Julius Baer Wealth Report: Asia

June 2013

Julius Bär

Dear Reader

Surveying the economic landscape over the past year, it is clear that a new, post-financial crisis equilibrium remains elusive. That said, exciting opportunities and challenges are ubiquitous, especially in Asia. Julius Baer remains deeply committed to being the pre-eminent, dedicated wealth management firm. Our growth in Asia and deep understanding of this market are the cornerstone of this conviction.

This year's Julius Baer Wealth Report highlights that the case for Asia's macroeconomic decoupling from mature economies is robust and underpins our confidence that the region will remain a key driver in wealth creation for the longer term.

Aligned with this broad-based growth in wealth, we have expanded our proprietary Julius Baer Lifestyle Index from the four original cities under coverage, Hong Kong, Singapore, Shanghai and Mumbai. Starting from this year, we have added Taipei, Jakarta, Kuala Lumpur, Manila, Bangkok, Seoul and Tokyo and this expanded list will form the basis of our future analysis. As our presence and client base in Asia continues to grow, broadening the scope of the Lifestyle Index over time better reflects the overall strategy of Julius Baer.

With this year's report, we also delve more deeply into individual constituents of the index, seeking to understand what factors are driving certain outcomes across Asia. At the same time, the results of our analysis reinforce our resolve to provide the best possible longer-term investment advice to our clients, as the spectre of inflation remains very real. Since the investment landscape will no doubt continue to evolve and supplant conventional perceptions our own strategic investment approach is geared towards tackling these developments and remaining ahead of the curve.

I invite you to share with me the insights of the 2013 Julius Baer Wealth Report and thank you for your interest.

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

Consumption and growth – reciprocal determination

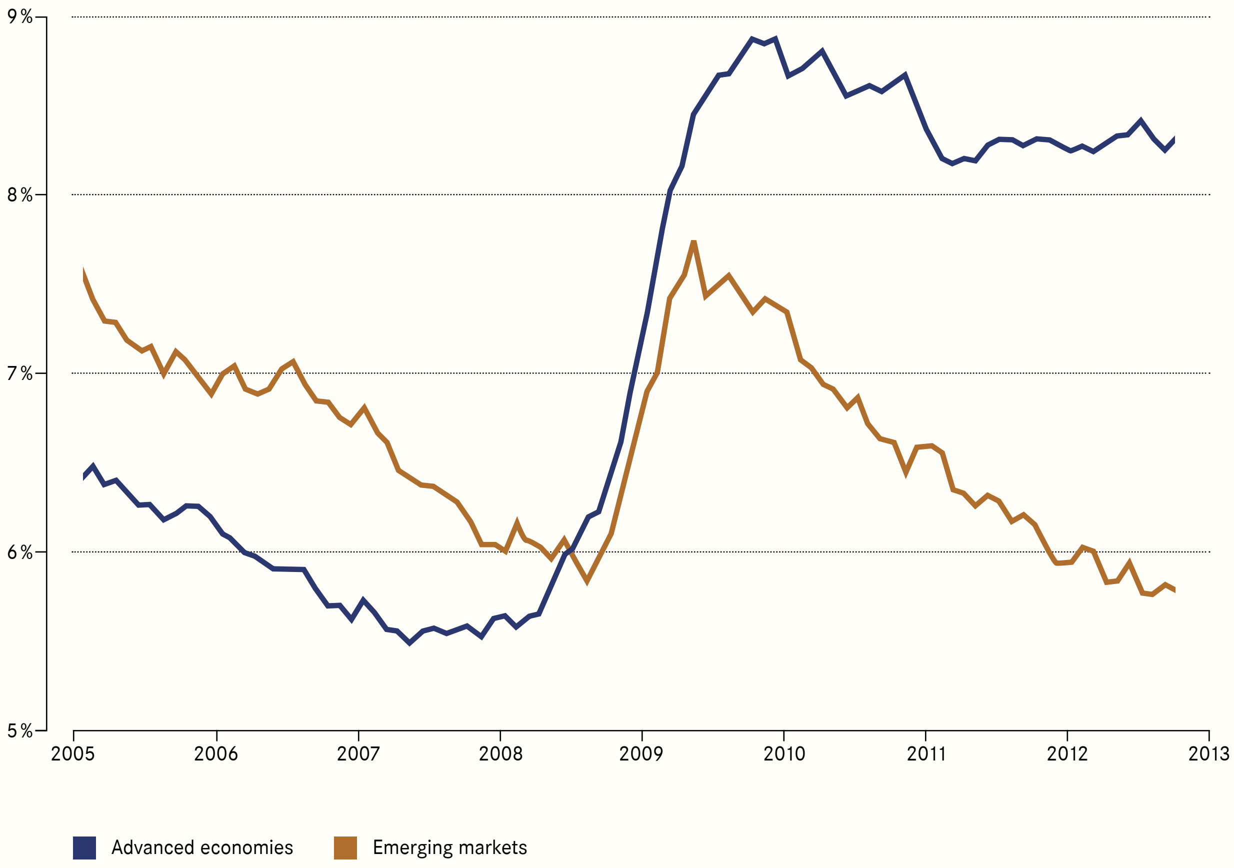
The increased role of consumption in developing economies has been the focus of financial market participants and academic research for several years, but with the memory of the global financial crisis and Great Recession still vivid in our minds, the time is right to examine the role of consumption and ask what is the way forward for Asia's economies.

The question of decoupling

As a starting point, we look back on the recent economic performance of Asia and consider the evidence for arguing that Asia has managed to decouple from mature economies. If a case for macroeconomic decoupling cannot be made, then it makes little sense to consider Asian consumption trends in great detail, as any conclusions may well be offset by trends in mature economies. We then compare how mature economies, namely the United States, grew to become predominantly consumption-oriented and ask whether Asia, in particular China, is on the same path.

When addressing the question whether Asia has decoupled from mature economies, we need to draw a distinction between macroeconomic performance and asset price movements. In terms of the latter, it is very clear that Asian assets, to varying degrees, still hinge upon international investors and capital market trends. Indeed, over the past few years, the correlations between Asian and mature market assets have actually increased. This is in part due to the globalisation of investing. As financial markets become increasingly integrated and capital flows more fluid, local factors tend to have less of an impact. Macroeconomic correlation, however, has decreased and there is mounting evidence that Asia is becoming ever more resilient in the face of economic shocks. Investors need not look any farther than aggregate unemployment levels in developed and emerging markets to see how fundamentals have diverged.

Chart 1
Unemployment rate

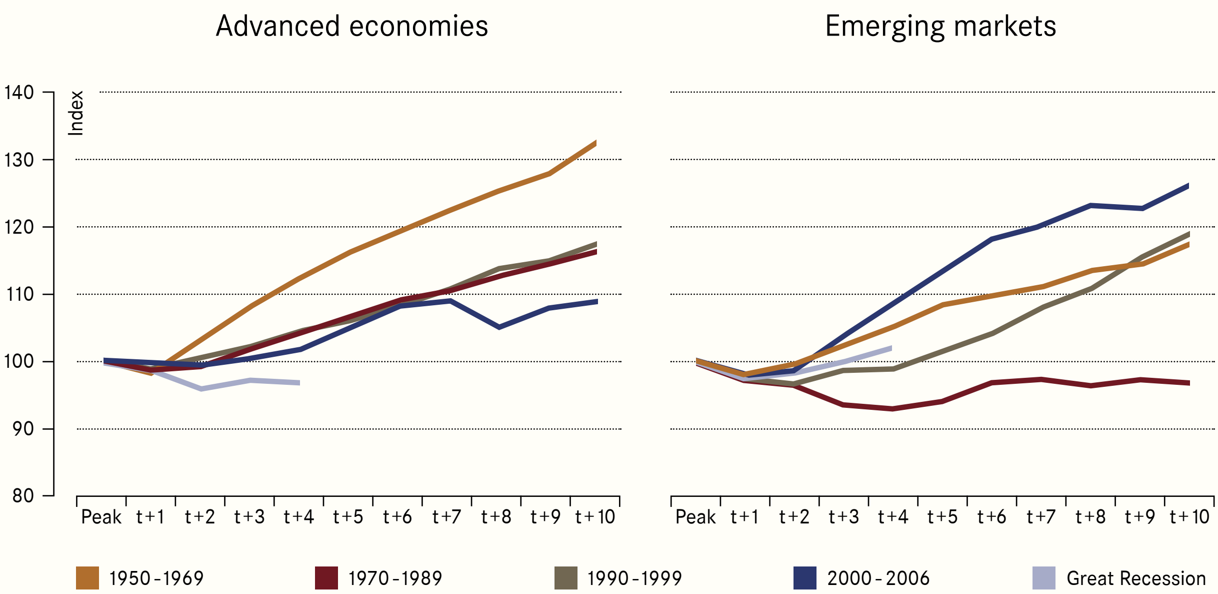


Source: JP Morgan, Julius Baer

Becoming more resilient over time

Indeed, taking a longer term perspective, a recent International Monetary Fund (IMF) study found that over the past six decades, the 100 emerging and developing countries under review experienced longer expansions and shorter downturns, with increasing frequency on both counts. As a group, the weakest period in terms of per capita gross domestic product (GDP) growth for emerging markets was in the 1970s and 1980s, but this was driven largely by poor performance in Latin America. Focusing on Asia, with the exception of 1997 and 1998 on average, strong growth has been recorded over the past six decades. Why is this the case? In general, the IMF study points to economies having low inflation and growing international reserves as hallmarks that encourage longer periods of expansion. In terms of keeping downturns short, it is found that moderate inflation, low government debt, international reserves, openness to trade and the degree of financial integration with the rest of the world play a role. In the context of the recent eurozone debt crisis, Asia's strong standing in terms of debt sustainability bodes well for the region. The IMF also points out that 'home-grown' crises in emerging markets, most notably banking sector shocks, have become far less frequent. To put this into context, in the wake of the US subprime market collapse and the global financial crisis, over 150 banks were forced to shut in the United States, according to the Federal Deposit Insurance Corporation.

Chart 2
Dynamics of output per capita following peaks, in years

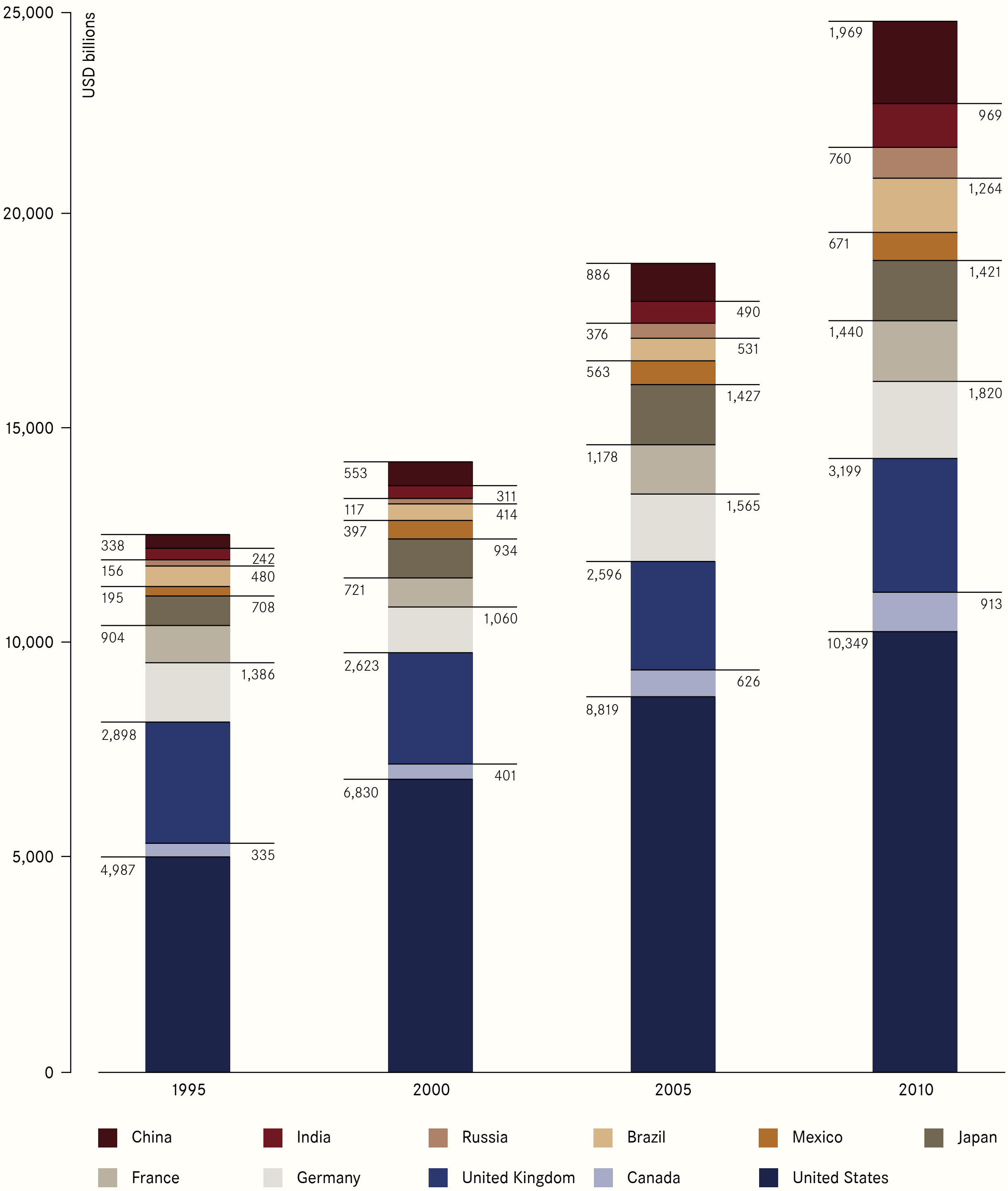


Source: International Monetary Fund, Julius Baer

Is consumption the path to prosperity?

Now let us turn to the role of consumption, and what this means for Asia. An oft-repeated phrase is that the US economy is comprised of 70% consumption, with several implicit messages conveyed at the same time. For example, this phrase highlights the global importance of the US consumers and what changes in their spending patterns may mean for the rest of the world, both positive and negative. Second, there is the suggestion that for the world's largest economy, the path to achieving prosperity is to focus policy-making efforts on duplicating this outcome. In other words, governments should enable private consumption, as this would lead to greater overall wealth. Indeed, when looking at the global distribution of private consumption spending, the United States still dominates all other economies, and by a wide margin. While it appears very certain that emerging market consumption will be in the driving seat over the longer term, the absolute size of American consumption is such that the US consumer will also keep an important role in the longer term.

Chart 3
Nominal consumption

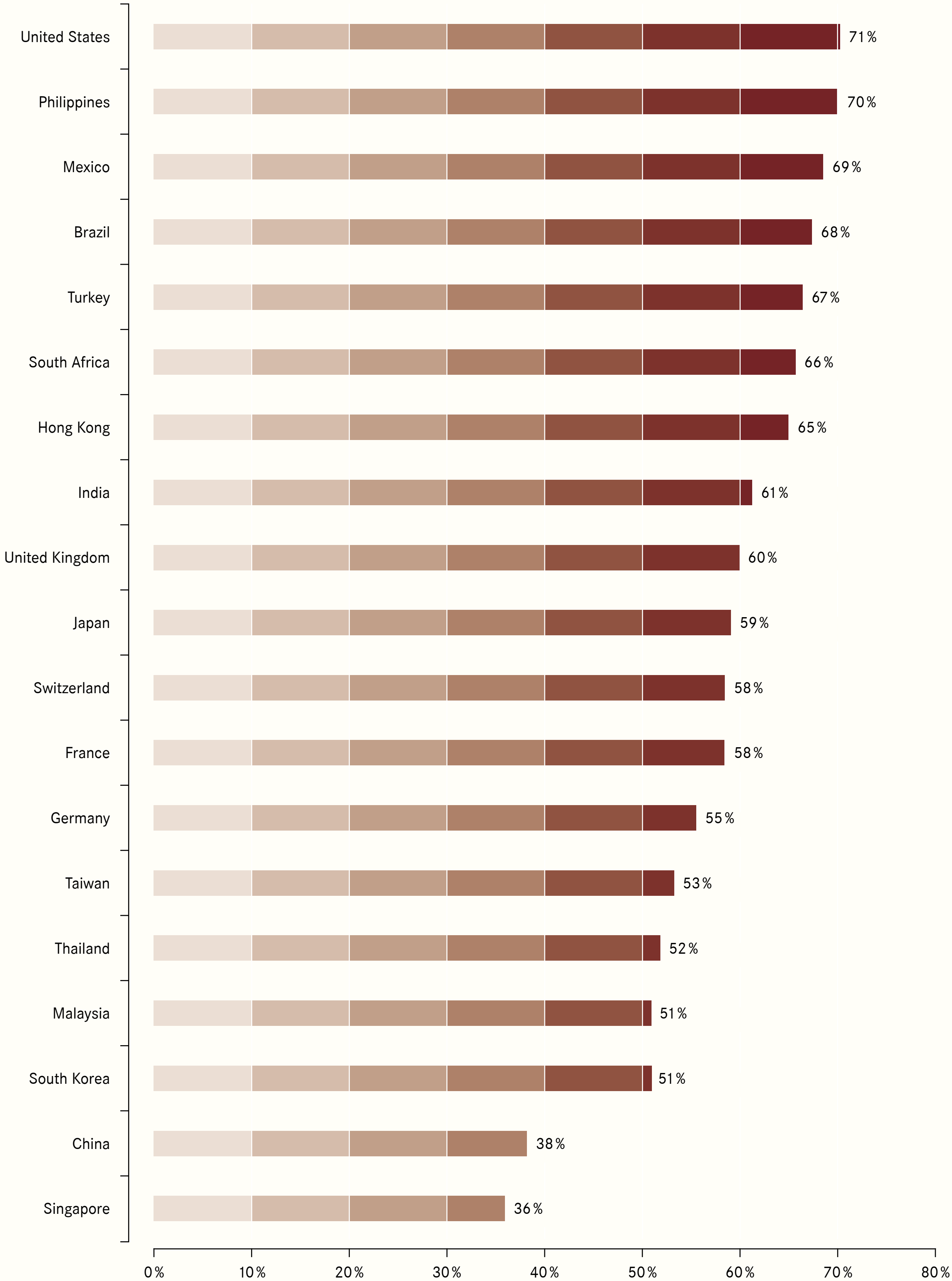


Source: Deutsche Bank, Julius Baer

Not ‘one model fits all’

However, even among wealthy nations, there is a wide range in terms of relative share of private consumption to GDP. The United States tops the list, but Japan is close to 59% and Germany to 55%. As a consequence, it cannot be said that promoting consumption as such is the only way forward. Indeed, many lower-income nations already have a high relative share of consumption in their economies, but are far from matching US per capita GDP. The critical point is what is being consumed and what trends can be seen as a result.

Chart 4
Private consumption as % of GDP, 2012

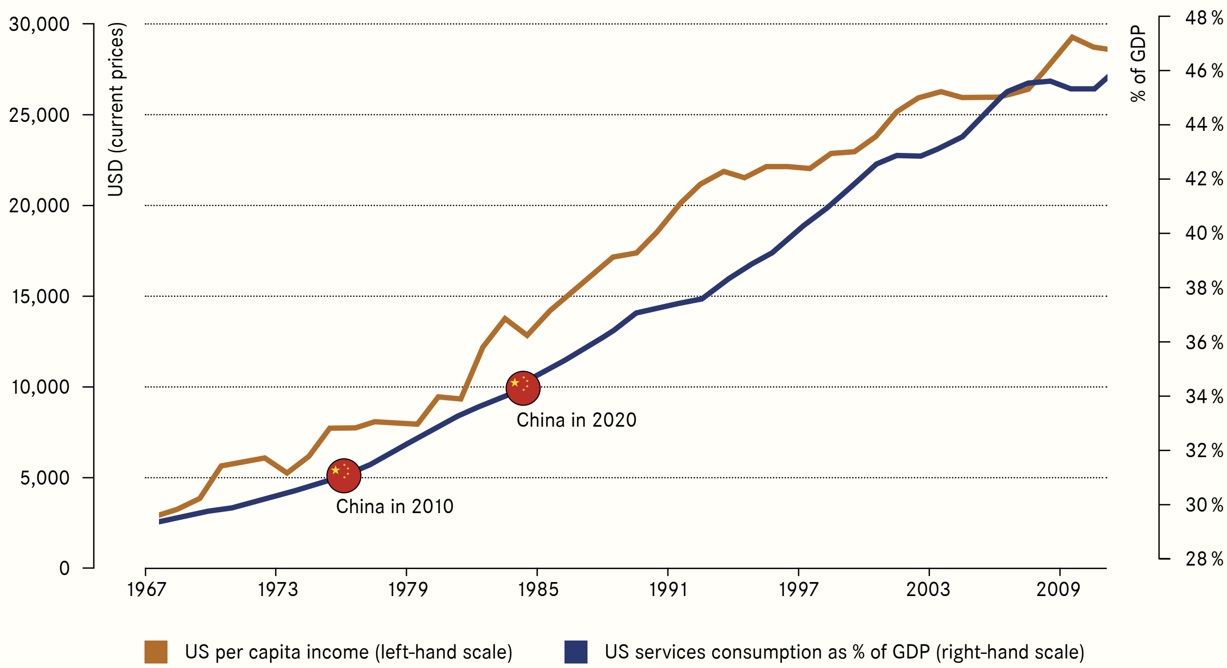


Source: Haver Analytics, UBS Investment Bank, Julius Baer

The important distinction: the consumption of services

History provides a useful guide to understand this issue better. According to Deutsche Bank, in 1688, food and drink made up 47% of average private consumption in the United Kingdom. By 2010 however, this had dropped to only 13%, a trend that is visible in all successful economies: food and basic housing costs make up a smaller share of disposable income over time. On the other hand, expenditure on services as a percentage of the total increases. This is the most important barometer in understanding what the prospects for Asia's economies are in terms of growth and wealth creation. Namely, what is the balance of services in the overall consumption basket relative to goods and how does this change over time? Hence conclusions need to be drawn carefully. The current situation, which still sees healthcare costs represent 16% of US private consumption spending, is contentious and will divide opinions as to whether this is an efficient or desirable outcome.

Chart 5
Spending on services and per capita income



Source: CEIC Data, US Census Bureau, HSBC, Julius Baer

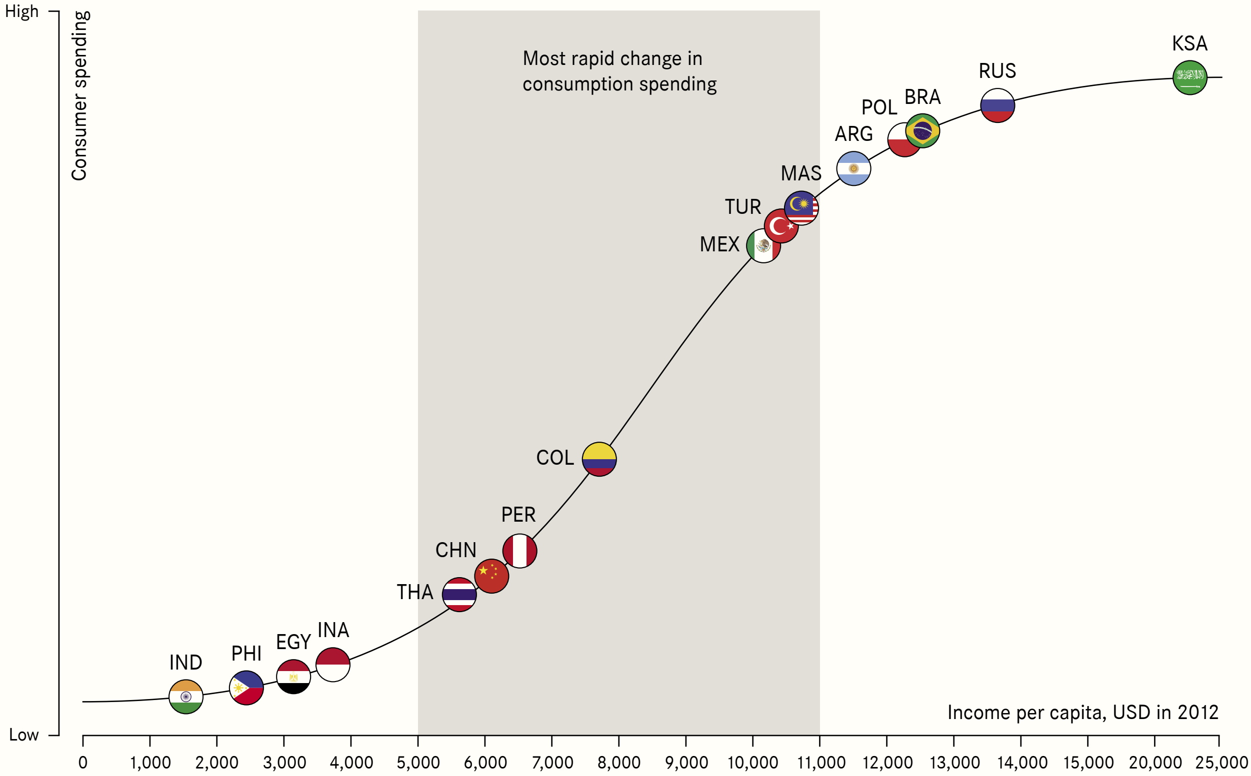
It all started in New York City

It can be argued that modern private consumption was launched, metaphorically, when the first department store came into being. According to Deutsche Bank, this occurred in 1846 in New York City. Alexander Stewart opened the Marble Dry Goods Palace, and within forty years American consumers had a host of other department stores to visit and could even shop from their homes, using the Sears, Roebuck & Company mail order service, the forefather of e-commerce that is ubiquitous today. Researchers are fortunate that the US Bureau of Labor Statistics has been keeping records on households since 1901, hence a detailed understanding of US consumption patterns is possible. In that year, average household income in the United States was USD 750 of which 80% was spent on food, clothing and housing. For every subsequent decade, the percentage spent on non-essential items increased, until it reached a plateau of 50% which was the case in 2002. In terms of incomes, the average hourly wage for most sectors was approximately USD 0.28 per hour in 1901 (finance, insurance and real estate were the outliers – the average wage was USD 0.50 per hour). To put this into context, twelve eggs cost USD 0.22 while a pound of pork cost USD 0.13. A century later, the average wage rose 60 times (with government workers now having the highest average hourly wage) in nominal terms.

Consumption trends do not occur in a vacuum

Average family size has dropped from five in 1918 to below three in 2002, while female workforce participation has surged to 55% today, from only 25% in 1901. What these statistics demonstrate is that economic development and consumption patterns are closely tied to demographics and many other socio-economic trends, not to mention the traditional policy-making arena. The key issue, however, is that there are changes in how the consumption basket is formed as income per capita rises. Rapid changes occur not only as consumers move from low to middle incomes, but again when they pass into the high-income brackets. At the highest-income levels, the changes level off, thereby symbolically consumption patterns take on a S-curve shape. The second critical issue is whether a nation 'gets stuck' on its journey of rising per capita income. This is commonly referred to as the 'middle-income trap'. According to the Asian Development Bank, looking at countries with a population of more than three million and excluding OPEC members, 28 nations have persistently remained in the middle-income bracket (defined as having a per capita gross national income between USD 1,025 and USD 12,476) over the period 1987 to 2009. While most of these are in Latin America, they also include Malaysia, Thailand and the Philippines. China is now classified as a middle-income nation and the key question is, in particular for the outlook on consumption, how high are the risks that China will 'get stuck'?

