

Julius Bär



WEALTH REPORT:
EUROPE

SEPTEMBER 2014



Dear Reader

At its most basic level, wealth refers to the accumulation of resources, both financial and non-financial. To estimate a household's wealth, we typically rely on the term 'net worth' – or the amount by which a household's assets exceed its liabilities. If the household owns more than it owes, it has a positive net wealth, and vice versa. As such, net wealth offers us an informative snapshot of a household's financial health.

Moreover, wealth is also a key component in the economic system. Rising wealth not only boosts confidence and spurs consumption spending, but also offers families a personal safety net in the event of unpredictable occurrences, like an economic downturn affecting one's business, a job loss or another emergency. And clearly, wealth can enhance entrepreneurial opportunities when used directly or as collateral for venture capital loans. As such, wealth always begets a responsibility, private and social alike, as our Chief Investment Officer, Dr Burkhard P. Varnholt, recently outlined in a separate publication Julius Baer 'CIO Viewpoints'.

Notwithstanding the key role wealth plays in our economies, research on the topic remains relatively scarce. This is exactly why we believe this inaugural Julius Baer 'Wealth Report: Europe' makes an important contribution. The report provides insight into the nature, evolution and challenges facing European wealth owners today, while also highlighting several special topics, ranging from inheritance to the important role family businesses play in building sustainable wealth in Europe.

Many of the insights from the report will be immediately relevant to you or your business. As such, the report reflects our commitment at Julius Baer to helping our clients navigate complexity by anticipating trends, offering best-in-class services, and through our exclusive focus on the client. This report is part of our untiring dedication to help our clients achieve their financial or strategic goals.

I hope you enjoy reading this report and thank you sincerely for your interest in this important topic.



A handwritten signature in black ink, appearing to read 'Boris F. J. Collardi', written in a cursive style.

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

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EXECUTIVE SUMMARY

The inaugural Julius Baer ‘Wealth Report: Europe’ provides insight into the nature, evolution, and challenges facing European wealth owners today. It also sheds light on a number of special topics related to wealth, and in some instances offers readers ‘tips and tricks’ on how to navigate some of the complexity related to managing wealth in Europe.

Robert Ruttmann, Julius Baer

The key findings of this report are manifold. In 2013, European wealth exceeded its pre-crisis peak, reaching a new all-time high of EUR 56 trillion, up 1.7% on the previous year. However, the evolution of wealth across countries since the financial crisis in 2008 has differed substantially, with the likes of Switzerland and Germany adding over EUR 1 trillion and EUR 2 trillion in net wealth to their pre-crisis peaks, respectively, while peripheral European countries like Spain and Greece continue to suffer large losses in wealth.

Of Europe’s total wealth, the report also finds that over two-thirds of Europe’s wealth lies in the large core countries Germany, France, the UK and Italy. The picture changes slightly when considering average wealth-per-adult levels across Europe. In this context, the smaller core countries like Luxembourg and Switzerland exhibit the highest wealth-per-adult levels at EUR 432,200 and EUR 394,900 per adult, respectively. These levels are distinctly higher than our estimate for average European levels of wealth per adult at EUR 167,100 in 2013.

The distribution of wealth in Europe is varied, but on average, we can say that the wealthiest 10% of European households own over half of the Continent’s wealth, while the bottom half of wealth holders own less than 10% of Europe’s total wealth. New long-term datasets suggest that the concentration of wealth in Europe is on the rise again, after much European wealth was destroyed in the 20th century due to the shocks of two world wars and the Great Depression of 1929.

The report also looks at the role family-run firms have played as vehicles to build family wealth. Many of Europe’s most enduring family-led companies remain well positioned to drive economic progress (and family wealth) in the 21st century. And as long as capital returns exceed economic growth rates, European families owning capital are set to gain a larger slice of Europe’s expanding wealth cake. This trend should also have a number of implications, ranging from the wealth effect driving up the demand for (and prices of) luxury goods, to the growing importance of intergenerational wealth transfers, both in terms of scope and complexity.

In addition to analysing trends in wealth, the report also offers ‘tips and tricks’ to help readers navigate special topics like wealth and tax planning, investing for social impact as an alternative to philanthropy, and how best to get started in wine and art investing. And finally, we also include three interviews: with our Chief Investment Officer, Dr Burkhard P. Varnholt, on how best to protect wealth in the current market, with Sir Richard Branson on the importance of promoting entrepreneurship in Europe, and with Professor Simon Evenett on how Europe can overcome challenges like high unemployment, low growth and high public indebtedness.

We at Julius Baer hope that this report will offer our readers some interesting new perspectives on wealth in Europe. Moving further into the 21st century, it will be critical that business leaders, policymakers, wealth holders and entrepreneurs work together to nurture an environment in which the active exchange of ideas forms the bedrock of social progress in Europe. We hope that this report can make a small contribution to this end.



PORTRAIT OF EUROPEAN HOUSEHOLD WEALTH

Europe remains one of the wealthiest regions in the world with total wealth having reached a new all-time high of EUR 56 trillion in 2013. Average wealth per adult also hit a new peak of EUR 167,100, but inequality remains high, with the wealthiest 10% of Europeans owning over half of Europe's total wealth.

