of IFF Advisors, Gerald Cavendish Grosvenor, The Duke of Westminster, Gregory Johnson of Franklin Templeton Investments, Michael Lee-Chin of AIC Investments, James Rothenberg of Capital Research and Management, Michael Saadie of ANZ Private Bank, Dr. Lee Shau Kee of Henderson Land Development, Charlie Simonyi, Domhnal Slattery of International Aviation Management Group, Dr. Paul Tiffany of The Wharton School of Business of the University of Pennsylvania and of the Haas School of Business of the University of California, Berkeley, and Dr. Cheng Yu-Tung of New World Development.



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# FOREWORD

## Our Eight Convictions about the Future of Wealth Management

By Bertrand Lavayssière, Managing Director of Global Financial Services for the Capgemini Group and Bob McCann, Vice Chairman and President of Global Wealth Management at Merrill Lynch & Co.

The world is witnessing the greatest period of wealth accumulation in history. Never before have so many people from so many different regions of the earth become so wealthy in so short a period of time. And never before have so many opportunities existed to create new wealth, both as the natural outcome of new ideas and the product of existing capital appropriately and prudently leveraged. Due to the downfall of the Berlin Wall in 1989, coupled with the concomitant rise of global capitalism and globally integrated capital markets, the twenty-first century presents an unprecedented opportunity for innovative and entrepreneurial spirits to profit from these long-term secular trends. This will continue to fuel the concentration and consolidation of wealth at the unprecedented velocity witnessed over the past decade. Although economic disruptions and volatility can by no means be relegated to history, we firmly believe that the future of global capitalism is bright. In support of this belief, we have documented and validated eight convictions, which we are convinced will continue to shape the world of wealth as it evolves in the twenty-first century.

### **Eight Firmly Held Convictions Regarding the Future of Wealth Management**

Based on our collective experience, extensive research and dozens of interviews conducted specifically for this book, we have developed eight firmly held convictions regarding the future of wealth management. We will illustrate all eight throughout the book by using detailed examples and case studies. We will demonstrate the myriad ways by which wealthy investors and their financial advisors, as well as the broader community of aggressive and informed investors worldwide, can materially benefit from the wide universe of wealth creation opportunities before us.

1. The global economy and investment focus for high-net-worth individuals is evolving from a two-pole world dominated by Europe and North America to a multi-polar world including Asia and the Middle East.
2. This multi-polar evolution will accelerate as an unprecedented wave of wealth transfer occurs, putting assets into the hands of a younger, more internationally focused and technologically savvy generation.
3. Diversification of investments across different investment vehicles, asset classes and geographies will be the key to consistent and, at times, superior performance.

4. New investment products will continue to arrive at a rapid pace, accompanied by rapid obsolescence and product cycles. As in the past, early adopters may benefit substantially before a new product is commoditized and returns inevitably revert to the mean.
5. Investor sophistication—the ability to understand these new products, to invest in them and to compare them—will depend on a mixture of cutting-edge technological information and expertise.
6. Investors will have an increasing responsibility to stay informed and educated. They must be ready to engage and question their financial advisors about wealth management strategies. They must participate in the dialogue.
7. Family education around financial issues will become increasingly important to demystify money, create family unity and prepare children to be good stewards of family capital—whether through investments or philanthropy.
8. Business ownership will remain the main driver of wealth creation. Business owners will increasingly demand that advisors manage their wealth as professionally as they manage their own businesses, prompting advisors to offer an ever-broader and deeper range of financial products and services to the wealthy and ultra-wealthy.

## TAKING FULL ADVANTAGE OF A WEALTH OF OPPORTUNITIES

The recent growth of global wealth prompts an obvious question: How can the wealthy (and those of us who aspire to join them) and their families maximize their returns, commensurate with their risk appetite, in a rational and measured way that permits them to sleep at night while achieving their increasingly complex financial and personal goals? The purpose of this book is to provide some insightful working responses to this question. Not only are we convinced that the current era promises an unprecedented opportunity for abundance, but that all of us can share in the seemingly limitless prosperity of our era.

While the various topics treated herein may be of keenest interest to present and aspiring possessors of wealth, the rapidly increasing population of financial advisors and their associates will find much to provoke their interest and stimulate discussion of the ever-shifting landscape of wealth management. While we can by no means guarantee that we will address every question posed by professionals, we can offer assurances that most of the broader dimensions of this holistic wealth management process have been covered.