Chart 6
The path to a consumption economy

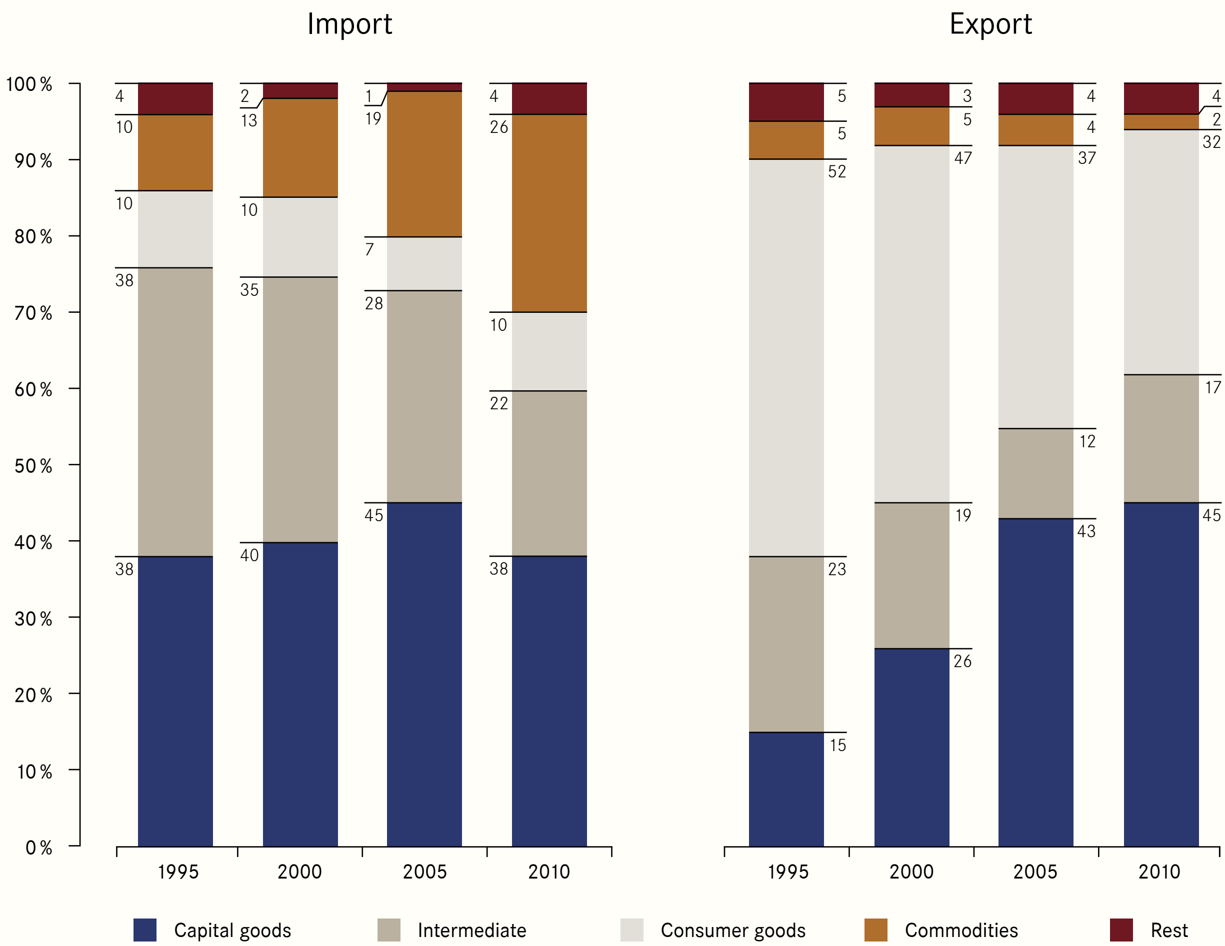


Source: World Bank, HSBC, International Monetary Fund, Julius Baer

How to escape the middle-income trap

The basic policy prescription from the Asian Development Bank is that nations need to move up the value chain and increase productivity. The key point is that even as wages rise as a result, an economy that is constantly innovating and upgrading will remain competitive and eventually graduate to a high-income nation. A minimal degree of social and economic stability is prerequisite, as highlighted by Latin America's historical experience with hyperinflation that was often cited as one reason for the prevalence of middle-income nations there. Regarding China, the data points to a rising share of higher value-added output, which is occurring with increasing speed. There are many more facets to this particular discussion, but in terms of what is the easiest to quantify, such as the composition of export products, China is clearly on the right path to avoid the middle-income trap.

Chart 7
China's consumption of imports and exports, by goods type



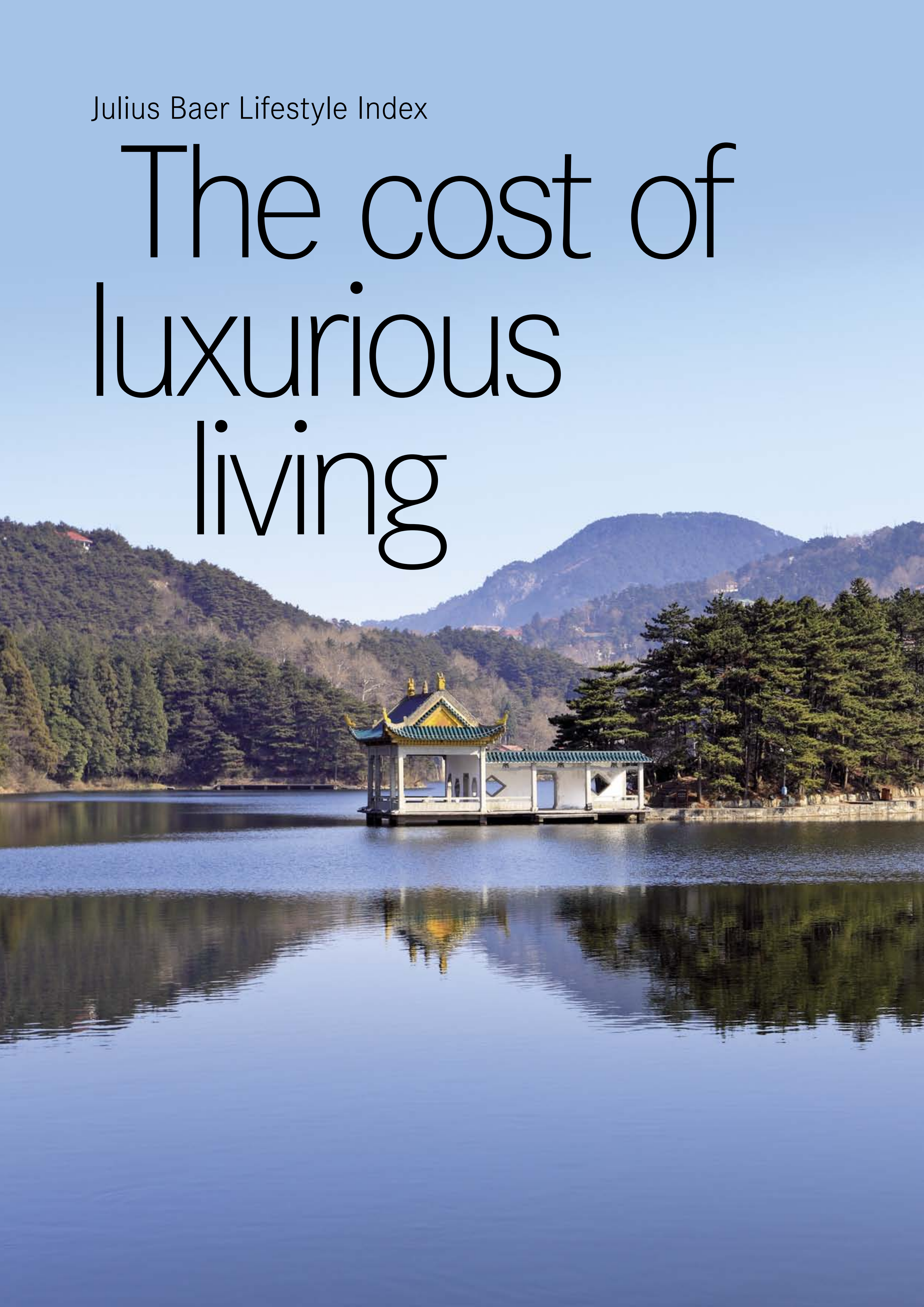
Source: International Monetary Fund, Deutsche Bank, Julius Baer

Learning from others' experiences

The historical experience of other countries demonstrates that there is not a single journey to achieving high income per capita, and indeed, there are pitfalls along the way that can cause some nations to stall. In addition, many mature economies have not embarked on the US path, which has led to a predominantly consumer-based economy. Hence the field is open for Asia and a 'one size fits all' policy framework makes little sense in this region. That said, for China in particular, the foundations are being laid for a much stronger and more sustainable consumer-based economy, as made visible by the upward migration in the value chain of both its exports and imports. This shift is occurring, at varying speeds, across Asia, but importantly supports the rise in incomes which in turn leads to better standards of living.

Julius Baer Lifestyle Index

The cost of luxurious living



The Julius Baer Lifestyle Index, now in its third year, tracks the price of a basket of luxury goods and services, indicating the true cost of living in luxury. The frequently cited index has, this year, been expanded to cover eleven key Asian economic centres, as well as continue to track the essential luxury basket across our original cities of Hong Kong, Singapore, Shanghai and Mumbai. In the following section, we compare the data across the full set of cities, setting the stage for the expanded index in the years to come.

Pressure on the luxury basket

The Julius Baer Lifestyle Index for 2013 has risen 8.0% in US dollar terms, slightly lower than last year's result. At the same time, across Hong Kong, Singapore, Shanghai and Mumbai, the corresponding mainstream inflation indicators have risen approximately 5.3% over the measurement period. This outcome also corresponds to what we learned in 2012, which is that Asia's high net worth individuals continue to face an increase in the cost of living that outstrips the conventional consumption basket.
As before, the index covers twenty goods and services, the prices of which are driven primarily by global factors (such as international education costs) while the bulk of the prices reflect local supply and demand.

The single largest increase is in the area of education. While fees at prestigious boarding schools have remained largely unchanged, the cost of attending Oxford and Harvard univerities have risen by 30% on average. This increase is more than double the surge of the next highest increase categories, namely wine, hotel stays and cigars. It is also notable that higher education saw the largest price rise in 2011, at 18%. Hence given these significant price trends in education, we have dedicated a section of this year's Wealth Report to examine some of the other issues that Asia's high net worth individuals may wish to consider in this area.

Find luxury: Building the Julius Baer Lifestyle Index

By definition, building any index involves a degree of subjective decision-making when it comes down to the final selection of constituents. The Julius Baer Lifestyle Index captures a snapshot of how the cost of living in luxury in Asia is evolving over time – but to do so means finding the right basket of goods and services that reflect this. Availability of the exact same item is not guaranteed across all of the cities under review, further choices are made to determine the right substitute.

The business class airfare data is a good case in point. In the area of luxury air travel, we have chosen to use business class fares from the Asian city to London and New York, averaged over a sample period. This is driven in part by the reliability of and access to data. At the same time, while the price trends of business class travel will tell part of the story, we also know that for Asia's high net worth individuals, this only reflects part of their travelling lifestyles. According to the aerospace consultants Frost & Sullivan, high net worth individuals in practice combine business and first class travel with chartered aircraft for their corporate or personal needs. Business aviation travel has competitive pricing compared to first class scheduled airline travel and is superior in providing many of the services such as privileged immigration, security, lounge access and most importantly not sticking to airline schedules. Indeed, Asia's private aircraft fleet excluding China has grown to 1,170 aircraft with an average compound annual growth rate of 12% and is set to expand further in the years ahead. The economics of this decision are simple: a party of five may end up spending the same amount on chartered aircraft or full-fare first class tickets, so why not choose the former? As a consequence, the data only tells part of the story.

Chart 8
Julius Baer Lifestyle Index

Item	Specification	Average price across countries, in USD Current year	 1 year ago	Average inflation %
Residential property	High-end property transaction	20,390,801	19,000,263	7.3%
Watch	Gold Rolex Oyster	36,932	34,265	7.8%
Ladies' handbag	Channel classic quilted flap bag	5,281	5,302	-0.4%
Wedding banquet	500 persons at a top hotel	116,466	110,207	5.7%
Wine	Lafite Rothschild 2000	4,174	3,587	16.4%
Jewellery	Tiffany's 2-carat diamond ring	109,867	102,260	7.4%
Men's suit	Men's tailored suit	2,949	2,665	10.7%
Facial aesthetics	Botox treatment	729	685	6.4%
Piano	Steinway & Son's Grand Piano	233,867	224,535	4.2%
Hotel suite	Four Seasons or Ritz Carlton	578	499	15.7%
Car	Black Mercedes	312,278	285,980	9.2%
Dental treatment	1 tooth implant	2,968	2,762	7.5%
Cigar	Cohiba Siglo VI, box of 25	1,171	1,035	13.1%
Lawyer	Simple will, 1 hour consultation	604	572	5.6%
Hospital	1-day stay, simple treatment	645	566	13.9%
Golf club membership	1-year membership at top club	251,184	244,638	2.7%
Ladies' shoes	Simple Louboutin 85mm pump	722	680	6.2%
Flights	Return to London/New York	7,394	7,211	2.5%
University	Oxford/Harvard average per year	78,076	59,757	30.7%
Boarding school	Eton/Deerfield average per year	50,306	51,363	-2.1%
Weighted average of Lifestyle Index across 4 cities				8.0%

A natural question may be, why not look at first class fares instead, as a gauge of high net worth spending on luxury travel? According to Frost & Sullivan, on average only one third of first class seats on a given flight are actually purchased, the balance are upgrades or mileage tickets. In business class, this number is 90%. Hence the large majority of those sitting in a business class have their full fares paid by their corporate travel desks or individually. As such it can be argued that business class better reflects actual, discrete spending on travel. In any event, this illustrates that pricing is just the beginning, a theme we look at more closely in the 'Luxury Focus' section on the coming pages.

Chart 9
Prices of Julius Baer Lifestyle items across cities, in USD

Hong Kong	Singapore	Shanghai	Mumbai
45,151,969	13,511,445	15,244,636	7,655,154
33,742	37,198	42,204	34,585
5,186	5,322	5,937	4,679
111,383	71,411	128,143	154,926
3,741	3,506	5,456	3,995
123,845	113,636	171,703	30,282
3,212	3,200	2,751	2,634
877	353	1,364	322
203,958	243,623	263,171	224,717
761	574	770	207
266,010	432,381	351,108	199,612
4,515	3,434	2,429	1,495
1,097	1,190	1,464	934
361	1,300	481	273
644	466	1,106	365
387,017	277,959	269,589	70,172
697	736	883	574
8,453	7,405	8,463	5,253
78,076	78,076	78,076	78,076
50,306	50,306	50,306	50,306

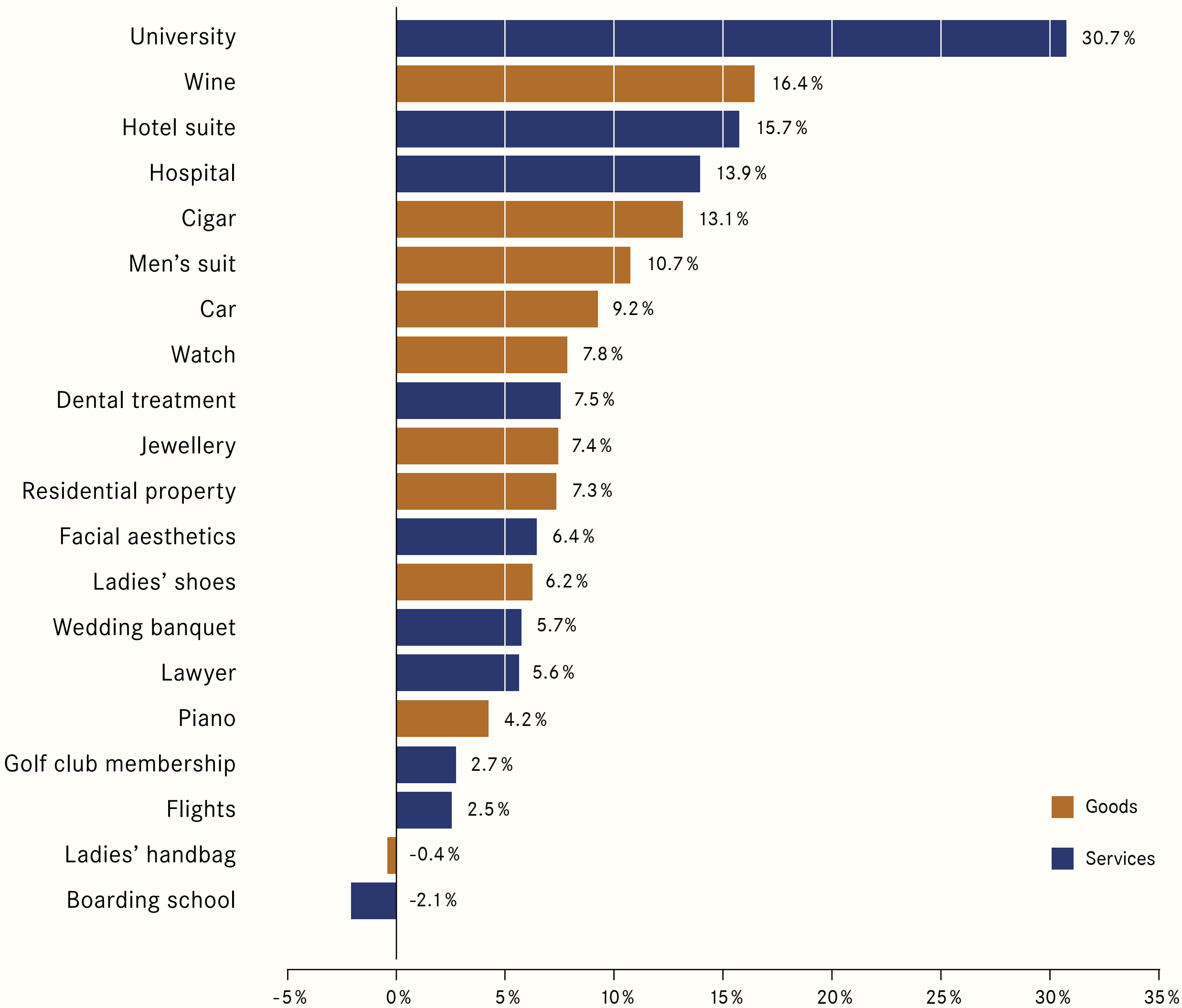
Source: Ipsos Loyalty, Julius Baer

Moderating property prices in China

Currency fluctuations have played less of a role in 2013 relative to the outcome last year. By definition, the Hong Kong dollar and US dollar outcomes are essentially identical, while the Chinese yuan has gently appreciated, resulting in the cost of luxury items US dollar in China to outpace the local currency price rises. Similarly to the 2012 outcome, India stands out for having the largest local currency price movements. The unweighted average of the Mumbai sub-index is 18%, double the outcome of Shanghai. Also in US dollar terms, Mumbai saw the highest jump in the index. While almost every item in Mumbai rose, the 20% increase in high-end property explains the bulk of the move, given the dominant weight that this constituent has. The slight moderation in Shanghai property prices is what has held back this sub-index, as the average price increase of luxury items in this city has been around 10%. Other notable items in the 2013 Julius Baer Lifestyle Index include hotel stays, jewellery and watch prices, which rose consistently across all cities. Wine and cigar prices see the biggest changes relative to 2012, followed by men's tailoring and business-class air travel. The latter is inherently very volatile, hence we have taken averages over multiple time periods to obtain a better gauge of the developments in luxury travel costs across Asia.

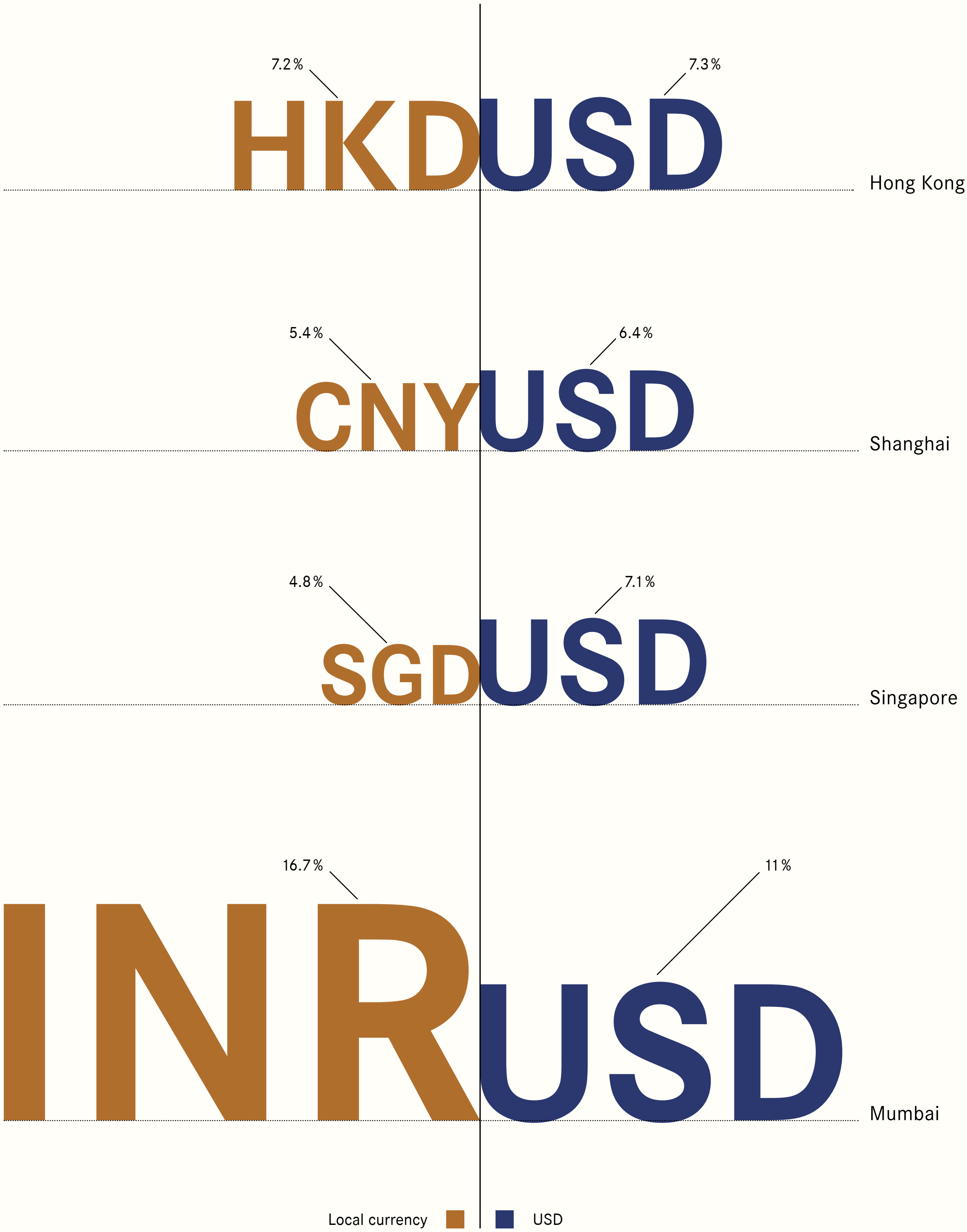
In the following sections, we take a closer look at the variability of prices in Hong Kong, Shanghai, Singapore, Mumbai, Jakarta, Kuala Lumpur, Taipei, Bangkok, Manila, Seoul and Tokyo.

Chart 10
Price increases of Julius Baer Lifestyle items, y/y USD terms



Source: Ipsos Loyalty, Julius Baer

Chart 11
Aggregate Lifestyle Index inflation – local currency vs. USD over measurement period



Source: Ipsos Loyalty, Julius Baer

Country Sections

Expanding the horizon of consumption

With this year's Wealth Report, we initiate the data collection that forms the basis for a new Julius Baer Lifestyle Index, expanding from the original four cities, Hong Kong, Shanghai, Singapore and Mumbai. With the new edition, we add Jakarta, Kuala Lumpur, Taipei, Bangkok, Manila, Seoul and Tokyo which, in effect, means that the Julius Baer Lifestyle Index will offer far more comprehensive insights into the cost of living for the region's high net worth individuals.

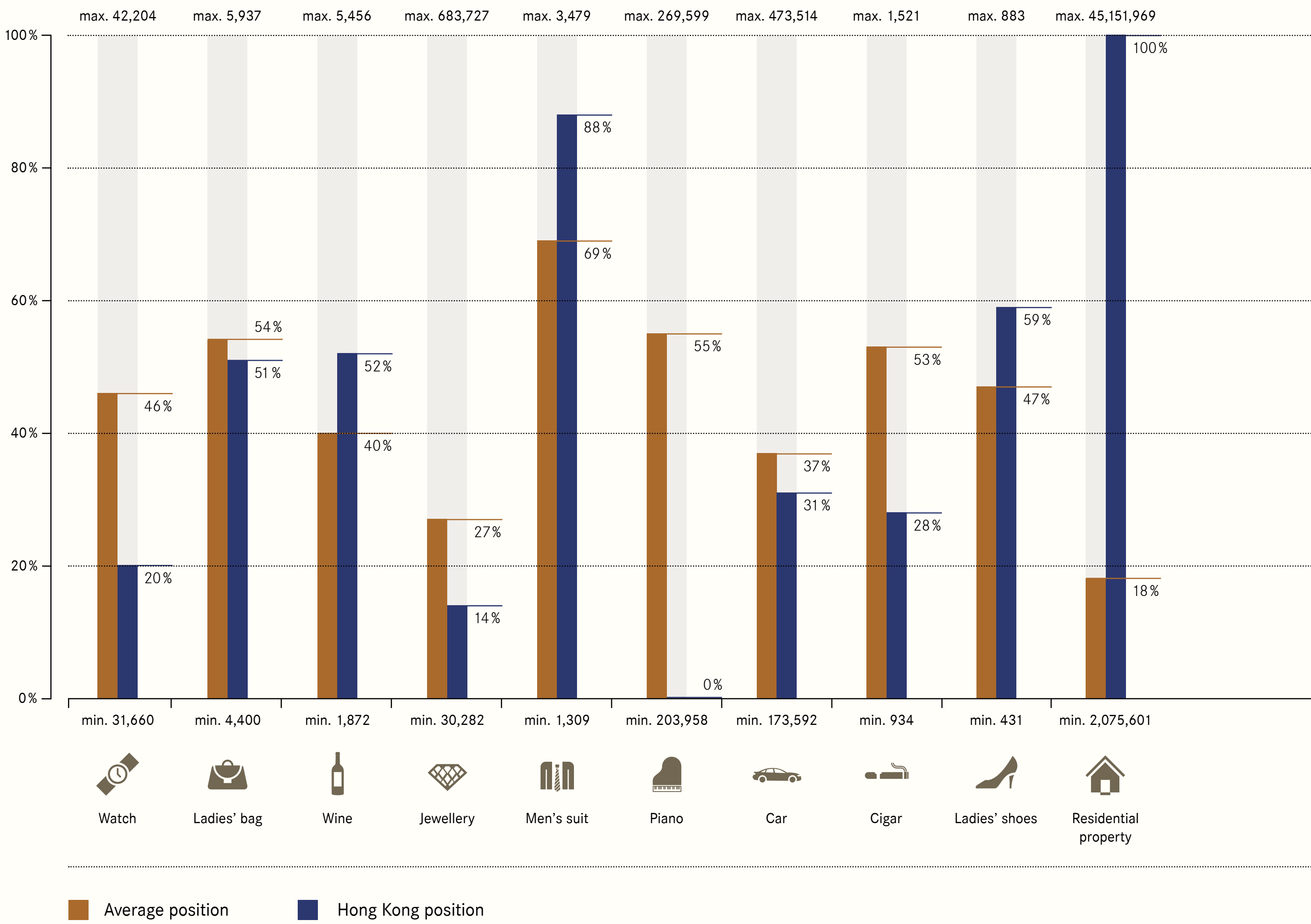
The current 2013 Julius Baer Wealth Report captures the transition where we show the original index changes for the original four cities, and for the new city data, we focus on the variation of index constituents for this year. In future, the inflation influence on these goods and services can also be captured.

The charts for each city are designed for direct market comparison. For each city, the Lifestyle Index components are divided into goods and services, as we maintain that there are distinct supply and demand dynamics that govern these two categories in different ways. For example, the luxury watch providers can easily shift supply from one market to the next, whereas a lawyer or plastic surgeon is largely tied to their base location and is 'non-traded' in this sense. Secondly, we have excluded the education items in the charts as the prices are set purely on an international basis, with the only local variation being driven by the exchange rate, offering little additional insights.

The charts are constructed based on US dollar terms, making all eleven cities comparable. The values across the top of the charts represent the maximum price level across the cities, with the minimum value at the bottom of the chart, thereby capturing the total range of outcomes for each index item. The 'average position' of the data point is represented as a percentage, so as to standardise the data. For example, the maximum value of a Rolex watch across all cities is USD 42,204 while the lowest price is USD 31,660. The average price is USD 36,539, which lies at about 46% from the minimum price of the watch. Lastly, we plot a city value (for example, 'Hong Kong position of 20%') which informs the reader how far above or below the average the price of a Rolex watch in Hong Kong is (USD 33,742), relative to the average across the eleven cities in Asia. The following sections will highlight the outliers for each of the cities under coverage.