Robert Ruttman, Julius Baer
Dimitri Bellas, Julius Baer

Private wealth gains widespread attention

The topic of personal wealth is attracting ever greater public attention. This is not least because more people are becoming wealthy as asset markets continue to hit record highs. However, reliable data on personal wealth ownership still remains relatively scarce and almost non-existent in some countries. To help bridge this gap, a number of institutions have published global wealth reports in recent years seeking to estimate levels and trends in global private wealth.

Unlike previous studies, this report has a clear regional focus – private wealth in Europe. Moreover, while the majority of previously published reports mostly limit their analysis to gross financial assets (i.e. liquid assets like stocks, bonds or funds), this report includes estimates for debt and privately owned real assets like real estate. We include these variables in order to get a more comprehensive picture of a household's net wealth, i.e. adjusting for the value of the debts it owes and the real assets it owns.

Chart 1: The definition of private net wealth

GROSS FINANCIAL ASSETS
– DEBT
+ REAL ASSETS
= **NET WEALTH**

Source: Julius Baer

A comprehensive view of private net wealth

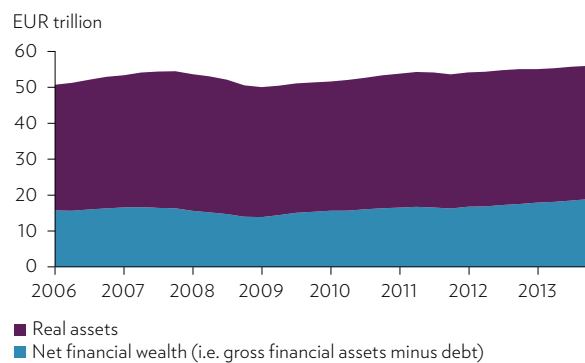
Using this more comprehensive view of net wealth is particularly important in Europe, since household debt levels make up a non-negligible one-third of gross financial assets on average. Furthermore, European home ownership rates reaching nearly 70% on average also suggest that the careful consideration of

real assets is equally important in estimating total private wealth. As such, we define net wealth as the value of gross financial assets, minus debt plus real assets (chart 1).

European wealth reaches record high in 2013

As Europe continues to emerge from a drawn-out recession, we estimate that aggregate European household net wealth grew by 1.7% in 2013 to reach EUR 56 trillion, surpassing its pre-crisis high of EUR 54.5 trillion in 2007 (chart 2). This confirms that Europe remains one of the wealthiest regions in the world, with private net wealth at an all-time high.

Chart 2: European wealth reaches new record in 2013

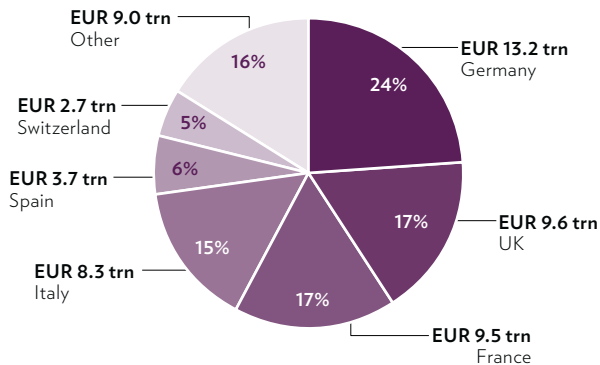


Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

Most wealth is concentrated in the core

Unsurprisingly, average levels mask significant differences across countries. For instance, the countries making up the biggest proportions of total European private net wealth include Germany at EUR 13.2 trillion, the UK at EUR 9.6 trillion, France at EUR 9.5 trillion and Italy at EUR 8.3 trillion (chart 3). Together, these four countries own over EUR 40 trillion in wealth, which is over two-thirds of the total European private net wealth of EUR 56 trillion.

Chart 3: Wealth concentrated in core countries

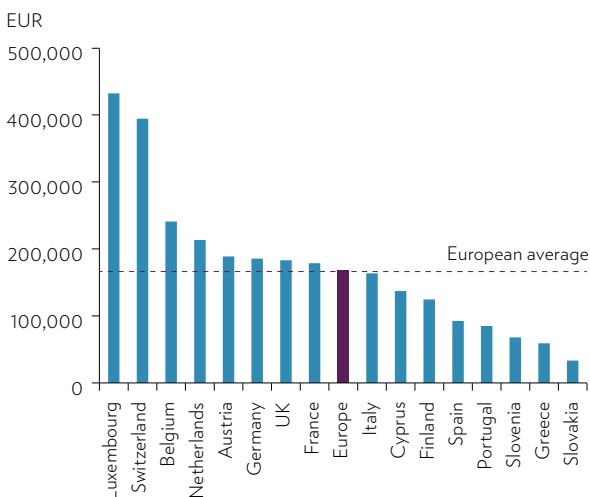


Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

Europe’s average adult owns EUR 167,100 in wealth

Breaking this country wealth data down to a per-adult level, we see that the average European adult owns net wealth of EUR 167,100. Again, this average conceals big differences between countries. For instance, average total private wealth per adult in Luxembourg (EUR 432,200), Switzerland (EUR 394,900), and Belgium (EUR 241,000) all exceed the European average, while countries like Spain (EUR 92,300), Greece (EUR 58,900) and Slovakia (EUR 33,300) all lie significantly below the European average (chart 4).