When Capgemini and Merrill Lynch published their first *World Wealth Report* in 1997, the goal of the project was modest and simple: to compile and distribute a discrete set of data points, conclusions and insights describing an explosively expanding class of individuals whom we dubbed HNWI (“high-net-worth individuals”), <sup>1</sup> individuals with more than US\$1 million in financial assets—about whom the financial services industry of the time knew astonishingly little.

We could not have known then that this project would inadvertently give birth to the now commonly used acronym, HNWI (pronounced by the cognoscenti as “HUNWEE”) which would later

destined to take pride of its place in the popular parlance of the burgeoning wealth management industry. As we began more closely to observe, track and interpret the distinctive needs and behaviors of these individuals, we identified an even more rarefied class of investors with financial assets in excess of US\$30 million, which we subsequently called ultra-HNWIs (ultra-high-net-worth individuals)<sup>2</sup> who exhibited behaviors more institutional-like than the “average” HNWI.

## APPRECIATING WHAT A DIFFERENCE A DECADE MAKES

The world of wealth described in that first seven-page report was positively quaint by today's standards. In 1996, the number of dollar millionaires had just topped six million; ten years later the ranks of the wealthy had swelled to nearly ten million. In 1996, the pool of assets controlled by the wealthy stood at approximately US\$17 trillion. By 2007, that number had surged to US\$37 trillion.

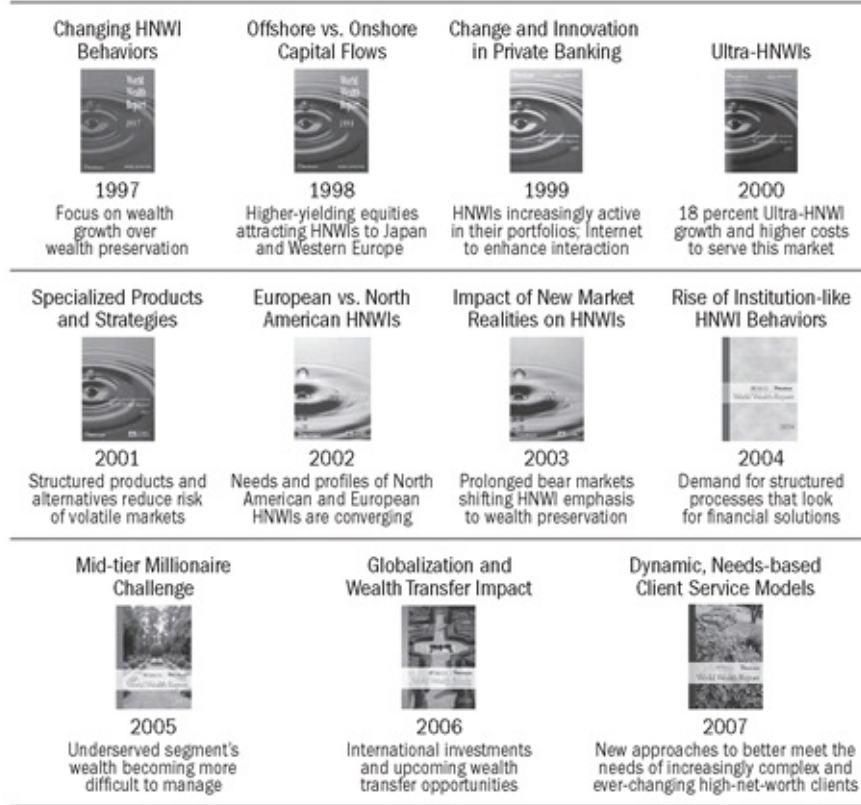
The approximately twenty trillion dollars in newly accrued assets accumulated by the wealthy and ultra-wealthy over the past decade represents not only a trend toward ever-greater wealth consolidation and concentration, but also its accelerating globalization. In 1996, the most dynamic regional wealth generators worldwide were in Asia and Latin America, although all the emerging markets were shortly to be significantly if briefly disturbed by the onset of economic contagion from Asia and its fallout. This included the disruptive default on Russian sovereign debt, which first raised its ugly head in the summer of 1997.