Hong Kong – property fever pitch

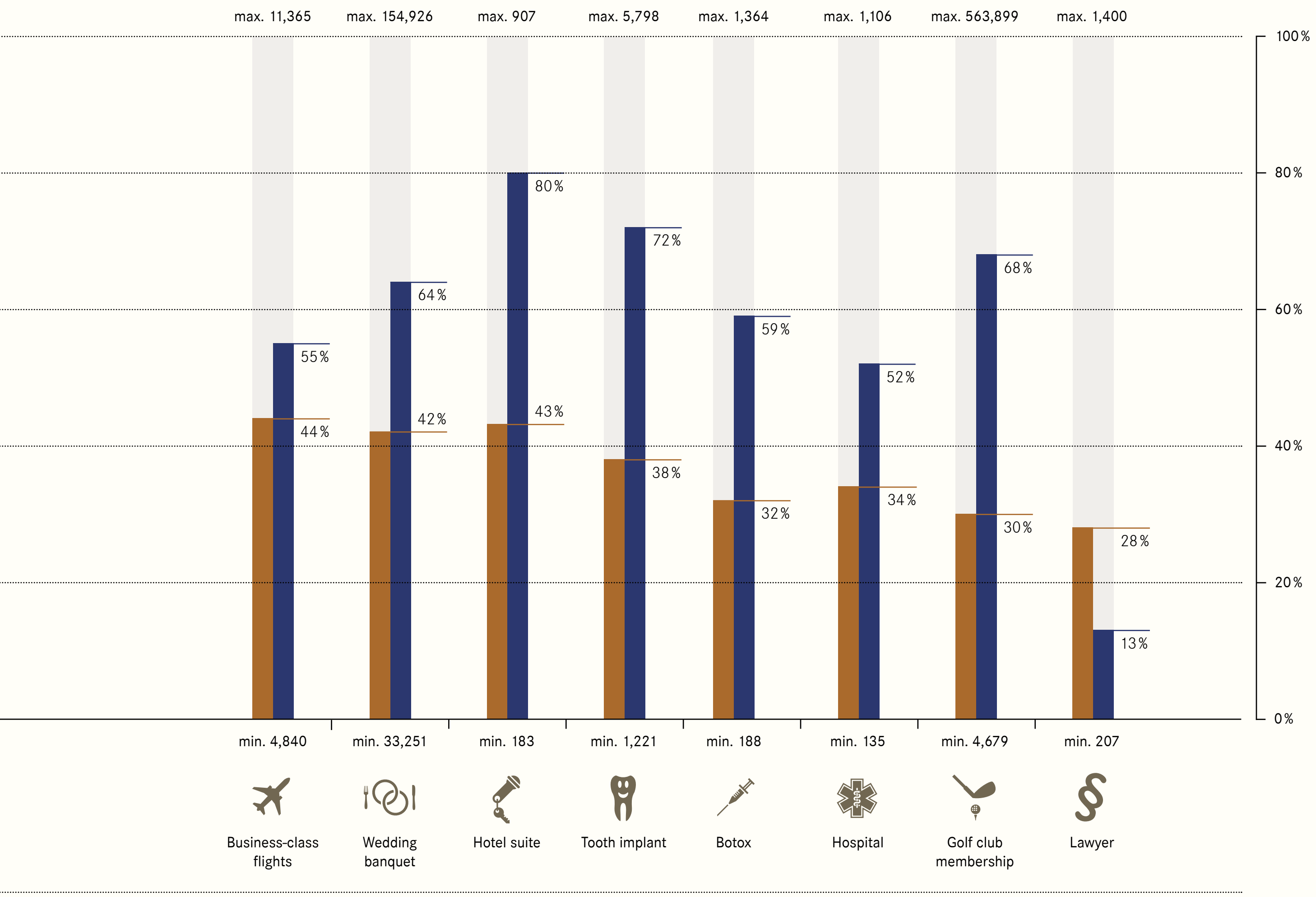
Chart 12
Hong Kong – Goods



The dominant feature over the Hong Kong data set is the high-end property sector. Prices in Hong Kong are the highest in the whole data set. Comparing property across cities represents unique challenges, as the search for similarly sized homes in a premium location is surprisingly difficult. In addition, some properties will command an extra premium given their prestige and significant local supply constraints. In Hong Kong, strong demand from international and local buyers has reached fever pitch and the jury is still out whether government measures to introduce restraint into the property market will have a meaningful impact – but it seems safe to assume that the highest segment will remain largely untouched.

For similar reasons of limited supply, golf club membership in Hong Kong is among the most expensive. At USD 387,000 per year for the most prestigious clubs, this is only dwarfed by the Tokyo data point. Indeed, excluding these two, the average luxury golf club membership in Asia drops to USD 102,060 in this year's data set, with access to golf clubs in Jakarta, Manila and Bangkok costing a fraction of this. At the other end of the scale, Hong Kong is an opportunistic location to buy diamond jewellery. Jewellers will make the case that every item for sale is unique and hence, as with property, strict comparisons are complicated and open to much debate.

Hong Kong – Services



Source: Ipsos Loyalty, Julius Baer

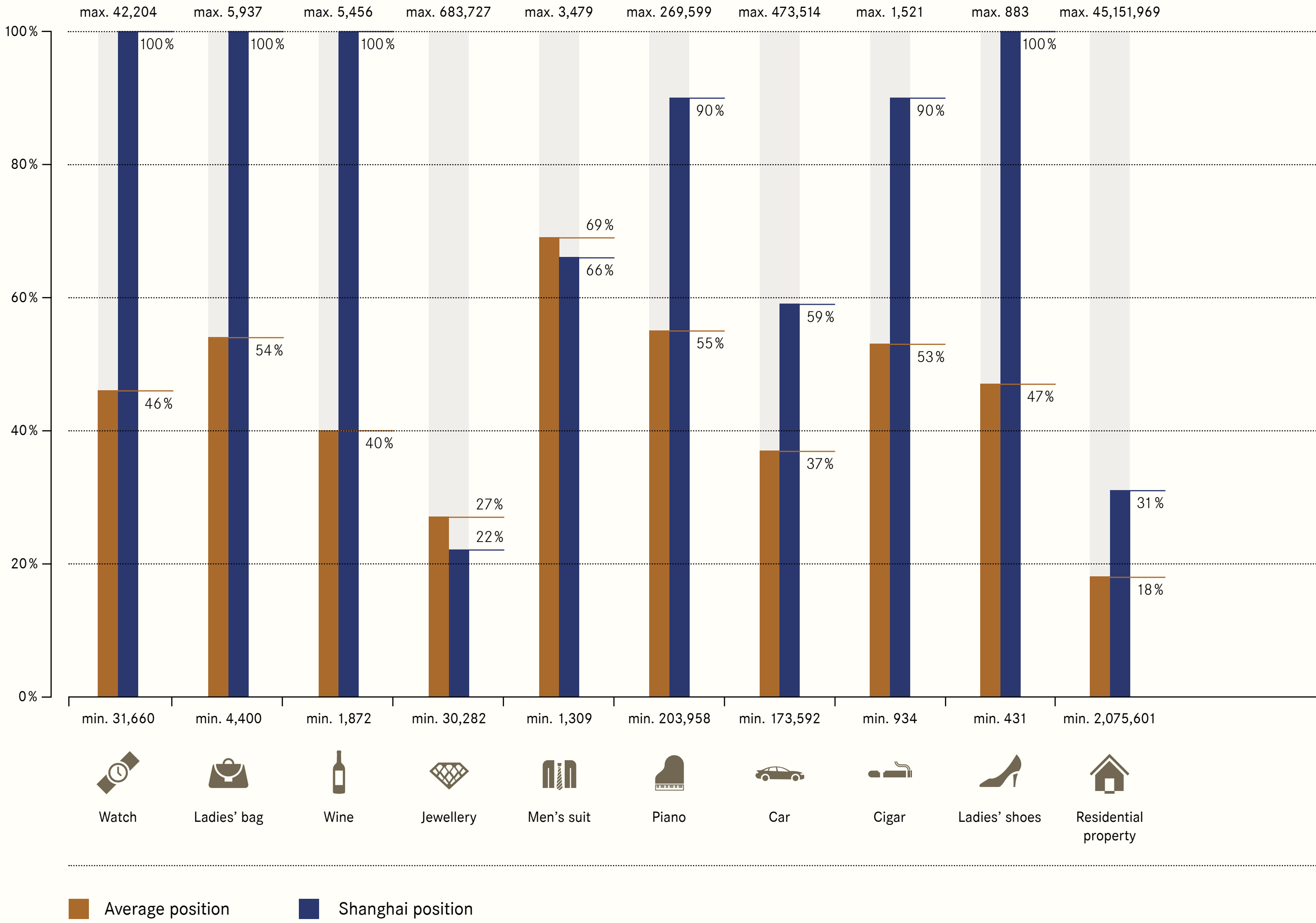
On the other hand, with reportedly more jewellery stores per square kilometre than any other city in the world, it must follow that investing time and effort to find the right diamond for you makes more sense in Hong Kong than anywhere else.

On the services side, Hong Kong is relatively expensive when it comes to hosting a 500-person wedding banquet and the corollary item of high-end hotel suites. Hotels offer multiple packages for different budgets, but our best effort to find similar wedding experiences still puts Hong Kong at the top end.

As with property and golf clubs, the limited supply of land is likely to be a driver in keeping banquet costs in this segment high. At the other end of the spectrum, legal fees (defined as a one-hour consultation for a simple will) in Hong Kong are relatively affordable. According to the Hong Kong Bar Association, there are over 9,000 practicing solicitors and barristers in the city from over 800 firms. This reflects Hong Kong's position as a key financial hub in Asia and the thriving legal profession is an important element of that result.

Shanghai – expensive all round

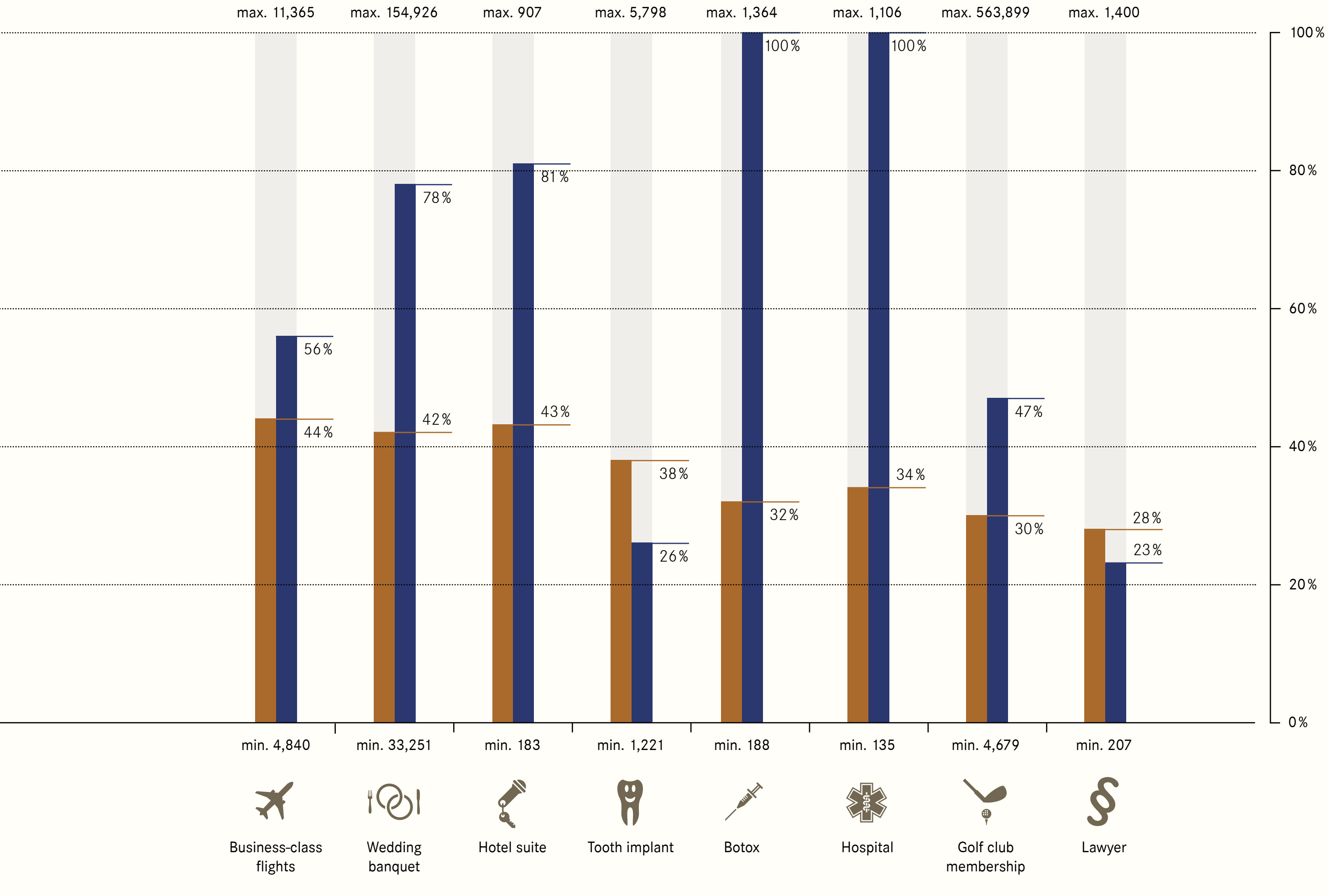
Chart 13
Shanghai – Goods



The most telling characteristic of the Shanghai data set is that many items are above the regional average. This covers both goods and services. For example, Botox treatments with top-end physicians in Shanghai can cost over USD 1,300 – which is a third more expensive than in the next highest cost location, Hong Kong. Finely tailored men's suits, wine and cigars are also noticeably above the regional average. In part, this will be driven by luxury consumption taxes (which range between 20% and 30%), thereby encouraging high net worth individuals to shop outside their home market, e.g. in Hong Kong and Europe, which are the major beneficiaries of this traffic. According to the United Nations' World Travel Organisation, Chinese travellers represented over USD 100 billion in overseas travel in 2012. This eclipses both German and American tourist data, now placing mainland Chinese tourists in the top spot.

In terms of property prices, the 2013 level fell slightly by 4% from the previous year. This is important as none of the other cities of which we also have 2012 historical data (Hong Kong, Singapore and Mumbai) saw a price dip. Nevertheless the Chinese authorities have long attempted to cool the property markets, hence this result is not surprising. According to UBS data, Shanghai property prices for newly constructed homes have just started to rise again, having largely

Shanghai – Services



Source: Ipsos Loyalty, Julius Baer

moved sideways since 2010. For much of 2011 and 2012, many Chinese cities were reporting either flat housing prices or experienced monthly declines with this trend reversing only very recently. We expect to see the top end of Shanghai property hold its ground and potentially rise higher since we believe the bulk of the cooling measures are behind us.

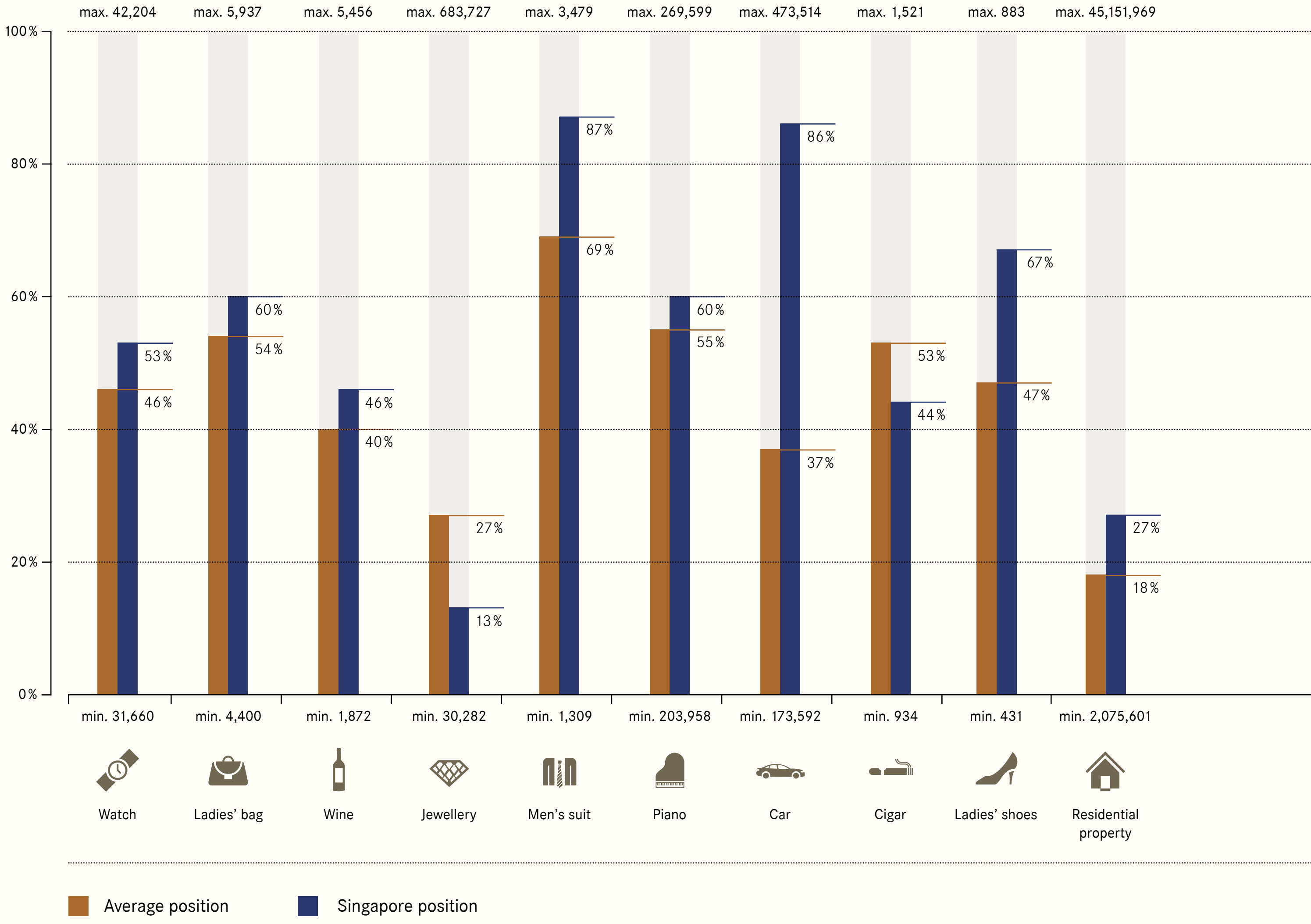
Similarly to Hong Kong, the price of hotel wedding banquets and rooms is relatively high in Shanghai compared to the rest of Asia. Staying overnight at a premium hospital is also the most expensive, at over USD 1,100 – which is almost double of what is paid in the next highest location of Hong Kong.

Beyond simple supply and demand, these results underscore China's pre-eminent position in wealth creation in Asia, as demonstrated in previous Julius Baer Wealth Reports.

Our baseline view remains that by 2015, China will be home to almost 1.4 million high net worth individuals, representing a wealth stock of USD 8.7 trillion. With such a rapid increase in wealth underway, demand for luxury is well outpacing supply, especially in terms of non-traded, purely locally consumed services.

Singapore – a mixed basket

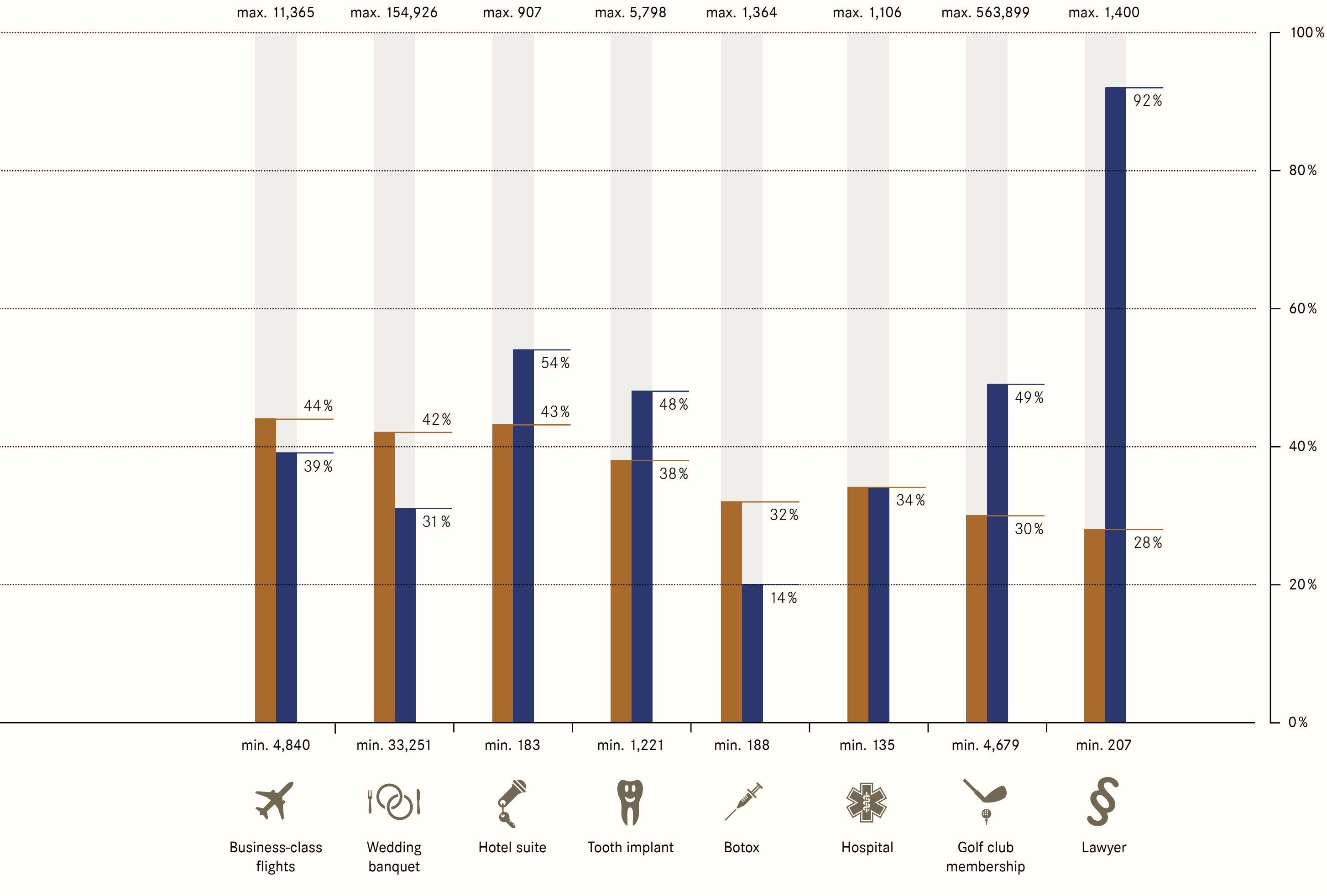
Chart 14
Singapore – Goods



Singapore is home to both relatively expensive and inexpensive luxury goods and services. Jewellery, Botox treatments, wedding banquets and business-class air travel appear below the regional average. At the same time, lawyers' fees, golf club memberships and finely tailored suits are more pricey. Also very notable is the cost of a luxury vehicle: the black, standard Mercedes SL 550 for USD 432,381. This is driven by special car-related taxes, and the Singapore price is only beaten by the cost of a similar Mercedes in Bangkok.

As we will outline later in this report, the price of beauty treatments, such as Botox, is much more intricate than simply buying something off a shelf. The deeply personal nature of aesthetic treatments masks the more superficial conclusions that can be drawn from looking at prices alone. While elsewhere Botox is available at a much lower price than in Singapore, the ease of access to high-quality advice may not be the same in all locations and it can be argued that this factor is as important, if not more so, than the treatment itself. In this regard, Singapore is a well-established centre for very high-level medical care and beauty advice.

Singapore – Services



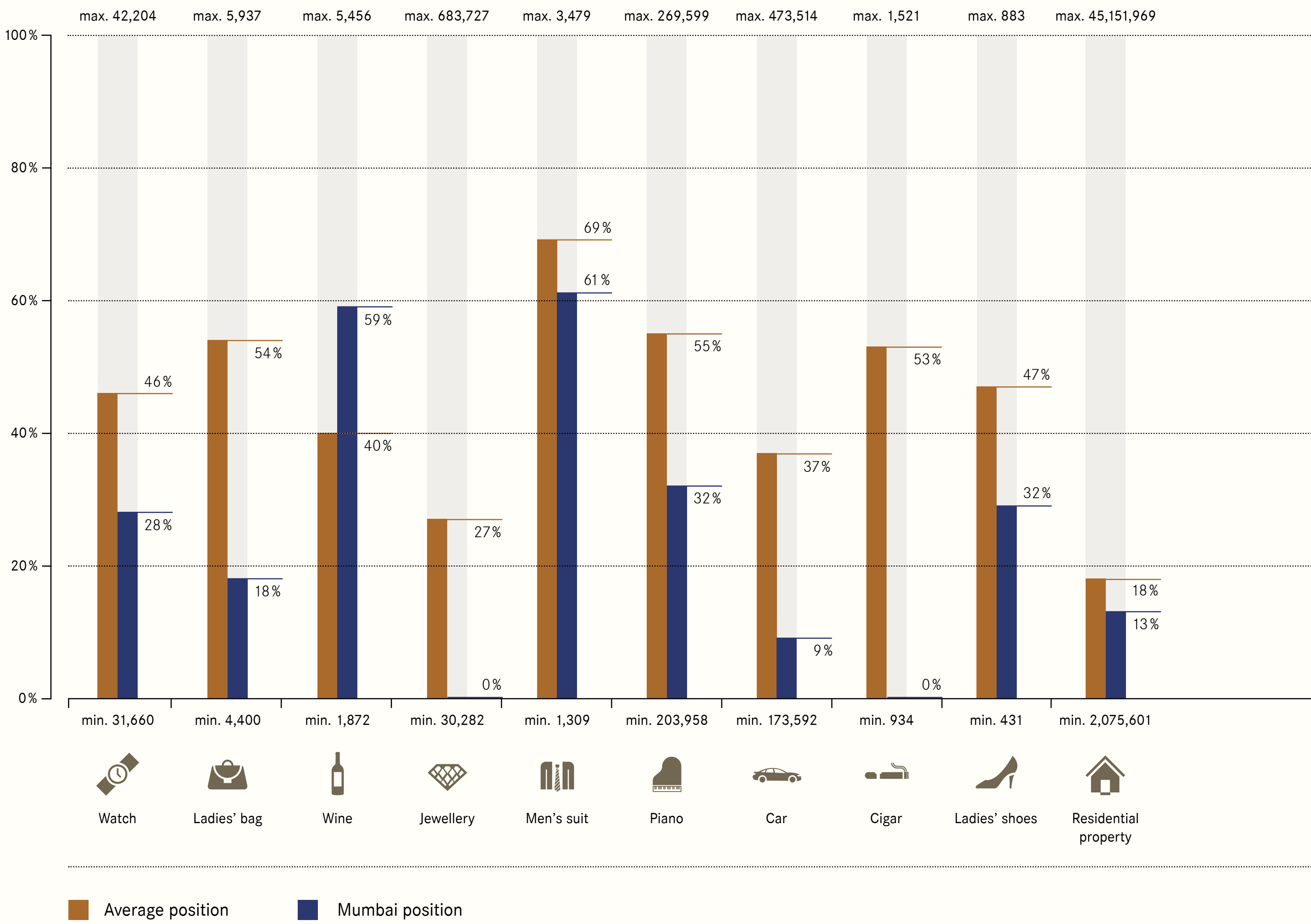
Source: Ipsos Loyalty, Julius Baer

In terms of business-class travel, the methodology used in the Lifestyle Index reflects the average over a series of days, covering flights to London and New York. For most of the cities covered, prices fluctuated, sometimes to a large degree. In Singapore's case, (as in Hong Kong's) the price variation was quite minimal. This may reflect Singapore's leading position in Asia as a transportation hub, thereby being home to more competition among airlines and supply keeping a lid on price variance. Seoul, Jakarta and Taipei have the largest variation in business-class travel prices over the sample period.