Chart 4: Higher net wealth per adult in core eurozone



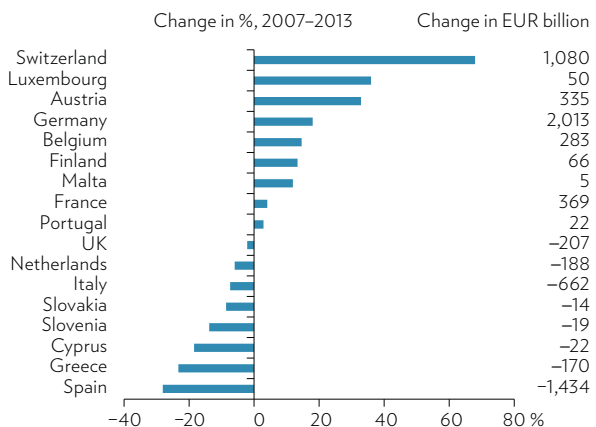
Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

Impact of the financial crisis on household wealth

The financial crisis has had a particularly dramatic effect on some European economies. Peripheral countries like Greece and Spain were affected most, with both countries having suffered big real gross domestic product (GDP) contractions (Greece -22%; Spain -6%) and both still battling high youth unemployment rates above 50%.

With contracting GDP, falling wages and collapsing prices, the value of private wealth in these countries has also fallen sharply since 2007. For instance, chart 5 shows that the largest decreases in net household wealth since 2007 have occurred in Spain (-28%) and Greece (-23%). This destruction in private wealth amounts to a total of EUR 1.4 trillion in Spain and EUR 170 billion in Greece in absolute terms.

Chart 5: Changes to wealth-per-adult levels since 2007



Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

Core countries grow their wealth since 2007

But many countries have also considerably expanded their household wealth since 2007. For example, Switzerland has increased its total household wealth by no less than 68%, amounting to an added net wealth of over EUR 1.1 trillion since 2007. Other countries that have grown their wealth include Luxembourg (+36%), Austria (+33%) and Germany (+18%), with Germany’s growth translating to a total gain in wealth of EUR 2 trillion since 2007 (chart 5).

This strong growth in wealth in the core countries has been the driving factor behind the expansion of total European wealth since the financial crisis, despite many peripheral European countries still finding themselves at the early stages of rebuilding the wealth that was destroyed during the financial crisis.

Wealth concentration is varied across nations

To help determine the degree to which European wealth is concentrated within countries, we combine our estimates on the level of private household net wealth across countries with data on the distribution of wealth within countries, which we obtain from the European Central Bank (ECB), national statistical agencies, the OECD and Eurostat. Our estimates suggest that the wealthiest 10% of European households have a net wealth of at least EUR 850,200, and make up no less than 50% of total European wealth (chart 6).

Households in Austria and Germany have an even higher concentration of wealth, with the top 10% of wealth holders in both countries making up at least 60% of each country’s total wealth (chart 6). On the other end of the spectrum, we see that countries like Slovenia, Greece and the Netherlands all have a much smaller concentration of wealth, with the wealthiest 10% of households in Slovenia owning less than 30% of total private wealth.

Top 1% wealth bracket owns big part of total

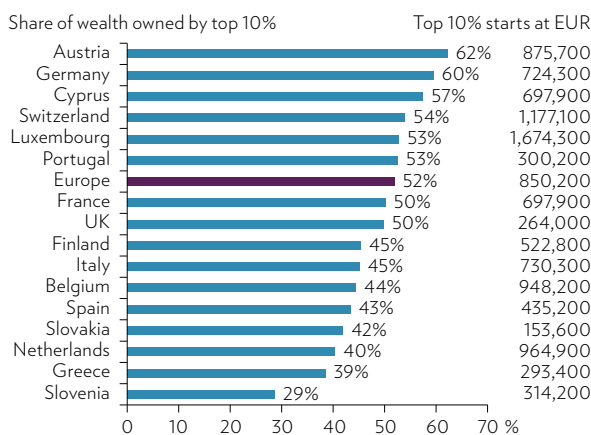
A similar analysis can be conducted for the wealthiest 1% of households in Europe. To this end, we see that the wealthiest 1% of European households own at least EUR 1.5 million, and make up as much as 27% of total European wealth (chart 7).

Again, the concentration of wealth varies across European countries, with the wealthiest 1% of households in Austria and Germany owning 40% and 35% of each country’s total private wealth, respectively. Slovenia, the Netherlands and Greece, on the other end, exhibit the lowest concentration of wealth, with the top 1% owning just 11% and 13% of total wealth, respectively (chart 7).

Number of millionaires concentrated in the core

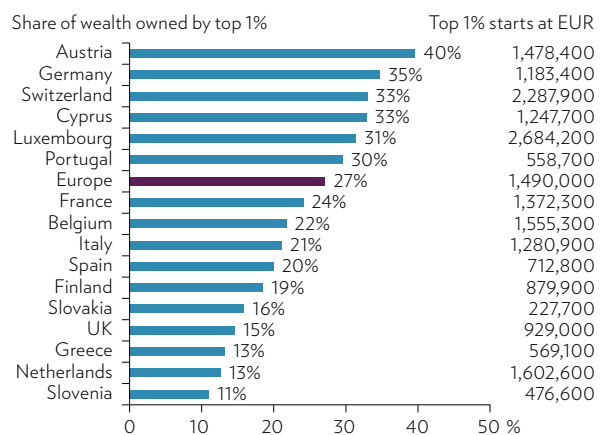
Another interesting dimension to the degree of wealth concentration in Europe relates to the number of millionaire households in each European country. To be classified as a millionaire household, we consider the private wealth of each household, i.e. each household’s financial assets plus real assets owned (mainly housing), minus debts. Clearly, this net sum should add up to at least EUR 1 million to be included in our estimate for millionaire households for each country.

