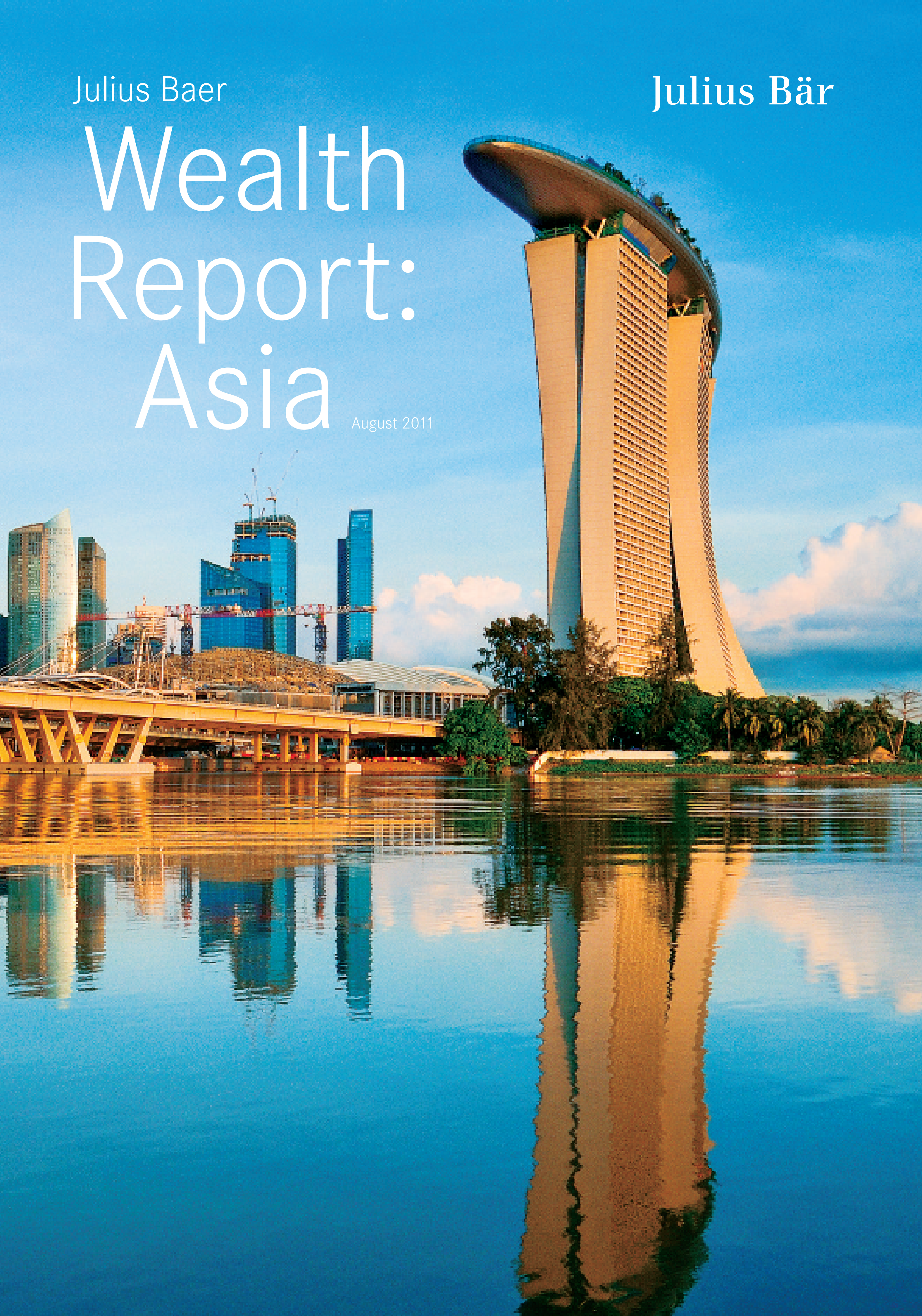
Julius Baer

Wealth Report: Asia

August 2011

Julius Bär



This “Julius Baer Wealth Report: Asia“ publication has been produced in close cooperation between the research teams of CLSA and Julius Baer.
CLSA is Asia’s leading independent brokerage and investment group.

Dear Reader

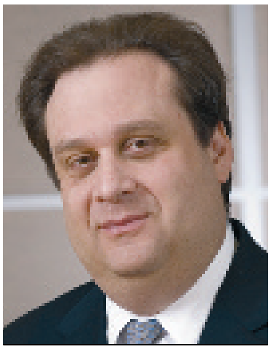
Asia is at the centre of both Julius Baer and CLSA's growth strategies. We have a parallel history of engagement and commitment to the region and in recent years, our relationship with Asia has strengthened in many ways; Julius Baer through opening business locations, enhancing product and service offerings and substantially increasing local staff numbers.

For Julius Baer, Asia is our second home market, as we retain our Swiss roots but embrace the growth opportunities that Asia excels in. For CLSA, the region represents the heart of our business, be it investment banking, brokerage, institutional asset management or research. It is in the area of research that we have leveraged our unique strengths.

In close cooperation with CLSA, this new Julius Baer Wealth Report is dedicated to Asia and showcases our understanding of the Asian wealth management landscape. In addition to making forecasts on the development of this market, we look at the consumption, investing and lifestyle choices and views of clients in the region. In addition, we launch the Julius Baer Lifestyle Index, which will track the cost of living well in Asia and discuss the implications of investment decision-making.

We trust you will find the Julius Baer Wealth Report on Asia an insightful guide to exploring this exciting market.

Boris F.J. Collardi
Chief Executive Officer
President of the Executive Board
Julius Baer Group



Jonathan Slone
Chief Executive Officer
Chairman
CLSA Asia-Pacific Markets

Introduction

Do we live in an Asia-centric world?

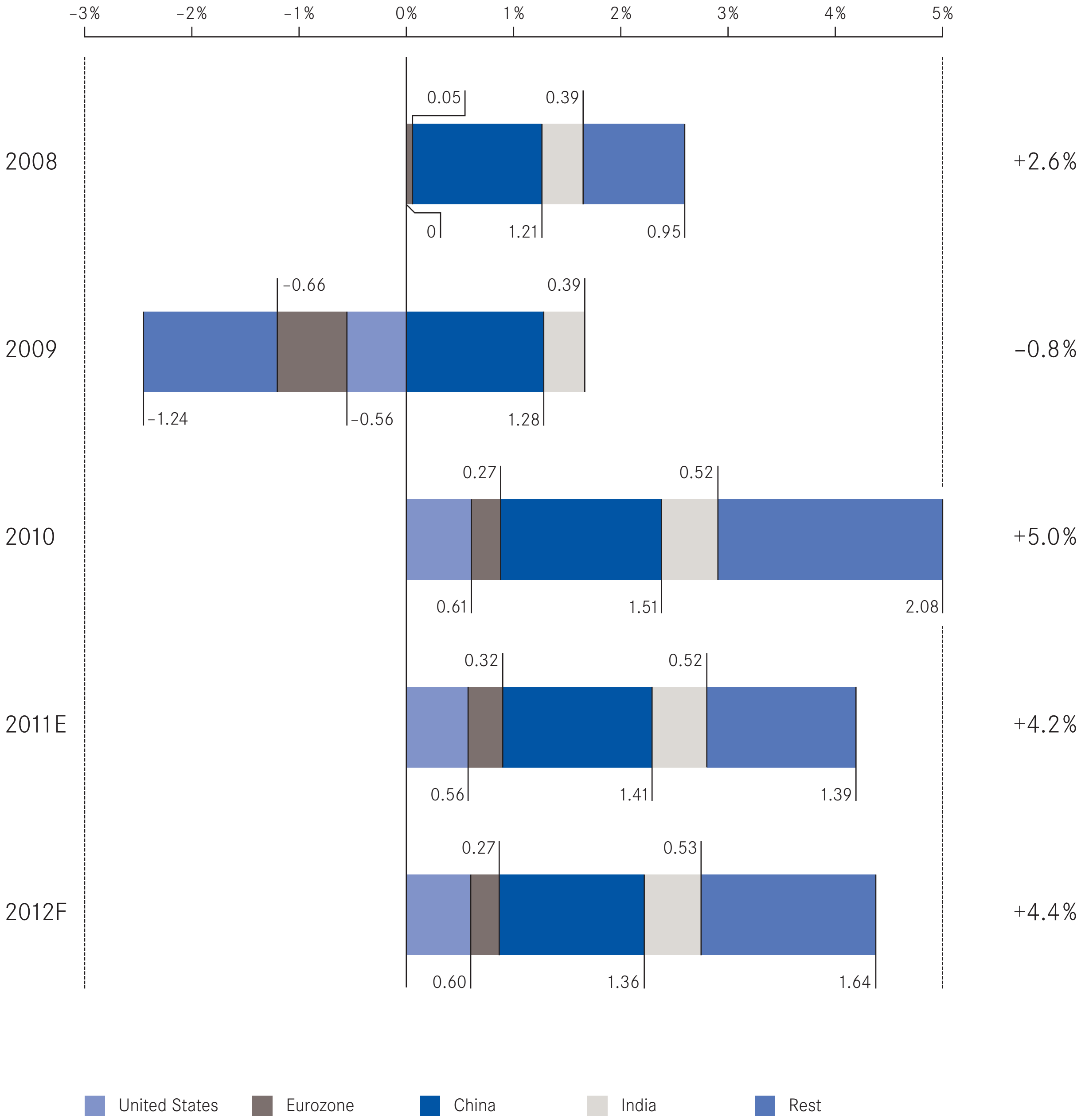
In surveying the global economic landscape in the summer of 2011, investors have tallied the good, bad and potentially ugly in terms of where we are in the growth cycle and what hazards and opportunities lie ahead. The US Federal Reserve saw the end of its 'Quantitative Easing 2.0' programme with little fanfare and in Europe, multiple stakeholders navigated their way through the latest chapter of the Greek debt crisis. Against a backdrop of a slowing global economy, by July most equity markets had delivered a subdued year-to-date performance, reflecting investors' restraint vis-à-vis risk-taking.

Yet, amidst these uncertainties, most emerging market regions displayed robust fundamentals. Labour markets, in particular, stand out in this regard. For example, while the United States lost net six million jobs since January 2008, over the same period Brazil registered over five million formal jobs. In Asia, job creation has remained buoyant, supporting a strong rise in consumption.

To illustrate, emerging Asia's car sales have risen from 18 million units in 2007 to almost 33 million in 2010, according to JP Morgan. While this is just one example among many, most observers would agree that Asia's high growth rates go beyond merely a cyclical phenomenon, but represent structural forces at work.

Chart 1

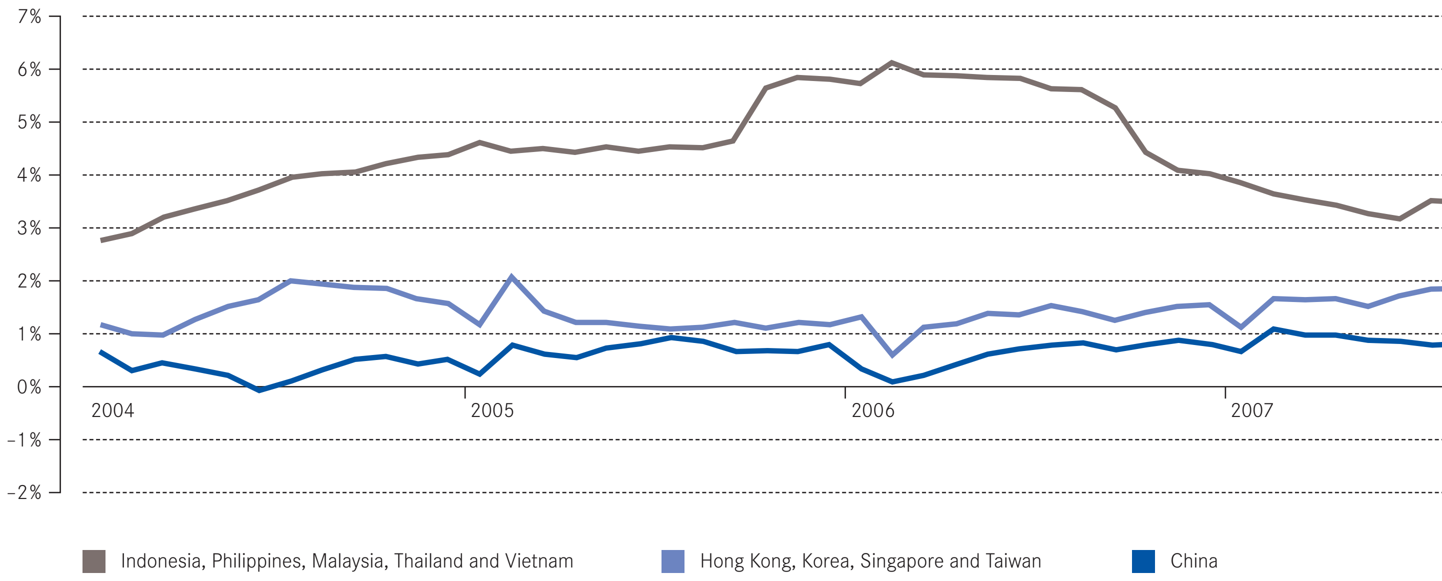
Contribution to global GDP growth: Asia in pole position



Source: Julius Baer

Chart 2

Core inflation, year on year % change – With rapid growth comes the challenge of inflation



Source: IMF, Julius Baer

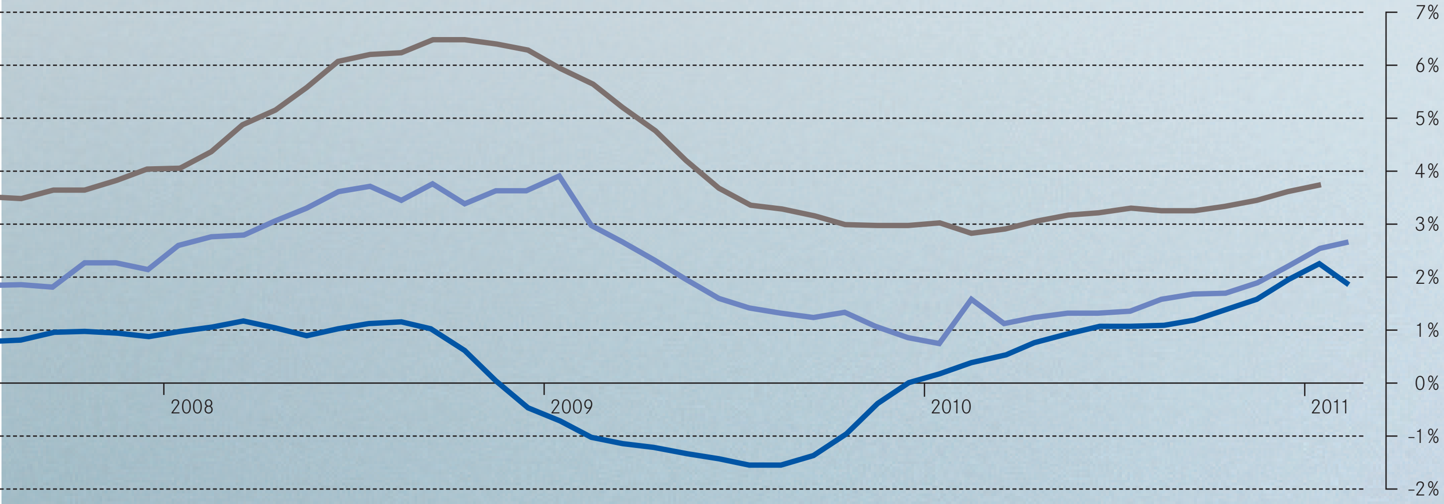
We believe the world is witnessing a shift in wealth creation. Furthermore, Asia is at the forefront of this next wave of wealth creation, supported not only by high savings and economic growth rates, but also promising asset price returns. In a research partnership with CLSA Asia-Pacific Markets, Julius Baer examined the ten most significant economies in the Asia-Pacific region to forecast the path of wealth creation and what the rising cost of living means for this growing population of High Net Worth Individuals (HNWI)[1].

We believe that over the period 2010–2015, the number of individuals with investable assets over one million US dollars (excluding their primary residence) will grow from 1.16 million to 2.82 million. At the same time, the assets owned by these individuals will nearly triple from USD 5.6 trillion to USD 15 trillion over the same period. We forecast that China will see the largest increase in absolute numbers of HNWI, rising from 500,000 today to 1.4 million in 2015. We expect China's HNWI to hold assets worth over eight trillion dollars, or 55% of the total wealth stock in the region by 2015.

With such increases in wealth forecast for Asia, it follows that global consumption patterns will continue to shift as well, with an ever-intensifying focus on the region. Whether this means global firms increasing their presence, investments and production in the region, or rising demand for European and US products from Asian consumers, the economic significance of Asia is set to increase over the longer term. On the other hand, managing rapid growth also presents unique challenges, especially inflation. With this in mind, we specifically examined the likely impact the rising cost of a luxurious lifestyle may have on Asia's HNWI community.

We are confident that the policy-making arena in Asia will master the broader challenges presented by high growth rates. Hence, increased economic prosperity in the region coupled with strong and supportive governance leaves our outlook very positive indeed. In our view, Asia will become one of the world's most important and influential regions globally – the epitome of a growth economy.

[1] Countries and territories covered in this study include China, India, Indonesia, Malaysia, Taiwan, South Korea, Thailand, The Philippines, Hong Kong (SAR) and Singapore.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6%
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3%
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-1%
-2%
2008
2009
2010
2011

The prospects for wealth creation in Asia

We have examined wealth distribution in ten of the most significant economies in Asia Pacific[1]. We find these countries have almost 1.2m High Net Worth Individuals (HNWI), defined as those with investible assets of USD 1m or above (excluding the property they live in). As per 2010, this income group comprises just 0.06% of the population in the countries being analysed. Less than one person of every fifteen hundred is estimated to be in the category of HNWI in this region.