Singapore, like Hong Kong, already has a relatively large population of high net worth individuals compared to the total inhabitants, meaning that the average and median wealth of the population is also quite high. As a consequence, the demand for some of the goods and services in the Lifestyle Index will apply to a larger part of the population in Singapore than in other cities, where the income skew is more pronounced. The price dynamics for lower-ticket items, such as shoes and cigars, are likely to be influenced by demand outside the rigid definition of high net worth individual.

Mumbai – wedding bells and bills

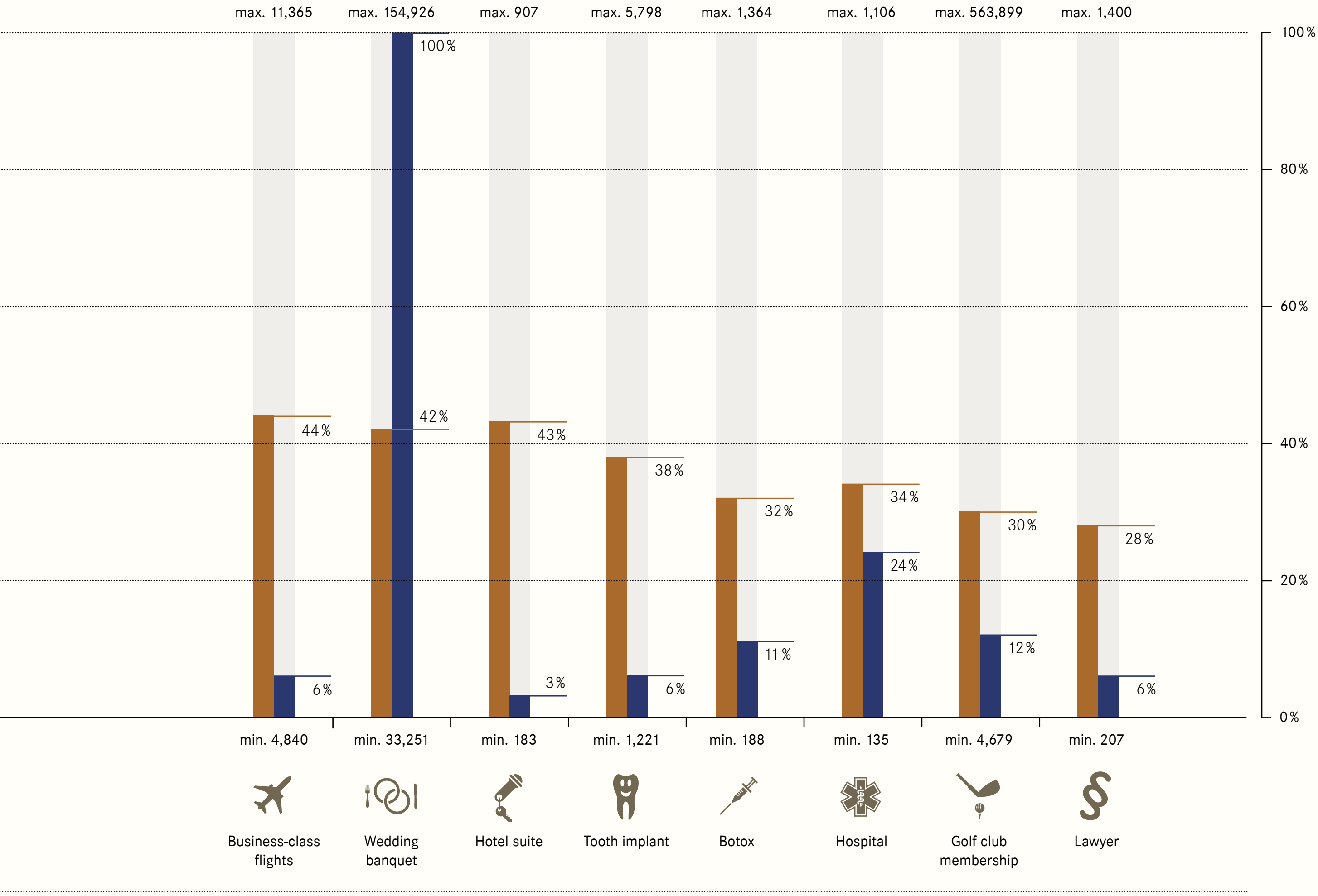
Chart 15
Mumbai – Goods



Delhi is the most expensive location in Asia to hold a 500-person banquet at the finest hotels. Reportedly 30,000 weddings take place in Delhi alone each year and an estimated USD 25.5 billion per year is spent in this industry, which continues to grow rapidly. It seems hard to overstate the intricacy, lavishness and scale of the trends being witnessed in the Indian wedding landscape – but it is fitting that pride of place in the Julius Baer Lifestyle Index for this constituent is Mumbai. It also seems fair to say that USD 154,926 does not reflect the full expense of a nuptial, implying that the gap between the next most expensive city, Tokyo, could be much greater.

At the other end of the spectrum, golf club memberships in Mumbai are comparatively affordable, as are lawyers' fees, hotel suites, business-class travel and high-end dentistry. In the goods area, we note that a box of twenty-five Cohiba Siglo VI cigars are well below the regional average. To help explain this outcome, our research indicates that for particular

Mumbai – Services



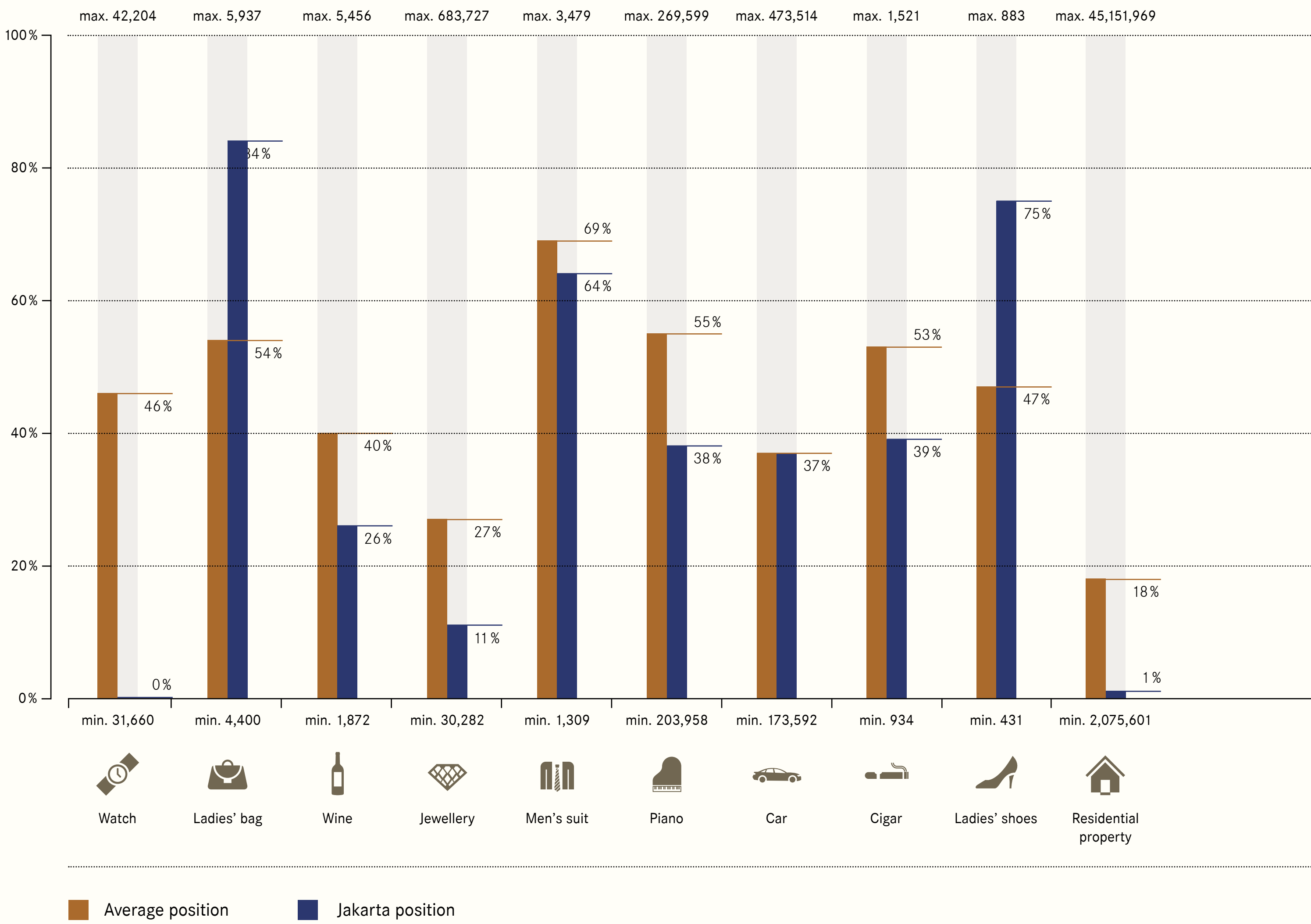
Source: Ipsos Loyalty, Julius Baer

items such as cigars and wine, high net worth individuals will make specialised overseas trips to gain access to a better selection than what may be available at home. In other words, India's high net worth individuals may choose to go to other centres in Asia or even farther afield and potentially pay more for the same luxury available at home, as long as there is access to choice.

There are two other noteworthy items in Mumbai: jewellery and the luxury vehicle. Exact models found in the other cities in the index were not available in Mumbai, hence both items are outliers at the low end of the price spectrum. In essence, this is the flipside of the importance of Indian weddings: how luxury is consumed will inevitably vary from location to location, but in aggregate the price trend should still give sufficient guidance in terms of the strength of demand for luxury lifestyles.

Jakarta – the sky is the limit

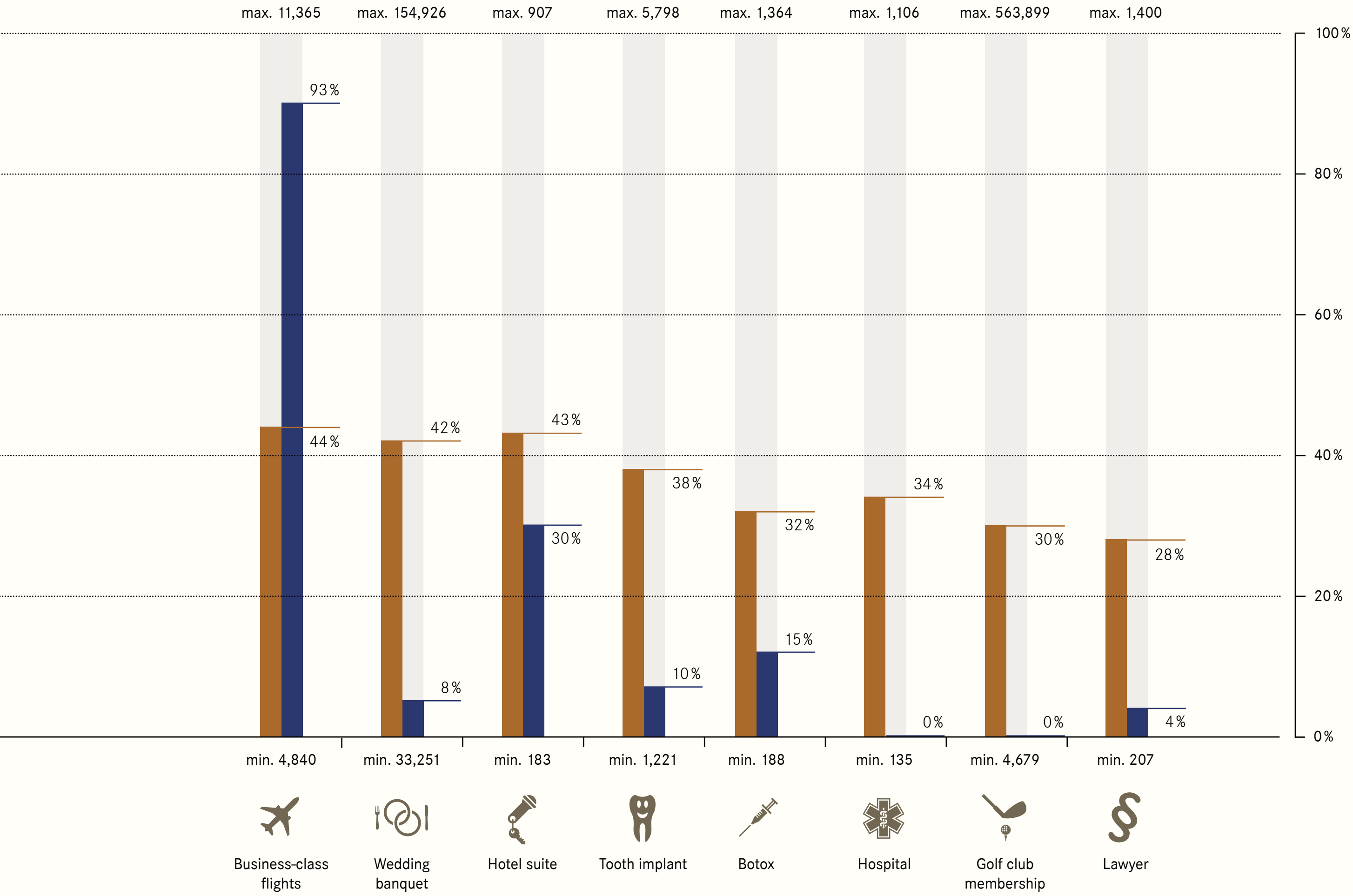
Chart 16
Jakarta – Goods



Indonesia is one of the fastest growing economies in South East Asia, a fact that also supports our forecast of the largest increases in the numbers of high net worth individuals in the region. The economy holds enormous promise, backed by a very large population and a broadly diversified base of commodities, manufacturing and services. Credit growth in Indonesia is strong, enabling businesses and entrepreneurs to expand and create jobs. Consumption spending, which UBS Investment Bank estimated to be at USD 400 billion in 2010, is significant and equivalent to the entire GDP of Austria. With such growth, however, comes inflation and the question whether the development of infrastructure will be able to keep pace and prevent bottlenecks that could hamper even higher growth.

When the price of items in the basket is reviewed, the large range of indicative prices relative to the regional averages suggests an economy that is both fast-paced, but likely to be experiencing speed bumps in its race for growth. For example, business-class travel originating inwwwww Indonesia is among the most expensive in Asia, arguably

Jakarta – Services



Source: Ipsos Loyalty, Julius Baer

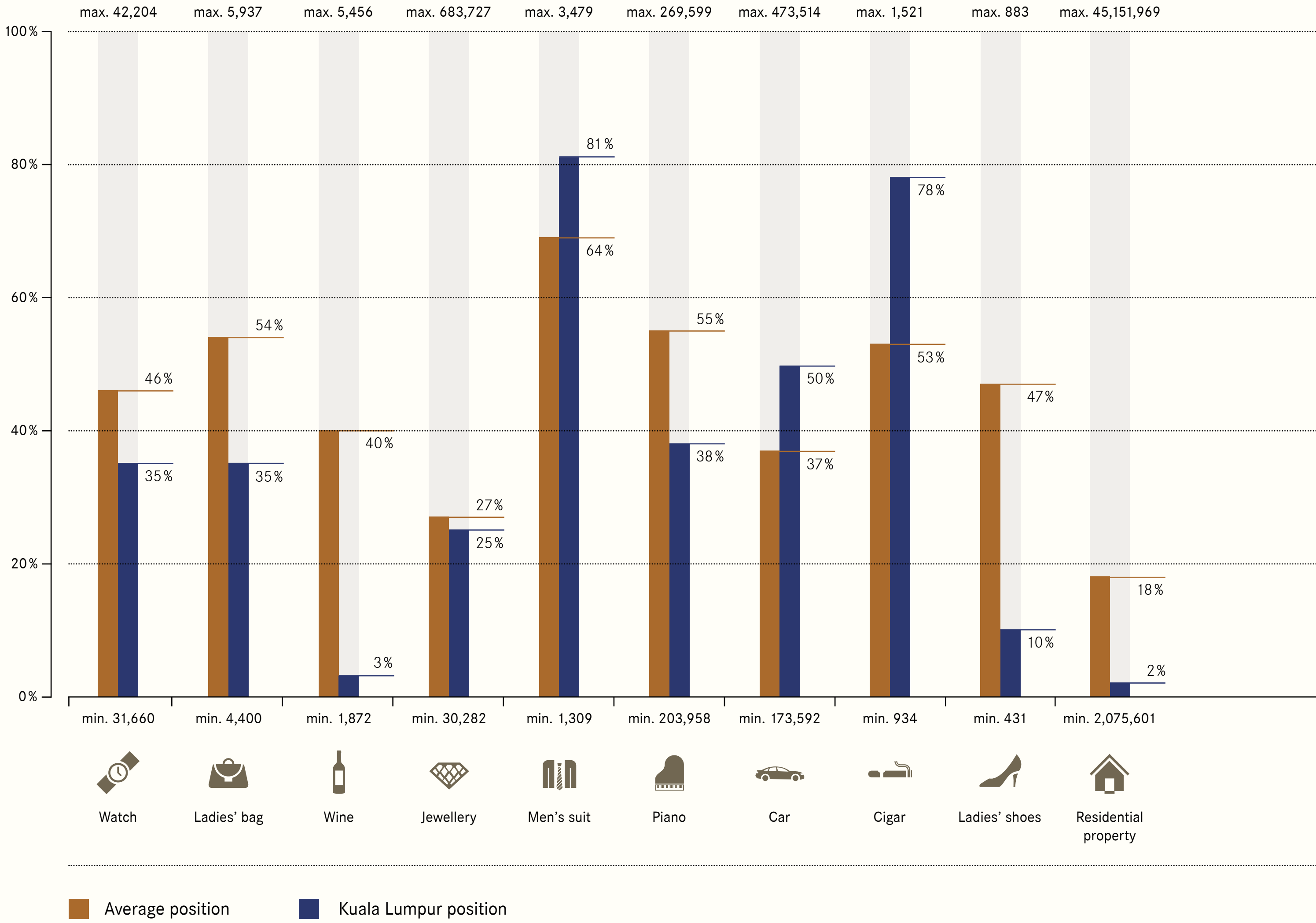
due to capacity constraints. The still relatively limited availability of very high-end retail space may help explain the high cost of Louboutin pumps in Jakarta. Over time, as infrastructure needs in Jakarta are gradually addressed, the variability could decline, all else being equal.

There are also ‘bargains’ to be found in Indonesia. The city stands out for having lower golf club membership fees, arguably due in part to the large numbers of courses (35 in all) in the vicinity.

With far more available space compared with Tokyo, Singapore and Hong Kong, golf in Jakarta can be termed as an ‘affordable luxury’. By the same token, while property prices have risen, a large luxury home with all the trimmings can be had for just under USD 1.5 million, which is still comparatively affordable in the region. With Indonesia on track to grow another 6% in 2013, the coming years will surely see further changes in the property landscape.

Kuala Lumpur – the mainstream ASEAN powerhouse

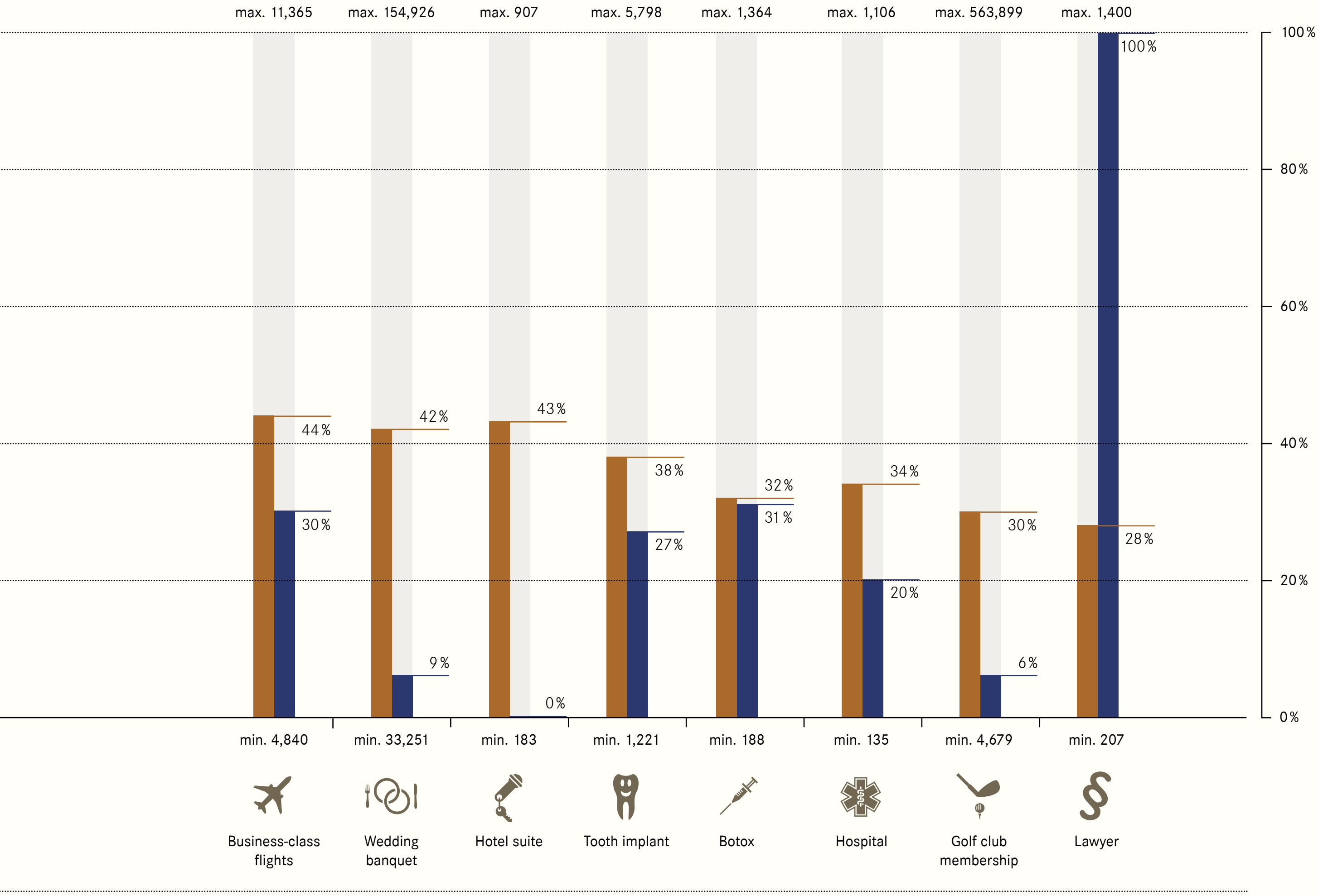
Chart 17
Kuala Lumpur – Goods



Together with Indonesia, Malaysia is among the growth leaders in the ASEAN community. Fixed investment and consumption are the two main pillars of this growth, but given the much smaller population in Malaysia, the scale is less than in Indonesia. That said, Malaysia is experiencing far tamer inflation which bodes well for the sustainability of the expansion. The variability of where Kuala Lumpur Lifestyle Index items are priced relative to the overall average is equally diverse, however.

Golf and property are once again comparatively affordable, despite the rise in real estate values in Malaysia. Wedding banquets, hotel suites, hospital stays, wine and women's shoes also rank below the regional average. Legal fees, on the other hand, are the most expensive among all the cities surveyed, at USD 1,400 per hour for a one-hour consultation for a simple will with a premium firm. Likewise, the SL550 black Mercedes is also substantially more expensive in Kuala Lumpur at USD 322,471 – but still USD 110,000 cheaper than what it would cost in neighbouring Singapore for the same model.

Kuala Lumpur – Services

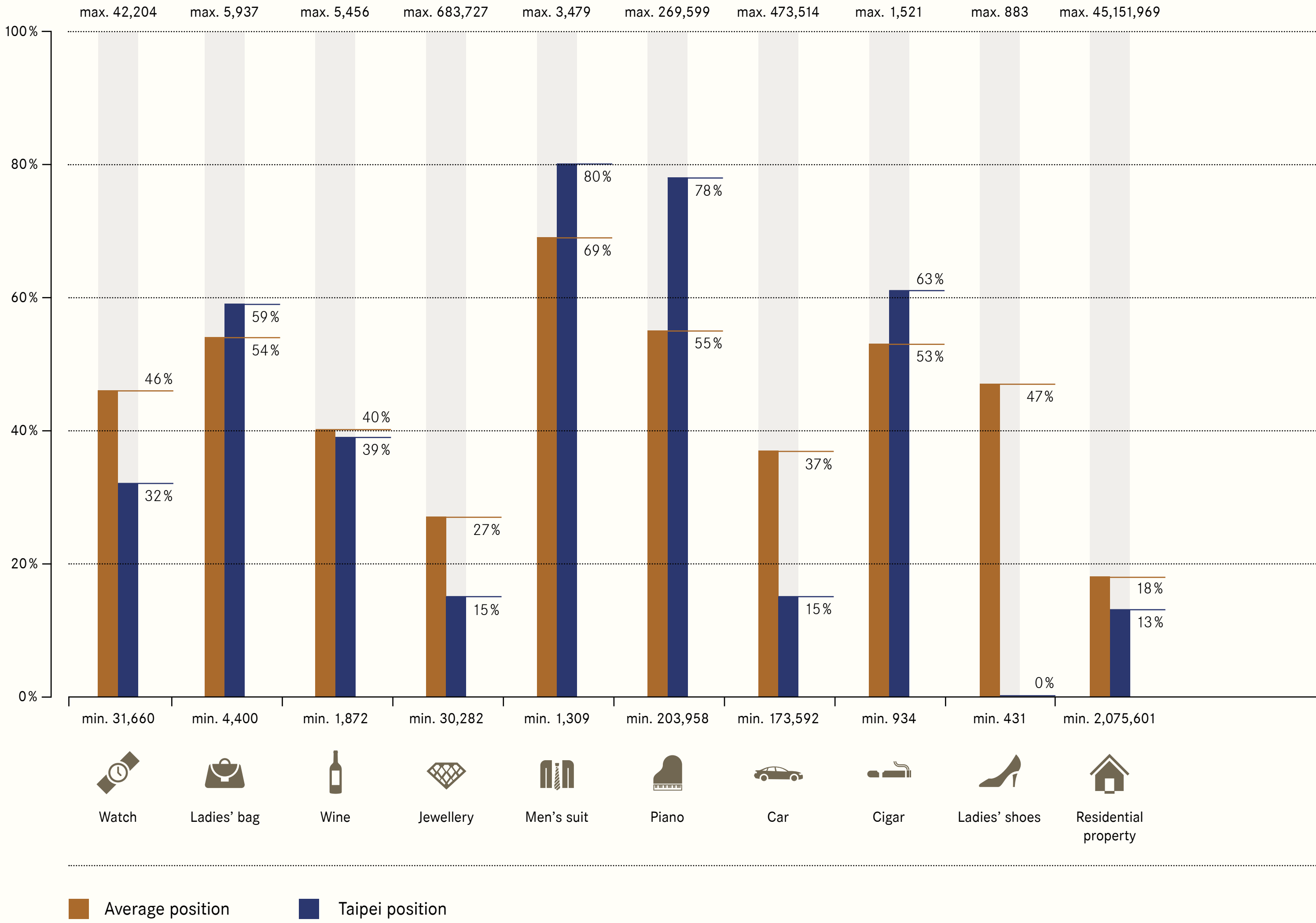


Source: Ipsos Loyalty, Julius Baer

Looking ahead, the sound management of the Malaysian economy renders it a prime candidate to outperform our initial forecasts for wealth creation – 68,000 high net worth individuals by 2015. In turn, all else being equal, we can expect that next year's values for the Kuala Lumpur Lifestyle Index will also show significant increases since the demand for luxury goods and services should rise accordingly.