Chart 6: Wealthiest 10% own large parts of total



Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

Chart 7: Wealthiest 1% own large parts of total



Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

To this end, table 1 shows that Germany, France, Italy and the UK have the highest number of millionaire households in absolute terms, with Germany boasting a total of 1.4 million households owning net wealth of over EUR 1 million, France with 1.3 million and Italy with over 800,000. This result is unsurprising given that these countries tend also to have the largest populations.

However, if one considers the density of millionaire households (i. e. number of millionaire households divided by the total number of households), a different picture emerges. The countries with the highest densities include Luxembourg and Switzerland, with over 22% of households in Luxembourg owning a net wealth of over EUR 1 million and 13% in Switzerland (table 1). On the other end of the scale, Slovenia and Slovakia have the lowest density of millionaire households at under 1%, or 6,784 and 9,532 in absolute terms, respectively.

Table 1: Europe's millionaire households

Country	Number of millionaire households	Millionaire households as percentage of total households
Germany	1,433,985	3.5%
France	1,334,066	4.4%
Italy	818,538	3.4%
UK	796,646	2.6%
Netherlands	703,108	9.1%
Switzerland	555,483	13.0%
Belgium	415,117	8.5%
Austria	200,298	6.3%
Spain	168,134	1.0%
Luxembourg	50,612	22.7%
Portugal	46,416	0.9%
Greece	34,723	0.8%
Finland	25,995	1.0%
Slovakia	9,532	0.5%
Cyprus	7,269	2.3%
Slovenia	6,784	0.8%

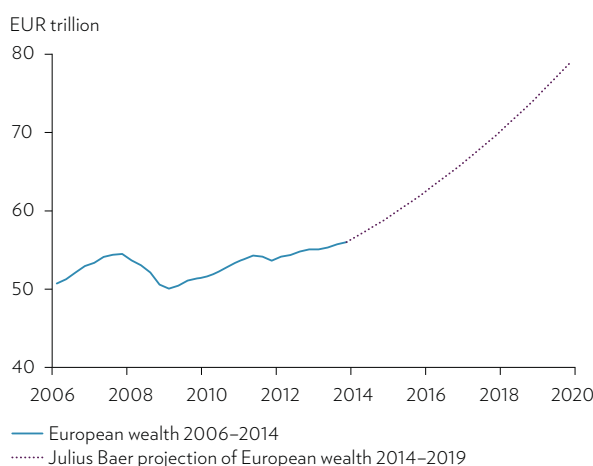
Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer

The road ahead for European wealth

Longer-term trends in household wealth are difficult to predict. This is largely because household wealth is strongly dependent on a number of factors like asset prices, demographics, and the overall economic cycle, all of which are typically difficult to forecast. Nonetheless, we have built five-year projections based on key forecasts needed to estimate both financial and non-financial assets using data from the International Monetary Fund's (IMF) latest World Economic Outlook database.

To this end, we expect European private net wealth to rise by 40% over the next five years, reaching a total of EUR 79 trillion by 2019. Most of this growth is likely to come from the larger economies recovering from recession, but an increasing contribution may also come from peripheral European economies rebuilding some of the wealth they lost since the financial crisis. These forecasts represent our base-case scenario for the evolution of wealth in Europe over the next five years, which allows Europe to maintain its spot as one of the wealthiest regions in the world.