Our study does not include analysis of industrialised economies outside of Asia, such as Australia and Japan, nevertheless it allows for comparisons of this Asian average with the more developed economies within the region. HNWI in Singapore and Hong Kong are approximately 1.5% of their populations. These wealthier city states would have high concentrations of wealth even by global standards. South Korea and Taiwan, with per capita GDP around USD 20,000 stand at about half the US per capita income level; HNWI are approximately 0.4% of the population in these countries. That is 8X as many HNWI compared to the ratio for China, and 20X relative to India and Indonesia.

Strikingly, in India and Indonesia only 0.02%, or one in five thousand of adults, are in the HNWI category; in China it is just 0.05% or one in two thousand. As the economies develop and wealth accumulates, the extremely low ratios of HNWI are set to rise sharply. We project within five years there will be 2.4X as many HNWI in the region compared to 2010. Simply put, we believe the number of HNWI in Asia will grow from the 1.16 million today to 2.82 million in 2015. By that time, we forecast the wealth of Asia's HNWI to reach USD 15 trillion, almost trebling the current stock of wealth.

The findings of our study on wealth in the ten countries are presented below. The nations range from the large, developing economies with big populations, China, India and Indonesia; to countries that are already fairly developed like South Korea and Taiwan, as well as Hong Kong and Singapore, city states that have a relatively small population but high wealth concentration. The analysis excludes Japan and Australia, where growth in wealth is likely to be more modest. China makes up just under half of the adult population for the countries examined. China, India and Indonesia together account for 91% of this region's adult population and 76% of its GDP.

Chart 3

Composition of HNWI in Asia Pacific (2010)

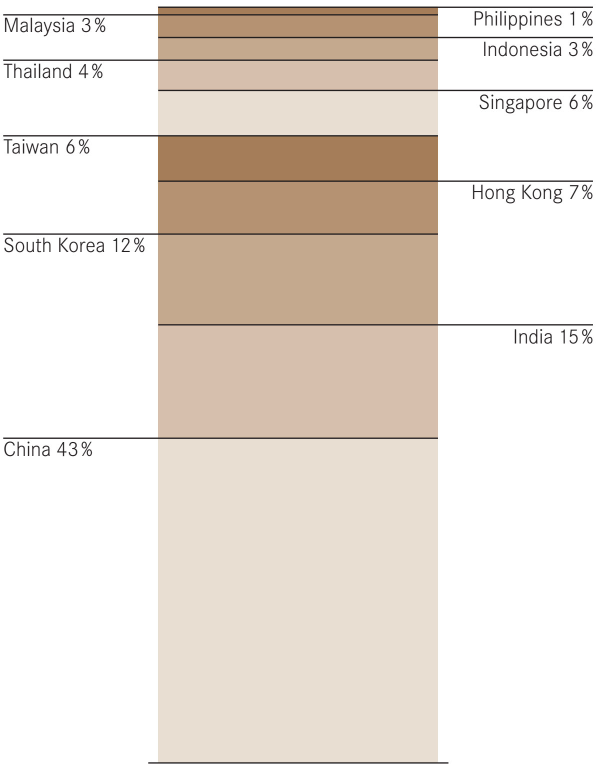
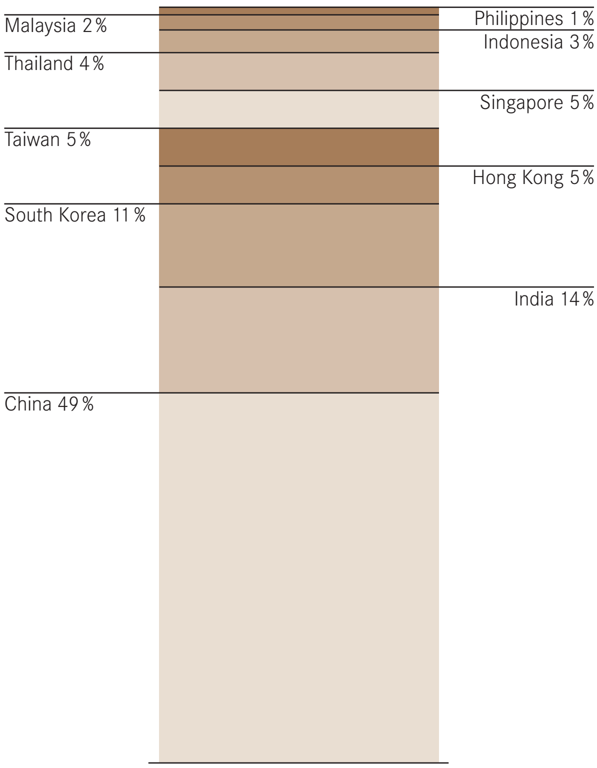


Chart 4

Composition of HNWI in Asia Pacific (2015 F)



Source: CLSA Asia-Pacific Markets, Julius Baer

[1] For the purposes of this report, the following countries have been included: China, South Korea, Taiwan, Thailand, the Philippines, India, Malaysia, Indonesia, Hong Kong (SAR) and Singapore.

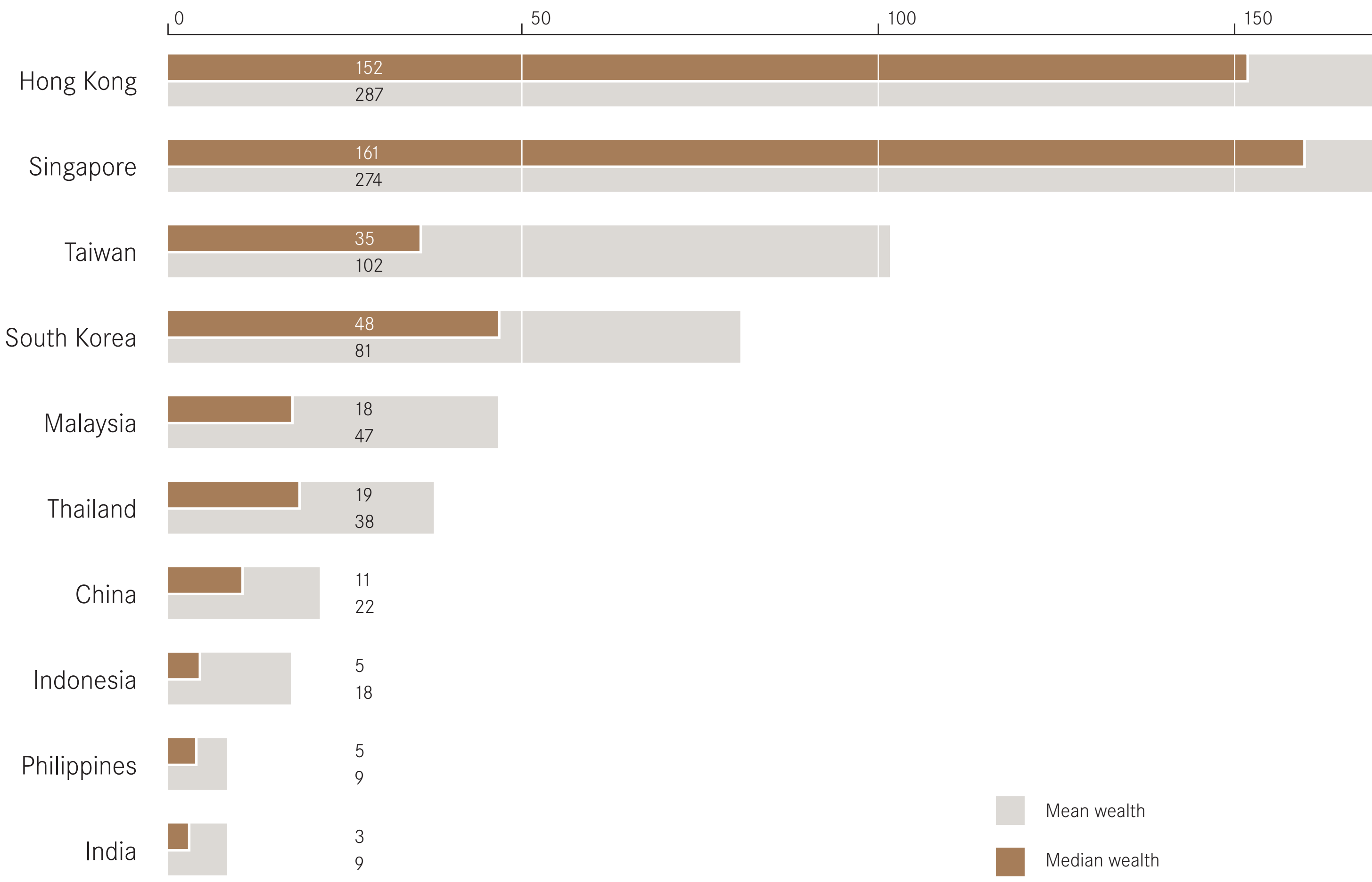
Wealth skew

Wealth is never evenly distributed, irrespective of the region being analysed. This is especially true for developing countries: the differences between those able to accumulate and build on wealth relative to the many who live at subsistence levels are compounded over time. A statistical measure of the disparity, represented by the Gini coefficient, is greater for wealth than for incomes. Between the countries in Asia as well, there are significant differences in income and very large differences in their wealth, as illustrated in the chart below.

Within these countries, average disposable incomes for the top three nations is 14X that of the lowest three. By estimates of median wealth however (i.e. the level of wealth where exactly half are below and the other half are above), the top three countries are some 28x relative to the bottom three countries. That is a powerful illustration of both the compounded effect of higher savings enjoyed by wealthier countries, as well as the skew in wealth distribution which pushes down the median especially in poorer nations.

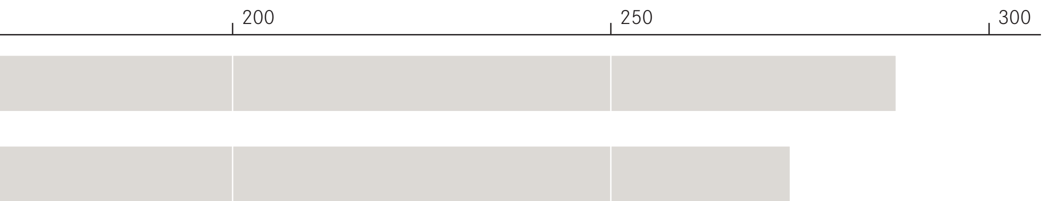
Chart 5

Wealth levels in Asia USD 1,000



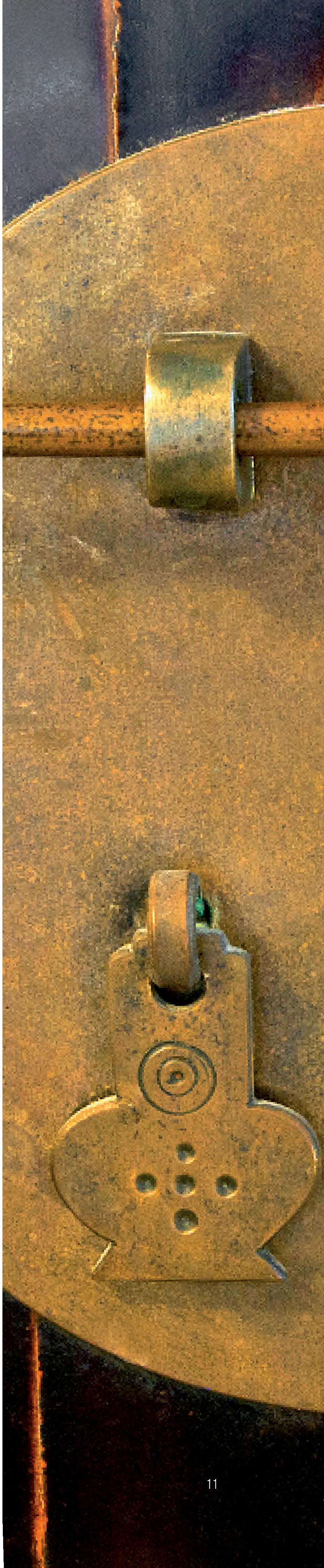
Source: CLSA Asia-Pacific Markets, Julius Baer

The chart also makes an important distinction in the average understood in terms of the mean versus the median. The mean is simply total wealth divided by total adult population. The median, as indicated above, is the level that divides into equal halves those who are above, and those who are below, that level. Due to the fact that a relatively large portion of wealth is usually held by a disproportionate few, the average person's net assets as represented by the median is generally much lower than the statistical mean.



By our estimates, median wealth in these countries is typically about half of the mean. The skew is more pronounced in some of the developing countries, with median wealth only about 30% of the mean in India and Indonesia. Wealth distribution is less skewed in more developed countries like Singapore and South Korea; but even here, median wealth is only around 60% of the mean.

The major differences in the wealth levels of the different countries are worth noting. In Singapore and Hong Kong, the average person's wealth, i.e. the median, is just above USD 150,000 per head. For the less developed countries, wealth levels are a fraction of these. The typical person has less than USD 5,000 wealth in India, the Philippines and Indonesia. In China, average wealth defined as the mean is estimated at around USD 22,000 but the median is only around USD 11,000 per adult.



Wealth explosion

Individuals become wealthy in different ways but across nations, the drivers of wealth creation can be analysed in terms of:

1 Increase in savings as a function of economic growth
2 Return on assets – the yield and appreciation in capital values
3 Appreciation of Asian exchange rates, impacting wealth defined in US dollar terms

The forces for wealth creation appear extremely favourable for Asia over the coming years. These economies are growing faster than any other region in the world. Savings ratios are high. Stock markets over time are providing strong returns. The value of business investments is rising on the back of strong growth and low cost of capital. Property prices are escalating as the middle class move their cash out of low yielding bank accounts into appreciating real assets. Meanwhile, rising Asian currencies are lifting the dollar value of these assets.

Chart 6

Estimates of wealth and HNWI: 2010

	Adult population (m)	No of HNWI (1,000)	Wealth of HNWI (USD bn)
China	975.0	502	2,627
India	729.7	173	949
Indonesia	153.4	33	129
Philippines	50.5	16	60
Thailand	49.7	47	214
South Korea	36.8	138	412
Taiwan	17.9	70	269
Malaysia	17.2	32	143
Hong Kong	5.8	86	484
Singapore	3.8	64	312
Total	2,040.0	1,161	5,599

Estimates of wealth and HNWI: 2015 F

	Adult population (m)	No of HNWI (1,000)	Wealth of HNWI (USD bn)
China	1,024.7	1,378	8,764
India	805.6	403	2,465
Indonesia	161.0	99	487
Philippines	56.9	38	164
Thailand	52.2	128	609
South Korea	38.5	310	1,074
Malaysia	19.2	68	329
Taiwan	18.7	136	593
Hong Kong	6.2	131	711
Singapore	4.1	129	616
Total	2,187.1	2,821	15,812

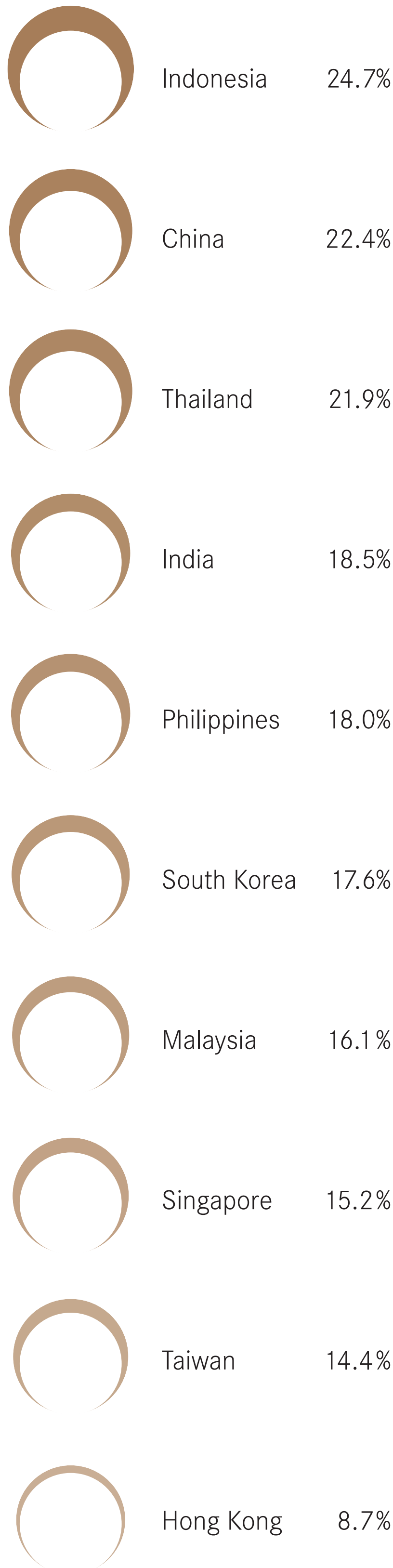
Source: CLSA Asia-Pacific Markets, Julius Baer

The assumptions that we use as inputs in estimating the increase in wealth over the coming years are shown below, from page 16 onwards. We believe that by and large they err on the conservative side, especially with regard to property price appreciation. We expect prices to be stable in Singapore and forecast only moderate property gains in South Korea, Hong Kong and Taiwan. Stock markets are expected to provide better returns averaging 12% annually across the region while currencies are estimated to appreciate at an average rate of just under 4% per annum.

The more buoyant but nevertheless realistic projection is on economic growth. We estimate nominal GDP growth to range from 5.0% to 16.5% per annum and on average to grow at approximately 10.5% per annum in nominal terms for these countries. Note that rising wealth is a function of the increase in savings and assets in dollar terms, thus the relevant growth rate for our analysis is in nominal rather than inflation-adjusted 'real' terms.

The results of combining these relatively conservative assumptions, however, are staggering. Over the next five years, the number of HNWI in the region is set to increase at around 19% annually. Wealth in the region is set to grow 23% per annum. Within five years, the number of HNWI is projected to rise to 2.4X of what it was in 2010, rising from approximately 1.2 million to 2.8 million. The dollar value of their assets we estimate will almost triple from USD 5.6 trillion to cross USD 15 trillion.