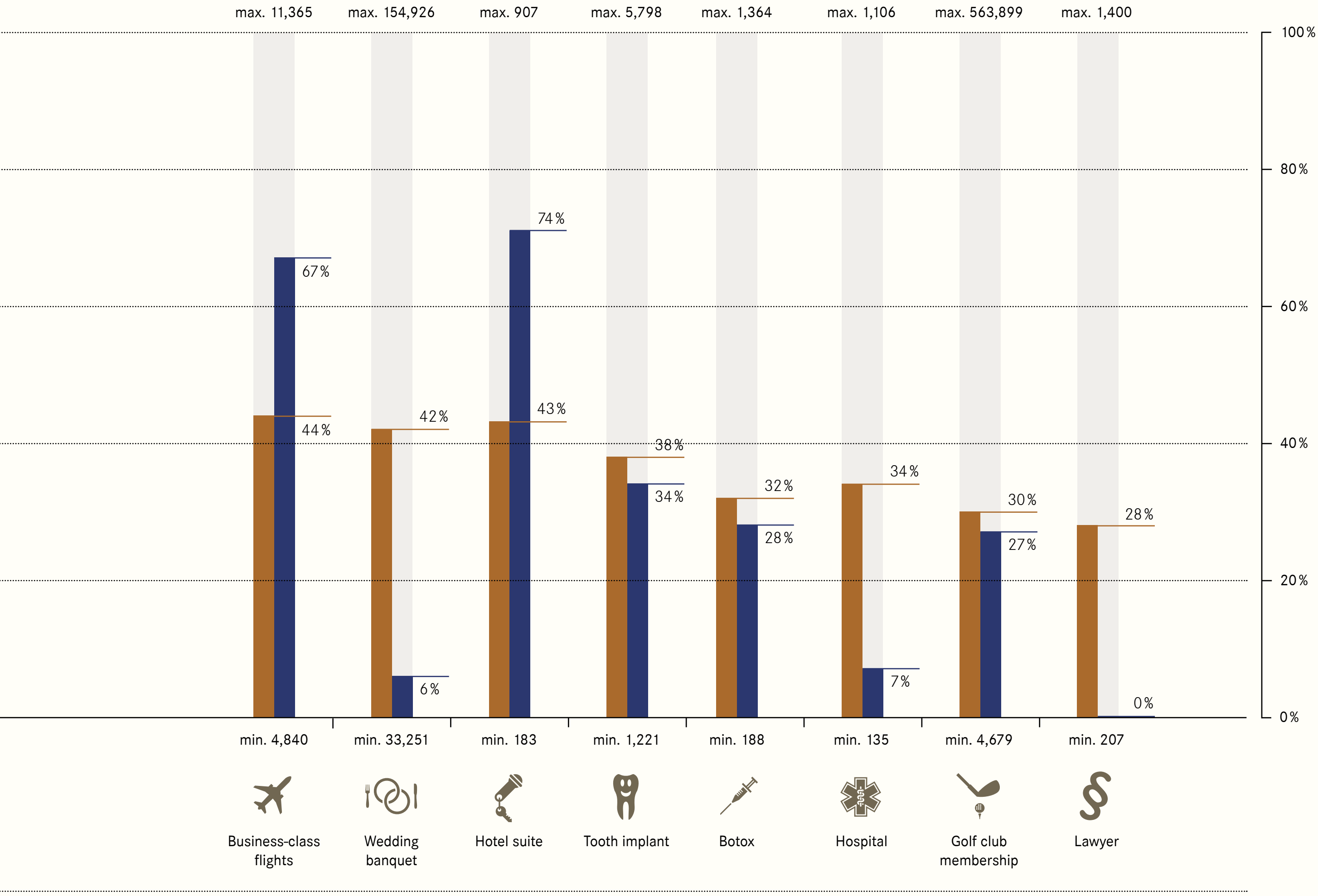
Taipei – Asia's barometer

Chart 18
Taipei – Goods



Taiwan is a direct reflection of the global economy, given the important role of cyclically sensitive exports, in particular in the information technology arena. Chilling winds or the green shoots of recovery are often detected early in its export numbers, which is why Taiwan is considered a key gauge of global demand. With a per capita GDP of approximately USD 20,000, Taiwan is well above the middle-income bracket and we forecast it to house over 136,000 high net worth individuals by 2015. In the current global economic environment, the path of Taiwanese exports going to non-Japan Asia, Europe, the United States and Japan itself have been very illuminating: the persistent strength in export demand from Asia excluding Japan is another pillar of support for our confidence in the region.

Taipei – Services

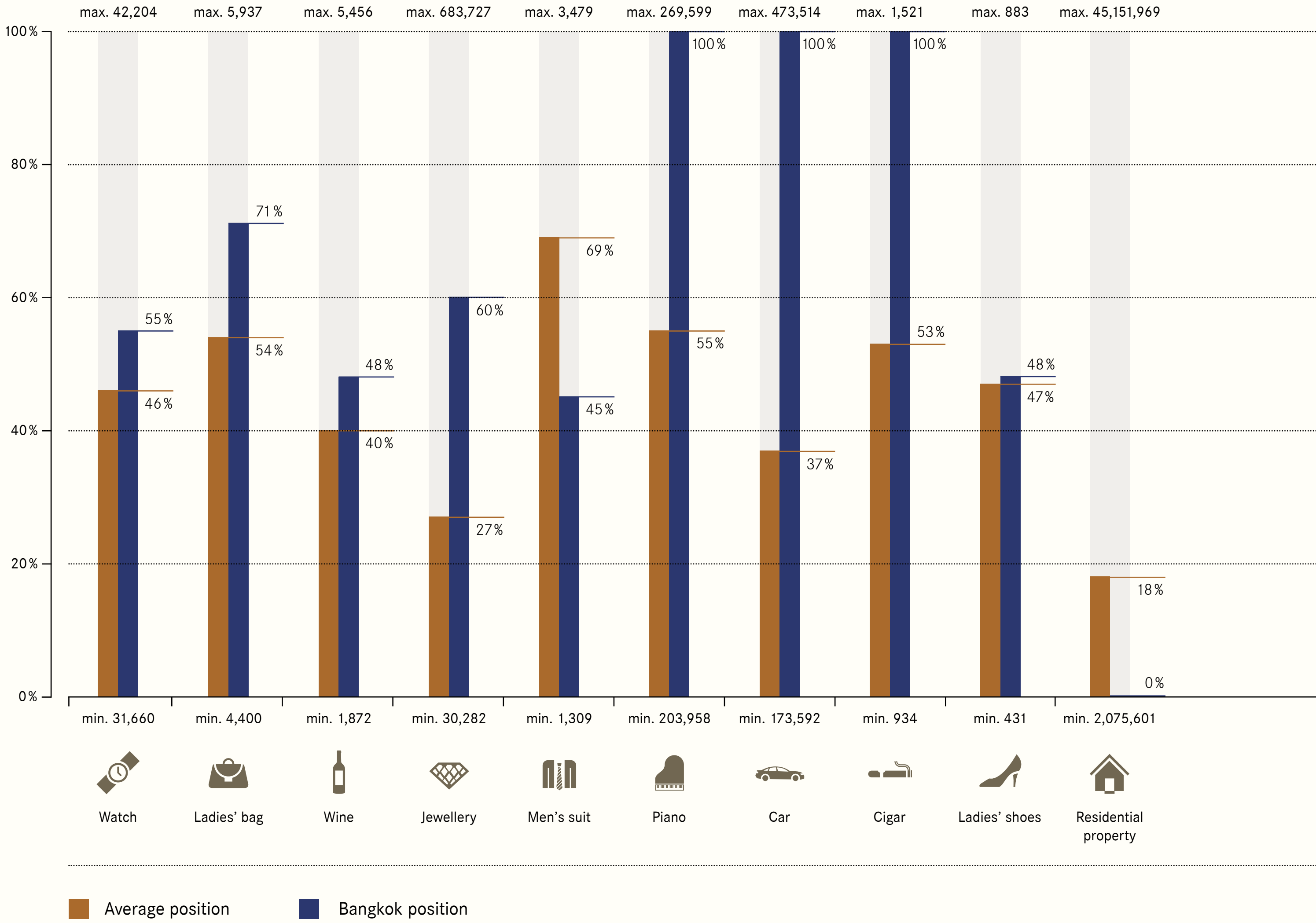


Source: Ipsos Loyalty, Julius Baer

In terms of the Lifestyle Index data for 2013, Taipei experiences less outlining pricing than other cities in the region, with the prices in this city being closer to the average. In terms of outliers, the tailoring of a fine suit in Taipei is akin to the higher expense incurred in Tokyo, Seoul, Singapore and Hong Kong. Most other items in the goods category do not stand out in terms of price differences. What is interesting is that in the services area, the variability is greater. Business-class travel and hotel costs are considerably higher whereas wedding banquets, hospital stays and legal fees are at the other end of the spectrum, a relative bargain. Taipei's close proximity to Hong Kong may be playing a role in some of these variations, as Hong Kong may offer some Taiwanese high net worth individuals access to a greater choice for certain index constituents.

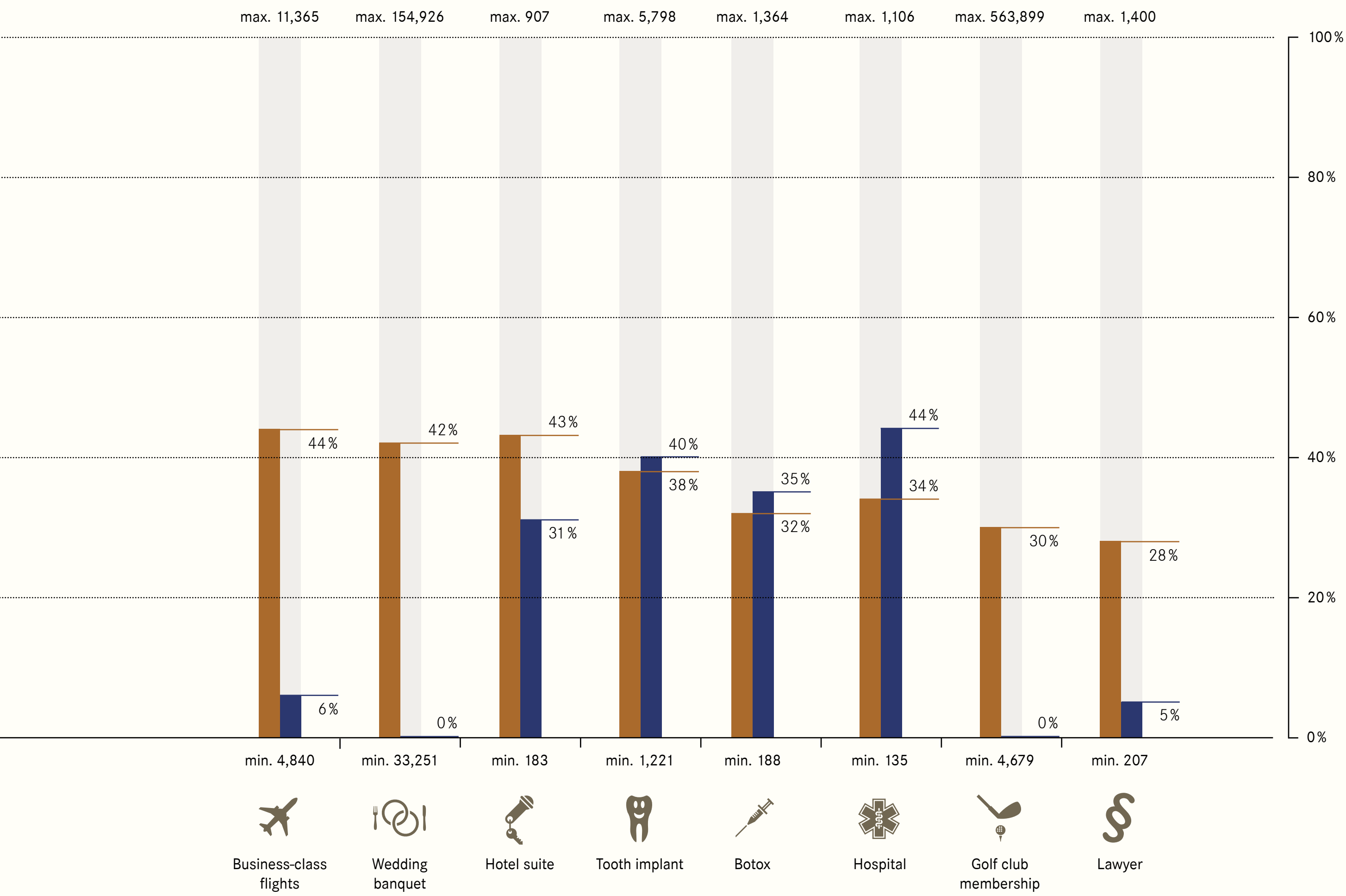
Bangkok – serving up growth

Chart 19
Bangkok – Goods



Taken as a whole, the Thai economy has a larger manufacturing sector than both Malaysia and Indonesia combined. But the picture is not what one would expect when looking at the results of the Bangkok Lifestyle Index constituents: it is services, not goods, that are in the driving seat. With the exception of premium dentistry and hospital stays – for which Bangkok has become increasingly famous – all other services items are below the regional average. Such an outcome underscores how competitive Bangkok is as a tourist destination, be it in the premium or mass-market brackets. Golf club membership is almost as inexpensive as in Jakarta and the high-end hotel landscape offers enormous choice. These developments reflect the importance of tourism for Thailand, which attracted over 22 million visitors in 2012, according to government sources. On the goods side, the situation is

Bangkok – Services



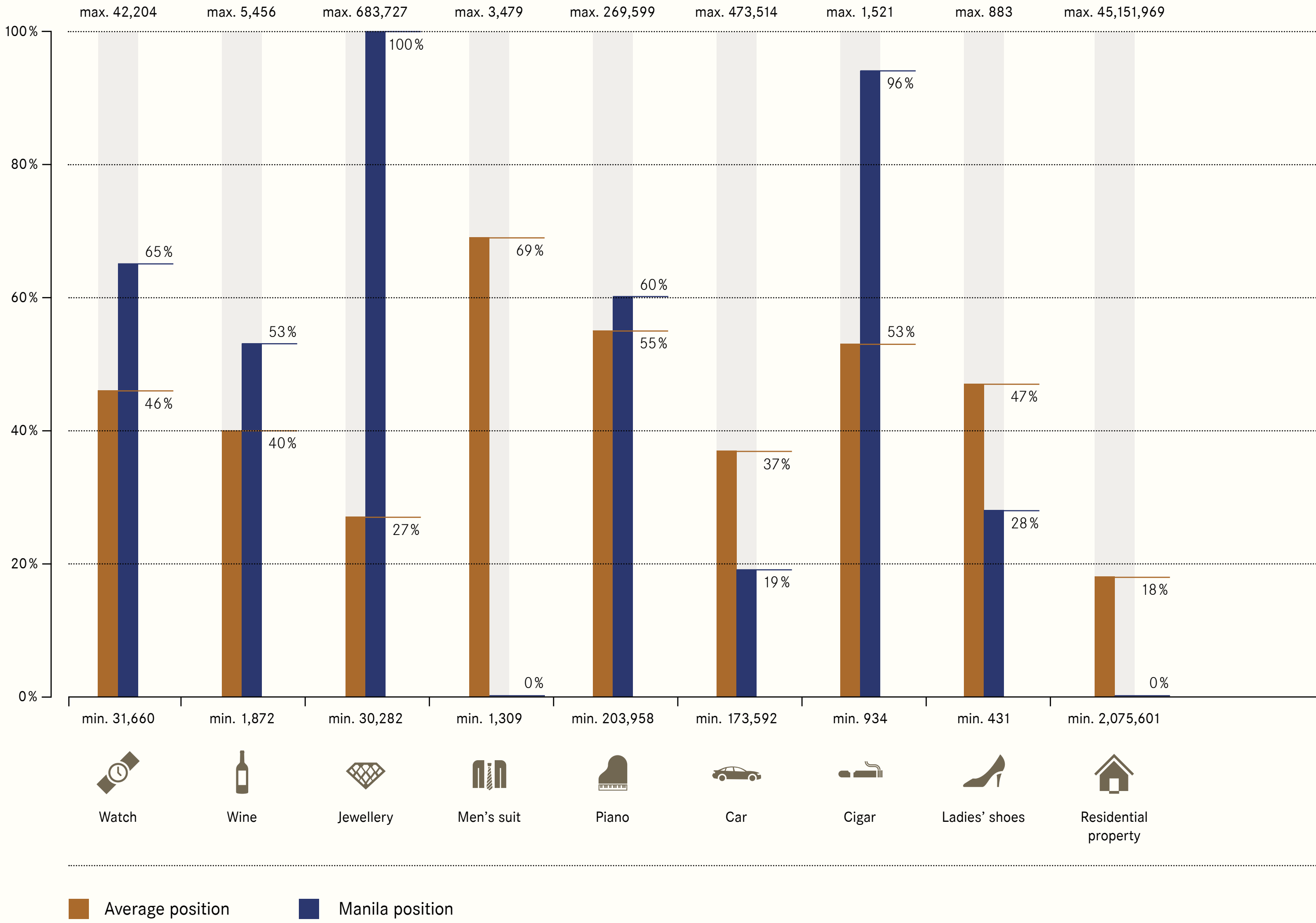
Source: Ipsos Loyalty, Julius Baer

somewhat reversed. The cost of cigars, our selected luxury vehicle and piano is above the regional average whilst most other items in the basket sit close to the average price.

In other words, when it comes to goods, the cost of living for a high net worth individual in Bangkok is higher than the regional average, especially for those items that are not influenced by tourism. Explained differently, it is not intuitive why an international traveller would want to purchase a luxury piano in Bangkok, but a high net worth individual living in Thailand can equally benefit from competitive hotel-related services.

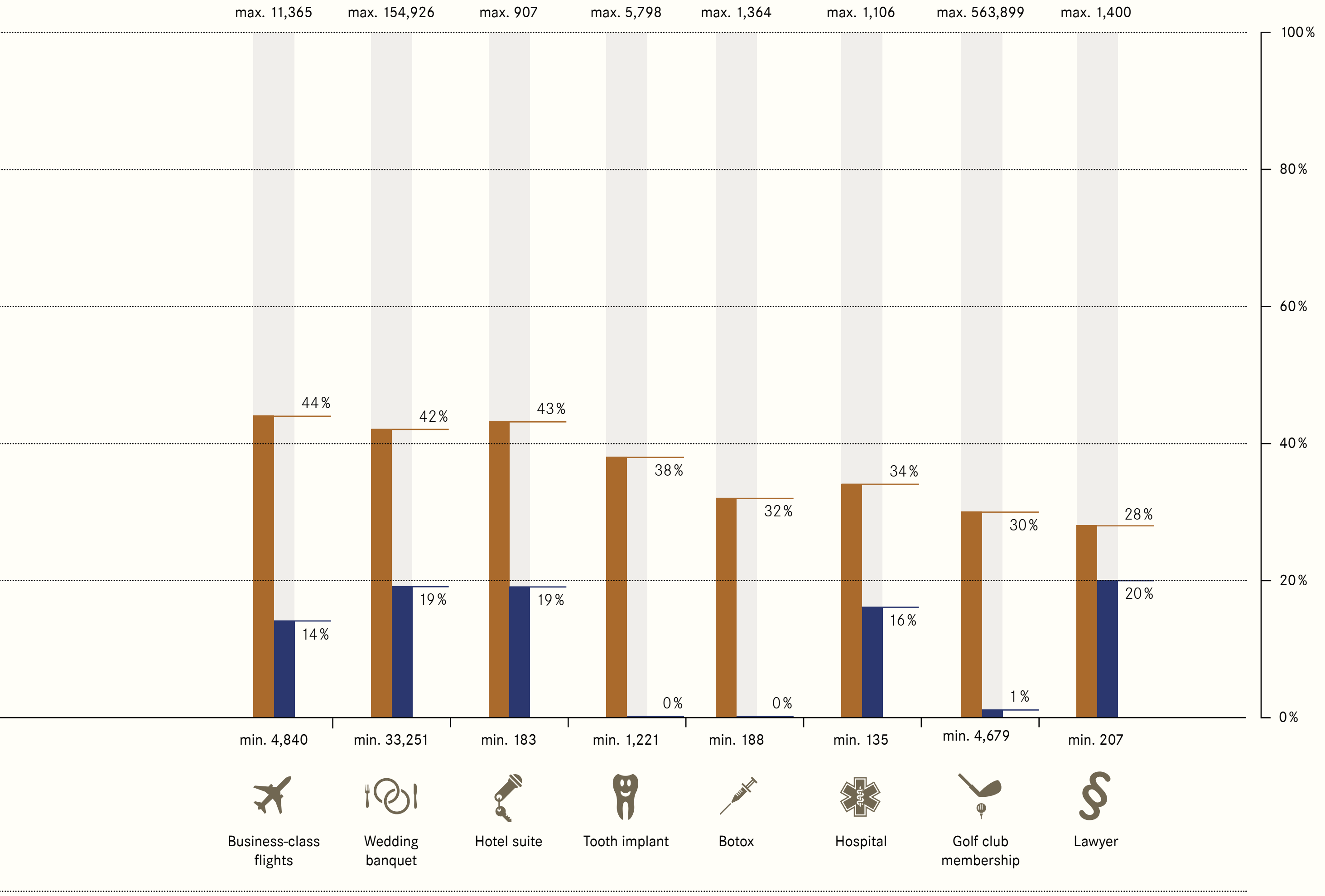
Manila – set to shine

Chart 20
Manila – Goods



The economic rise of the Philippines has been overshadowed by its larger neighbours' developments, but the strides made in recent years have placed it on an exciting path. The Philippines has an important agriculture sector, coupled with a manufacturing sector that, measured in share of GDP, is similar to Malaysia's, but the future arguably hinges upon the Philippines' ability to capitalise on its strengths in the services area. In particular, the business service outsourcing industry, in which the Philippines is especially competitive, should foster job creation and wage rises, and hence promote overall growth. In the Manila Lifestyle Index constituents, there are some similarities to Bangkok. The services components including weddings, hotel suites, hospital stays and golf club memberships are competitively priced relative to the Asian average price. What is noteworthy is that several goods items are well above the average including jewellery, the piano and the price of cigars.

Manila – Services

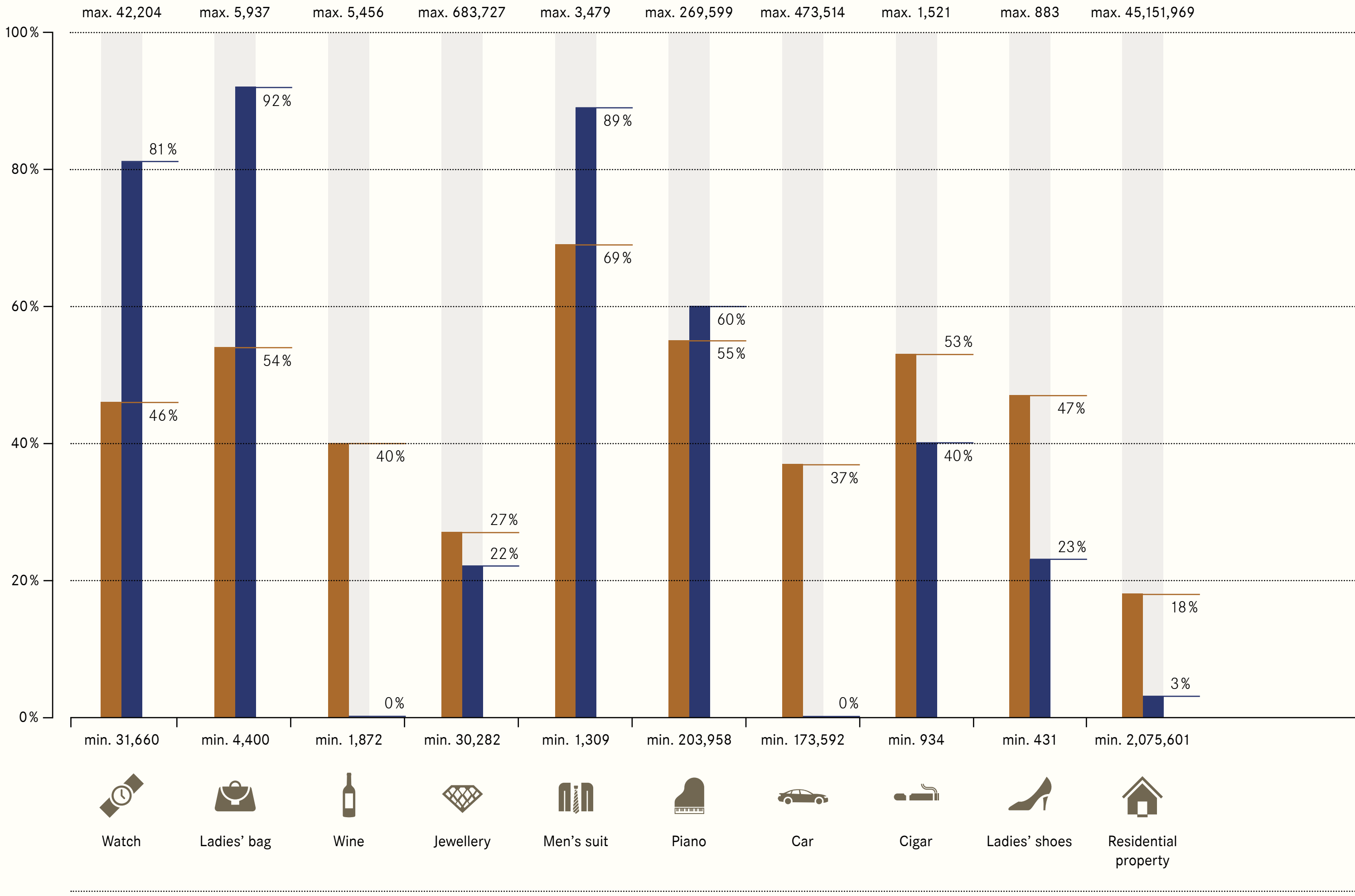


Source: Ipsos Loyalty, Julius Baer

The key exception is property. While prices in Manila have undoubtedly risen, the property landscape in Manila echoes what we found in Jakarta: luxury properties with amenities such as swimming pools and other extras are still relatively affordable compared to Singapore, Hong Kong and other cities in Asia. If the Philippines remains on its current growth trajectory, this would put local properties in a compelling light.

Seoul – on-trend

Chart 21
Seoul – Goods

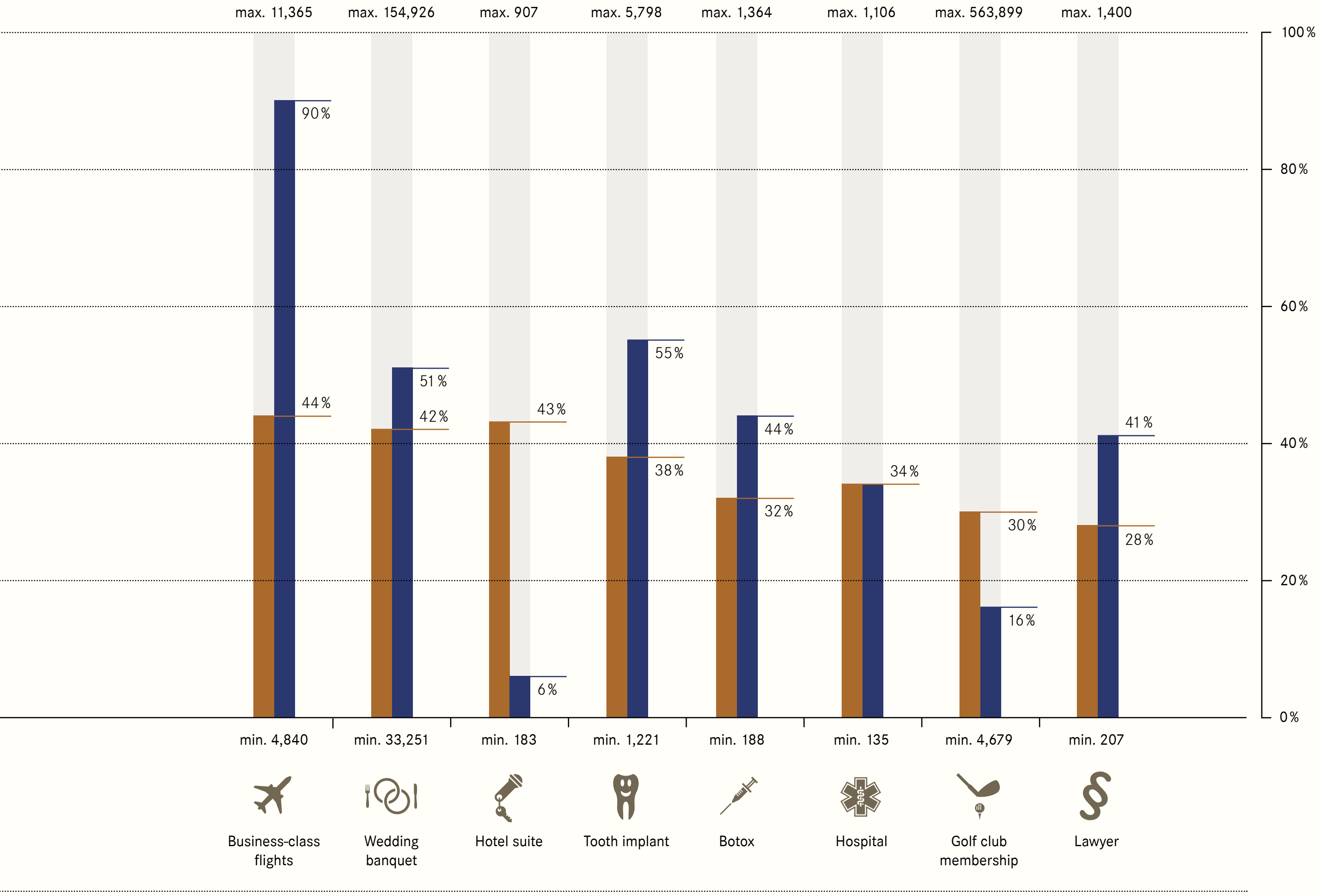


Average position
Seoul position

South Korea's per capita GDP at USD 23,000 is on par with Taiwan's, and it is also an economy that feels the pulse of the global cycle earlier than most other regional peers. With a significant share of electronics and capital goods exports, a slowdown or acceleration among its key trading partners is felt quickly. Recently South Korea has become a world leader in innovation. According to the National Science Foundation, the country spends 3.5% of its GDP on research and development, eclipsing Japan, Germany and the United States.