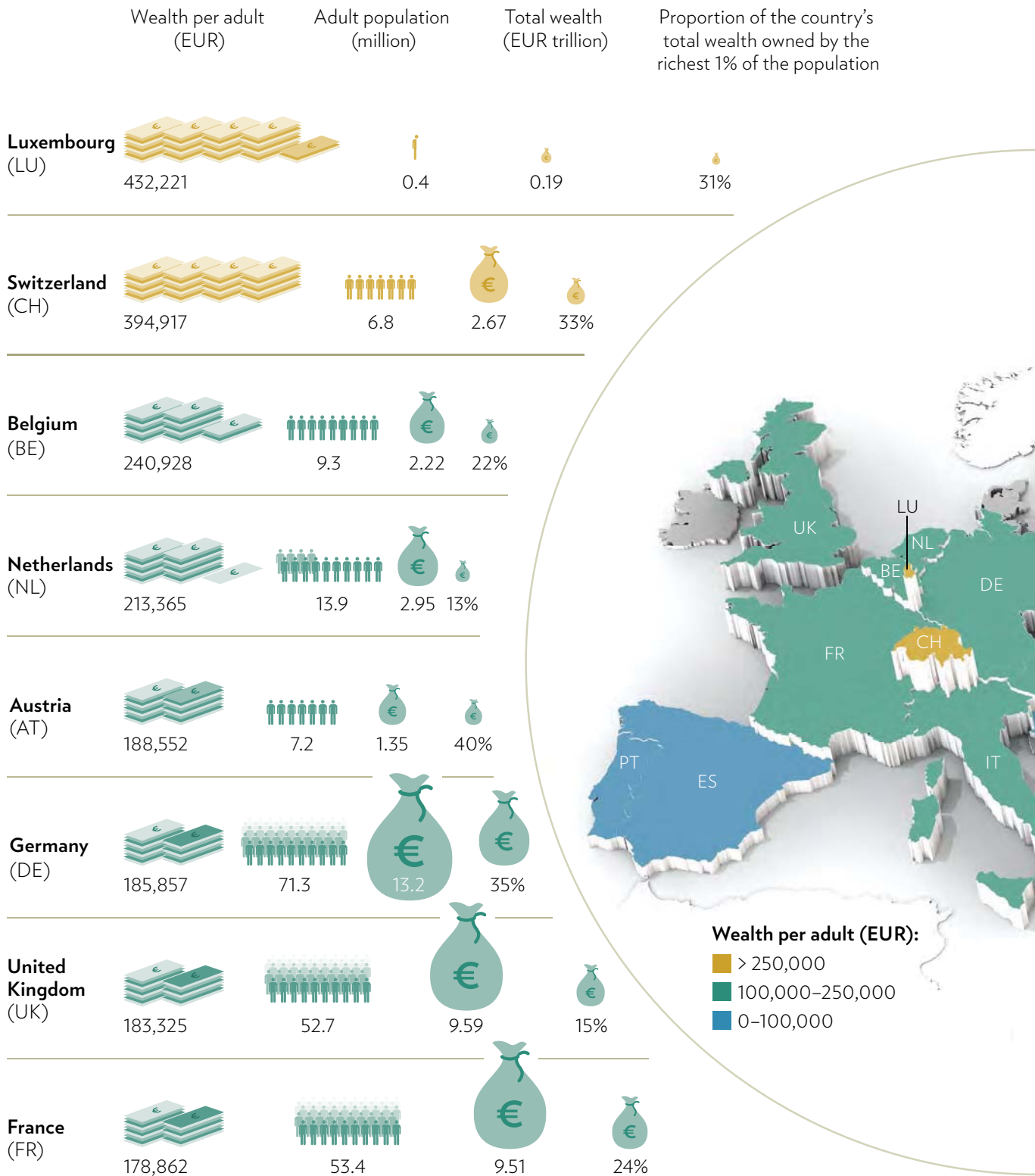
Chart 8: European wealth set to rise by 40% by 2019



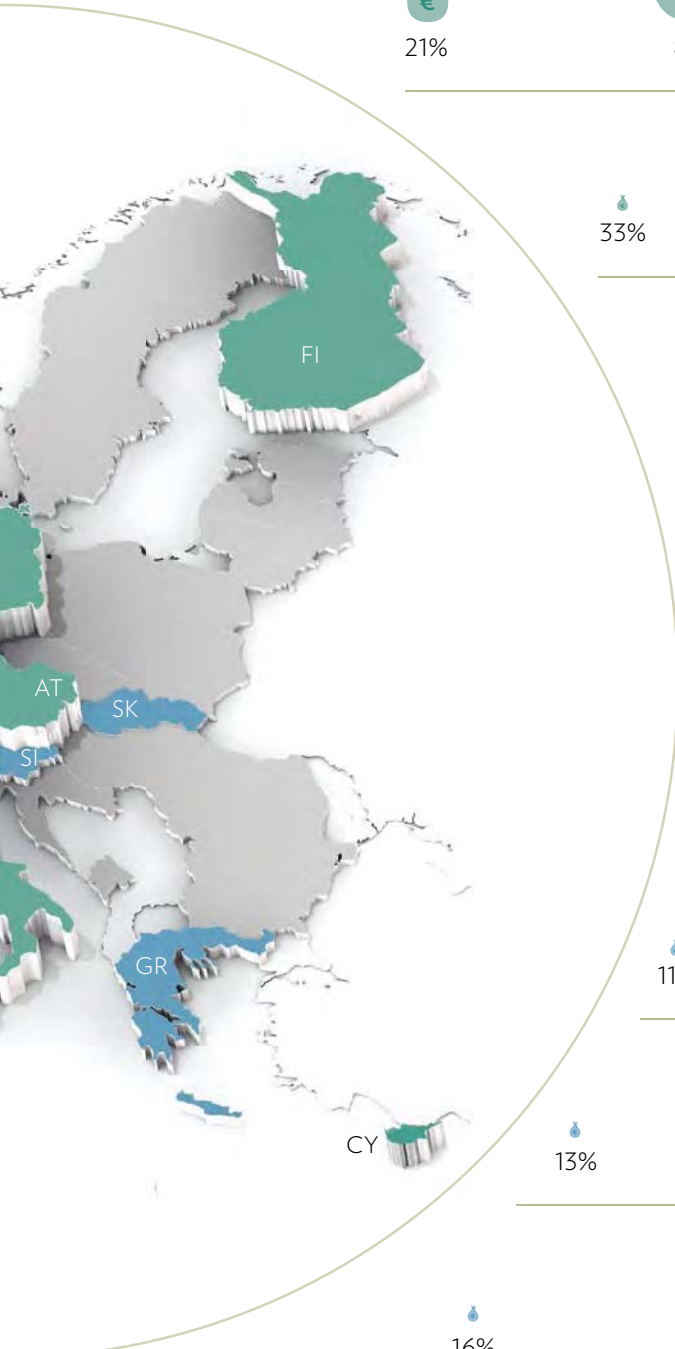
Source: Eurostat, ECB, IMF, national statistical agencies, OECD, Julius Baer

MAP OF WEALTH IN EUROPE

The distribution of wealth in Europe is heterogeneous. The map below offers an illustrative overview of how European countries differ from one another with respect to their average wealth-per-adult levels. Clearly, the core European countries with the smallest populations tend to have the highest average levels of wealth per adult.