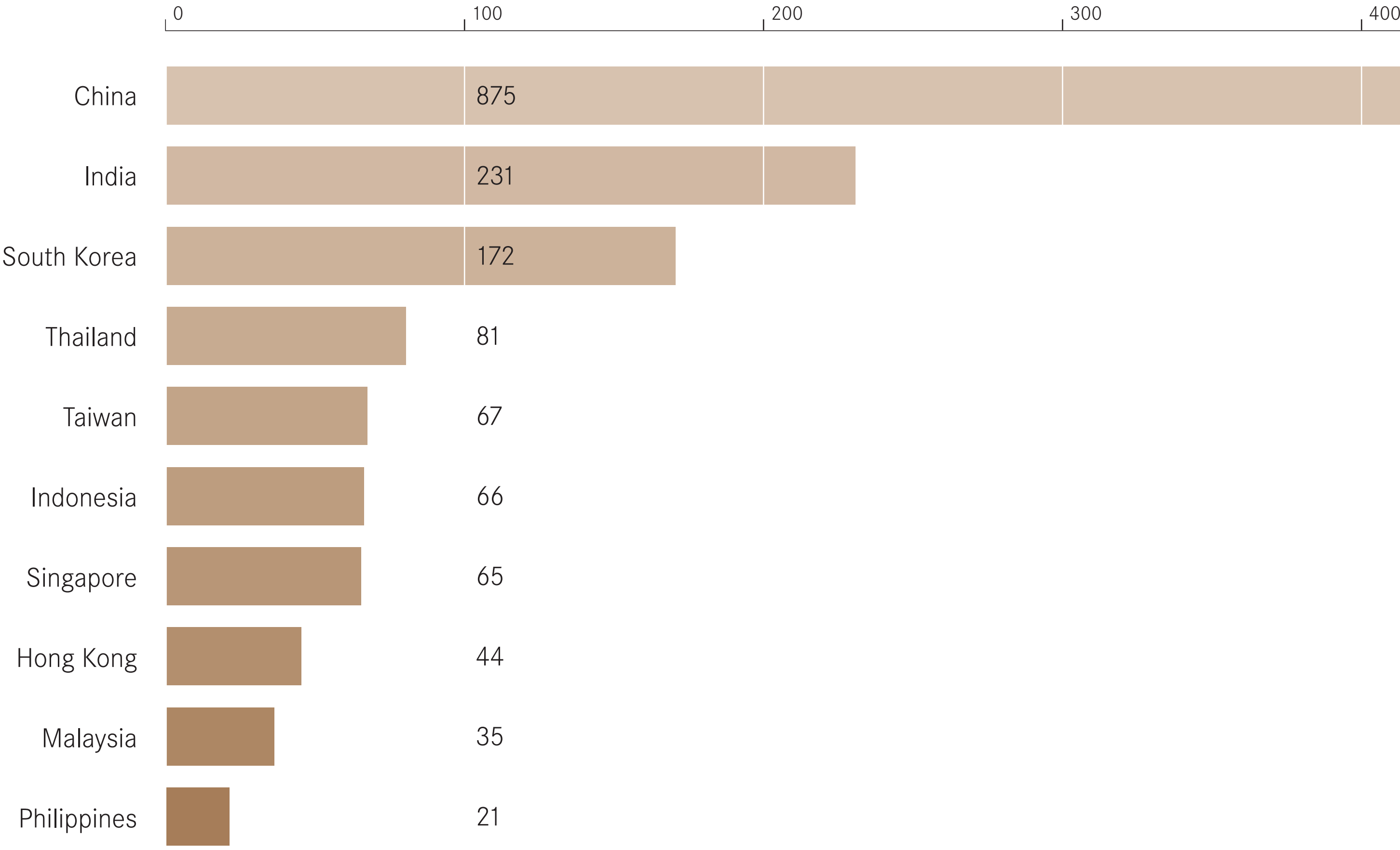
Chart 7
5-year growth forecasts in HNWI by country (%)



Source: CLSA Asia-Pacific Markets, Julius Baer

Chart 8

Increase in number of HNWI over 2010–2015 F



Source: CLSA Asia-Pacific Markets, Julius Baer

China will make up the largest part of the increase in wealth for the region, given projection of nominal GDP growth of 14.5% per annum combined with a currency appreciating at 5% per year in dollar terms. By our estimate just under 0.1% of its population will enter the HNWI category over the coming five years. This will mean almost 900,000 individuals will be added to the wealth bracket in China alone. Together with Hong Kong, it will make up over 60% of the estimated increase in total wealth of HNWI in the region. India is a distant second, accounting for 15% of the estimated increase in investible assets of HNWI for these countries. The other nations contribute a much smaller share of the wealth generation.


500
600
700
800
900

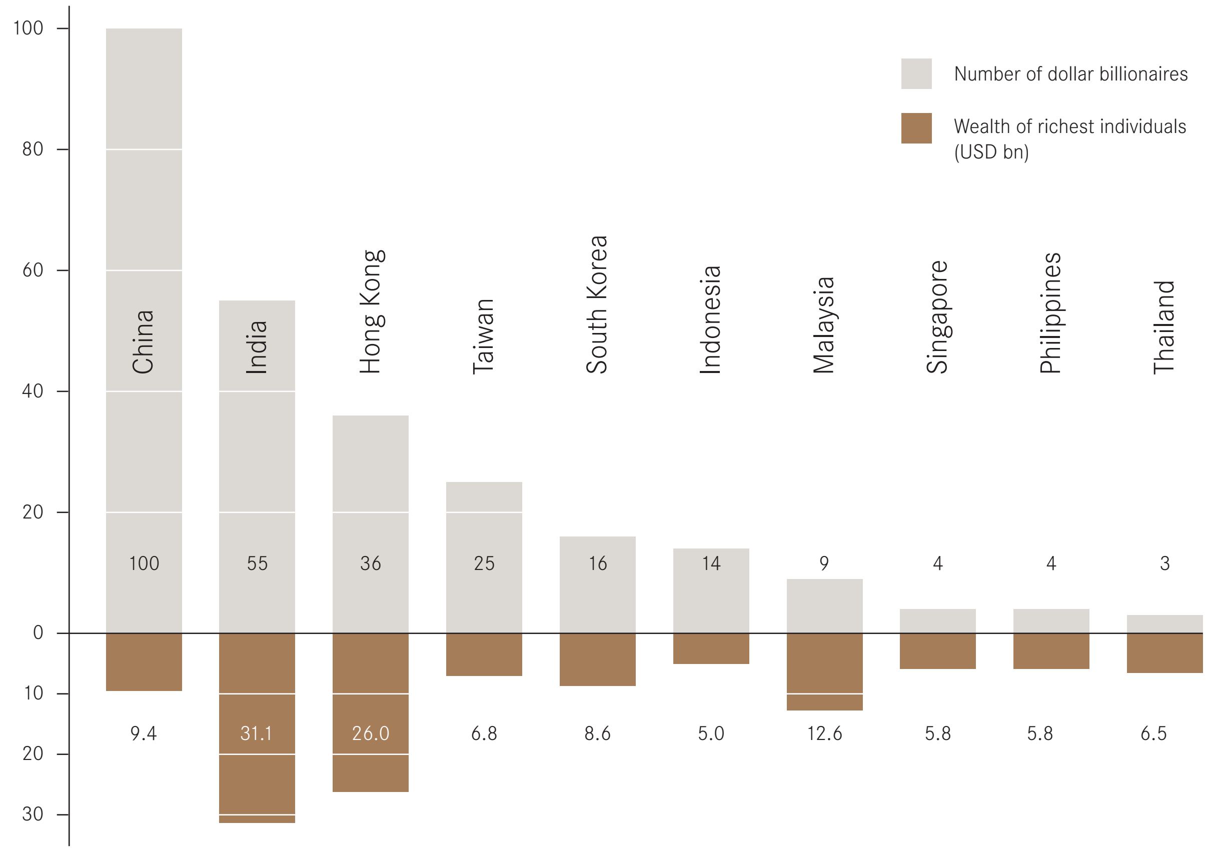
Methodology: Estimating wealth

To estimate the number of High Net Worth Individuals and their wealth, we used public data on private sector savings in these countries over the last 50 years. Based on CLSA's research on the middle class in Asia, in particular the Mr and Mrs Asia 2009 regional survey, we took data on average composition of assets of the middle class in each country to reflect the average composition of savings in various asset classes, i.e. properties, equities, bonds, cash and private investments. We applied historic data on the returns of these assets to arrive at total wealth in these countries. From this, we used data on wealth distribution from an academic study (Davies JB, Sandstrom S, Shorrocks A, and Wolff EN, "The World Distribution of Household Wealth", United Nations University, February 2008).

We also took the most recent 2010 estimates by Forbes for the number of billionaires and the wealth of the richest individuals in each country[2]. The wealth distribution data allows us to create a Pareto function of the best fit for the number of individuals as a function of wealth levels. The academic literature indicates that across observed countries, there is a similar inverse relationship in the number of individuals and wealth levels shown on a log scale for both variables. At the extremes of very high and very low wealth levels, the distribution might be away from the best-fit Pareto function, but for the middle range of wealth distribution including to those with assets crossing over USD 1 million, this function for each country gives a fairly reliable fit.

Chart 9

Number of dollar billionaires and wealth of richest individuals



Source: Forbes.com, CLSA Asia-Pacific Markets, Julius Baer

The function for the log scales of population to wealth has a slope greater than one in all countries observed. For instance the equation has a slope of minus 1.4 for China. This indicates that as we move down the best-fit line, the number of people at lower levels of income rises proportionately faster than the change in wealth. It also indicates that as wealth levels gradually rise for the country, moving this function up and to the right, the number of people at a given level will rise at a faster rate than the wealth increase.

Our projections are based on CLSA's economics team's estimates for nominal GDP growth. We use CLSA's equities research team to estimate the up-side from the stock markets in each country, and their property analysts to project property values for each of the countries. We calculate the growth in wealth initially in local currency terms as a function of the return on existing assets combined with incremental wealth from each year's savings. To derive the wealth expansion in US dollar terms, we apply estimates of currency appreciation for each currency, except for the Hong Kong dollar which is assumed to remain pegged to the US dollar.

[2] See the weblink: www.forbes.com/lists/2010/10/billionaires-2010_The-Worlds-Billionaires_Rank_ 13.html

Asian currency boost

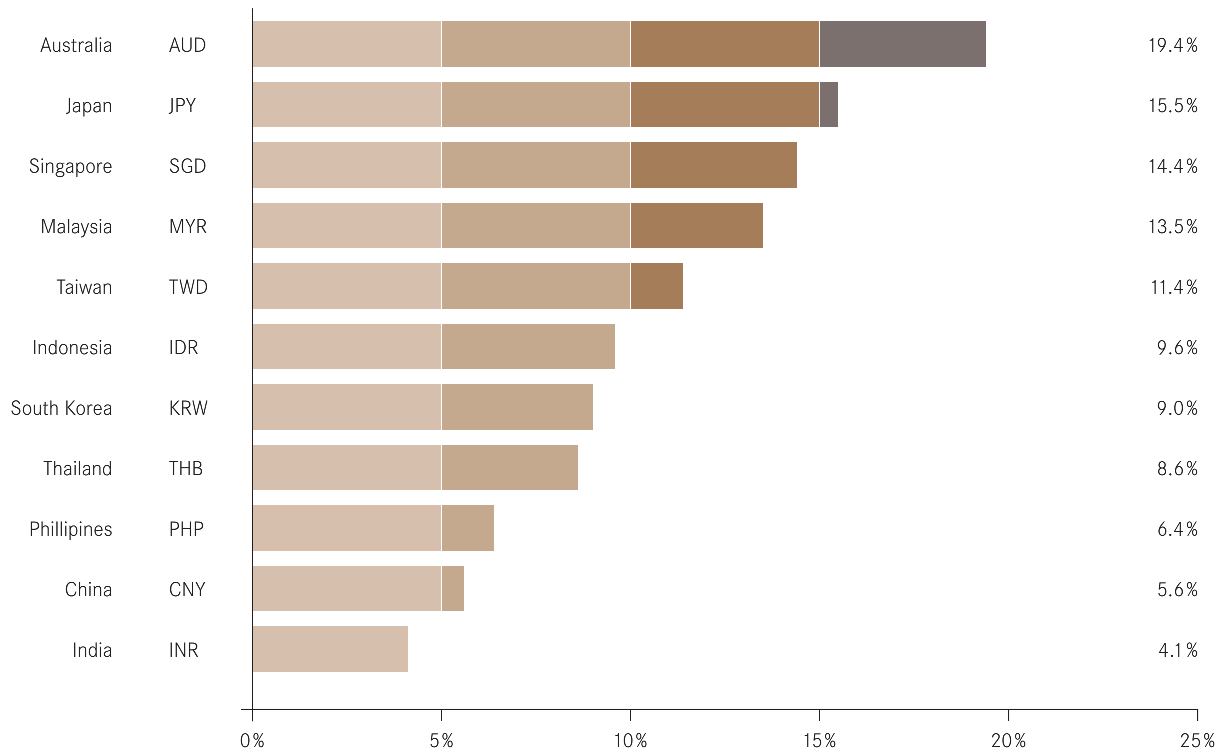
The Asian currency index has appreciated 7% against the US dollar since the start of 2010 to the middle of 2011. Currency appreciation has been as high as 14% for the Singapore dollar and Malaysian ringgit in the last 18 months while for the Taiwan NT dollar, Korean won, Thai bhat and Indonesian rupiah have each gained around 10% against the US dollar. Robust economic growth in the region has pushed inflation rates up, resulting in high nominal GDP growth. Usually, rising inflation leads to depreciating currencies. In Asia, however, we believe that most currencies are undervalued. Thus high nominal GDP growth is here coupled with appreciating currencies. The effect is to significantly boost the number of dollar millionaires for the region.

The number of HNWI for these countries is estimated to grow at just under 14% compounded annually if the currencies do not appreciate.
The growth rate gets a 5.5% point boost to 19% per annum with the effect of these currencies estimated to appreciate on average by around 4% per annum For China, yuan appreciation pushes up the the growth rate of HNWI from 16% to just over 22% per annum. The impact of higher dollar values of Asian currencies will lift the growth rate of HNWI in dollar terms by just over one quarter higher on average for these countries. That means an addition of almost 600,000 individuals getting into the category of having USD 1 million in investible assets because of the rise in Asian currencies.

The charts on page 19 show Hong Kong has the lowest projected growth in HNWI defined in US dollar terms; one of the main reasons is that there is no boost in its numbers from currency gains, as the HK dollar peg to the US dollar will likely remain. For the other countries, the growth rate in HNWI on a US dollar base is on average 6% points higher per annum, or boosting the growth rates in HNWI by about half on average compared to the wealth increase without currency appreciation.

Chart 10

Percentage change in currency value, H1 2011 against the US dollar



Source: Bloomberg Finance L.P., CLSA Asia-Pacific Markets, Julius Baer

Chart 11

Nominal GDP growth 2010–2015 F
in local currency and USD terms

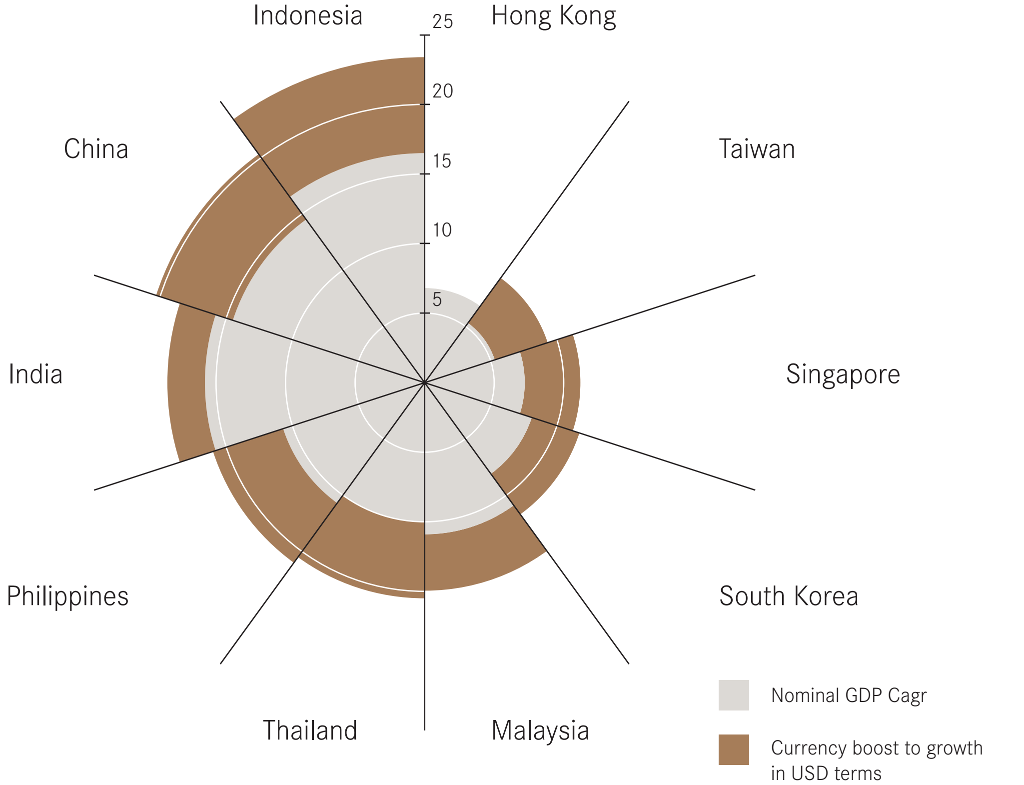
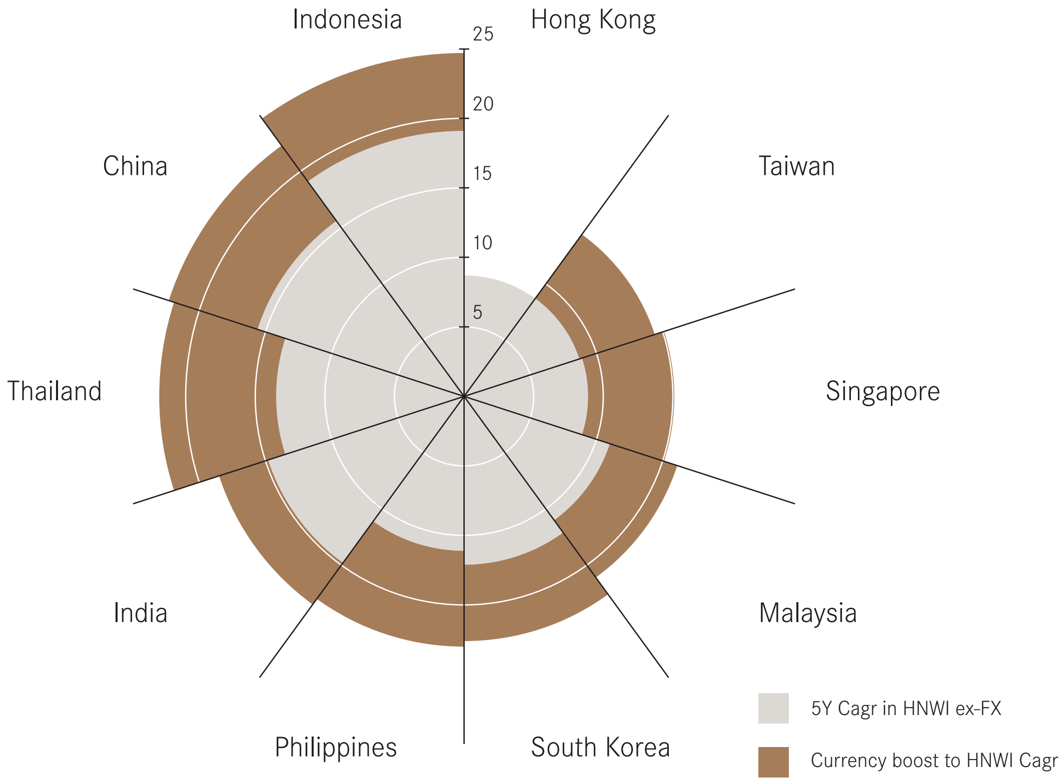