We also documented a trend by which many of the world's wealthiest individuals and families were abandoning traditional private banking havens in Switzerland in favor of offshore centers in the Caribbean. Additionally, we identified a behavioral pattern that has since accelerated, as the wealthy and ultra-wealthy diversified their portfolios to embrace a number of then-radical and exotic investment strategies, loosely grouped under the generic term “alternative investments.”

Whether those alternative investments included taking the plunge into frontier emerging markets, making a proprietary private equity placement, or perhaps purchasing one or more holdings from a rapidly expanding menu of comparatively exotic structured financial instruments and vehicles,<sup>3</sup> the penchant of the wealthy and ultra-wealthy to seek enhanced performance closely mirrored an increased appetite for measured and structured risk—i.e., alternative investments—on the part of institutional investors. By late 2007 and 2008, however, the global credit crunch threatens to cast many of the rosy scenarios underlying these pooled assets into question.

A brief history and synopsis of the ten-year trends can be found in [Figure 0.1](#).

**Figure 0.1** - *World Wealth Report* Spotlight Sections, 1996-2007



From 1997 to 2007, the number of HNWIs grew at an annual rate of 7.6 percent, from nearly 5 million to nearly ten million. At the same time, their financial assets surged at an annual rate of 7.6 percent, to US\$37.2 trillion from US\$16.6 trillion. In 2006, for the first time, the Forbes 400 was composed strictly of billionaires. HNWIs, who tend to be older than the general population and have accumulated wealth somewhere on the cusp of traditional retirement age, have been saving and spending in their lifetimes according to patterns and strategies quite different from the wealth accumulation and preservation strategies employed by their parents. What is more, as these wealthy individuals pass their assets on to their children, they will in all likelihood usher in a new generation, armed with a different mindset and approach, which is likely to give rise to yet newer forms of investment methods and strategies. The profound social and economic implications of what is predicted to be the largest intergenerational transfer of wealth in history will be discussed at length in later chapters. This growth over the past decade is broken down into an annual timeline in [Figure 0.2](#) below.

**Figure 0.2** - World Wealth Report Scorecard, 1996-2006

Source: Capgemini Lorenz Curve Model; Capgemini/Merrill Lynch 2007 World Wealth Report

HNWI Global	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Financial Wealth (US\$ trillions)	16.6	19.1	21.6	25.5	27.0	26.2	26.7	28.3	30.7	33.4	37.2
Number of HNWIs (millions)	4.5	5.2	5.9	7.0	7.2	7.1	7.3	7.7	8.2	8.8	9.5

Running concurrently with these long-term economic and demographic trends has been the overarching phenomenon of globalization, coupled with the advent of sophisticated technologies that have integrated the world's capital markets while fostering the creation of a steady stream of complex

financial instruments. If two decades ago the financial services industry resembled a mom-and-pop sidewalk food stand offering a mere handful of plain-vanilla entrees on its menu—stocks, bonds and mutual funds—today’s financial marketplace more closely evokes a full-service restaurant located inside a five-star hotel, replete with smiling and eminently capable maîtres d’hôtel and a concierge prepared to meet—and ideally anticipate—every conceivable need, articulated or not, of the discerning investor.

The popularity of structured instruments—including collateralized debt obligations and other forms of asset-backed securities, some of which courted controversy and even outright incredulity during the credit crunch of 2007—is clearly responsible for a significant proportion of the new wealth spawned within the first decade of the twenty-first century. Yet broader access to these high-performance and often high-risk vehicles (the Porsches and Maseratis of the financial world) has not come without cost or anxiety. The sheer complexity of such instruments demands a level of expertise to fully comprehend and navigate through their exotic universe and has only increased the value of expert guidance and advice to baffled yet justifiably intrigued clients. Many of today’s structured products require advanced math degrees not only to create, but even to comprehend.<sup>4</sup> The global nature of the investments also means that numerous tax and regulatory jurisdictions may come into play, further enhancing the chances that expert guidance in the field will be required by clients and advisors alike when engaging with a wide variety of products.

Just as the *World Wealth Report* colorfully accomplished over the past decade, this book will trace the evolution of the financial services industry, from its comparatively humble beginnings as a straightforward purveyor of stocks, bonds, mutual funds and garden-variety investment advice to the affluent masses, to a globally distributed group of high-level custom-shops or boutiques, frequently contained within and supported by global financial powerhouses, and offering a staggering array of products and services precisely targeted at the wealthiest of wealthy individuals and households. We will also provide guidance on the strategies and insights developed by many HNWI’s to take full advantage of the plethora of often exotic products and services on the menu.