Source: Eurostat, ECB, national statistical agencies, OECD, Julius Baer



Proportion of the country's total wealth owned by the richest 1% of the population

Total wealth (EUR trillion)

Adult population (million)

Wealth per adult (EUR)



21%



8.35



51.3



163,493

Italy
(IT)



33%



0.10



0.7



137,298

Cyprus
(CY)



19%



0.56



4.5



124,285

Finland
(FI)



20%



3.67



39.6



92,341

Spain
(ES)



30%



0.76



8.9



84,847

Portugal
(PT)



11%



0.12



1.8



67,878

Slovenia
(SI)



13%



0.56



9.4



58,877

Greece
(GR)



16%



0.15



4.6



33,295

Slovakia
(SK)

SHIFTING SHARES: EUROPEAN WEALTH DISTRIBUTION OVER TIME

New long-term datasets suggest that the concentration of wealth in Europe is on the rise again, after much family wealth was destroyed in the 20th century due to the shocks of two world wars and the Great Depression of 1929. As wealth grows faster than the economy, Europe's wealth holders get a larger slice of the expanding European wealth cake.

Robert Ruttman, Julius Baer
Dimitri Bellas, Julius Baer

Everyone is talking about inequality

The distribution of personal wealth has become one of today's most widely discussed and controversial issues. Part of the reason for the heightened discord on the topic is that much of the debate still relies on conjecture and ideology rather than on any reliable datasets spanning over several decades. Indeed, most commentators still subscribe to the notion that rising aggregate wealth inevitably reduces inequality in a country, as Simon Kuznets, a Nobel prize winning economist, argued in the 1950s.

Gini coefficient as an imperfect proxy

In the absence of reliable data on the evolution of wealth distribution, many economists rely on income dispersions as a proxy for wealth distribution, like the Gini coefficient. The Gini coefficient is a measure of the income distribution within a country, and runs from a value of 0 (where all have the same income) to 1 (where one person has all the income).

In the case of Europe, chart 1 suggests that the degree of European income inequality is largest in Spain, Portugal and Greece, and smallest in Sweden, the Netherlands and Finland. But the Gini coefficient is just a snapshot of outcomes. It does not inform about why those gaps have opened up or about how changes in the concentration of wealth or income have changed over longer periods of time.

A new set of data on wealth distribution

In efforts to help bridge this data shortage, French economist Thomas Piketty published the most complete and consistent dataset on historical income and wealth data on record, particularly for Europe and the USA. Mr Piketty's efforts are path-breaking in that he painstakingly uses tax statistics to document the changes in the concentration of income and

Chart 1: Gini coefficient estimates income inequality



Source: Eurostat, national statistical agencies, Julius Baer

wealth over a period of 300 years. This data is documented in his book, titled 'Capital in the Twenty-First Century' (2014¹), which made it onto the New York Times best-seller list – a notable achievement for an economics text.

Mr Piketty's expansive dataset makes it possible to measure a country's total stock of assets and liabilities, and not just the flows of income, output and consumption usually available from national accounting statistics. As such, the new dataset offers us a picture of a country's national private wealth, including real estate, financial capital, as well as industrial capital over long periods of time.

Wealth-to-income ratio as a key indicator

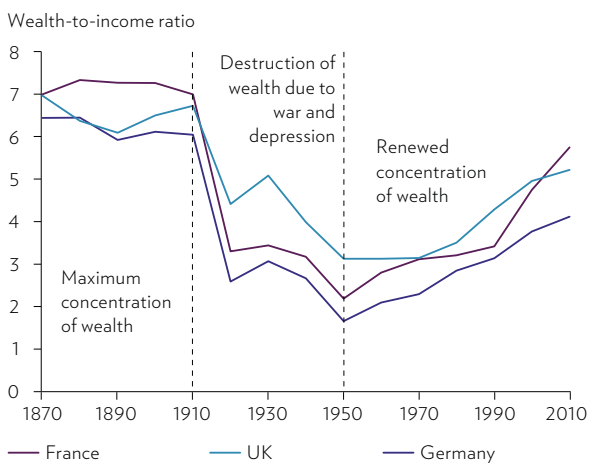
This data on national private wealth is particularly interesting when one considers its evolution relative to a country's annual output (or income). The resulting wealth-to-income ratio offers insight into the import-

¹ Original French version published in 2013, English translation released in 2014

ance of accumulated wealth in society. In other words, a high or rising ratio suggests that capital holders benefit disproportionately to income earners from the creation of wealth, thus increasing its concentration among existing owners of capital.