Chart 12

Impact of currency appreciation on growth
on HNWI in Asia: 2010–2015 F



Source: CLSA Asia-Pacific Markets, Julius Baer

Conservative on property

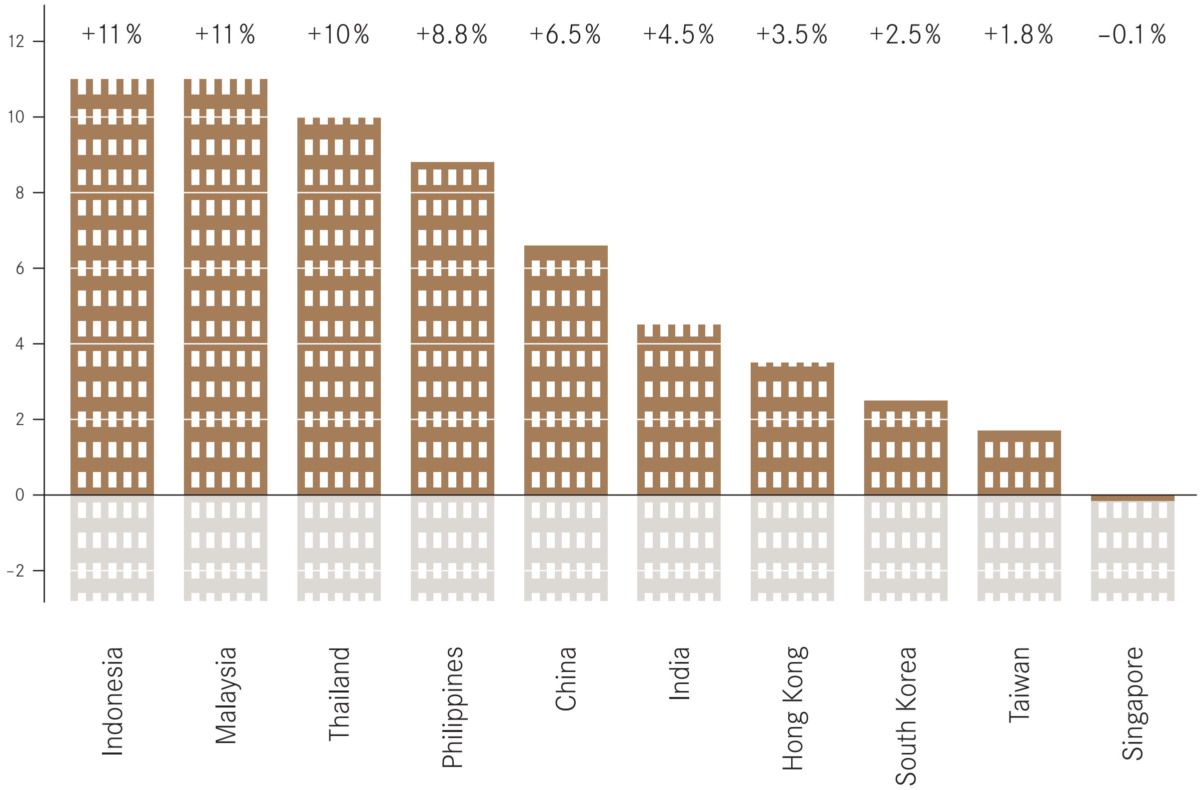
Notably the assumptions we have used are generally conservative on property prices. In Singapore, the estimate is that over the five years to 2015, property prices would be essentially flat, while in Taiwan, South Korea and Hong Kong prices are not estimated to rise much more than an annual rate of 3%. Underlying factors remain bullish for property with low interest rates, rising inflation which pushes down real interest rates, high savings, wealth creation and the desire of individuals to upgrade their properties. The view, however, is that the authorities will act to keep a lid on property prices.

The assumption on properties is important as around 40% of total wealth in the region is in properties. (In estimating the number of HNWI, where we use the definition of investible assets in excess of USD 1 million, we make adjustments in each country for the estimated percentage of total assets tied up in the home these individuals live in.) On average we estimate property prices in these ten countries to rise close to 6% per annum. For China, we estimate that the curbs on the property sector are likely to ease soon, as they have been effective in controlling price increases over the last twelve months. We thus estimate over the coming five years, property prices will rise at almost 7% per annum.

Property prices in choice locations however generally rise at a much faster rate than the average. As the HNWI are likely to own in generally more desirable areas, most of them will see gains in their property investments higher than the estimates for general price appreciation. Where the projection for property prices is relatively modest, there is upside in the estimates of wealth if property prices rise faster than anticipated.

Chart 13

Projected average property appreciation, 2010–2015 (%)



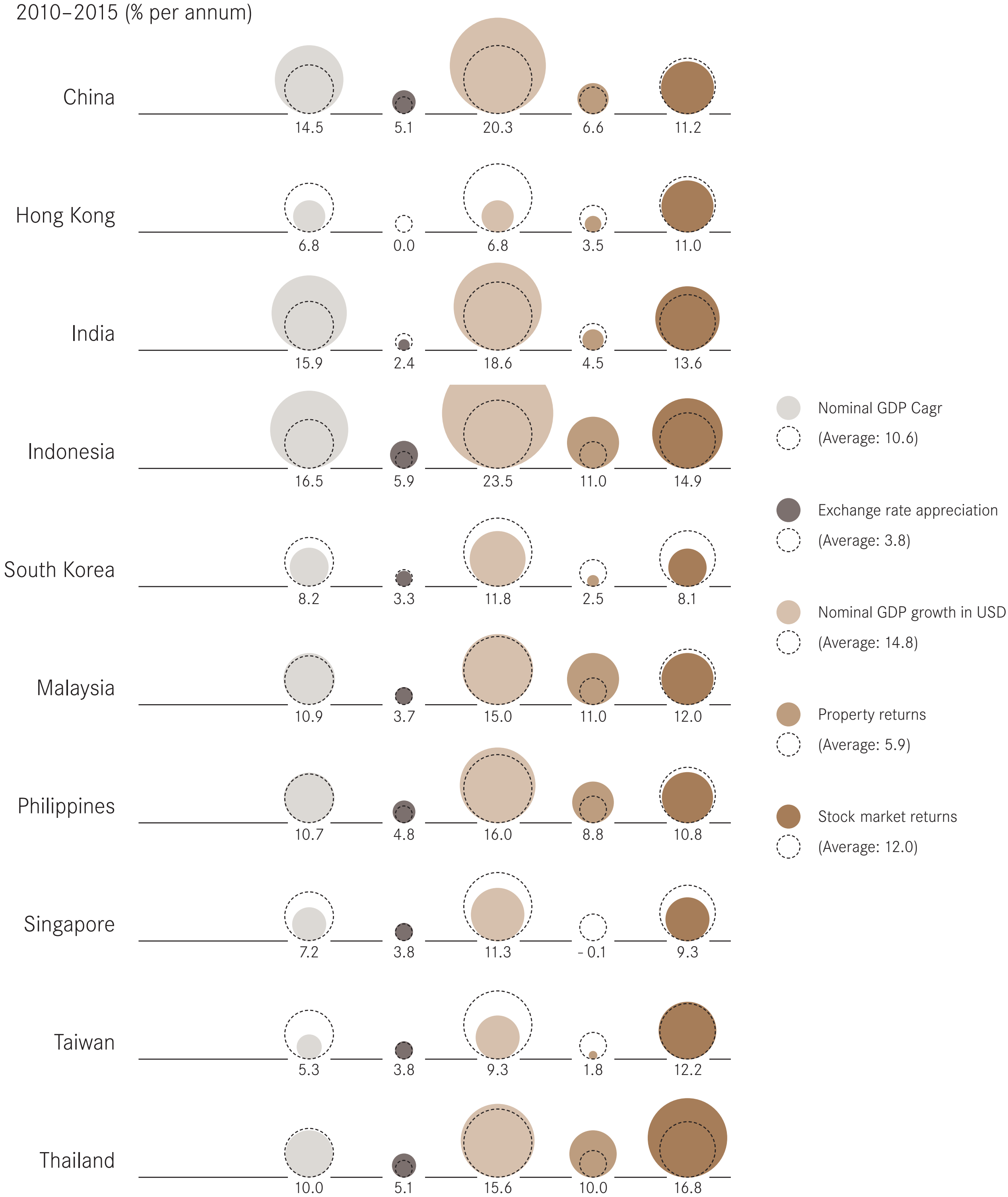
Source: CLSA Asia-Pacific Markets, Julius Baer

Country analysis

Our study of wealth and growth in HNWI is for ten Asia-Pacific countries. Below we provide a summary of our findings for the larger countries in our study – China, India, Indonesia and South Korea – as well as the city states, Hong Kong and Singapore, which have the highest concentration of wealth. The key assumptions that we use for forecasting the growth in incomes, wealth and HNWI numbers for all these countries are shown in the below chart.

Chart 14

Key assumptions for wealth projections: 2010–2015 (% per annum)



Source: CLSA Asia-Pacific Markets, Julius Baer

China

China has a massive population, strong economic growth and high savings leading to rapid wealth creation. Presently, just one in two thousand of the population (0.05%) are estimated to be in the HNWI category, or approximately half a million persons. One of the highest economic growth rates combined with an undervalued currency appreciating at about 5% per annum will lead to almost 900,000 mainlanders breaching the threshold of HWNI. China will thus account for over half of the growth of HNWI in the region.

In real terms, the economy is growing at around 9% per annum. With inflation we estimate the growth in nominal terms at 14.5% per annum, which is slightly lower compared to the 16.1% growth rate over the last five years. The GDP deflator, i.e. the difference between the real and nominal growth rates of the economy, has consistently been higher than the official inflation figure, which may suggest that further work is required in terms of fully estimating inflationary forces in China. Nevertheless, the rapid wealth creation is plain to see, with a build-up in the momentum in recent years.
The official data is what we need to go by, even if often the data has been revised generally up, as more of the unofficial economy gets captured in the measurement of economic activity.

Currency appreciation of 5% per annum compounded on 14.5% local currency growth rate leads to a growth rate in US dollar terms pushing at 20% per annum This will lead to an economy in dollar terms by 2015 set to be 2.5X its size in 2010, a much faster expansion compared to 97% growth over the period without yuan appreciation.

We estimate that the A-share stock market will provide mainland equity investors with returns of approximately 11% per annum for the coming five years, driven mainly by earnings growth. There is upside risk to these estimates as current valuations for the market are below historic averages.
Property prices have been almost unchanged for the last year with the government having imposed restrictions to control speculation. These measures reduce the risk of a bubble developing in the sector. Our assumptions are that property prices in China rise on average by just under 7% per annum over the coming years.

In dollar terms, we project median wealth to rise 19% per annum We project the number of HNWI in China to grow just over 22% per annum Rising numbers entering this set, together with wealth increase of those already in the group, lead to investible assets of HNWI projected to rise from USD 2.6 trillion to USD 8.8 trillion, an explosive compounded growth rate of 27% per annum. China will thus contribute over 60% of the growth in wealth for HNWI in the region.

Chart 15

China: 2010–2015 Key wealth estimates

	2010	2015	5 year Cagr %
Adult population (m)	975	1,025	1
Number of HNWI (,000)	502	1,378	22.4
Wealth of HNWI (USD bn)	2,627	8,764	27.2
Nominal GDP (RMB bn)	39,798	78,311	14.5
USD/RMB	6.61	5.16	5.1
Nominal GDP (USD bn)	5,880	14,829	
Property market returns			6.6
Stock market returns			11.2

Source: CLSA Asia-Pacific Markets, Julius Baer

India

India is the second largest economy in Asia excluding Japan. Its total population now at 1.2bn is close to that of China's (1.3bn). However a much larger segment of India's population is made up of children. By adults over the age of 20, India's population is just under threequarters that of China. Its economic development has lagged its larger neighbour, with total of GDP of USD 1.7 trillion compared to China at USD 5.9 trillion in 2010. India's disposable income per capita at USD 1,100 last year, is less than half that of China. Lower levels of income coupled with a lower savings ratio results in wealth being much lower. Median wealth, estimated at USD 3,500 per adult for 2010, is about one third that of China's.

India's economic growth should however be stronger than China's over the coming years. Coming from a lower level of income, it has greater growth opportunities. Demographics are also in India's favour. China's adult population is now barely growing (and in about five years will likely start to decline), India's however will continue to grow at around 2% per annum for at least the next decade. We expect India's economy to grow at close to 16% per annum in local currency terms, some 1.5% points faster than China's growth.

However, we are less bullish on appreciation of the rupee. India's current account deficit contrasts with China's surplus and will lead to muted currency appreciation. We project the rupee to appreciate by 2.4% per annum over the next five years, just under half the rate of appreciation for the yuan. Thus in US dollar terms, the expansion of the Indian economy will be slightly slower than for China.

Growth of wealth in India will nevertheless be extremely strong. Median wealth is projected to double over five years on the back of GDP growing at approximately 19% per annum in dollar terms. Robust returns from key asset classes will push up Indian wealth. The stock market is estimated to provide almost 14% annual returns, while properties are projected to rise on average close to 5% per annum. The number of HNWI is set to rise from approximately 170,000 in 2010 to over 400,000 in five years. From HNWI being one in five thousand of the adult population, in five years we estimate it rises to one in two thousand, similar to the ratio for China last year. Investible assets of this segment of the Indian population are estimated to grow at 21% per annum; thus in five years assets of Indian HNWI are set to be 2.6X of what they were in 2010.

Chart 16

India: 2010–2015 Key wealth estimates

	2010	2015	5 year Cagr %
Adult population (m)	730	806	2
Number of HNWI (,000)	173	403	18.5
Wealth of HNWI (USD bn)	949	2,465	21
Nominal GDP (INR bn)	78,779	164,433	15.9
USD/INR	45	40	2.4
Nominal GDP (USD bn)	1,731	4,065	18.6
Property market returns			4.5
Stock market returns			13.6

Source: CLSA Asia-Pacific Markets, Julius Baer

Indonesia

Indonesia is positioned for the fastest growth in HNWI as well as in investible wealth of the countries we examined. This is on the back of the fastest growth rates for the economy. In local currency terms, we estimate nominal GDP to grow at 16.5% per annum over 2010–15. The rupiah is also one of the strongest currencies with still 29% upside to its Purchasing Power Parity (PPP) value. Over the coming five years we estimate that the rupiah will appreciate close to 6% per annum. Thus in US dollar terms, we expect the Indonesian economy to grow at 23.5% per annum.

Wealth will be boosted by expected robust returns on key assets. We believe that Indonesian property values could rise 11% per annum in local currency terms, while we project the stock market to provide returns close to 15% per annum, matching earnings growth.

Wealth levels are still very low but will see robust growth. Currently, just 0.02% or one in five thousand Indonesians are estimated to be in the HNWI bracket. Their numbers, at around 33,000 estimated for 2010, is projected to triple over five years and reach close to 100,000.

We estimate that the wealth of the HNWI will grow at the fastest rate in the region, at approximately 21% without currency gains or around 30% per annum taking into account rupiah appreciation.

Chart 17

Indonesia: 2010–2015 Key wealth estimates

	2010	2015	5 year Cagr %
Adult population (m)	153	161	1
Number of HNWI (,000)	33	99	24.7
Wealth of HNWI (USD bn)	129	487	30.4
Nominal GDP (IDR tn)	6,423	13,805	16.5
USD/IDR	9,009	6,750	5.9
Nominal GDP (USD bn)	708	2,029	23.5
Property market returns			11
Stock market returns			14.9

Source: CLSA Asia-Pacific Markets, Julius Baer

South Korea

South Korea is not one of the fastest growing economies in the region. However, it has a relatively high number of HNWI and our appraisal of wealth prospects indicates it is set to have the third largest increase in HNWI in the Asia Pacific, after China and India. We estimate that Korea's nominal GDP will grow 8% per annum over the coming five years. With the South Korean won projected to appreciate 3% annually, economic growth in US dollar terms will be close to 12% per annum.

We project only fairly conservative asset price appreciation of 2.5% per annum for properties and 8% per annum for Korean equities. The result is that median wealth is likely to grow at 12.5%, while the number of HNWI is set to rise at faster rate of almost 18% annually. From approximately 140,000 in Korea in the HNWI category, within five years this could rise to 310,000. In absolute terms this is the third highest increase in HNWI in the region; however the growth rate of Korea's HNWI is slightly lower than the overall average for the countries surveyed.