As we noted a decade ago, the traditional world of the obsequiously discreet and low-key private banker was even then fading fast into a dusty past. “Private banks can no longer expect to receive handsome fees for providing old-fashioned trust and investment management services merely to protect assets from inflation or domestic taxation.” Clients then, as now, “are becoming increasingly sophisticated and demanding...and expect not only outstanding service but consistent strong performance, active wealth management, and a multi-market investment strategy.”<sup>5</sup>

Family offices and multi-family offices that provide tailored advice to an exclusive and limited network of families, relatives and friends have continued to proliferate in the HNWI universe. Financial services boutiques (many located within larger institutions) that strive to maintain the high-touch intimacy of the traditional private bank have continued to thrive. Several of the largest financial institutions have been quite aggressive in preserving the best of the private-banking tradition by carving out private banks within their larger wealth management divisions, while supplementing the skill sets of their high-production private bankers with expertise drawn from the broad array of activities conducted by the firm.

# LEVERAGING HOLISTIC WEALTH MANAGEMENT TO MEET THE DEMANDS OF THE MASERATI INVESTOR CLASS

Wealthy and ultra-wealthy investors' perennially urgent demand for convenient and comprehensive access to markets and information has given rise to a dazzlingly broad range of bespoke products and asset classes. The most avid consumers of these new asset classes consist primarily of a new client class we have labeled "active performance-driven investors." While once upon a time the average wealthy investor might have sought out a private banker for his or her high-end investment advice—probably the same private banking house that served his or her parents or grandparents—today's more versatile, knowledgeable and empowered HNWI is inclined to take a broader view of their entire financial picture. This broader view has in turn ushered in an era of financial service in which a comparatively small number of firms with a global footprint are prepared to combine the intimacy of a financial boutique with the intellectual capital of a financial powerhouse.

Active performance-driven investors require returns backdated into the past and thrusting far into the future, encompassing asset allocation, risk management, credit, tax strategies, insurance, estate planning, college planning, financial education and philanthropy—not to mention the occasional provision of a sought-after ballet ticket, entree to an intimate lecture by a world-class financial expert or possibly even a financial boot camp for their children so they are more fully grounded in legal issues and the ins and outs of intra-generational wealth transfer.

When a HNWI turns to a wealth manager in our era, he or she invariably demands to know about and perhaps even fully understand the identity of the newest exotic investment vehicle being offered, much as the same discerning consumer might prefer to acquire a custom-made designer suit, as opposed to a mass-production item pulled straight off the rack. Whether it is the most secure risk management tactic, the latest estate tax strategy, or the best way to structure a charitable foundation in accordance with local tax law, the inherent complexity of managing wealth in this day and age demands a genuinely holistic approach.

Particularly for many of the more recently minted HNWI, as well as for entrepreneurs so often busy building their businesses that they lack the time or inclination to dwell on wealth management issues, it is critical to grasp the fact that a more holistic wealth management view offers the surest path to wealth for the broadest class of discerning investors. For advisors, it pays to know that HNWI will increasingly expect this breadth of service. For large banks, with complex global structures, it has become all the more urgent to break down silos and integrate across lines of business and geographies to provide the holistic service HNWI need and will expect.

In our chapter on investor sophistication, we examine the remarkable strides in financial literacy among HNWI, arguably driven by three factors:

1. The enormous amount of information available via the Internet, which allows HNWI to educate themselves more easily than ever before;
2. Globalization, which has forcibly broadened HNWI's investment views;
3. Steadily increasing household liquidity. Through initial public offerings and private equity buyouts, entrepreneurial HNWI, or those with a family business, may suddenly find themselves with tens or even hundreds of millions of dollars on hand, which they must wisely allocate across asset classes and geographies.

A key finding here is that as HNWI's become more engaged than ever before in their investment decisions, they are less and less self-directed.

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HNWI's will continue to require and value the high-level expertise and sophistication that a good financial advisor can bring to the table. That may be good news for advisors, but it also means that HNWI's are relentlessly raising the bar of expectations for them. They fully expect their financial advisor to understand and explain how products fit into the overall portfolio. Or, depending upon the product or instrument in question, they expect their advisor to be in a position to call upon the right expert to add their specialized knowledge to the relationship—a synergy that private banks cradled within global financial institutions and offering a wide array of products and services excel at delivering.