In addition, according to the Organisation for Economic Co-operation and Development (OECD), average labour productivity growth over the past decade has been about 6%, surpassed only by Taiwan and China. In other words, if efficiency and innovation are the key to securing future growth and rising standards of living, South Korea is one of the most exciting economies in Asia.

Seoul – Services

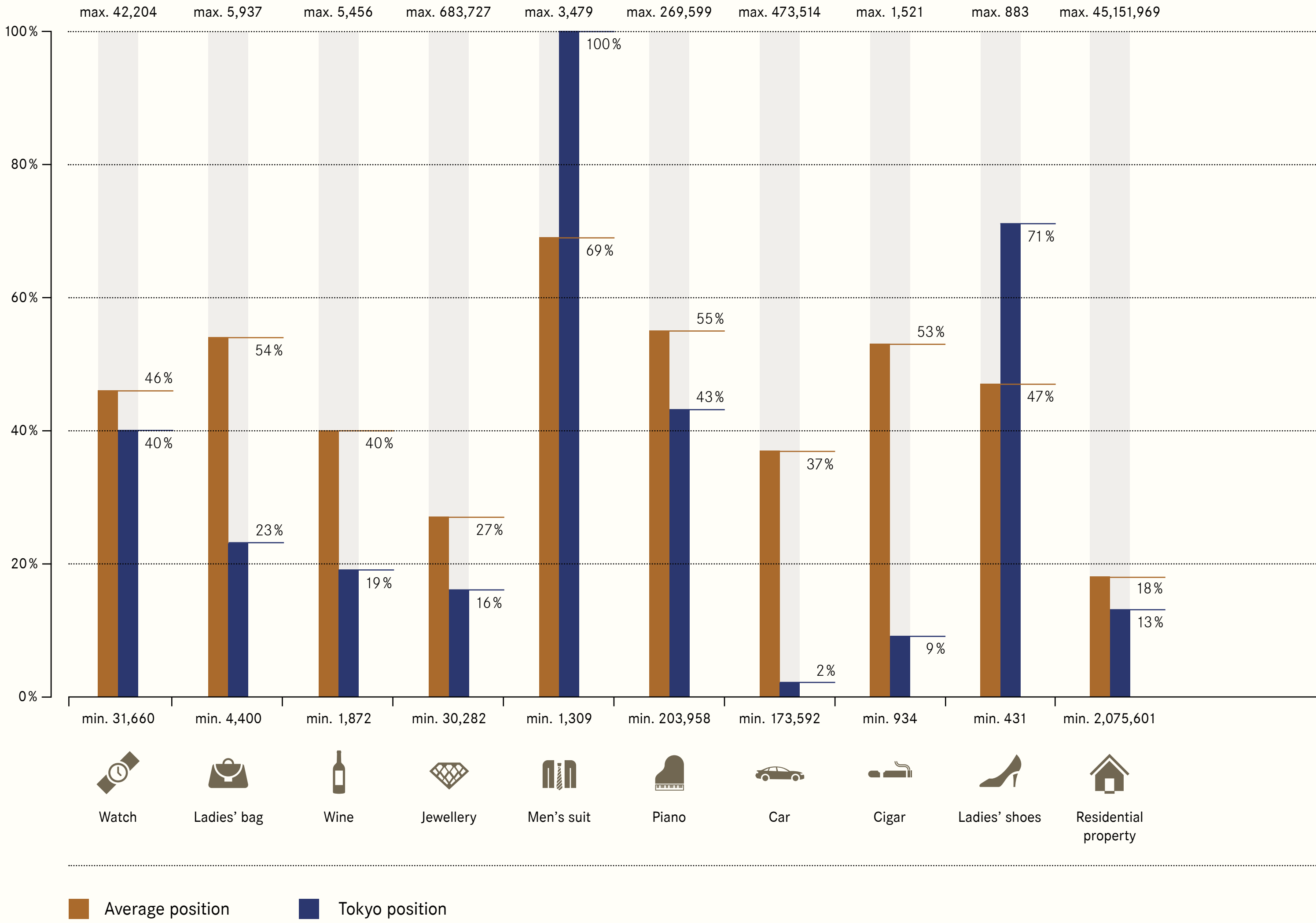


Source: Ipsos Loyalty, Julius Baer

With the leaps that the country has been making, it will not come as a surprise that many of the items in the Seoul Lifestyle Index are above the regional average. Men's tailoring, luxury watches, Botox treatments and cigars are more expensive in Seoul. The trend also extends to the services components: legal fees, tooth implants, business-class travel and wedding banquets are all above the regional average. This reflects the rapid gains that South Korea has made in recent years and consequently we expect Seoul to remain at the higher end of the pricing curve when it comes to cost of living in luxury.

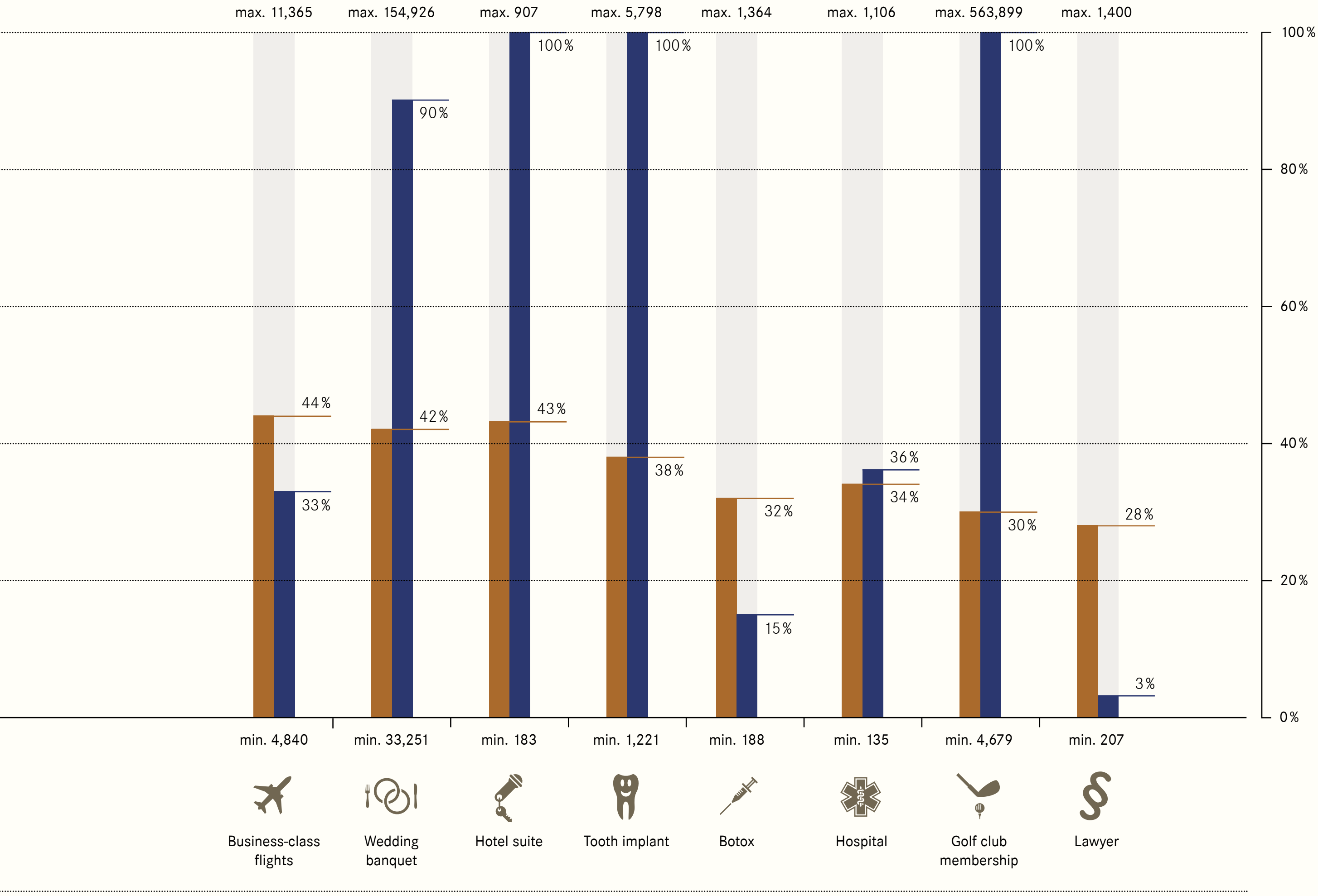
Tokyo – the gold standard

Chart 22
Tokyo – Goods



With this year's Wealth Report, we introduce Tokyo to our cities under coverage, both from a macro-economic and Lifestyle Index perspective. On a per capita basis, Japan is the wealthiest nation in the region, with GDP per head of USD 46,000. The long-standing reputation of the Japanese economy is that it has stagnated while the rest of Asia has been pushing ahead; at the same time, it remains one of the more expensive capitals of the world to live in. Indeed, the Tokyo Lifestyle Index confirms elements of the latter: golf club membership in Tokyo can cost a staggering USD 564,000 which puts this cost in a league of its own in Asia. Most of the services items are also well above the regional average, reflecting the generally higher labour cost and renowned quality level of Japanese service.

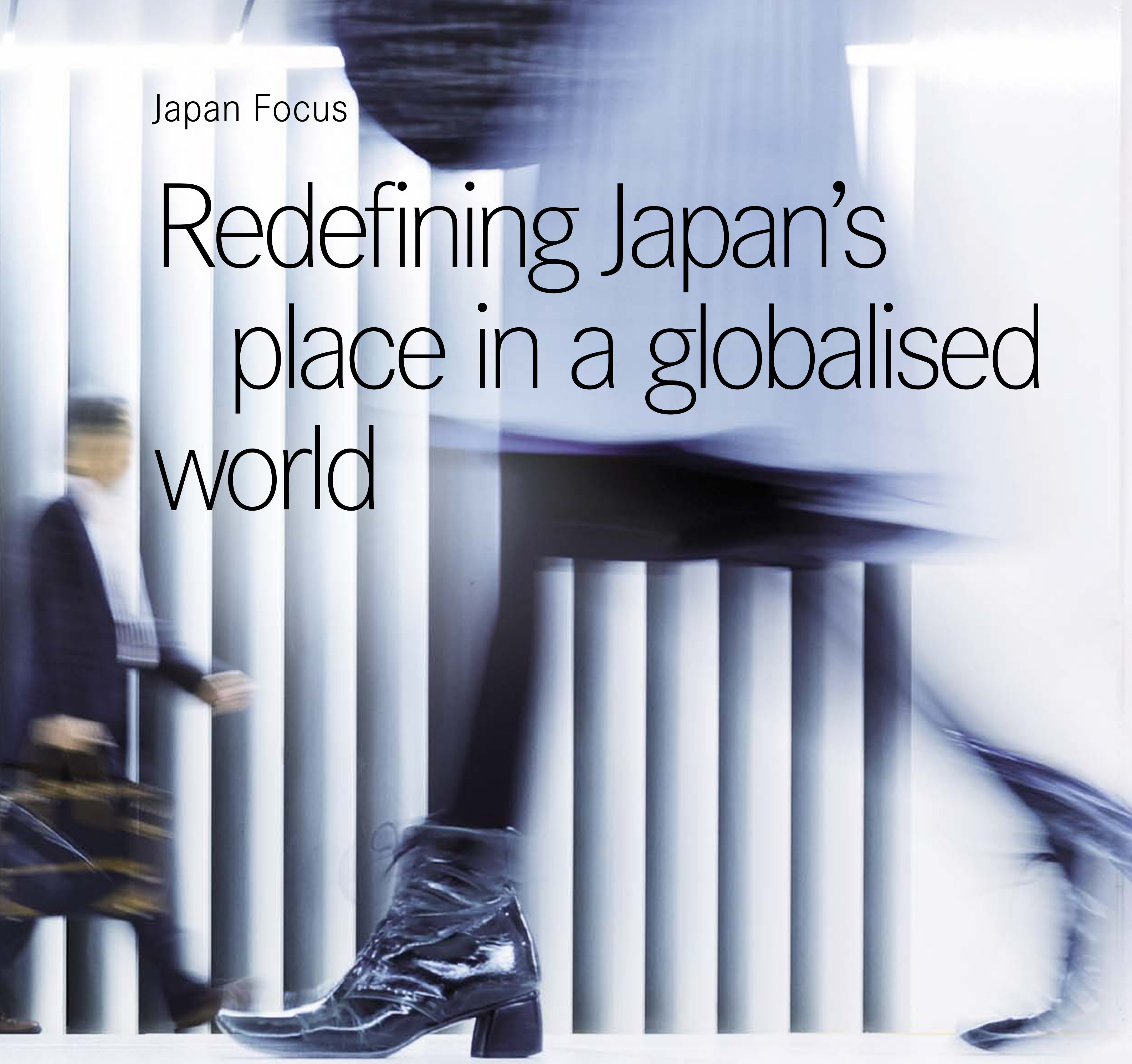
Tokyo – Services



Source: Ipsos Loyalty, Julius Baer

In the goods area, men's tailoring and ladies' shoes are relatively expensive on a regional basis whereas wine, cigars and Botox treatments are cheaper than in other Asian capitals. What needs to be considered is that Japan is currently in the midst of potentially profound change when it comes to prices. This is driven by the Bank of Japan's new commitment to achieving a 2% inflation target, which would represent a structural increase in inflation expectations and it is hard to imagine how luxury goods and services could remain immune to this new inflation regime. In essence, of all the cities under review in the Lifestyle Index, Tokyo could see the most interesting shifts in the years to come since the overall inflation landscape in Japan may undergo a radical change. We believe that previous economic stagnation could be replaced by a renaissance of growth, which could breathe new life into an already exciting luxury goods and services field.

Redefining Japan's place in a globalised world



Japan's stuttering growth as well as several misconceptions have led to the view that the third-largest economy is unable to meet the challenges of a globalised world. On the other hand, Japan remains a key source of demand for luxury goods. A more in-depth analysis, however, reveals that Japan is anything but stagnant. The launch of 'Abenomics' could speed up the pace of change even further.

Slipping from view

In addition, IMF data shows that the last two decades have seen Japanese GDP growth average only 0.8%, well below that of other large economies such as the United States (2.6%) and Germany (1.3%), coupled with persistent bouts of deflation. For many investors, Japan has increasingly fallen out of view especially since the local equity market has failed to keep pace in relative terms and it now only represents 7% of the global total capitalisation of stocks, on a MSCI basis. Worse still, economic stagnation has given rise to the idea that Japan has stood still while its neighbours, notably China, are undergoing structural transformations that propel per capita income to new heights. As other parts of this report demonstrate, Japan is a key source of global consumption, in particular of luxury goods. How do we reconcile these seemingly contradictory outcomes?

Misconception of Japan

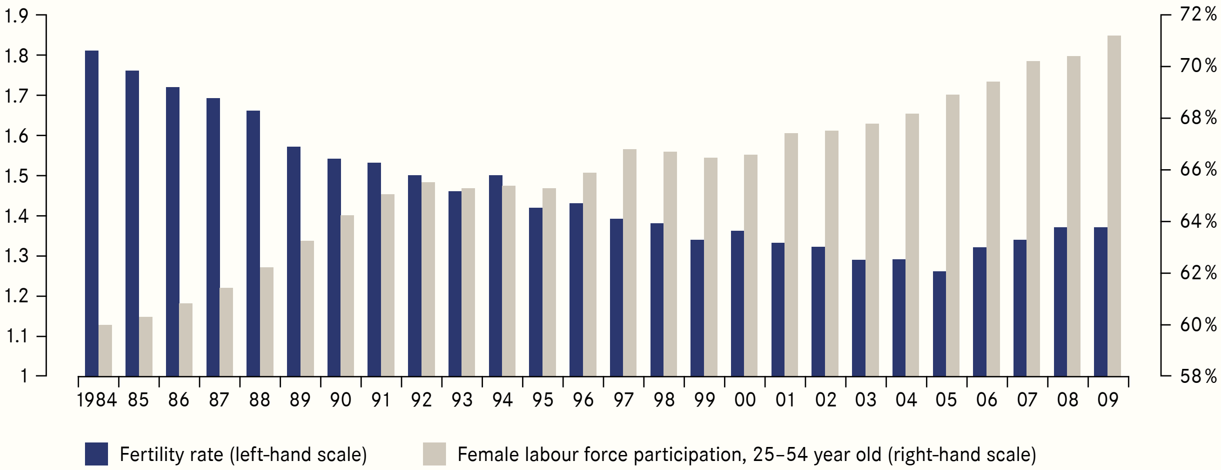
While some of the mentioned arguments are undoubtedly true, there are also a number of significant misconceptions. Most importantly, there is the erroneous idea that Japan has not adapted itself to face the challenges and opportunities of a globalised economy. In part, low economic growth is a consequence of a rapidly ageing population and limited immigration. Deflation, however, increases the purchasing power of accumulated savings in real terms. Hence while deflation is bad for growth, the approximate USD 12 trillion in savings owned by Japanese households, according to Bank of Japan data, have maintained their value over the longer term. Indeed, adjusted for changes in the Japanese yen, per capita income has largely kept pace with that in the United States, which has a GDP per capita of USD 50,000.

Chart 23
Japan's per capita income has kept pace with the USA

Source: International Monetary Fund, Julius Baer

Some of the counter-arguments are based on currency movements and, critics may charge, are not meaningful or active signals of social or economic change. In response to an ageing population and declining birth rate, Japanese women have increasingly joined the labour force. In the face of labour cost competition, Japanese companies have switched to contract work, which has improved the flexibility of the job market, but in turn has seen companies invest less in their workers, according to the OECD. Hence it is too soon to say that the longer-term impacts of maintaining competiveness in the shorter term will be unambiguously positive.

Chart 24
Japanese women entering the workforce, gradually but persistently

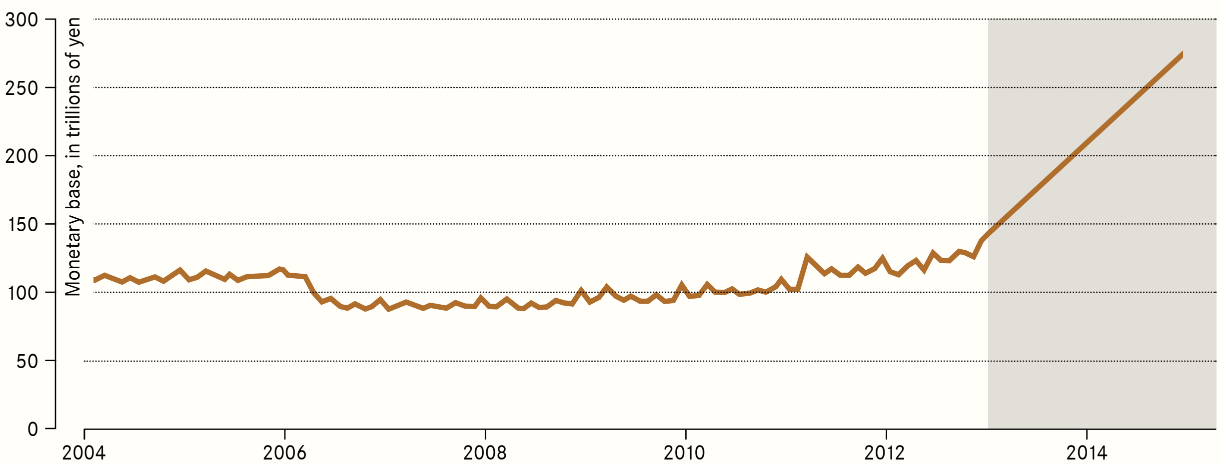


Source: OECD, Julius Baer

Understanding 'Abenomics'

Addressing Japan's legacy of deflation goes to the heart of the policies set out by Prime Minister Shinzo Abe's government, installed in December 2012. The policy programme has three main pillars: a shorter-term boost in government spending to kick-start growth, a major shift in stance at the Bank of Japan and third, a longer-term drive for growth via deep structural change. The first two steps have been accomplished. The supplemental budget passed in February includes spending increases, setting aside concerns over the government's large debt stock. At the Bank of Japan, the new governor Haruhiko Kuroda has launched massive monetary easing, effectively promising to deliver a 2% inflation outcome in two years. These actions have not gone unnoticed by financial markets, resulting in a significant weakening of the Japanese yen. In the longer term, whether 'Abenomics' will be successful in terms of defeating deflation will hinge upon the last pillar of structural reform. For example, further increases in youth and female labour participation will help ease demographic challenges. Harnessing Japan's strengths more effectively in the area of technology and innovation, in addition to new regional trade initiatives, is planned as well. It is still early days for 'Abenomics', but such measures could lay the foundation for a post-deflationary Japan.

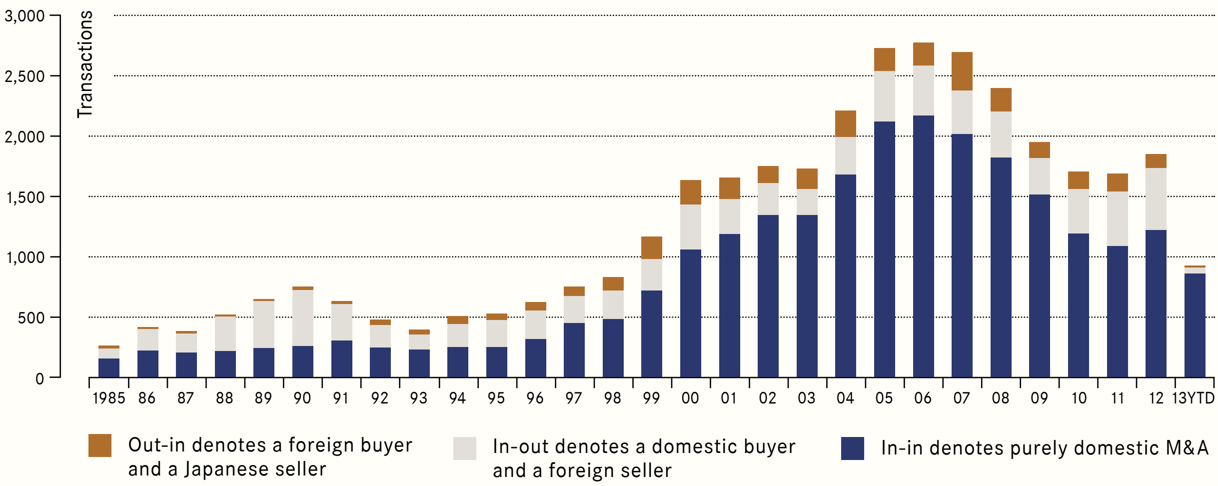
Chart 25
Bank of Japan has launched a major monetary expansion



Source: JP Morgan, Julius Baer

Most striking of all is the misconception that Japan has retreated from the outside world. Japanese corporate activity has progressively internationalised over many years, first in terms of production, as of 2010 approximately 30% stems from overseas operations, according to UBS Investment Bank. Looking only at the subsidiaries of Japanese companies, they generated USD 130 billion of profits for their parent firms in 2010, according to Macquarie data, reaching the previous 2007 peak. This is important as it demonstrates another facet of modern globalisation: today about one-third of all trade actually comprises the movement of goods between subsidiaries of the same companies, located in different parts of the world. Japan is a key exponent of this trend of corporate globalisation. Another barometer of Japan's advanced globalisation can be seen in the mergers and acquisitions (M&A) records. While M&A between domestic firms remains the dominant variety, so-called 'in-out' M&A, in which Japanese firms merge with or acquire foreign companies, has increased notably. The fact that domestic M&A surged over the past decade also argues that Japan is anything but stagnant. In addition to ongoing restructurings at home, the internationalisation of corporate revenue streams means that Japan can 'import' growth, in particular from other countries in Asia.

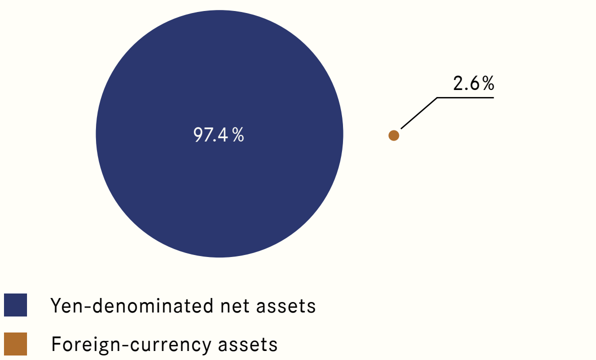
Chart 26
Japan's dynamic mergers & acquisitions landscape



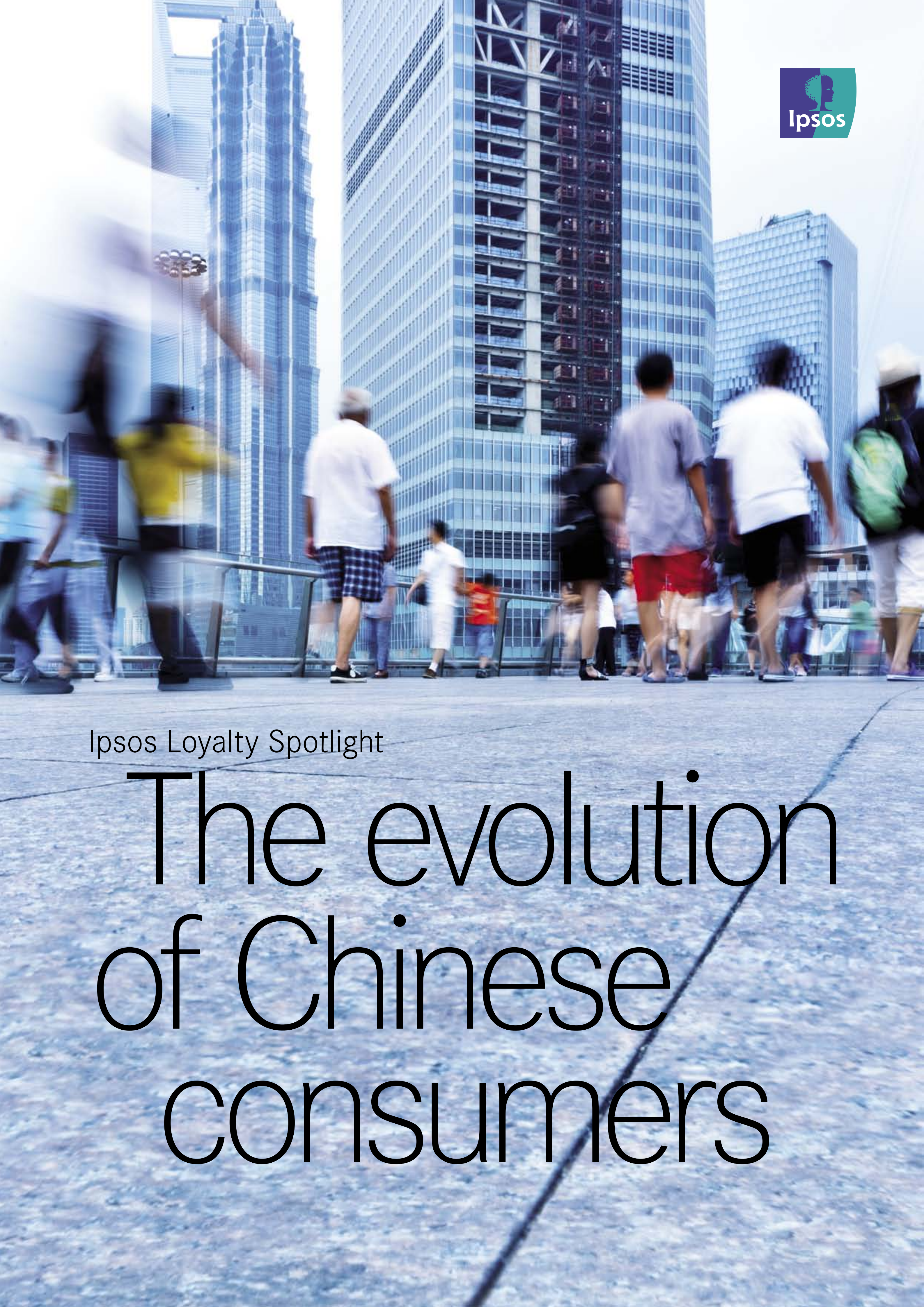
Source: Macquarie, Julius Baer

The final area where we see considerable room for change is the globalisation of household assets. While as an overall economy, Japan holds significant assets abroad, the breakdown of household portfolios is very different: according to the Bank of Japan, only 2.6% of Japanese savings are in non-Japanese assets. In line with trends seen in the corporate landscape, we expect this to change over the longer term as Japanese investors seek returns from a more international set of options. After all, relying on deflation to generate real returns cannot be seen as a viable longer-term strategy. As Japan is challenging the perception that it is immune to change, international investments may prove to be a new and future source of wealth.