While South Korea has 12% of the estimated HNWI of these ten countries as at 2010, we project it will make up a lower share of 10% of the new HNWI for the region over the coming five years.

Chart 18

South Korea: 2010–2015 Key wealth estimates

	2010	2015	5 year Cagr %
Adult population (m)	36.8	38.5	0.9
Number of HNWI (,000)	138	310	17.6
Wealth of HNWI (USD bn)	412	1,074	21.1
Nominal GDP (KRW tn)	1,170	1,735	8.2
USD/KRW	1,120	950	3.3
Nominal GDP (USD bn)	1,012	1,769	11.8
Property market returns			2.5
Stock market returns			8.1

Source: CLSA Asia-Pacific Markets, Julius Baer

Singapore

The highest concentration of HNWI relative to population in the region is found in Singapore. The island republic has a GDP almost exactly the same as Hong Kong at approximately USD 225bn, but Singapore has a smaller population, a higher savings rate and thus higher income as well as wealth per capita. We estimate 1.7% of its population to be in the HNWI bracket, slightly higher than 1.5% for Hong Kong. On its smaller population base this translates to 64,000 HNWI, compared to 86,000 for Hong Kong.

Our assumptions for growth in wealth are relatively modest for Singapore. Nominal GDP is projected to rise 7% per annum With the appreciation of the Singapore dollar, this translates to around 11% per annum in US dollar terms. Wealth grows steadily as a large part of income is saved with a national savings ratio (savings to GDP) of 46%, the second highest in the region after China.

However, we expect only moderate returns on Singapore assets. After a rapid appreciation in property values over the last two years, the government has come out with a series of measures to put a lid on property speculation. The recent electoral setback for the government will likely keep the authorities vigilant on property prices, a major issue for a large part of the local population. Over the next five years, we project property prices to be about flat. We are more positive on Singaporean equities, which we expect to provide an average 9% annual return.

Median wealth levels are estimated to rise 9% per annum in US dollar terms. The number of HNWI and their total wealth is set to grow just over 15% per annum In five years, HNWI in the island republic will thus double to reach close to 130,000. Currently, one third of the population are non-Singaporeans. The election result will likely tamper growth in visas for foreigners to work and live in Singapore, but we believe the authorities are likely to remain open for immigration from those with targeted skills and with substantial wealth. The city state maintains a policy of allowing those with SGD 10 million in investible assets in Singapore and a total net worth of SGD 20 million to get in by their investment visa programme.

Chart 19

Singapore: 2010–2015 Key wealth estimates

	2010	2015	5 year Cagr %
Adult population (m)	3.8	4.1	1.7
Number of HNWI (,000)	64	129	15.2
Wealth of HNWI (USD bn)	312	616	14.6
Nominal GDP (SGD bn)	305	433	7.2
USD/SGD	1.28	1.06	3.8
Nominal GDP (USD bn)	224	383	11.3
Property market returns			–0.1
Stock market returns			9.3

Source: CLSA Asia-Pacific Markets, Julius Baer

Hong Kong

Hong Kong has a lower ratio of HNWI to its population relative to Singapore but has a higher total number of HNWI estimated at 86,000. The greater number of ultra-HNWI in Hong Kong is illustrated by the 2010 Forbes rich list, which estimates 36 dollar billionaires in the territory. Singapore has just four with the highest net worth for a Singaporean estimated at USD 4 billion. Hong Kong has ten individuals estimated to have greater wealth than the highest in Singapore, with Hong Kong's richest man indicated to be worth USD 26 billion. The figures from the Forbes wealth list need to be taken with care as they are based on holdings mainly of publicly listed assets and will not fully capture privately held assets, but also will not take into account their debt. Nevertheless they are illustrative of the likely size of the über-rich in each country and rough estimates of their wealth.

With a currency pegged to the US dollar, the growth in incomes and wealth in Hong Kong is tied to just what is achieved in local dollars. The economies of both Hong Kong and Singapore are projected to grow at about 7% per annum in local currency terms; but with currency appreciation the growth in wealth in US dollars is set to be faster in Singapore. A currency that remains under valued will however mean asset prices appreciate in local currency terms at a slightly higher rate. We estimate somewhat higher returns on Hong Kong properties and equities relative to Singapore. Nevertheless, property price inflation is also an issue targeted by the authorities in the territory, and we project average property prices to rise just 3.5% per annum.

With the pegged currency, the growth in wealth in dollar terms in Hong Kong will be the slowest of the countries we examined. We estimate HNWI numbers to rise close to 9% per annum, which would take it up to 130,000 by 2015. The size of this wealth set and their investible assets expanding around 50% across five years is nevertheless quite solid growth for a territory that already has high levels of wealth.

Chart 20

Hong Kong: 2010–2015 Key wealth estimates

	2010	2015	5 year Cagr %
Adult population (m)	5.8	6.2	1.3
Number of HNWI (,000)	86	131	8.7
Wealth of HNWI (USD bn)	484	711	8
Nominal GDP (HKD bn)	1,748	2,431	6.8
USD/HKD	7.77	7.77	0
Nominal GDP (USD bn)	225	313	6.8
Property market returns			3.5
Stock market returns			11

Source: CLSA Asia-Pacific Markets, Julius Baer

Risks to Asian wealth

What could go wrong with these strong projections? Asian economies are extremely open and a global downturn will clearly affect the region's growth. Concerns remain on the strength of the Chinese economy with fears of a property bubble that might affect its banks. While property prices are certainly high in Tier 1 cities in China, however these are just four of over 150 cities with over 1 million population. Most mainland Chinese buy their properties with little or no mortgage debt, reducing the risk to banks. Still, hiccups in Chinese growth, now a major driver of Asian as well as global growth, are a risk on the income and wealth projections for the region.

We noted above that just over a quarter of the increase in Asian HNWI can be attributed to the impact of Asian currencies appreciating against the dollar. The outlook for the US dollar remains weak but the dollar is getting increasingly undervalued against major currencies. An unexpected rally in the greenback would not just impact the dollar translation of Asian wealth. Due to the dollar carry trade, essentially using cheap dollars to finance the purchase of Asian equities and other assets, a rise in the dollar would also have a negative impact in the local value of these assets.

The Julius Baer Lifestyle Index

What luxurious living costs

Having made forecasts of the numbers of HNWI across Asia through 2015 and estimated their future stock of wealth, we can turn to the topic of consumption. Living in an age where inflation concerns are prevalent across most emerging markets, it is natural to ask how an illustrative basket of goods that Asia's HNWI might consume would change in price terms over time.

Ultimately, the consumption decisions that all individuals make are impacted by a large range of factors, as the later survey section of this report will demonstrate. That said, looking at price changes will still yield useful results. In particular, the price changes in the basket of luxury goods and services can give investors direction in terms of future required investment returns to finance a certain lifestyle. As a first step in this process, we introduce the Julius Baer Lifestyle Index.

The Julius Baer Lifestyle Index is designed to capture typical items that would make up a large part of spending for HNWI in Asia. On average over the last year this index is up 11.7% in dollar terms for key cities in the region, with an increase as high as 14.7% in Singapore on the back of its appreciating currency. We do not have a longer time series for the index, but over the last ten years a representation of property and high-end automobiles has seen prices rising 8.5% per annum in dollar terms for the region. The recent ten years spanned the worst global economic crisis in 80 years, yet on average these key items of HNWI expenditure rose 126% across these Asian cities. Prices for aspirational goods clearly rise faster than the often-quoted CPI. This implies a higher real return on assets is required to match the Julius Baer Lifestyle Index.

Methodology: Lifestyle Index

The Julius Baer Lifestyle Index is based on a basket of 20 luxury goods and services that represent discretionary purchases of HNWI in the region. Current prices, as well as for one year back, for these were sourced from local high-end vendors across four major cities: Hong Kong, Shanghai, Singapore and Mumbai. Properties were accorded the highest weight of 30% and cars the next highest weight at 10%.

The list does not purport to represent the comprehensive spending patterns of HNWI in the region, but rather an indication of how various items they spend on have risen by. While properties and cars have a combined 40% weight, we gave an equal weight for the other 18 items in the index to sum to 60%.

Chart 21

Julius Baer Lifestyle Index

Item	Specification	Average price across countries Current price, USD	1 year ago, USD	Average inflation (%)
Wine	Lafite Rothschild 2000	3,336	2,807	21.9
Wedding banquet	500 persons at top hotel	92,146	78,783	18.8
Ladies handbag	Chanel quilted bag	4,185	3,509	17.5
Business-class flight	Avg. return to Ldn./NY	6,121	5,329	16.9
Piano	Steinway Grand	201,021	171,816	16.7
Hotel suite	Four Seasons 6 star	652	568	15.1
Residential property	4000 sq ft high-end	16,847,143	14,394,514	14.4
Ladies shoes	Classic Louboutin pumps	1,868	1,668	10.8
Hospital	1 day top-end hospital	443	400	10.8
Jewellery	Tiffany 2 ct diamond ring	96,479	85,140	10.3
Car	Mercedes S500	321,522	292,459	10.2
Lawyer	1 hour fee with partner	519	472	9.7
Watch	Oyster Rolex	32,102	29,515	9.1
Golf club membership	Top local golf club	304,818	287,306	7.6
Cigar	Cohiba siglo VI	760	711	5.0
Boarding school	Average Eton/Deerfield	51,499	49,364	4.6
Men's suit	Giorgio Armani	5,532	5,342	4.3
Rootcanal	Top local dentist	1,510	1,455	4.3
Facial aesthetic procedure	Sculptra liquid face lift	6,578	6,306	4.3
University fees	Average Oxford/Harvard	51,016	49,677	2.8
			Lifestyle Index Inflation	11.7

Source: CLSA Asia-Pacific Markets, Julius Baer

Lifestyle Index up almost 12% year on year

In US dollar terms, the Julius Baer Lifestyle Index is up 11.7% year on year measured as at April 2011. Of the four cities we examined, Singapore has had the highest rise in the Julius Baer Lifestyle Index based on a common currency. We use the US dollar as the common currency yardstick to compare the Year-on-Year (YoY) price change. (Note the relative ranking for YoY change in the Julius Baer Lifestyle Index of the cities would be the same whichever common currency chosen as a base.) The index is up 14.7% in US dollar terms in Singapore. Shanghai has seen the next fastest annual rise at 13.1%, followed by Hong Kong where the Julius Baer Lifestyle Index is up almost 12%. In dollar terms, Mumbai has seen the slowest escalation of the Index, although still up 7% from a year back.

Chart 22

Aggregate inflation: USD vs. local currency – over the past year (%)

Source: CLSA Asia-Pacific Markets, Julius Baer

In local currency terms, however, the Julius Baer Lifestyle Index registered an average 7.2% YoY increase across the four cities. Currency appreciation mutes the local currency rise in this index. Chart 23 shows a general inverse relationship, as one would expect, between the Lifestyle Index in local terms and the appreciation of the currency. Singapore, which has seen its currency rise by 10.6% in the last 12 months, has seen the index in local currency terms rise just under 3%. The Hong Kong dollar is pegged against the US currency and has the highest increase in the Lifestyle Index in local currency terms, rising almost 12% per annum.

Pricing issues for these items are more complex when retailers or professionals are penetrating into new markets like Mumbai and Shanghai; for these two cities we find that in local currency terms the index has risen about 7% over the last year, with Mumbai somewhat off the equation of best fit for the Julius Baer Lifestyle Index YoY change to currency appreciation.

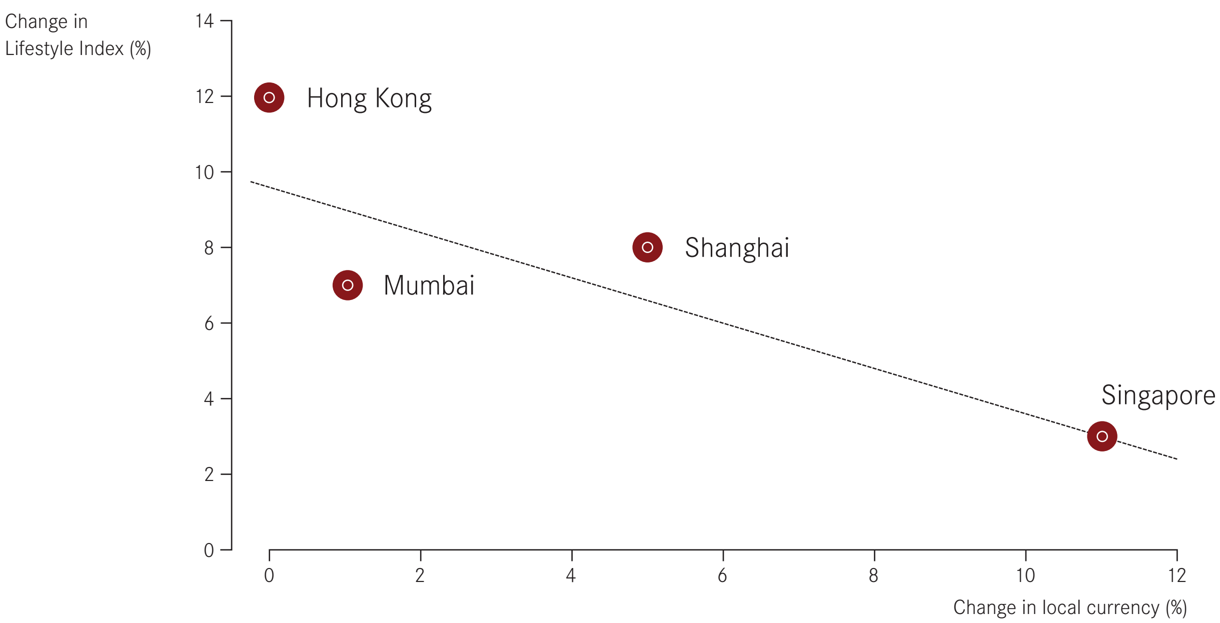
The increase in the Julius Baer Lifestyle Index in dollar terms is significant for HNWI given that much of the goods in their consumption basket have an international dollar price. To maintain, or reach, an aspired lifestyle the US dollar returns on assets for HNWI will have to be at least at this rate.

Even in local currency terms, the Julius Baer Lifestyle Index is rising significantly faster than the oft-quoted inflation figure. CPI has averaged a 5.2% rise for these four cities over the last year. Inflation by the CPI basket is largely driven by food which has around 30% weight for most developing countries. Food, however, accounts for much less of the spending of HNWI. Food price pressures appear set to ease from their rate over the last twelve months and this could bring down the headline inflation rate in these countries. The Julius Baer Lifestyle Index, however, will quite likely continue to rise as in most cities retailers and high-end professionals price up according to the ability of their target segments to pay for exclusivity.

Going forward, the required return for HNWI to maintain a certain lifestyle is thus likely to widen over and above the domestic inflation rate.

Chart 23

Appreciation of local currency vs. change in Julius Baer Lifestyle Index



Source: CLSA Asia-Pacific Markets, Julius Baer

Varying prices

Differences between the cities in the cost of Lifestyle items are quite striking. In Hong Kong, a 4000 sq. ft. residential property would cost as much as USD 36 million, more than triple a similar unit in the other cities. Top-end golf club memberships would cost USD 360,000 in the territory, significantly higher than the other cities (although golf club memberships in Mumbai are approaching prices in Hong Kong). If one is in Hong Kong, it is worth making sure your teeth are in good shape. A root-canal procedure would cost over USD 3,000 for a top-rated dentist, about 70% higher than in Singapore.

To illustrate further, locally in Singapore, a Mercedes S500 would cost almost USD 400,000, 69% more expensive in Singapore compared to Hong Kong. A Chanel handbag is priced almost 60% higher while Louboutin shoes are some 2.8X the price in Hong Kong. It isn't the best place to buy good cigars either: a box of Chohiba siglo VI is some 3X the price in Hong Kong, or double compared to Shanghai and Mumbai.

Chart 24

Prices of Julius Baer Lifestyle items across cities, USD

Item	Hong Kong	Singapore	Shanghai	Mumbai
Wine	3,205	4,023	3,076	3,038
Wedding banquet	108,700	61,800	99,100	99,000
Ladies handbag	3,746	5,891	4,291	2,813
Business-class flight	7,260	7,088	6,198	3,938
Piano	177,900	219,000	238,400	168,800
Hotel suite	579	896	646	486
Residential property	36,042,100	9,776,800	15,380,800	6,188,900
Ladies shoes	965	2,766	1,154	2,588
Hospital	460	732	308	270
Car	229,600	387,700	331,100	337,600
Lawyer	386	672	769	248
Watch	28,300	32,900	33,400	33,800
Golf club membership	360,400	244,400	276,900	337,600
Cigar	418	1,401	600	619
Boarding school	51,900	52,500	49,400	52,300
Men's suit	5,149	4,074	6,152	6,752
Rootcanal	3,218	1,874	385	563
Facial aesthetic procedure	9,000	7,500	5,000	4,800
University fees	52,300	52,300	50,300	49,200

Shanghai and Mumbai are cheaper for most items, but with exceptions. A Steinway grand costs almost USD 240,000 in Shanghai, significantly more than in Singapore or Hong Kong. The Rolex Oyster retails for USD 33,400, and is 15% cheaper in Hong Kong. Top lawyer fees are also higher in Shanghai; hourly consulting for a lawyer specialising in family matters costs almost USD 800 per hour.

Meanwhile, various luxury items are hard to find in Mumbai and harder on the wallet to buy. A Giorgio Armani suit costs almost USD 7,000, about 10% more expensive than in Shanghai and over 30% compared to Hong Kong. Very specialised facial aesthetic procedures cost 50% to 80% more in Hong Kong and Singapore compared to Shanghai and Mumbai.

We do not wish to speculate as to whether the differences of the goods and services being tracked in the four target cities will converge over time. Rather, we will monitor the Julius Baer Lifestyle Index in the time to come and publishing annual updates, using the results to enrich our understanding of the Asia HNWI landscape and spending habits in the region.