This data allows Mr Piketty to sketch out the long-term evolution of national private wealth-to-income ratios in Germany, France and UK since the beginning of the industrial revolution in the 18th century, when European society was highly unequal. Between 1870 and 1910, private national wealth was around six times bigger than national output (income) for all three countries, as wealth remained concentrated in the hands of a few rich families that sat atop a seemingly impenetrable class structure (chart 2).

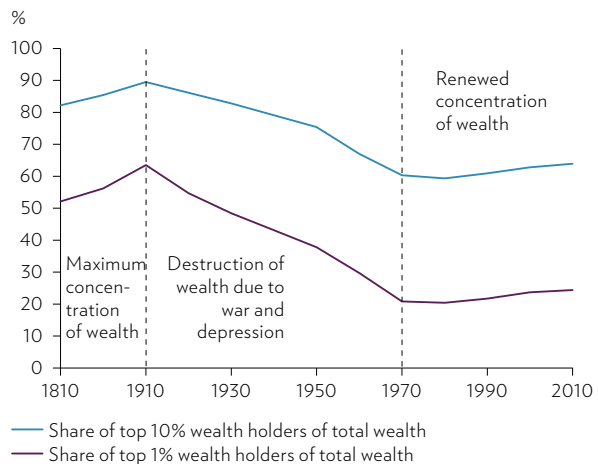
Chart 2: Wealth concentration is rising again



Source: 'Capital in the Twenty-First Century' (2014), T. Piketty, Julius Baer

Chart 3 also shows that in 1910, the wealthiest 10% of European households controlled almost 90% of the total wealth (the top 1% owned 65% of all wealth), as the flow of rents and dividends on capital contributed to a very big divergence in income between wage earners and capital holders. Mr Piketty refers to this period as an era of 'patrimonial capitalism', as it was devoid of any meritocratic allocation of wealth.

Chart 3: Growing share of total for top wealth brackets



Source: 'Capital in the Twenty-First Century' (2014), T. Piketty, Julius Baer

Wealth destruction began in 1914

This blatant social inequality of wealth persisted until the outbreak of the First World War in 1914, when the chaos of war eroded the stock of private national wealth by destroying physical capital, dramatically increasing taxes and nationalising private property. The Great Depression of 1929 continued the destruction of fortunes, this time via capital loss and bankruptcy, causing wealth-to-income ratios to fall further, reaching their nadir around the end of the Second World War in 1945, with Germany reaching a wealth-to-income ratio of just 1.6 (chart 2).

It is important to note that this reduction in inequality had more to do with the economic and political shocks of the 20th century, than with any progressive policies promoting social mobility.

Renewed wealth concentration after 1945

The post-war period from 1945 to 1975 referred to in France as the 'Trente Glorieuses' and in Germany as the 'Wirtschaftswunder' saw a rapid rebuilding of capital, causing wealth-to-income ratios to rise again. In the 1980s, wealth-to-income ratios accelerated even further as owners of capital benefited from wide-

spread financial deregulation, falling interest rates and rising asset prices. Today, wealth-to-income ratios are again approaching their pre-war levels of 1910 (chart 2), suggesting that the shocks of the 20th century have now faded, signalling a renewed concentration of wealth in Europe.

Explaining rising concentrations in wealth

Mr Piketty offers a simple explanation for this rising inequality: wealth generally grows faster than the economy. In essence, it comes down to a simple mathematical equation. If the numerator of the wealth-to-income ratio (wealth) grows faster than the denominator (income), the wealth-to-income ratio will rise, suggesting that wealth holders grow their wealth faster than income earners. This increases the concentration of wealth in society, which appears to be confirmed by data.

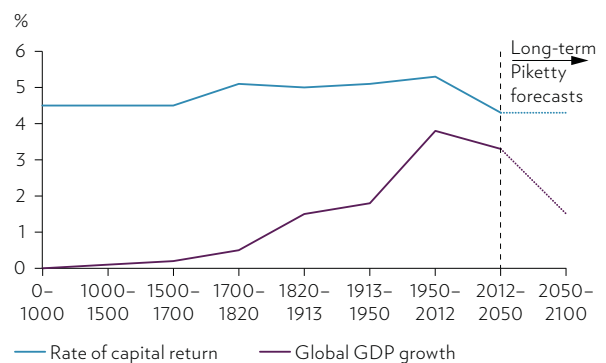
Chart 4 shows that since 1700, the rate of return on capital (both property and financial investments) has remained remarkably steady and has consistently exceeded the rate of economic growth. It was just in the 20th century that rapid population growth and free trade briefly lifted economic growth closer to the rate of capital returns. But with falling population growth rates and advancements in technology proping up capital returns as machines are substituted for workers, the returns on capital are likely to continue outstripping economic growth rates, thus further increasing the concentration of wealth.

The future of wealth distribution in Europe

Given the deep structural challenges European economies face – from high unemployment to low population growth rates – the outlook for European economic growth remains uninspiring. Our analysts expect little less than 1% growth in 2014 and 1.3% growth in 2015. At the same time, if one assumes the rate of capital returns to remain close

to its 200-year average of 4%–5% per year, it stands to reason that the concentration of European wealth is likely to increase persistently in the years to come. In other words, the wealthy are likely to get an even larger slice of a gradually expanding private wealth cake.