To ensure the highest level of service, HNWI's need to be active participants in a dynamic dialogue between client and advisor. Investors cannot be passive bystanders to the management of their wealth. Advisors, for their part, need to know how to encourage and stimulate this dialogue so that goals may be clearly understood and expectations managed on both sides. The wealth of opportunities available today mean that one's net worth should be viewed as a means to achieve life goals, in addition to being a potential revenue stream.

## **RECOGNIZING “ASSET ALLOCATION” AS SIMPLY CODE FOR “RISK MANAGEMENT”**

“Asset allocation” is, in fact, code for “risk management.” HNWI's and their advisors should use asset allocation as a tool to achieve acceptable risk levels. If conducted correctly, unexpectedly high returns are as much a warning sign that risk levels are out of sync as low returns. While concerns about achieving high returns are perfectly understandable, rest assured that the rules of investing are suspended for no one and that unexpectedly high returns will very likely over time lead to unexpected volatility and losses. According to the “wealth allocation framework” designed by Ashvin Chhabra, former head of wealth management strategies and analytics at Merrill Lynch—now at the Institute for Advanced Studies at Princeton—HNWI's and their advisors should move beyond modern portfolio theory, today the basis of virtually all investment strategies, and put *risk allocation* ahead of *asset allocation*.

## **PREPARING FOR INCREASED DEPENDENCE ON ALTERNATIVE INVESTMENTS**

We delve deeply into the heady issue of alternative asset classes, including hedge funds, private equity, derivatives of all stripes and even investments of passion such as art or yachts. All are playing an increasingly critical role in the ongoing quest for diversification of assets and concomitant mitigation of risk. Collectively, alternative assets have shifted from a minor component of the average HNWI investment portfolio ten years ago to roughly 25 percent today; in addition, this multifaceted asset class has become a veritable wellspring of financial innovation and high returns for clients and



advisors alike. While financial advisors must ensure that their clients have been provided with access to the best thinking around these innovative products, attaining diversity through an appropriate distribution of risk across multiple alternative asset classes remains the key to consistent and even superior performance. HNWI's who fail to demand educated access to these asset classes are, by definition, failing to optimize their returns in the current environment.

## **WITNESSING THE RISE OF INTERNATIONAL INVESTING**

The rise of international investing is the natural outgrowth of globalization and the free flow of capital it encourages. This international flavor in investing has been adopted by a large percentage of investors globally. An exception has been North American investors, who have not taken full advantage of the growth and benefits international diversification has to offer. They have historically invested the least overseas, certainly by comparison to their European and Asian counterparts, thanks to the deep and stable U.S. market. This provincial strategy has until recently served them fairly well, but as exotic frontier markets including Vietnam, Dubai and Brazil continue to mature, such reluctance to invest overseas will limit potential returns. Overall, international investing will continue to grow and play a more significant role in investor portfolios, including those in North America. This has been highlighted in the *WWRs* over the past three years.

In the meantime, emerging markets are attracting local investment on a scale never seen before. Asia and the Middle East, where local wealth frequently flowed without question to Europe and North America, more capital is staying onshore. We see local

HNWI's as canaries in the coal mine, with their increasing participation in their own markets and local economies a powerful validation of the growing internationalization of capital (and of returns), which every wealthy individual or household worldwide should strongly consider emulating.

## **EXPLORING THE EMERGENCE OF GENERATIONAL WEALTH ISSUES**

We zero in on the trends around educating children and multiple generations about wealth. Not long ago, parents could, if they chose, keep most of the details of their fortune hidden from children. Many did this not for the purpose of deception but out of a not unreasonable fear that if the full scope of their fortunes were known they would demotivate their children and create passive "trust funders"—children who sponge off their inherited wealth and never develop into fully formed adults who contribute to society.

Today's parents no longer have the luxury of nondisclosure—even if they think they still do. Information age tools, such as the Internet, and greater mandated disclosure by players in increasingly transparent financial markets mean that children are able to find out plenty about their family fortune in the absence of parental consent. According to the most sophisticated advisors in this area, it is generally advisable to talk directly with these children about wealth, the responsibility it brings, and



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