Chart 25

Price increases of Julius Baer Lifestyle items (%)

	Hong Kong		Singapore		Shanghai		Mumbai	
	USD	Local CCY	USD	Local CCY	USD	Local CCY	USD	Local CCY
	11.1	11.1	20.3	7.5	55.5	48.1	0.5	–
	16.6	16.6	21.3	8.4	36.8	30.3	0.5	–
	15.0	15.0	29.9	16.1	24.6	18.7	0.5	–
	–	–	18.0	5.5	32.2	25.9	17.2	16.7
	6.3	6.3	24.3	11.1	35.6	29.2	0.5	–
	18.4	18.4	11.9	–	29.6	23.5	0.5	–
	25.0	25.0	11.9	–	5.0	–	15.6	15.0
	–	–	11.9	–	15.8	10.3	15.6	15.0
	–	–	17.8	5.3	13.0	7.7	10.5	10.0
	11.5	11.5	15.8	3.5	13.0	7.7	0.5	–
	–	–	23.1	10.0	5.0	–	10.5	10.0
	5.3	5.3	16.6	4.2	14.0	8.5	0.5	–
	–	–	11.9	–	18.1	12.5	0.5	–
	–	–	11.9	–	7.7	2.6	0.5	–
	11.2	11.2	9.0	–2.6	1.3	–3.5	–3.1	–3.6
	–	–	11.9	–	5.0	–	0.5	–
	–	–	11.9	–	5.0	–	0.5	–
	–	–	11.9	–	5.0	–	0.5	–
	9.2	9.2	6.0	–5.3	1.4	–3.4	–5.2	–5.6
Average	6.5	6.5	15.7	3.4	16.4	10.9	4.4	3.9

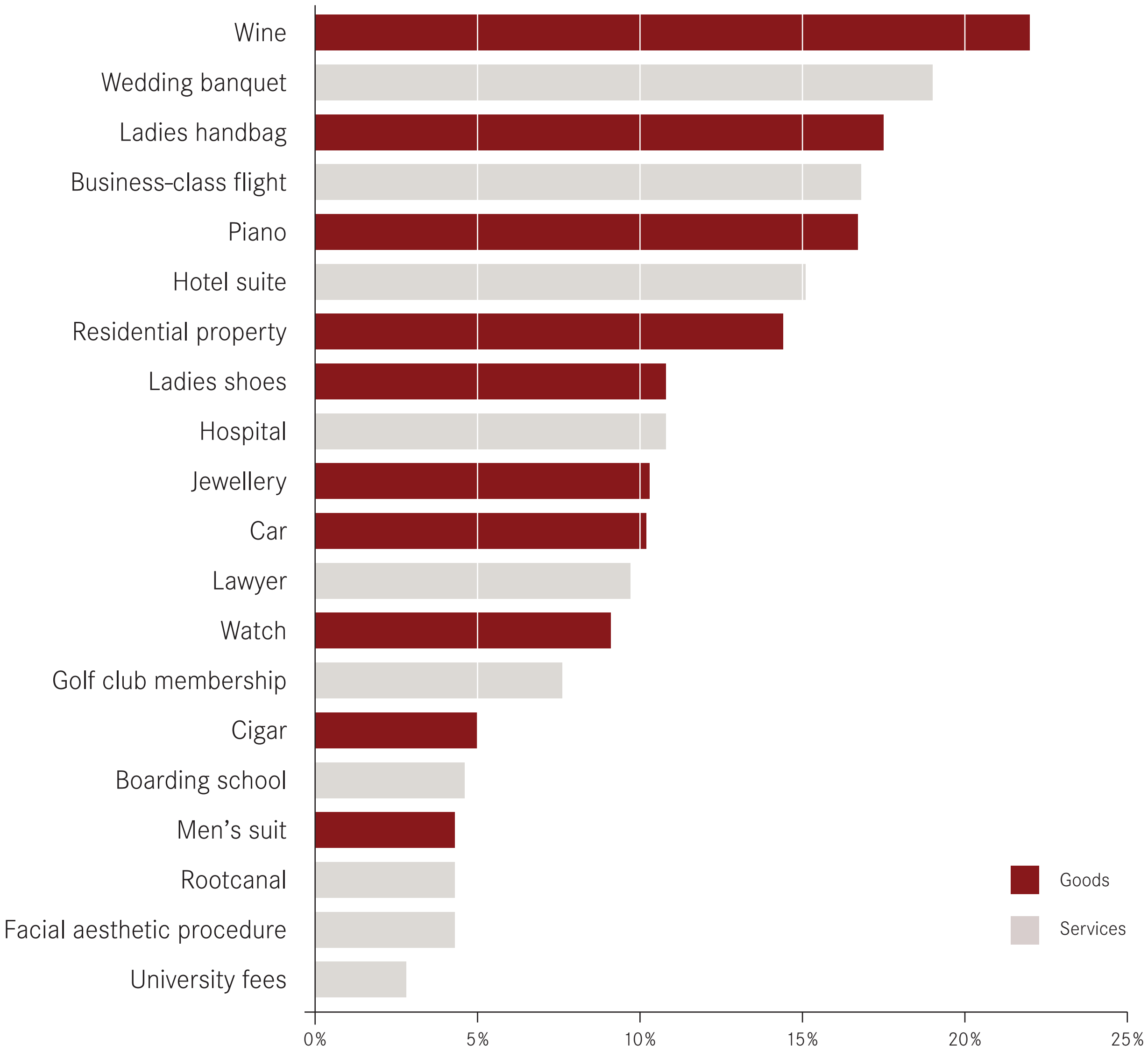
Source: CLSA Asia-Pacific Markets, Julius Baer

Although properties have a 30% weight in the Julius Baer Lifestyle Index, they accounted for more than half of the total increase in the index. On average top-end residential property prices are up 25% over the last year in Hong Kong and 15% in local terms in Mumbai. In Singapore and Shanghai, prices are fairly flat over the last twelve months. However, translated into dollar terms, high-end properties in these four Asian cities are up on average 14% over the previous twelve months.

Prices for exclusive jewellery, handbags, hotel suites, wine and business-class flights all went up by more than 10% in USD terms over the past year. Interestingly, education costs were at the other end of the spectrum: university and boarding school costs are up less than 5%. Note, this is based on boarding schools and universities in UK and the US. Coming out of the global financial crisis, these institutions may have held down their charges. Going forward, as governments in the West seek to rein in their deficits, university fees may see a fairly sharp rise in these countries.

Chart 26

Price increases of Julius Baer Lifestyle items, USD terms –YoY (%)



Source: CLSA Asia-Pacific Markets, Julius Baer

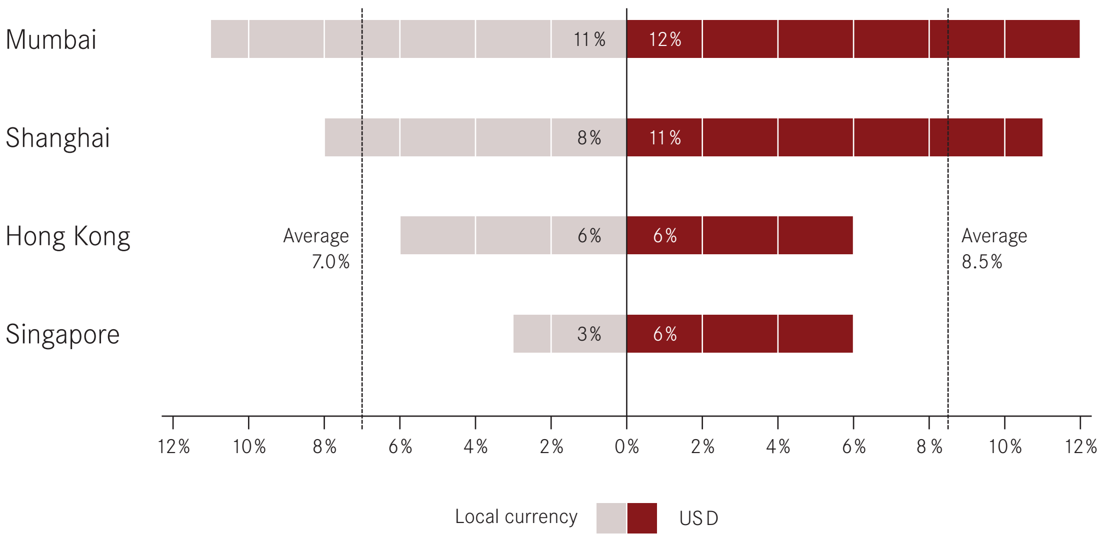
Ten-year estimate

We do not have the prices for the 20 items we used in the Julius Baer Lifestyle Index going back ten years. However, the two items that are the largest part of the spending items for HNWI in the region are properties and cars. To arrive at an estimate of how the cost of HNWI living has risen over the last ten years, we give these two items a 75:25 weight, similar to their relative weight in the Lifestyle Index, and examined how these two items have risen over the last ten years across the cities.

With low real interest rates over the last decade, domestic savings have been channelled into hard assets, namely property. In India, property prices have more than tripled (i.e. rising 250%) while in China they are 2.5X what they were ten years back. On average, property inflation in local currency terms rose at a compounded rate of 10.4% over the last ten years for the four cities, twice the rate of increase for business-class flights and five times that of cars over the same period.

Chart 27

10-year annual rise for property-car composite (%)



Source: CLSA Asia-Pacific Markets, Julius Baer

Mumbai and Shanghai, the financial capital for each of the two fastest growing giant Asian economies, have seen the fastest increase in this composite of home and car prices. In local currency terms, this composite is up 11% per annum in Mumbai. For Shanghai it has risen 8% per year in local terms. Translated into dollars, these prices have risen on average 11% compounded for these two cities. For Singapore, the composite has risen at the slowest rate; in US dollar terms, however, it is up 6% per annum, similar to Hong Kong.

Over ten years, going by the appreciation of properties and cars, a HNWI in Hong Kong and Singapore would have required asset returns of 81% to match the rise in key Lifestyle items. In Mumbai and Shanghai the required ten-year return was 184%. For the four cities, this two-item composite is up 126% on average (8.5% compounded). Even across a decade that saw the worst global economic crisis since the Depression, returns on assets across the peak and trough of asset values, had to be at quite a high rate for HNWI to match or exceed the cost of typical items in their expenditure basket.

Investor portfolio positioning in Asia

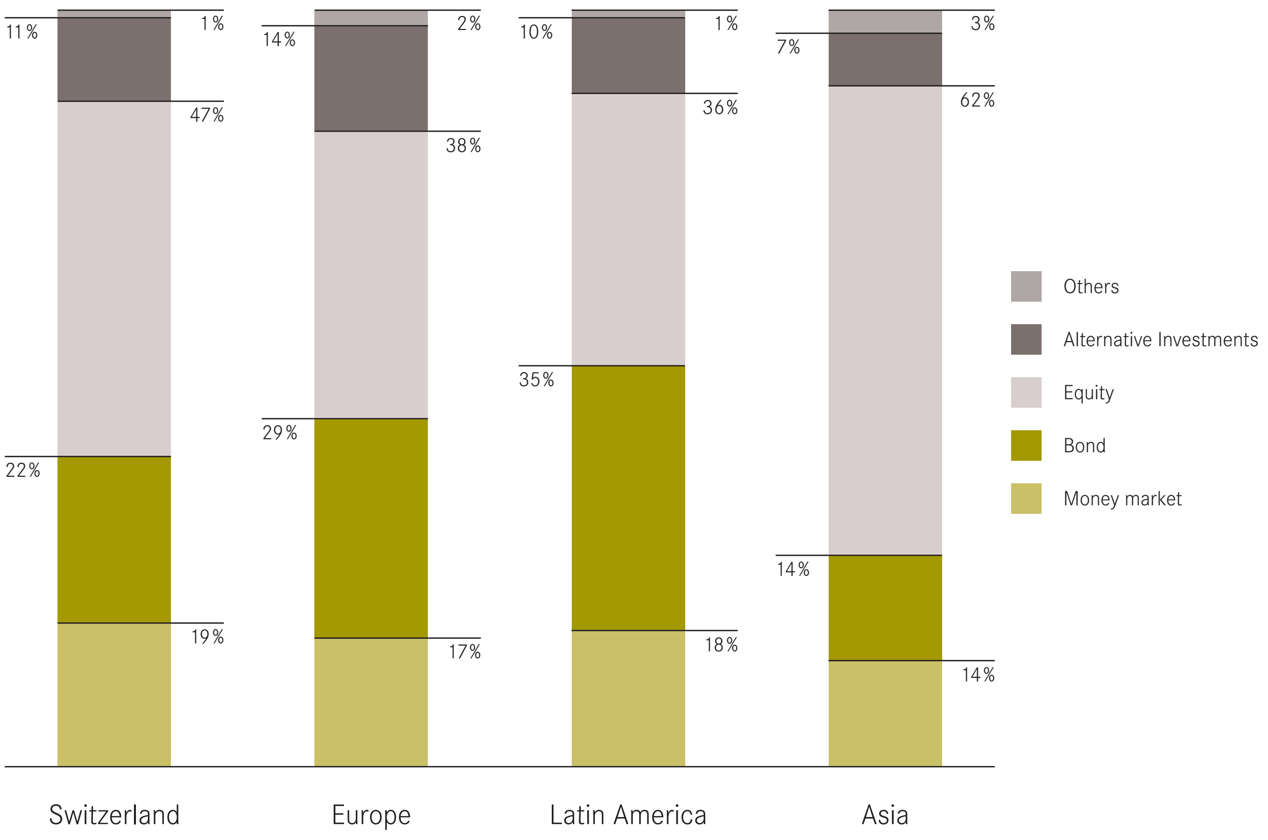
Having considered the issue of consumption price trends for Asia's HNWI, we now turn to the equally important question of how these investors are positioned in terms of their investment portfolios. The two are intrinsically linked, as investment returns are one vehicle by which consumption can be financed. No two investors are the same and the unique combination of risk tolerance, desired returns, personal and business circumstances, among other factors, ultimately dictates what kind of investments are made. Nevertheless, looking at HNWI in Asia on an aggregated basis will still yield some valuable insights into how this investor group is positioned.

To do this, we have surveyed Julius Baer's global booking centres to ascertain how our own self-directed Asia-based HNWI are invested.
We have then compared these results to clients from other domiciles. We break down the results from these surveys into three main areas. First, how does that asset allocation differ across client regions? Second, how pronounced is the home bias? Third, we examine how Asia-based HNWI compare in terms of allocation of individual investment positions in their portfolios?

To begin, on an asset allocation basis, our Asia-based investors generally have a higher proportion of equities relative to other regions. The cash (money market or equivalent) and fixed income allocations are relatively low. In aggregate, this would imply a greater risk tolerance, but also higher return expectations from the underlying portfolio. The lowest equity allocation can be found among our Latin America- and European-based clients.

Chart 28

How are Julius Baer clients invested by asset class?

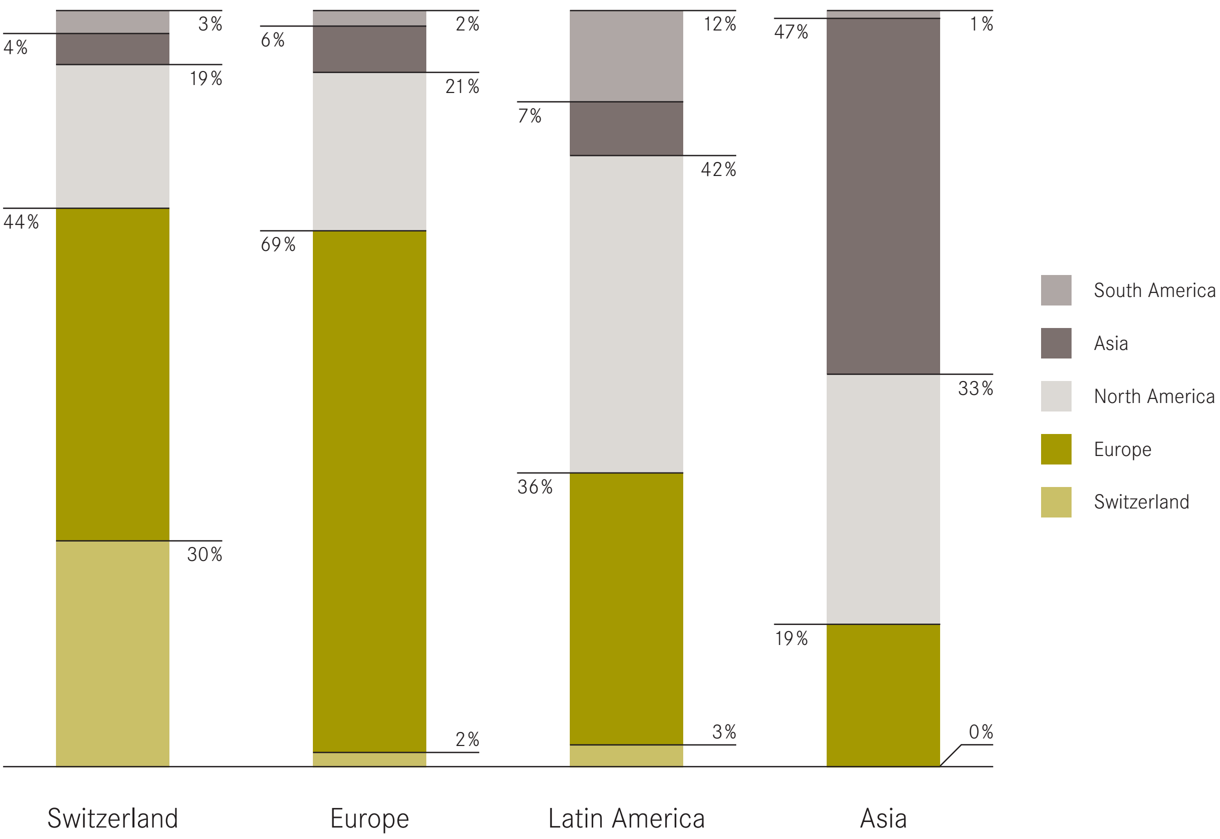


Source: Julius Baer

With regards to home bias, almost 50% of the investment portfolios of our Asia-based clients are in assets from the region itself. This represents a fairly strong home bias, but is less pronounced than our Europe-based investors which have close to 70% of their assets invested in their home region. Swiss-based clients also show a strong home bias, with around one third of their investments being placed domestically. Of all client regions, our Latin America-based investors have the smallest allocation to their home region.