Chart 27
Households have very few non-yen assets



Source: Bank of Japan, JP Morgan, Julius Baer



Ipsos Loyalty Spotlight

The evolution of Chinese consumers

China represents the quintessential economic powerhouse given the unique combination of its population size and the speed of average rising incomes. As a consequence, seemingly small changes in consumer behaviour are destined to have an enormous impact on providers of luxury goods and services. In other words, 'getting your strategy right' in China matters a lot more than in other target markets, where changes in preferences may be much more subtle and gradual.

Ipsos Loyalty, the market research partner for this Julius Baer Wealth Report, finds that there is an emerging segment of Chinese consumers who are becoming increasingly savvy and discerning. These consumers have accumulated experience with a range of luxury brands over the past decade. In recent years, findings have shown growing sophistication in the attitude and consumption patterns of the affluent Chinese consumer. Ipsos Loyalty expects this shift to continue as China moves to a structurally lower rate of overall GDP growth, reflecting broader changes such as the emphasis on greener technologies and higher value-added production.

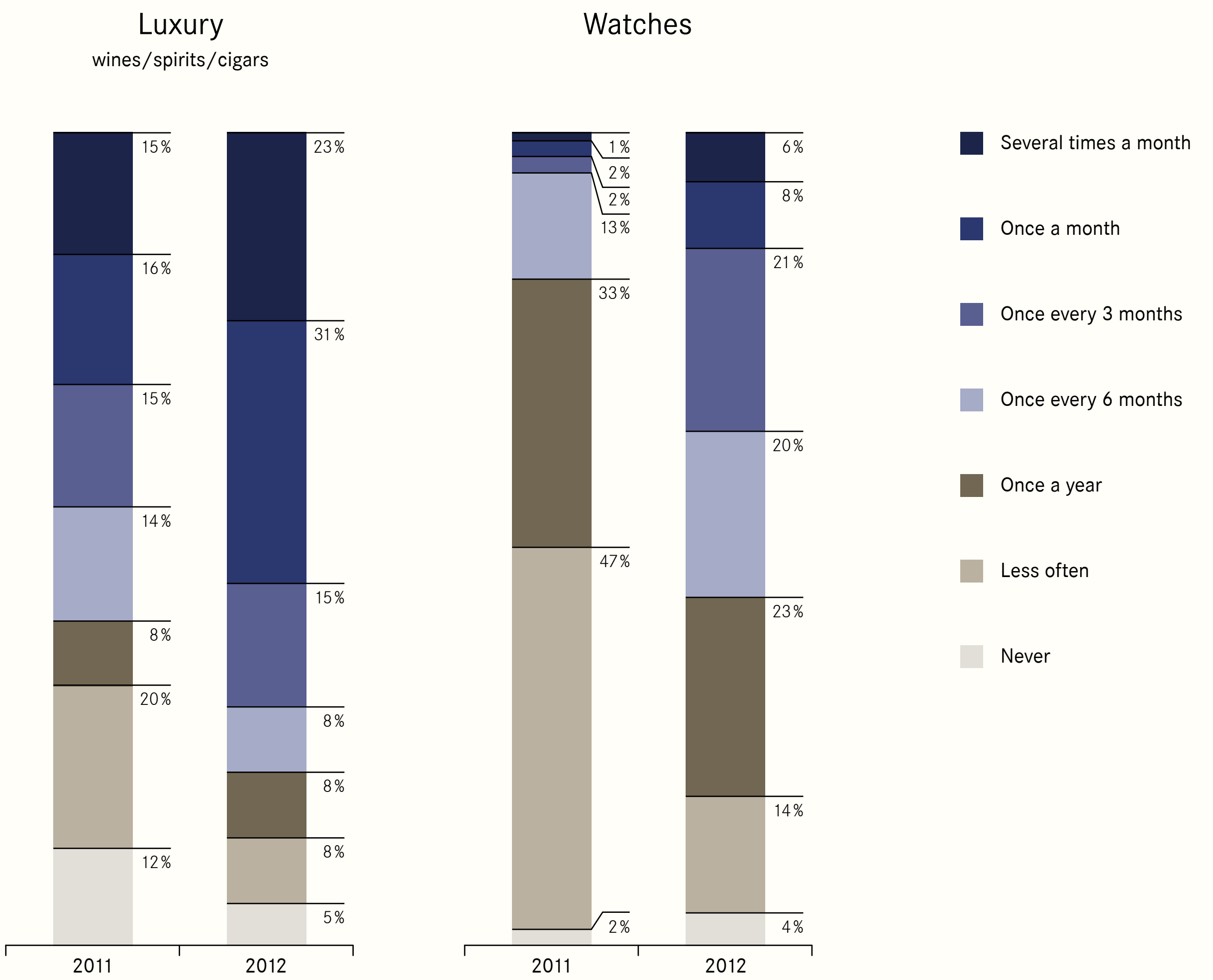
Affluent consumers becoming 'elevated elite'

Today's affluent Chinese consumers see luxury as a way of life, not just the occasional purchase of a good or service, separate from the rest of their lives. From 2011 to 2012, there was a doubling in the percentage of consumers with annual household income of more than USD 78,000. This increase has led to purchases across a greater number of luxury categories (from 7 to 13 categories). For example, luxury watches were purchased less than once a year in 2011 while in 2012, watches were purchased on average every 6 to 12 months. More than 50% of the consumers purchase luxury wines, spirits or cigars at least once a month in 2012 compared to only 31% in 2011. This indicates a growing awareness of a range of luxury items, in particular 'one-off' consumables, which are then purchased repeatedly and becoming part of their lifestyle.

In terms of location of purchase, travel has always featured prominently in China's luxury segment. Indeed, as has been the case for a longer period of time, Chinese consumers are still purchasing luxury products predominantly overseas. In 2011, popular destinations included Europe, Hong Kong, Macau, Japan and South Korea. The list has expanded to the United States, Singapore, Taiwan and Australia in 2012. While we expect the domestic component of luxury sales to continue to grow, the more interesting part of this trend is to monitor the new locations that China's luxury consumers are venturing to.

When it comes to the preference for brands, established large brands such as Chanel, Louis Vuitton, Gucci and Christian Dior continue to dominate. But consumers are also expanding their repertoire to contemporary brands, such as Marc Jacobs, Shang Xia, Shiatzy Chen, Stella McCartney and Alexander Wang. The speed with which China's luxury consumers have adopted new brands is surprising. We explain this trend partly because, according to our research, consumers are very open to finding out the background, heritage, unique selling points and positioning of a brand. In other words, those brands that 'reach out' and compete partly on the basis of making their proposition to consumers well known stand a

Chart 28
Frequency of purchases



Source: Ipsos Loyalty, Julius Baer

good chance of finding very receptive buyers. This is not the case in established luxury markets. For example, relative to mainland Chinese buyers, we find that Hong Kong-based consumers operate differently in that getting more information about a brand does not have much of an impact.

Rising middle class as the ‘new’ affluent?

The rising middle-class consumers in China (mostly coming from tier 2 and tier 3 cities) also deserve attention as purchasing power continues to grow. As the middle-class consumers are still grasping the initial few experiences with luxury brands, their current attitudes, behaviours and preferences look very much like those of the ‘old’ affluent consumers.

When discussing luxury, Louis Vuitton (for apparel) and Rolex (for watches) have the greatest recognition amongst middle-class consumers. When asked, ‘what does luxury mean for you?’ the three most common answers were: luxury means ‘superior quality products’, ‘unique product styles/designs’, and ‘established heritage’. The main reasons given for buying luxury items were obtaining social recognition/acceptance by ‘boosting confidence’ and personal fulfillment through ‘self-rewards’.

In contrast to higher-income Chinese, product purchases are still focused on smaller-sized items, such as luxury cosmetics and fragrances, accessories and small leather goods. There are fewer purchases on watches, jewellery and handbags compared to the affluent population. For luxury good providers, this means that ‘smaller items’ are the entry level before income growth sees these consumers graduate to bigger-ticket purchases such as handbags and watches.

Characteristics of the new generation of affluent consumers

It has taken Chinese consumers less than a decade to exhibit spending patterns that are seen in established luxury markets such as the United States and Europe. This is especially true among younger Chinese. They have grown up in a period in which China's economy experienced significant growth. Coming from the period of the 'one-child policy', the current younger generation has invariably been the focus of family attention and spending. Compared with their parents and grandparents, they have led a lifestyle where they consume and experience brands and products akin to their counterparts in Western economies.

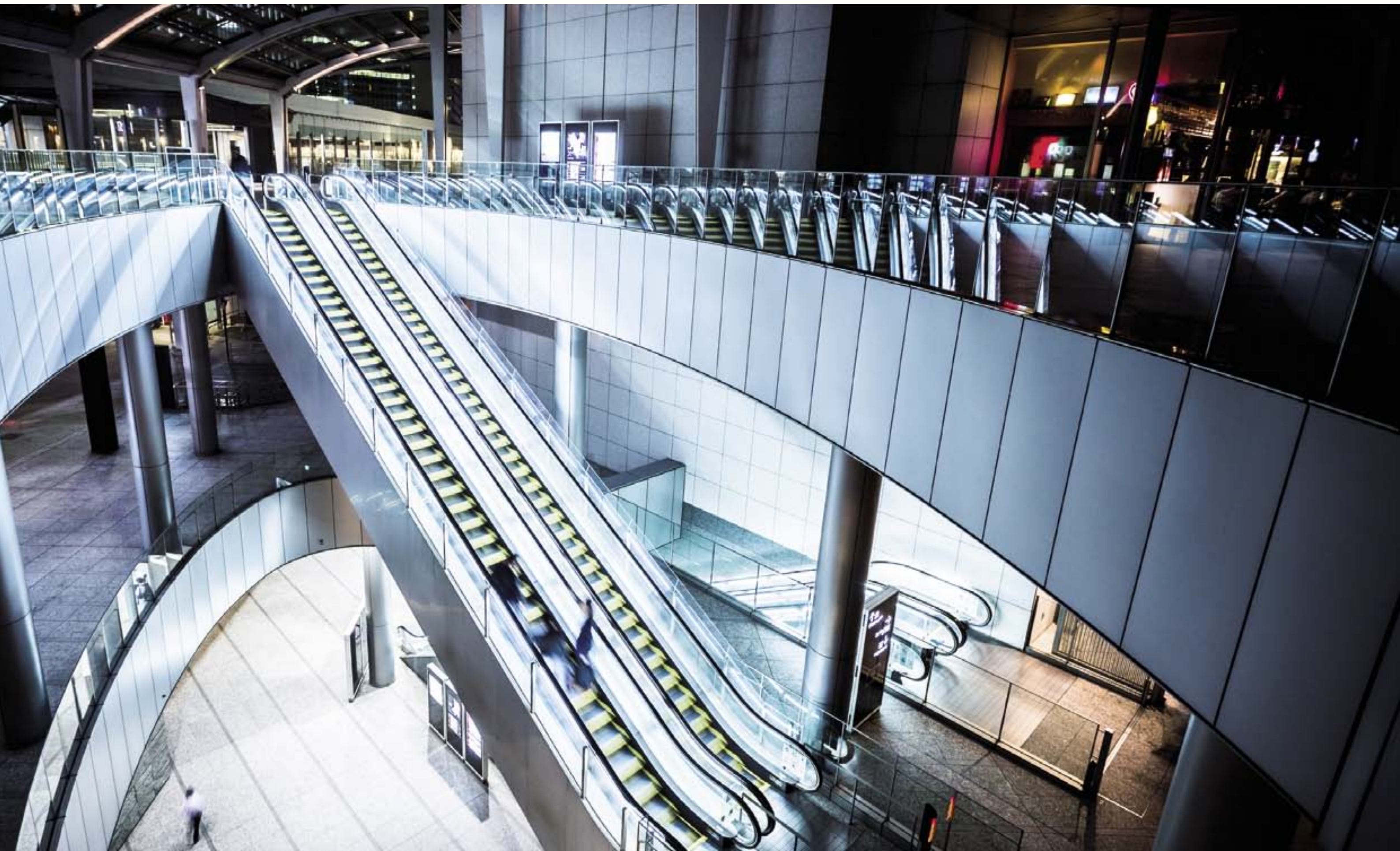
There are several broad trends taking place in this segment:

- They are more aware of brands and luxury goods.
- They are becoming savvier about the relationship between quality and price.
- They are expressing a growing appreciation for authentic luxury products.
- They are looking for quality (over the importance of logo).
- They are looking for understatement.
- They are tapping into heritage.

What is the future of luxury in China?

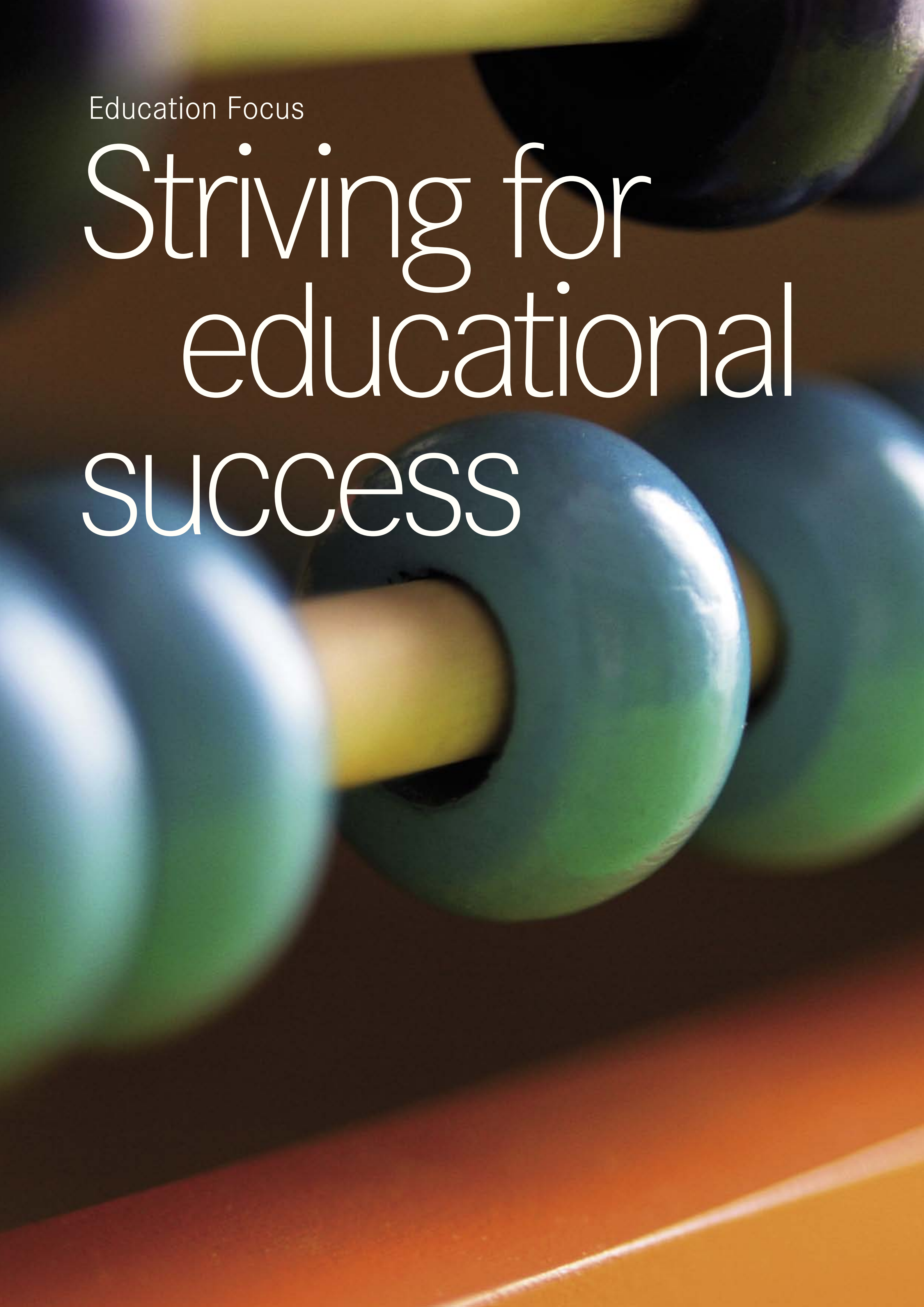
The pace of change in China remains very rapid, which entails uncertainty. However, some of the scenarios that could potentially evolve are:

- The rise of a luxury brand that is distinctly Chinese, built for the Chinese market that caters to the local needs. Currently, there are many Western brands that are retrofitted to Chinese consumers.
- The emergence of the northwest cities that are becoming important centres of luxury consumption.
- Current luxury brands can develop lifestyle offers to meet the changing lifestyle needs of the elevated Chinese elite. Fusion between craftsmanship offered by Western brands and Chinese elements could attract Chinese consumers with heightened cultural awareness.



Education Focus

Striving for educational success



Exclusive educational institutions have obvious appeal. It is an honour to be chosen to follow in the footsteps of students who went on to win Nobel prizes, lead countries or create world-class businesses – sometimes, like Mark Zuckerberg of Facebook, even while they were still studying.

There is no doubt that going to a prestigious university opens doors. Alumni networks are valuable resources even years after students graduate. However the Julius Baer Lifestyle Index indicates that the price of admission to these universities, and sometimes the schools that lead to them, rise significantly year on year. This year alone the price has increased more than 30% for top university applications.

There is a strong belief among Asian parents that these top universities are required for their children's success. According to Jason Ma, founder of ThreeEQ, an educational consultancy, the world is becoming increasingly competitive in terms of job opportunities, even at the internship level. Having a good degree from a top school helps a graduate not only to stand out from the crowd, but even to circumvent some of the job application process since many top employers actively recruit from those elite universities for their top-talent internship positions.

However, top universities and schools do not guarantee success. Experts sometimes talk about the Steven Spielberg effect: all of the top film schools he applied to rejected him, so he went to a very ordinary college instead. Yet he still managed to win Oscars. Nevertheless, Steven Spielberg and Steve Jobs are considered exceptional successes.

Faced with such realities, what should parents do? The first challenge for parents is to help their children avoid any reason for admission officers to reject their applications. "The challenge for admissions officers at highly selective schools is therefore to find reasons not to admit an applicant," says Andrew Ferguson, whose book Crazy U is about getting into top universities.

This is where consultants can help. At the very least they can guide parents through unfamiliar education systems and application procedures that involve personal essays and highlighting attractive extracurricular activities. The best usually have inside knowledge of how the admission tutors think. Many have worked in admissions offices themselves and know how the process works. Typically charges start at around USD 3,000 a year and can be as high as USD 20,000.

One note of caution, however, anyone can set themselves up as an admissions consultant as there is no regulator overseeing the business. However, the Independent Education Consultants Association and National Association for College Admission Counselling are determined to raise ethical and professional standards. They are based in the United States and are widening their scope internationally.

It is perhaps worthwhile to consider this ongoing cautionary tale when deliberating the use of a consultant for your child's academic planning. In 2007 a Hong Kong couple hired a former lecturer in 'total education management' for their two sons who were then at boarding school in the United States. The initial package looked impressive. For USD 4,000 a month each, he and his staff would become substitute parents for the boys, guide them through school and give them the best possible chance to get into a top university. The team arranged private tutoring, extracurricular activities and extensive counselling as university entrance approached. The consultants promised to act as substitute parents for the boys while they studied on the other side of the world. The parents then changed to a retainer of USD 1 million per boy. But by 2010, they were suing the same consultants for their money back. For his part, the consultant said he had done nothing wrong.

"There are some outstanding educational consultants and there are complete charlatans who are trying to make a quick buck," Mr Richard McDonald, Headmaster of the prestigious Swiss boarding school Aiglon College, "If we work with agencies we are extremely careful that they hold up to our standards."

There are several key points to remember, many of which are also echoed by consultants themselves who are concerned that some agents are affecting the reputation of the whole sector by overpromising and under-delivering. Dr Elizabeth Kwo, President of New Pathway Education and Technology Group, a test preparation and academic consultancy in China, cautions, "Be wary of consultants who guarantee admission to a specific school. Some consultants may say they have connections or 'pull' at particular universities if parents donate, but admissions offices always consider the student's calibre above all else. In addition, many agencies will fill out an entire application for the student without any student input, which is a disservice to the student and unethical."

The role of a consultant, as Dr Kwo points out, is to increase the planning and preparedness for children to have success, and to act as a mentor in the process. "The ability of the consultant is half of the equation, the other half is the child's ambition, their ability to strive and their passion to try their absolute best. We teach the students whom we work with to be excited about learning, to identify their true passion and to actualise their true potential, since this will be a driving force for success for the rest of their lives."

In practical terms this means many things. Preparing kids early for university seems key. Jason Ma highlights, "Parents who really get it start their kids early, often in middle school. The expert mentoring process provides an overlay to the educational experience."

Experience in English language skills are a must for Asian applicants. Extra English courses can be run in the child's country of residence, at local and overseas summer camps, and of course through the boarding school experience. Richard McDonald highlights the need for balance at these schools, "It is wrong to suppress the mother tongue of children, but you must also nurture the new language when it is emerging."

All of the educators whom we talked to for this article highlighted the need for children to become well rounded in their development. Mr McDonald highlights "US universities have to grapple with a high number of applicants from Asia but their overall aim is to have a diverse student body. Having a score of 800 in an SAT within an application for a top school is becoming increasingly common so this alone cannot be the only selection criteria."

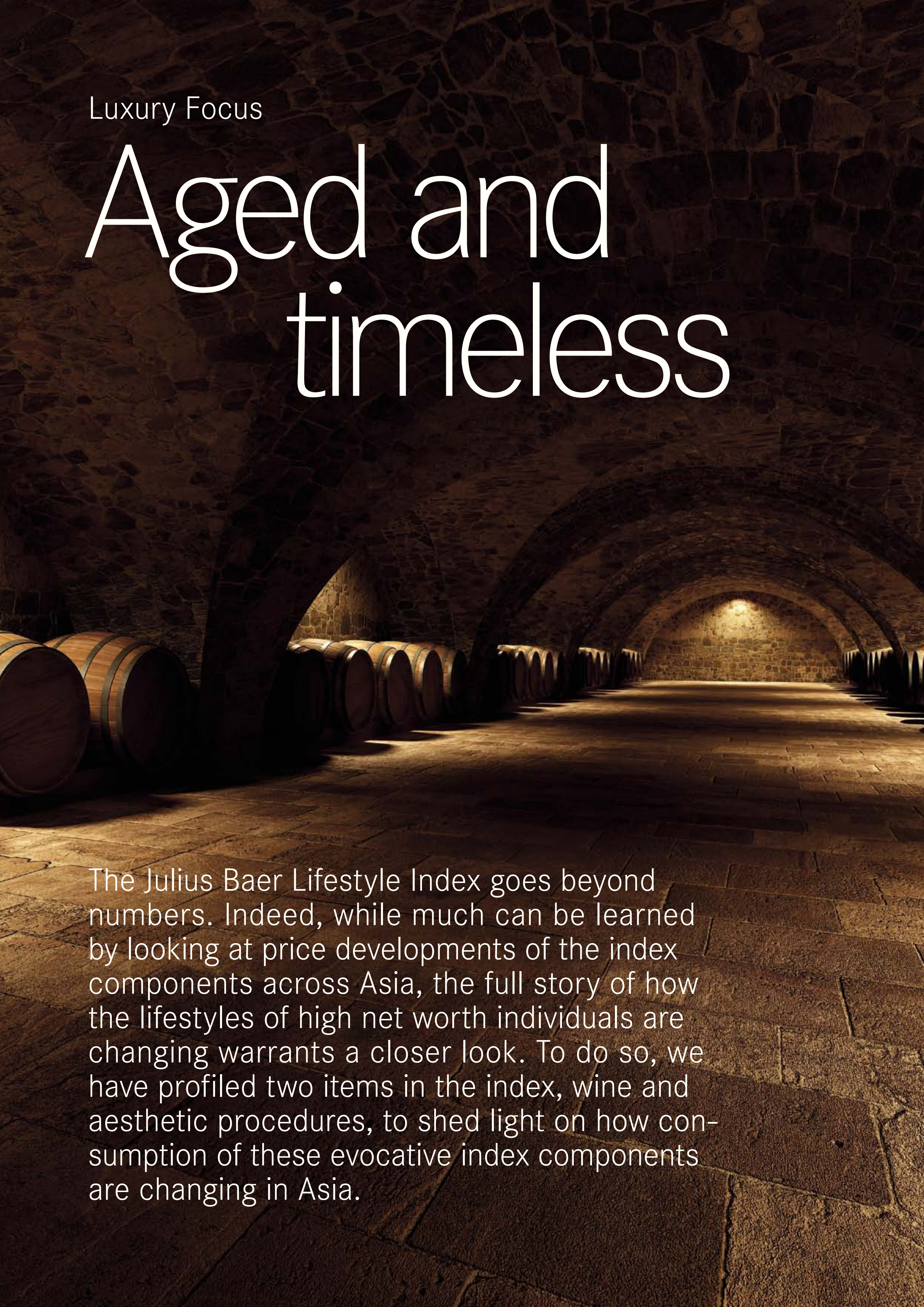
Schools want applicants who stand out even outside of the classroom. Dr Kwo highlights that team-based activities are important, for example sports performance and healthy academic team competitions are good to start early. Whilst she highlighted that team sports nurture the ability to work collaboratively and give an opportunity for leadership demonstration, her company has been recommending additional sports such as fencing or squash as a possible extracurricular activity over the past few years.

Community service is also considered an important part of the application. Jason Ma highlights that the selection of certain activities can also act as an elaboration of an applicant's leadership skills or ability to innovate. These activities, beyond charitable, need to fit the values that a child wishes to demonstrate clearly in their application.

Essentially as Richard McDonald highlights, "We are looking for kids who have been and done other things." It seems that in the race to differentiate oneself in the application process for schools and universities it is all too common to become just like everyone else. One aspect Mr McDonald highlights from his recent discussions with the head of admissions from Harvard, is that they are seeing the appeal of applicants who have taken a gap year, so that those youth can demonstrate their entrepreneurial or creative talents, beyond the unfortunately too common top grades.

Luxury Focus

Aged and timeless



The Julius Baer Lifestyle Index goes beyond numbers. Indeed, while much can be learned by looking at price developments of the index components across Asia, the full story of how the lifestyles of high net worth individuals are changing warrants a closer look. To do so, we have profiled two items in the index, wine and aesthetic procedures, to shed light on how consumption of these evocative index components are changing in Asia.