Chart 29

How are Julius Baer clients invested across regions?

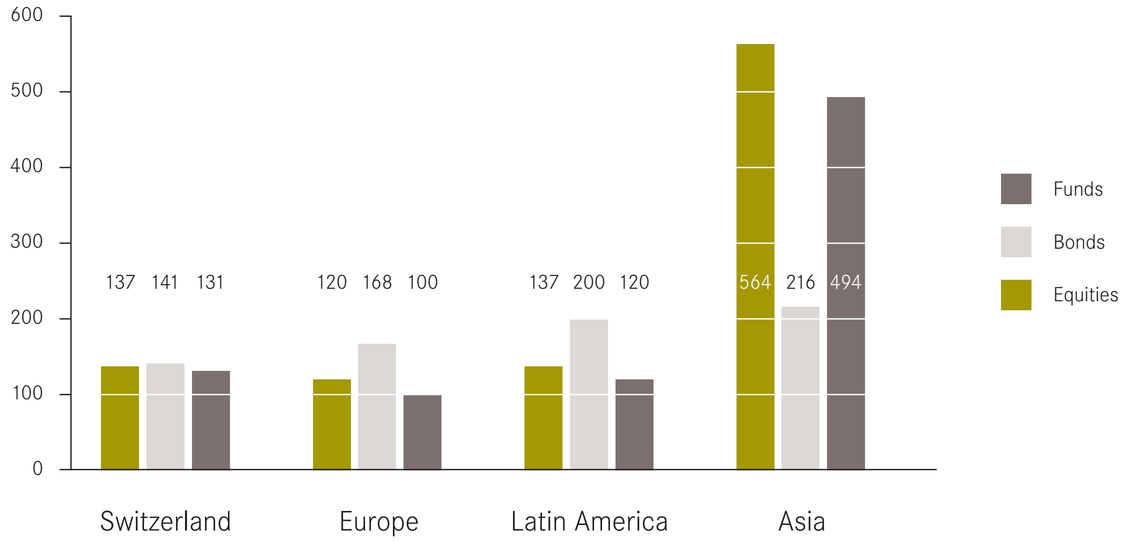


Source: Julius Baer

On the question of allocation of positions, we find that our Asia-based investors hold larger individual investments than their peers in other markets. This is measured by looking at the size of individual asset positions and average number of individual positions across all clients. For example, the average size of a holding in an individual equity in Asia is three times the size of those found for our Switzerland-based clients. At the same time, the number of individual positions in both equities and bonds is smaller. In addition to the stronger bias towards equities, our Asia-based investors appear more risk tolerant in terms of the willingness to make concentrated investments relative to our other client regions.

Chart 30

Average position size (CHF 000)



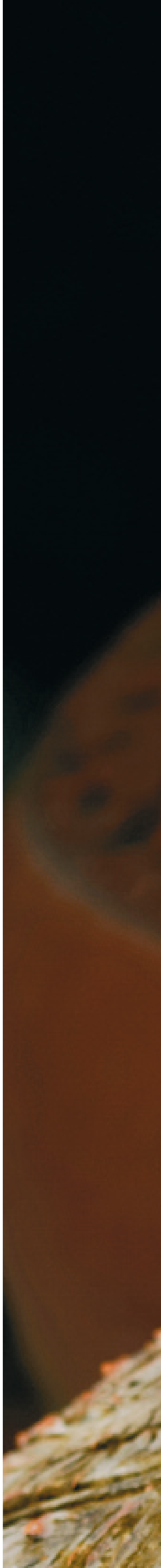
Source: Julius Baer

Beyond the Julius Baer Lifestyle Index

What does this mean for investors?

Having addressed the cost of living for Asia's High Net Worth Individuals with the Julius Baer Lifestyle Index and considered their current investment asset allocation, we can now complete the circle by turning to investment advice.

As detailed in earlier sections of this report, every investor is unique and their individual needs and characteristics will help determine the course of their investment decisions. Providing in-depth, tailored investment advice remains paramount in ensuring the preservation and accumulation of wealth over the longer term. With this in mind, we can take a bird's-eye view of our Asia-based investors and draw some stylised conclusions regarding asset allocation, given initial signals from the Julius Baer Lifestyle Index.



As a framework for investment advice, we should consider 'life cycle management'. This is the organisation of total financial needs, financial income and financial assets over an individual's lifetime in order to reach a long-term investment goal. Long-term goals may include wealth accumulation for retirement, real estate acquisition, financing children's university education or founding a charitable trust. The key element of life cycle analysis is the projection of future cash inflows and outflows. Given the long time horizon of a life cycle analysis – depending on the individual's age, life cycle analysis generally spans an investment horizon of forty to sixty years – the comprehension of inflation is essential.

Inflation is measured by the rate of change of the consumer price index (CPI), the price of a fixed basket of products and services. We calculate with an annual inflation for Asia of 5.1%. In the past, prices of luxury goods have increased at a faster pace than the CPI. The annual rate of change of the Julius Baer Lifestyle Index is currently at 11.7%. However, we expect that the inflation differential between CPI and the Julius Baer Lifestyle Index, currently at 6.7%, is not sustainable and will decrease to 3% over the next three decades. We believe this is a reasonable assumption as the first data point of 11.7% has been captured at a cyclically very strong point in Asia, thereby accentuating the differential.

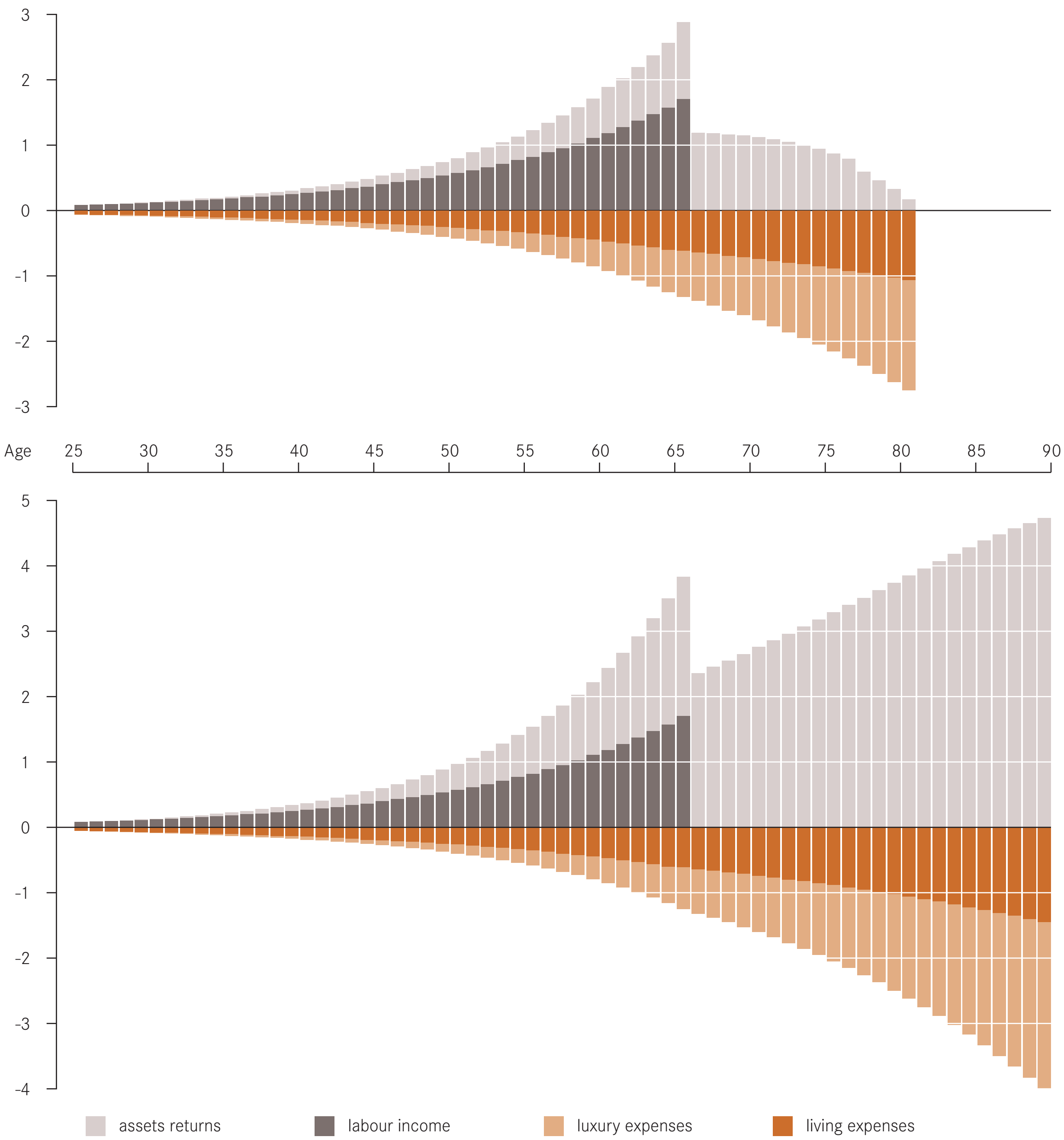
Life cycle management is an important tool to define the required rate of return of the investment strategy in order to reach the financial goals of the individual. For long-term investors, asset allocation is the most important investment decision. As wealth accumulation over long investment horizons is very sensitive to asset returns, the choice of the right investment strategy is a key element. The main risk of life cycle investing is the failure to accumulate sufficient capital in order to support living expenses through retirement. A proper analysis of projected cash flows over an individual's lifetime and the choice of a suitable investment strategy substantially reduce these risks.

The life cycle of an individual is typically divided into an accumulation phase and a decumulation phase. During professional life, an individual accumulates wealth to reach his or her long-term financial goals. A young employee generally needs most of his or her labour income to pay for living expenses. The contribution to saving and hence returns from accumulated capital is small. The labour income of a mid-life saver, e.g. a senior executive, is likely to have significantly increased, both in nominal and in real terms. Despite increased consumption, the individual accumulates significant savings. Larger investment returns at this stage can dramatically increase retirement wealth. A retiree must fund living and luxury expenses through retirement savings accumulated during working life. The amount of accumulated capital at retirement and the expected investment returns thus determine the standard of living after retirement.

Chart 31 shows a reduced version of our life cycle model for a senior executive where the two most important categories of income and expenses are shown. The grey bars depict the manager's projected cash inflows, divided into labour income (dark grey bars) and income from asset returns (light grey bar). Under our model, we assume the manager retires at the age of 65. Hence, from 65 on going forward, the only source of income is the drawing down of the accumulated capital and/or the investment returns on this capital. The brown bars below the x-axis depict expenses, sub-divided into basic living expenses (dark brown) and luxury outlays (light brown). We assume, that during the accumulation phase, real expenses are growing at a rate of 3% and stay constant thereafter. The cash flows in the decumulation phase increase only because of inflation.

Chart 31a and 31b

Annual Cash Flows – in million USD



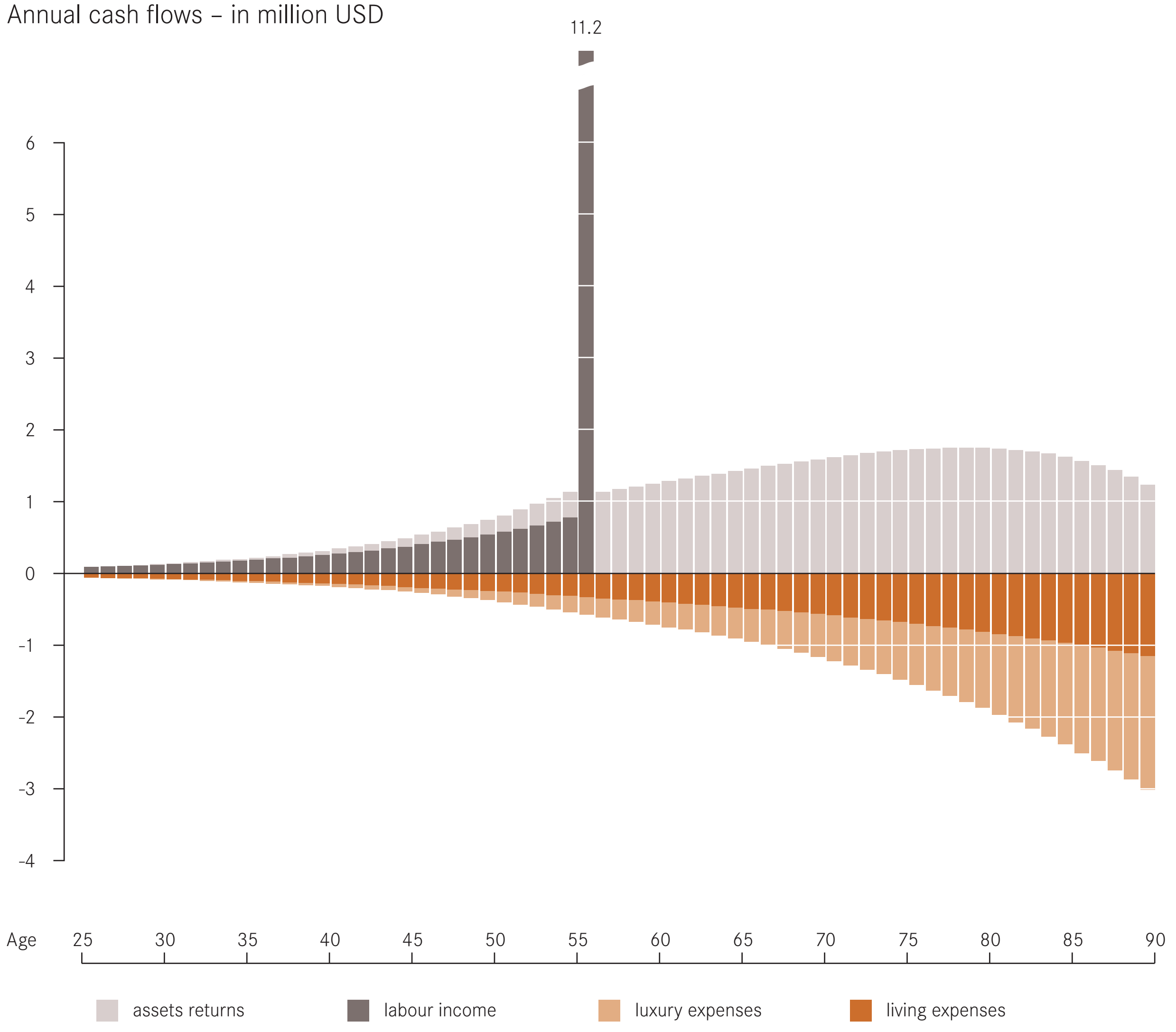
Source: Julius Baer

The two panels in Chart 31 show the effect of two different investment strategies on the cash flows of the senior executive described above. In 31a, the underlying investment strategy yields an annual return of 7% per annum. In this case, the investment return is not sufficient to pre serve the accumulated capital. In other words, at the age of 82 years all capital would be exhausted. Chart 31b exhibits the situation where the investment strategy yields an annual return of 9% per annum. As the life cycle analysis shows, this return on assets is sufficient to maintain the level of wealth at retirement over the next 35 years without being forced to lower living and luxury expenses.

Chart 32 exhibits a life cycle model for an entrepreneur. Until the age of 55, we assume the entrepreneur runs his or her company and receives labour income. At the age of 55, the company is sold and the founder retires. The proceeds from the sale of the company are invested into a multi-asset class portfolio to generate annual cash flows to finance living and luxury expenses. As the accumulated capital at retirement is substantially higher than for the senior executive, an investment strategy that yields 7% return per annum is sufficient to maintain or even increase the wealth level at retirement.

Chart 32

Annual cash flows – in million USD

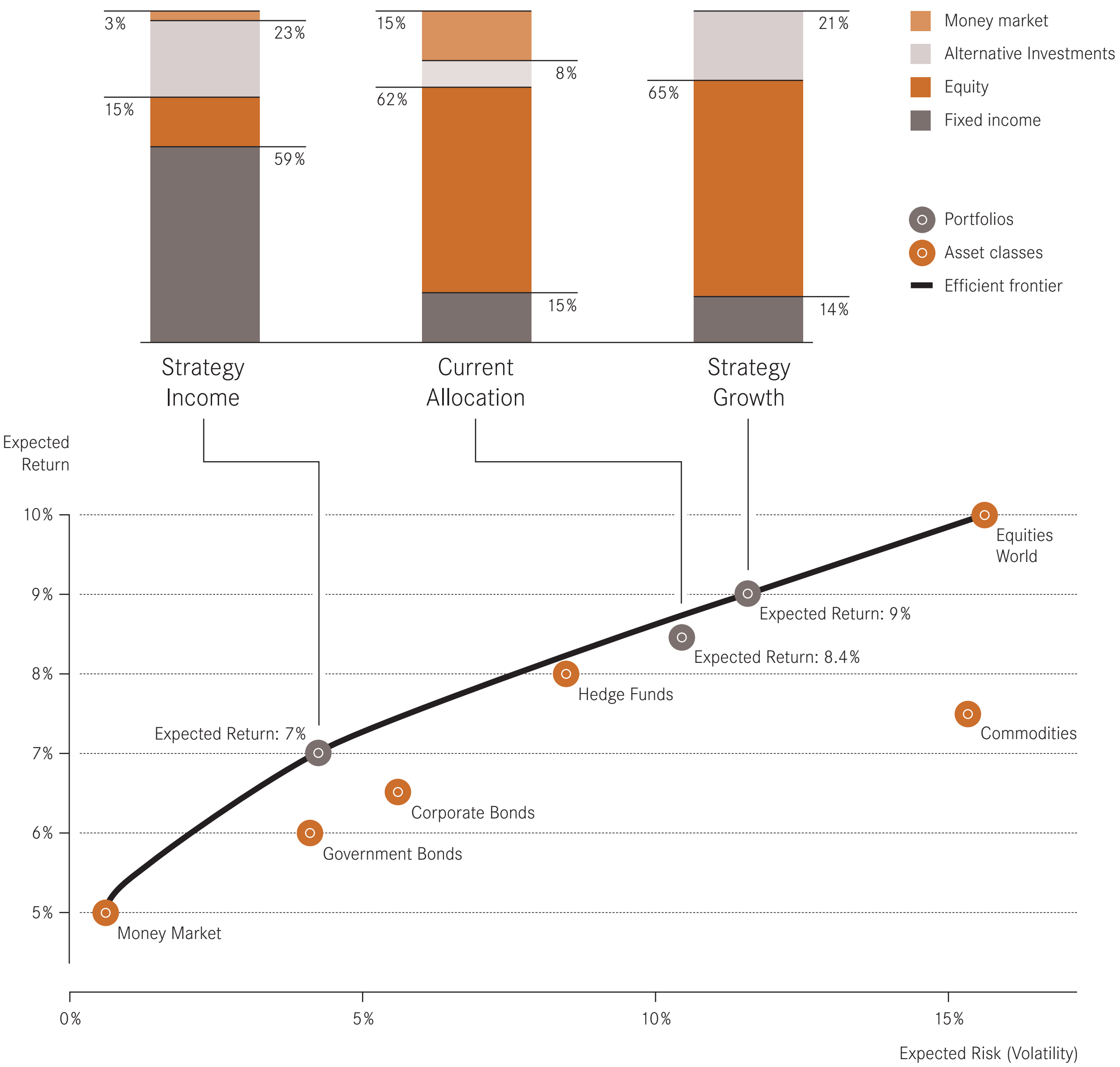


Source: Julius Baer

For long investment horizons, the definition of an appropriate investment strategy that matches the investor's risk-return profile is of outmost importance. The efficient frontier graph in Chart 33 shows combinations of risk and return that are achievable and efficient. For any given expected risk the strategy with the highest expected return is on the efficient frontier. The graph shows the current average allocation of Asia HNWI as well as two efficient multi-asset class strategies 'Income' and 'Growth' with an expected return of 7% and 9%, respectively. The figure shows that Asian HNWI clients are currently invested close to the efficient frontier, on average. It can be argued, however, that a slightly higher equity allocation may yield better results. Such a conclusion represents an important starting point in the dialogue with investors that must consider many other factors before making investment decisions.

Chart 33

Portfolio strategies of Asia HNWI



Source: Julius Baer

What are our clients saying?

At the core of providing the highest standard of private banking is listening and understanding the views and needs of clients and investors. In the context of this Wealth Report, Julius Baer surveyed and interviewed over one hundred clients from the region to gain greater insights into how Asia's HNWI view the world. We believe the results of these efforts, carried out over the course of May 2011, can be seen as being illustrative of Asia's HNWI community in terms of the key issues of the day.

We begin by looking at the findings of the Client Survey[1] and follow by taking a closer look at some of the insights from the in-depth Client Discussions[2], which served as an add-on to the survey itself. When asked about their greatest concerns regarding the economic development in the medium term, four out of five respondents mentioned the risk of an economic downturn in Asia, a correction in local stock markets and foreign exchange volatility. Less worrying, but still causing some unease, was a rise in interest rates as well as volatility in real estate prices. Concerns such as the European sovereign debt crisis and political turmoil in the Middle East

Chart 34

Ranking of concerns

1	Economic downturn in Asia
2	Correction in stock markets
3	Foreign exchange markets volatility
4	Rising interest rates
5	Volatility in real estate prices

Source: Julius Baer

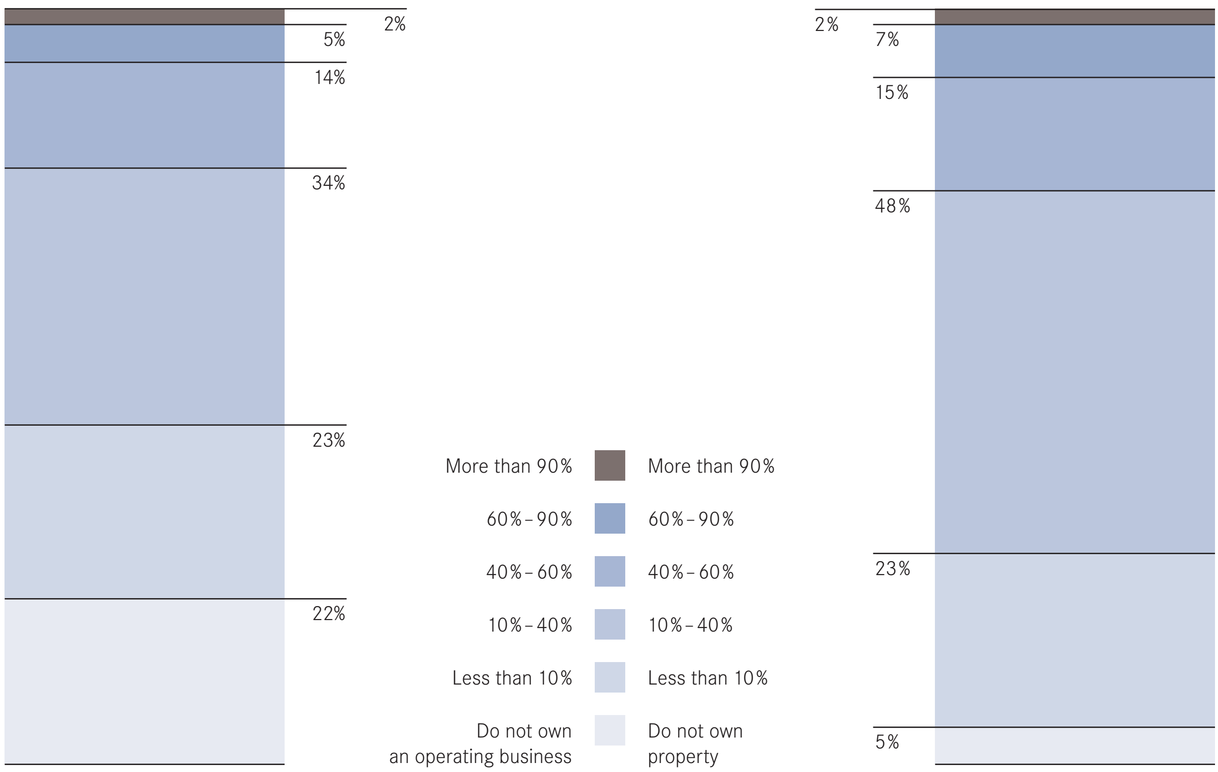
also received some notice, but to a far lesser extent. Interestingly, inflation did not feature prominently in the results. In terms of regional splits, we found that clients based in both North and South Asia had similar views across all of the main "concern" categories.

What do we take away from this result? On the one hand, there is a clear recognition of Asia's role in supporting global growth, both during the recent downturn and in the recovery phase. On the other hand, the majority of respondents continue to link their wealth to their operating businesses. In other words, there is an important and direct linkage between the GDP growth prospects for Asia in the medium term and how respondents see their wealth developing over time. While real estate forms an important part of many of our clients overall wealth, falling property prices did not feature as an especially vexing concern.

Chart 35

What percentage of your wealth is connected to your operating business?

What percentage of your wealth is connected to real estate?



Source: Julius Baer

In terms of philanthropy, approximately 50% of our respondents said they actively contributed in this area. In terms or regional splits, clients based in South Asia more frequently commented on their inclination to donate to charity than their North Asian counterparts. The bulk of the philanthropy is focused on social causes. Turning to the environment, clients overwhelmingly associate global warming as being caused by human activity. In this vein, the bulk of respondents, on average, would be willing to pay up to a 10% premium for a hybrid car.

[1] In May 2011, Julius Baer distributed a questionnaire to clients domiciled in Asia to measure their attitudes towards the firm and general market trends. The statistically meaningful survey results presented here are based on the responses of over 100 clients (78% male, 68% between 40 and 59 years old).

[2] A total of 15 in-depth Client Discussions for the sole purpose of this report were carried out.

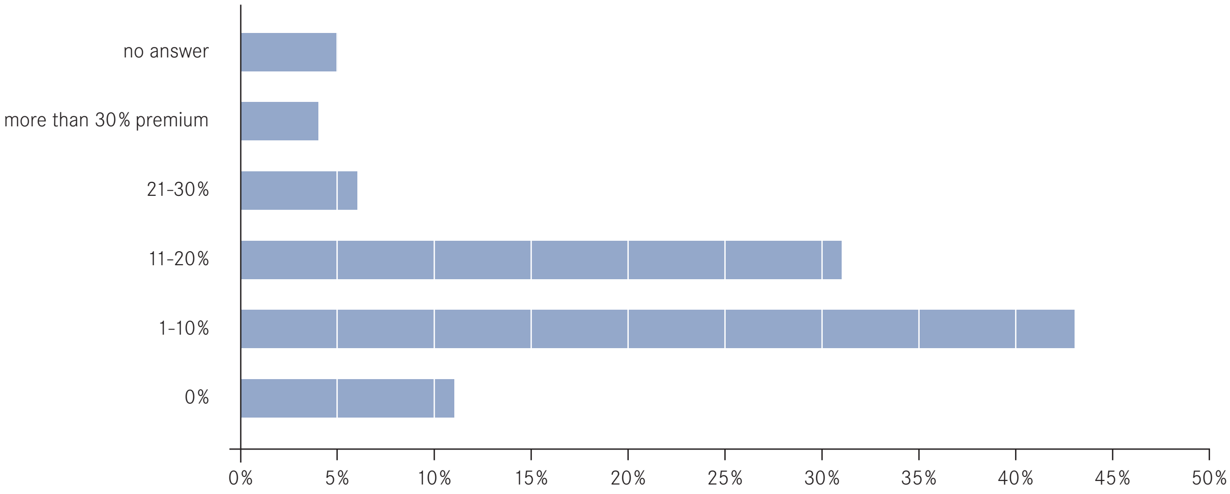
We now turn to the Client Discussions, which sought to gain deeper insights into the topics raised in the Client Survey. Of the many topics covered, arguably the most interesting and controversial related to China and the environment. As a starter, interviewees residing in Hong Kong raised the issue of air quality, but pointed out that the level of air pollution cannot rest with China alone. That said, the majority of interviewees argued that over the shorter term, it is appropriate for China to sacrifice a degree of environmental protection in order to facilitate faster economic growth. The pressure to deliver a higher standard of living for China's population meant that shortcuts are needed. Opinions were strong on both sides of this issue; however, with many clients taking the view that protecting the environment had moral dimensions as well.

The direction of the currency markets was a frequent topic of discussion with clients. Overall, Singapore dollar-based investors echoed the rising economic confidence of Asia in the increased value of their currency, while Hong Kong dollar-centric investors lamented the decline in their international purchasing power. Overall, despite the short-term benefits of rising currencies across most of Asia, clients raised long-term concerns over the US economy, thereby reflecting the still deep links between these two regions.

On the topic of brands and lifestyle choices, in general most interviewees noted that over time, there is a gradual shift in terms of recognising "local heroes" options over "international" ones. For example, local clothing brands made the list of preferred choices, alongside well-known international brands. Asian airlines were strongly identified as being preferred carriers, especially Cathay Pacific and Singapore Airlines. These results dovetailed similar sentiments in terms of services: respondents noted that locally available health care and education had improved substantially in recent years and it was no longer a foregone conclusion that specialised treatments or higher-education needs prompted travel outside the region.

Chart 36

What premium would you pay for a hybrid car?

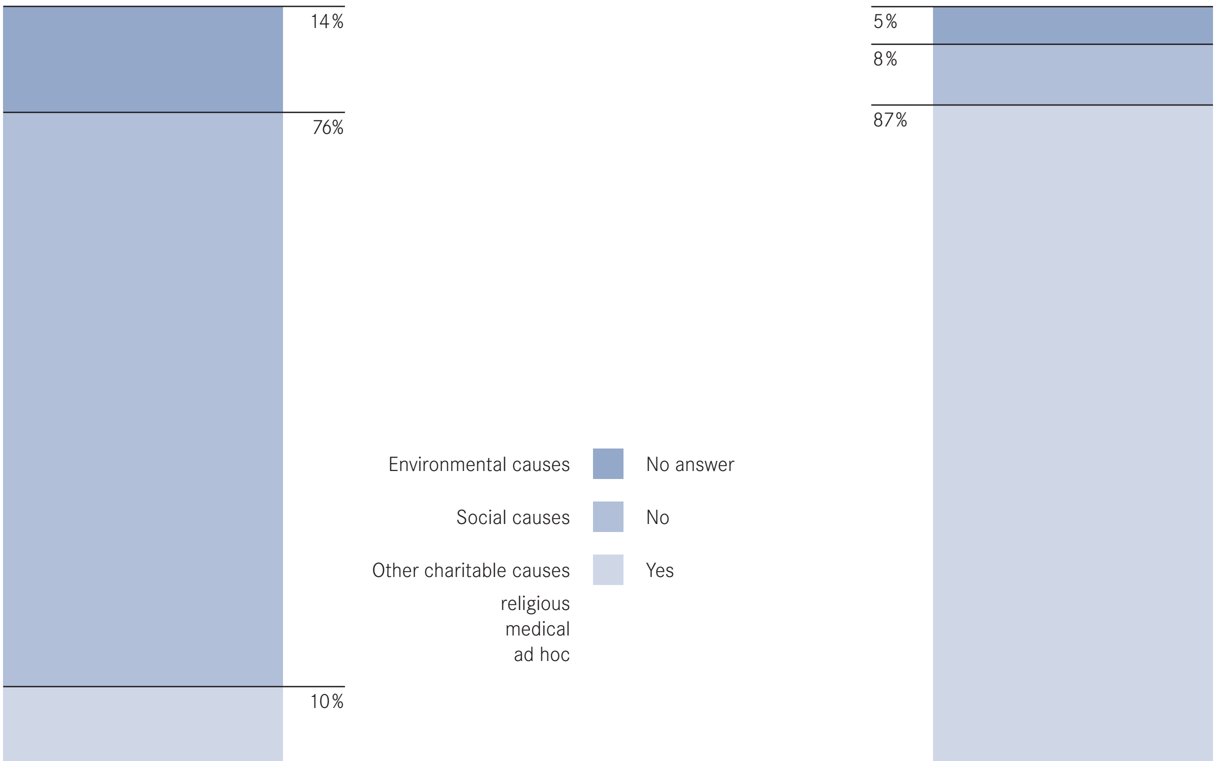


Source: Julius Baer

Chart 37

What kind of charity are you mainly supporting?

Does human activity cause global warming?



Source: Julius Baer

Jean-Claude Biver, CEO Hublot

‘If you plant potatoes, don’t expect them to grow after one month, even if the sun is shining every day.’

That is Hublot in mainland China: twenty months after entering the market and just 0.89% of turnover comes from China. For every one hundred watches Hublot makes, one is sold in China. That’s compared to our competitors who ship 40 to China out of every 100 manufactured. Our catch-up is huge, but it highlights the enormous potential our brand has there. As long as China maintains its pro-growth and pro-prosperity agenda, then the luxury industry has a bright future in China. Five and seven years from now we expect Chinese sales to account for 12–15% and 20% of our total turnover.

We never change our product design to fit a particular market. Indeed a great deal of the charm for the Chinese is to buy European-designed goods. Yet we are adopting our marketing strategy to fit the Chinese market. Role models and ambassadors matter in the Chinese culture. Since brand awareness is number one in China, taste and affordability second, we run never-done-before television campaigns specifically targeted at the Chinese market, with the likes of Jet Li, a popular martial arts professional-turned actor in the country. Not only this but we normally only introduce the brand in upmarket department stores and jewellers. In China, we will open eight Hublot boutiques in 2011 and 15 by the end of 2012 giving us stand-alone prestige and visibility.

The Hublot Strategy

By chance we have no dedicated sponsorship in China. This is because the three main sports followed in the West are also popular in the East: football, basketball and car racing. All of which we sponsor already. Unique to our Chinese tact is direct contact marketing. We invite between 100 and 150 Chinese VIPs every other month to my home, our factory and other luxury goods manufacturers such as Louis Vuitton or Ferrari. Every second month we host a European-themed event like wine and cheese tasting in China. To reach the younger generation we team up with Chinese business schools and invite them to carry out case studies on Hublot.

Communicating what you stand for, your style, social status, wealth and power is important to the Chinese. In Europe, we occasionally enjoy a more understated approach. Take 100 millionaires in Germany and 40 will buy an expensive watch. Take 100 millionaires in China and 100 will buy not one, but up to four watches in one year! And for every 100 watches sold in mainland China, an additional 100 are bought by the Chinese abroad. The Chinese travel to shop which explains why Louis Vuitton and Galeries Lafayette rank second and third as the most frequently visited sites in Paris by Chinese tourists, after the Eiffel Tower.

to entering China

Conclusion

Where do we go from here?

As we close the inaugural Julius Baer Wealth Report, it is worthwhile to return to the question raised in the introduction to this report, "do we live in an Asia-centric world?" In part, this is answered in the top-down and medium-term perspective on wealth creation in Asia, for which the prospects are very promising.

Today many Asian countries still have low numbers of HNWI relative to their population sizes – with the notable exceptions of Singapore and Hong Kong – but economic growth, supportive savings rates and asset market returns will likely see an explosion in this segment of the population in the years ahead. China is expected to be at the forefront in the numbers of new HNWI, but across Asia we expect to see prosperity flourish.

Managing rapid growth, however, is always accompanied by social and economic challenges. Chief among these is inflation. This is in part why Julius Baer has launched the Lifestyle Index. We believe that inflation, also in the luxury segment, is an everyday issue that has important investment and asset-allocation implications. By monitoring and modelling high-end consumption price developments over time, investors will be better able to organise their financial affairs to meet their longer term needs.

Keeping in mind the results of our Client Survey and Discussions, the rise in local heroes and service providers further highlights the importance of being a local player. For Julius Baer, Asia is our "second home market", long having recognised the strategic importance and growth opportunities that the region represents. In this light, for us and CLSA, our long term commitment to Asia is a core value and illustrated by this Julius Baer Wealth Report.

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