Message in a bottle

"The age of one-upmanship in wine in Greater China is over," declares Simon Tam, Head of Wine China at Christie's, the renowned auction house. Buyers are becoming less interested in owning the supreme, prestige labels in the luxury wine landscape and are broadening their horizons. This is the single most important development in a rapidly changing field. While wine has always been featured as a beverage of choice in Greater China, some recent pivotal events have moved the market into a new direction.For Simon Tam, the epicentre of these changes was the April 2010 Hong Kong sale of a case of 1982 Lafite for HKD 480,000. This record-setting sale grabbed headlines. It reinforced the notion that Hong Kong was fully established as a major trading hub for wine, in particular after the cancellation of the wine tax in 2010. Indeed, the active efforts by the Hong Kong government to support local trading and storage of wine no doubt played a key role as well. But more importantly, it underscored that while wine has always been popular in Greater China, the lengths that buyers would go to reach the pinnacle had attained a new level. As a consequence, supplies of 1982 Lafite from Europe were released as owners sought to capitalise on this new demand. Two years later, the same twelve bottles were sold for HKD 280,000.

The unique dynamics of the auction process

At first glance, observers can be forgiven for thinking that Hong Kong was witnessing a bubble in the prestige wine segment, followed by a return to common sense. Simon Tam points out that this view would not fully capture the dynamics of the auction process. Ultimately, a single sale between two individuals set the price standard of the 1982 Lafite on one given day. Such trades are never a reflection of the broader market. Indeed, the Julius Baer Lifestyle Index confirms still robust increases for wine across Asia, also in 2013. Other than the price correction itself, there are far more meaningful changes that followed.

Simon Tam,
Head of Wine China at Christie's

First, Mr Tam maintains that it encouraged wine connoisseurs to discover and experience wines that were of similar quality, but simply lacked the cachet of the ultra-high end of the market. In this process, buyers from Greater China have demonstrated a very steep learning curve and adventurous nature, open to a wide range of vintages and geographies. Whereas the previous market standard was to impress by owning prestige bottles, the new trend is to demonstrate knowledge and variety of the wines in one's cellar. The rich heritage and multifaceted nature of wine buying and consumption make this transition a natural fit, says Mr Tam, and the sophistication of Greater Chinese wine lovers is such that we should not expect a repeat of the 1982 Lafite phenomenon any time soon. Second, wine collection has become an integral part of the lifestyles of Greater Chinese high net worth individuals. Looking ahead to the next five years, Simon Tam expects the market to continue evolving, driven primarily by the search for new high-end quality wines that have yet to make a splash on the auction scene. Sellers need to entice buyers with much more than just the rarity of the bottles themselves, but of course scarcity and prestige will remain part of the firmament. At the end of the day, however, as Simon puts it, "There must be life beyond the 1982 Lafite."

Dr Tinny Ho

The evolution of beauty

Few items in the Julius Baer Lifestyle Index attract as much attention as the cost of the aesthetic procedure, and for good reason. Arguably, this is the most personal item in the index, touching upon how people see themselves and how they would like to be seen. The complexity of the decision to have a medical procedure to enhance one's physical appearance is not reflected in the price per se, but it provides a good starting point to understand the trends in cosmetic procedures across Asia. To better comprehend this landscape, the renowned physicians Dr Tinny Ho, a specialist in dermatology (MBBS [HK], MRCP [UK], FHKCP, FHKAM [Med]) of Hong Kong and Dr Georgia Lee (M.B., B.S [SG], Dip. Derm [SG], Member A4M [US]) of Singapore offer their insights.

In Singapore, Dr Lee finds that the general demographic of patients is becoming younger and there is an increased focus on maintenance of appearance, as opposed to reversing the ageing process. Dr Ho concurs that there is a greater emphasis these days on maintaining a natural appearance and patients look upon such procedures as an investment, rather than a 'quick fix' that may also risk appearing unnatural. For the very high end of such aesthetics procedures, the patient demographic in Hong Kong has remained relatively stable over the past five years. But Dr Ho notes that there is a wide price range available in the market – with the high end of the market experiencing less volatility to the pricing pressure that can be offered in a cosmetic or spa setting. In this regard, Dr Lee commented that the patients are increasingly looking farther afield and are willing to travel to other locations, such as South Korea, to have their cosmetic procedures and surgeries done.

Doctors are the gatekeepers

How does the process start? Dr Lee shares that in her experience, patients have usually had extensive conversations with family and friends and/or have done their research prior to stepping into the doctor's office. At this stage, the trust and relationship established between the patient and the doctor brings the process to the next level. Indeed, Dr Ho believes that "Doctors need to be the gatekeepers," in the sense that patients need to have clear and open advice in terms of what would be sensible. As with all medical proced ures, there are elements of risk and potential benefits, which need to be considered in detail. Dr Lee explains further that discussions with clients can often mimic a tug of war, where a patient might have a strong view of a certain procedure that is important for their happiness, but the specialist might advise otherwise and the outcome would not necessarily enhance their appearance, or could even make them look odd and unnatural. Dr Ho is also of the opinion that being in a position to command a premium price for your services means that honest and open advice is a necessary and integral part of this value process.

Dr Georgia Lee

Looking ahead, both doctors agree that patients will gravitate more towards non-invasive options when considering their treatments. This naturally bodes very well for items such as Botox, fillers and laser therapies. In terms of pricing, Dr Ho warns that if patients move too far down the price ladder, they risk being offered procedures that might not be in their best interests. Specialist surgeons command a premium because the number of new doctors entering the field each year is very limited. In general, both Dr Lee and Dr Ho expect demand for aesthetics to remain robust in the coming years, with Dr Ho sharing that the global financial crisis had little impact on her practice, which speaks of the resilience of the client base and the strength that underscores the demand for aesthetic procedures.

Wealth planning

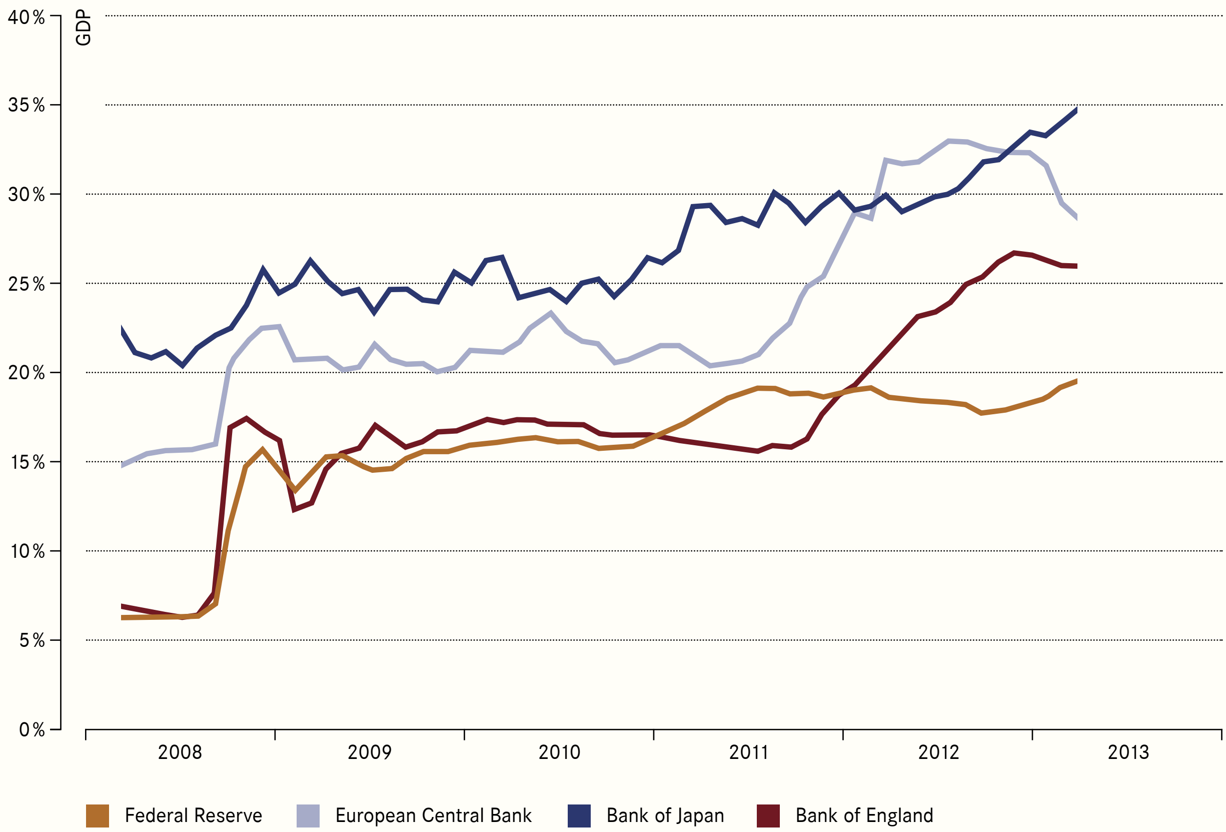
Living and investing in an inflationary world

The theme of this year's Wealth Report is the Julius Baer Lifestyle Index. In keeping with the previous year's outcome, the 2013 result continues to show that the cost of living for high net worth individuals in Asia outpaces more standard measures of inflation.

There have been some profound differences since Julius Baer launched the Lifestyle Index. Namely, the number of central banks engaged in actively expanding their balance sheets has reached an unprecedented scale, raising the spectre of inflation in a serious way. If Milton Friedman is right that "Inflation is always and everywhere a monetary phenomenon," investors are rightly worried about inflation. For high net worth individuals, having access to a portfolio of financial and/or real assets means that possibilities exist to protect against inflation risk. The recent financial crisis has prompted central banks in major economies to use unconventional monetary policies to avert a sustained economic downturn. While both the magnitude and method differ from one central bank to another, the common denominator is a significant surge in liquidity globally. Excess liquidity affects all asset classes from equities, bonds, commodities and not least currencies. It also raises questions about, and fears of, inflation.

How can investors protect themselves against inflation risk and can hedge funds help to hedge inflation? While measured inflation in developed economies is still relatively modest, the 'expectation' of future inflation is being shaped by central banks' higher tolerance for elevated inflation levels as long as it remains under control. Faced with such unconventional action, should investors turn to unconventional solutions, such as hedge funds?

Chart 29
Central banks' balance sheets have expanded significantly

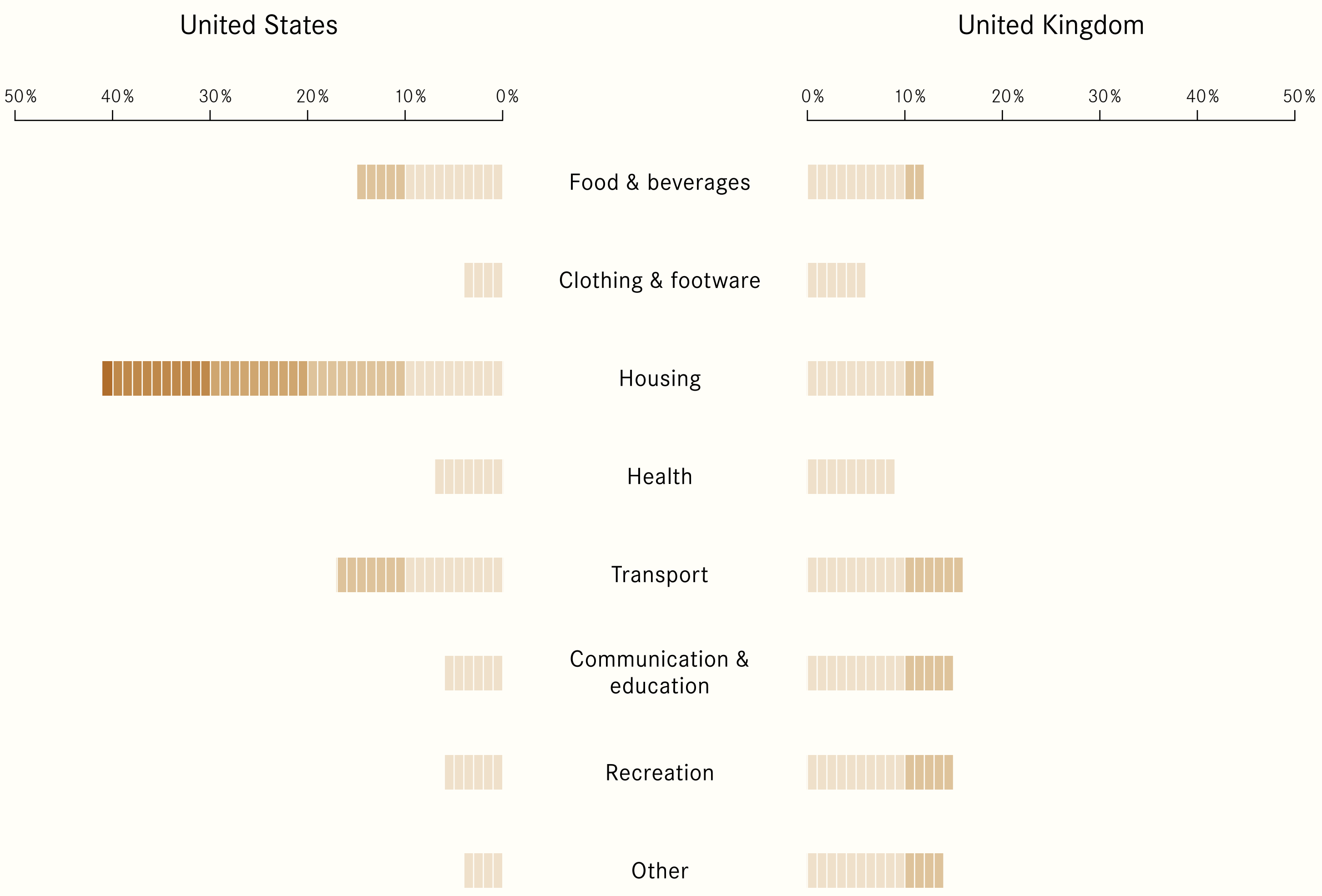


Source: Datastream, Julius Baer

Investors need to understand their inflation exposure

In a world where investors are prone to worrying about inflation, clarity of definitions is important. Indeed, inflation is a very general term and investors are not equally affected by it. While most of the world has been facing positive rates of inflation, Japanese investors have been experiencing negative inflation rates. There are also regional differences between inflation indices. This is important since most available financial instruments are based on some official measure of inflation. Hedging the 'wrong' inflation could create a mismatch, which could prove costly. There are important differences in inflation impacts between world economies. For one, energy inflation might have different consequences for investors depending on where they live. Another important difference is the still high allocation to food in developing countries' consumer price inflation (CPI) calculations.

Chart 30
Differences between US and UK inflation basket



Source: Deutsche Bank, Julius Baer

Instruments for inflation protection

Having established the inflation risks, what are the instruments at investors' disposal? Inflation-linked bonds (such as Treasury inflation protection securities or TIPS) have built-in mechanisms to compensate for capital erosion through inflation. With positive inflation, cash flows from inflation-linked bonds will increase according to predetermined formulas based on well-defined inflation indices (such as CPI). Break-even inflation, i.e. the inflation rate that matches the expected return from nominal bonds with comparable inflation-linked bonds, represents useful price information for investors. Trend and volatility of break-even inflation are a good gauge of the overall expected inflation risks.

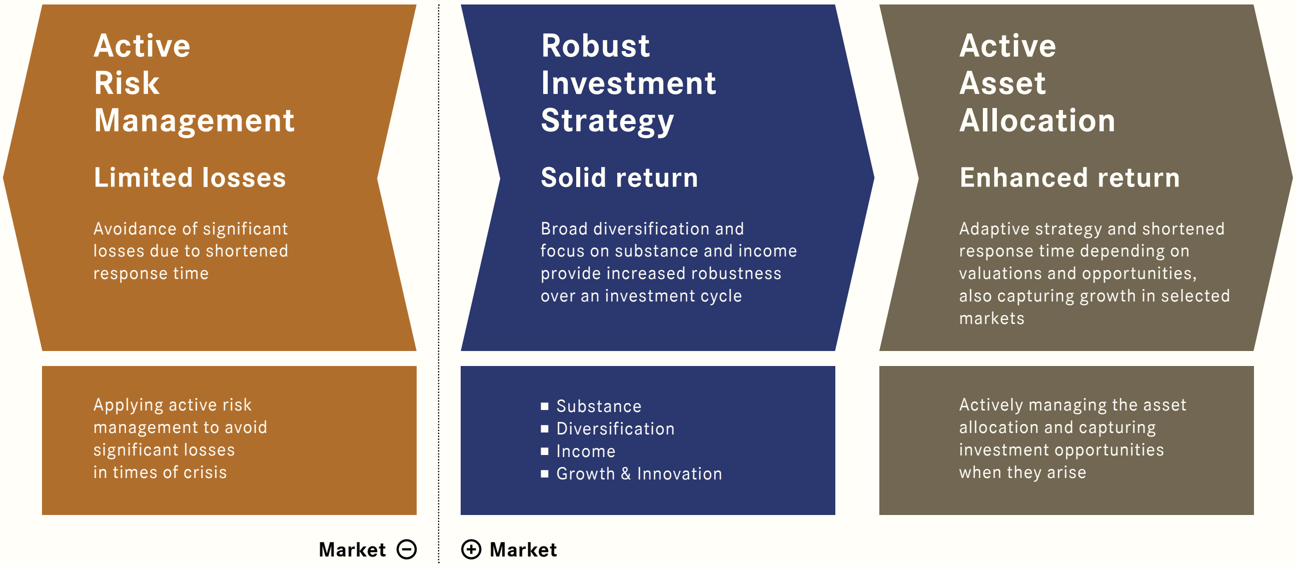
Chart 31
US 10-year break-even inflation

Source: Bloomberg Finance L.P., Julius Baer

Hedging inflation

Hedging broad inflation exposure can be done in a number of ways. Julius Baer's new investment approach, for example, applies a three-pillar model to active asset management. A Core Substance portfolio is complemented by an Active Risk Management pillar as well as an Active Assat Allocation pillar, both of which address inflation. For instance, the Julius Baer Investment Committee has hedged against rising yields by entering into an interest rate swap. Similarly, exposure to asset classes that might benefit from inflation (such as certain commodities and commodity-related equities) can be gained via the Active Allocation pillar.

Chart 32
Three pillars of our investment approach



Source: Julius Baer

Hedge funds and inflation

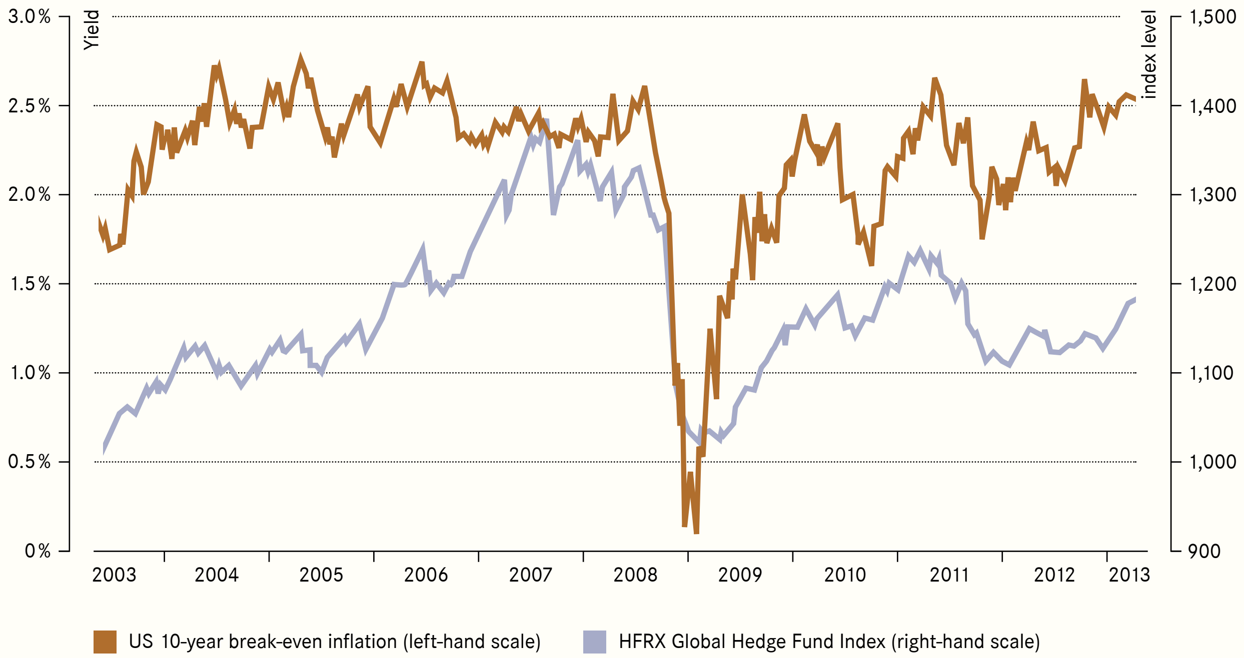
As their name indicates, hedge funds are generally expected to have a 'hedged' approach to exposure. But do hedge funds overall offer an adequate hedge to inflation? Hedge funds are usually divided into a number of categories, such as: long/short equities, tactical trading (i.e. global macro/managed futures), relative value arbitrage and event driven. These categories are distinguished by the style of investing as well as the underlying asset classes involved. A hedge fund index such as the HFRX Global Hedge Fund Index includes a diversified allocation to all these categories. Do combined strategies offer protection against a rise in inflation?

Chart 32 seems to confirm no systematic relationship between the HFRX Global Hedge Fund Index and the US 10-year break-even inflation rate, meaning that inflation does not seem to be a major driver of hedge fund returns. This is not entirely unexpected as hedge fund investments are predominantly long or short positions in equities, bonds, credit, commodities and currencies.

Even though inflation represents a factor present explicitly or implied in a number of hedge fund positions, inflation 'beta' is not the dominant sensitivity factor of a fund of hedge fund index.

If hedge funds overall do not provide a good hedge to inflation, can hedge fund sub-strategies be an alternative? Of the strategies mentioned above, the ones most closely associated with assets directly affected by inflation (i.e. bonds) are global macro/managed futures. Therefore, while hedge funds may not be an appropriate inflation hedge, subsets of hedge fund strategies might be more useful. However, it needs to be considered that different investors have different investment horizons. While pension funds attempt to achieve their targets over the long term, private investors usually prefer much shorter time spans. Thus investor horizon might significantly impact the choice of the appropriate hedge fund strategy.

Chart 33
HFRX Global Index vs. US 10-year break-even inflation



Source: Bloomberg Finance L.P., Julius Baer

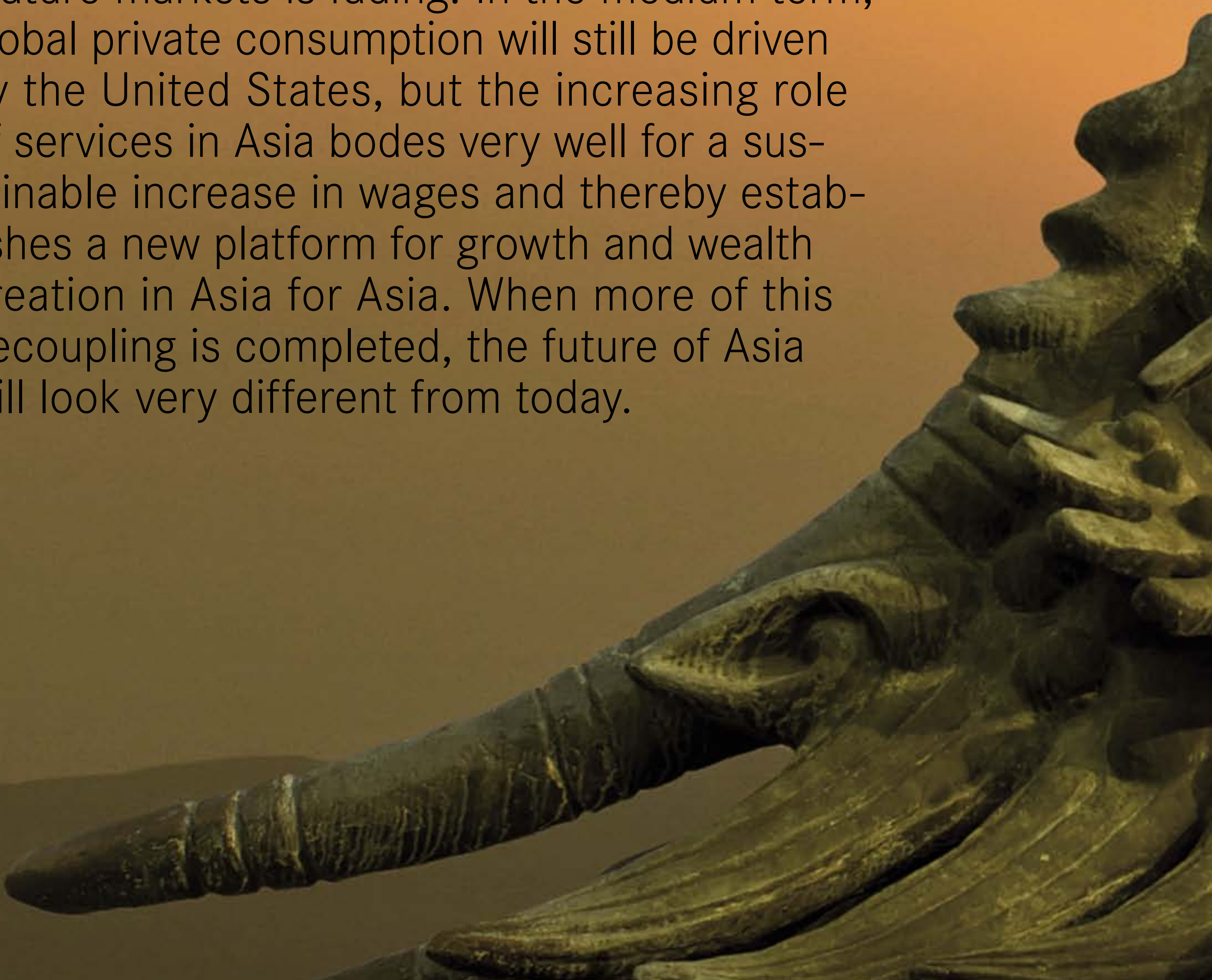
Conclusion

While inflation is on every investor's mind there is no single best protection approach for all investors. There are tools available for active investors, but since the global financial crisis, investment approaches to managing risks and maximising returns have changed dramatically. Faced with the unprecedented expansion of central bank balance sheets, investors should be even more vigilant in terms of inflation risks and look beyond conventional tools. In general, hedge funds are a crude instrument to protect against this type of exposure, but hedge fund sub-strategies such as managed futures might be more appropriate than a general hedge fund index. Some investors are exposed to very specific inflation risks. If this exposure is large enough, a customised hedging strategy would be needed. In this context expertise of hedge fund types might prove particularly valuable. Airlines kerosene price hedging programmes, or fat-tail market protection as offered by some hedge fund managers are some examples. The objective is to identify the exposure and develop a hedging strategy that a) maximises hedged profit when inflation risk materialises, while b) minimising the cost of maintaining that protection.

Conclusion

Exciting times ahead

Surveying Asia's leading economies over the past year, there are mounting arguments that the importance of the old business model of being reliant on producing exports for mature markets is fading. In the medium term, global private consumption will still be driven by the United States, but the increasing role of services in Asia bodes very well for a sustainable increase in wages and thereby establishes a new platform for growth and wealth creation in Asia for Asia. When more of this decoupling is completed, the future of Asia will look very different from today.



Over the shorter term, the Julius Baer Lifestyle Index tells us that the spread between standard inflation measures and the cost of living for high net worth individuals remains significant this year although there has been a positive correction of this spread so that the two types of inflation are more aligned. Nevertheless, maintaining a luxurious lifestyle over the longer term continues to have significant implications in terms of the need for appropriate financial advice.

The Julius Baer investment approach is geared to protecting investors' assets while taking opportunistic positions to deliver the desired performance, taking account of the 'real cost' of being wealthy. An investment approach, which is flexible and challenges the conventions of financial markets in the post global financial crisis world, is key in this approach.

In the coming years, the expanded Julius Baer Lifestyle Index will fully cover the eleven key cities in Asia, enabling a more complete picture of the dynamics in the luxury lifestyles in the region. Asian economies are integrating rapidly and the centre of gravity in the global context continues to move to the East. At Julius Baer we remain committed to being at the forefront of understanding these developments and sharing them with our clients.

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