Chart 4: Capital returns exceed economic growth rates



Source: 'Capital in the Twenty-First Century' (2014), T. Piketty, Julius Baer

Implications of growing concentrations of wealth

The growing concentration of wealth in Europe has important implications for our investment strategies, our economies and the social fabric of our European societies. One clear implication is that wealth holders will likely play an important role in tackling the structural challenges facing European economies, whether by promoting entrepreneurship in Europe (see interview with Sir Richard Branson on page 32), by facilitating the investment in education and skills, or by directly deploying capital to address social and environmental challenges via impact investing (as described on page 42). Together, these measures would not necessarily reduce inequality, but make wealth differences more meritocratic and less static.

My philosophy is that if I have any money I invest it in new ventures and not have it sitting around.

Sir Richard Branson, founder of Virgin Group

Source: Interview in The Sunday Mirror, 16 January 2000



EUROPE'S WEALTHIEST BILLIONAIRES: TOP 10 MEN¹

Rising asset prices in recent years have led to big jumps in the wealth owned by Europe's wealthiest citizens. The data below offers an overview of Europe's ten wealthiest men. It is interesting to note that eight of the ten wealthiest men built their fortunes in their own lifetimes, with only two men inheriting their wealth.

Andreas Bächli, Julius Baer

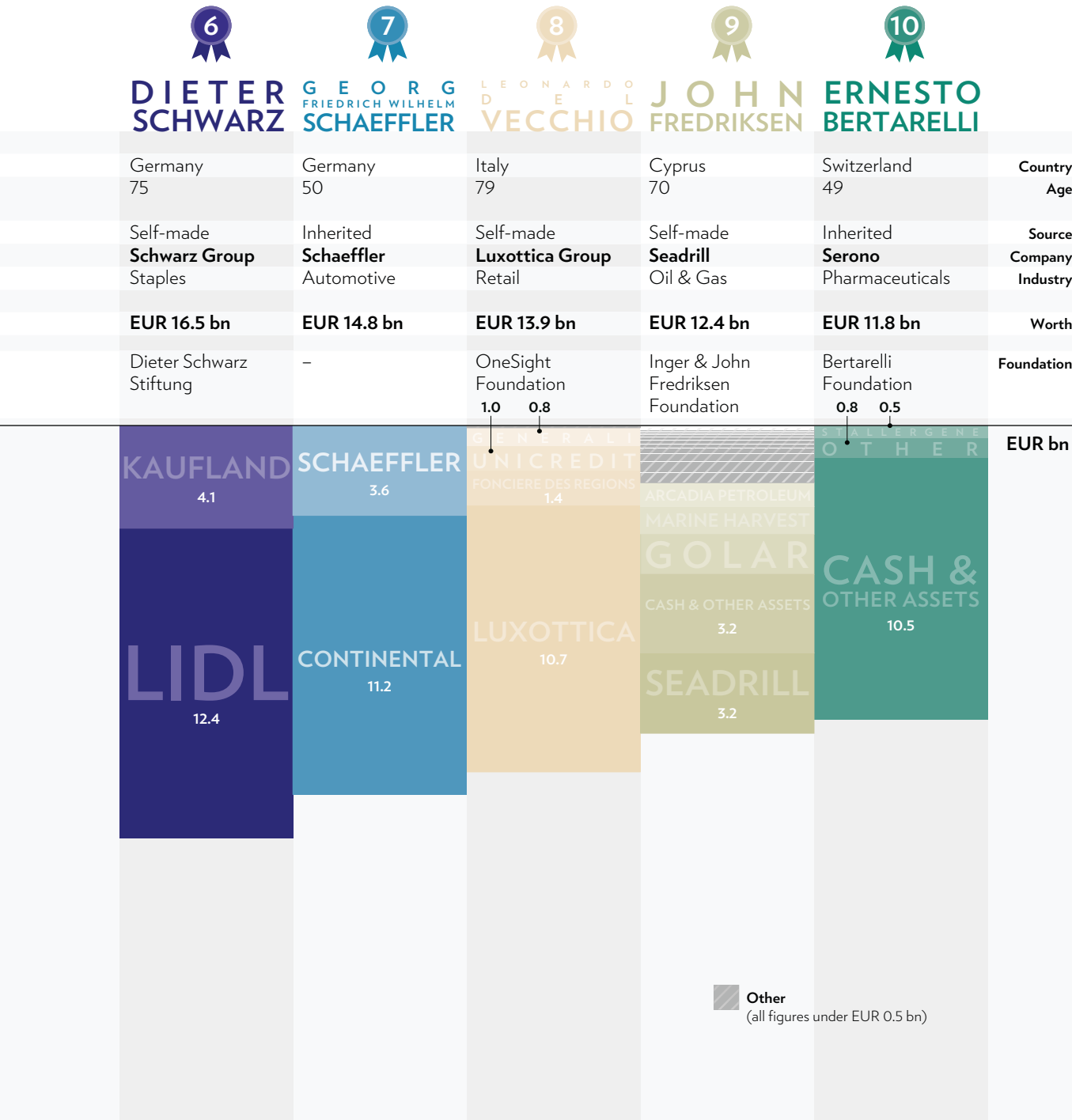


Source: Bloomberg Finance L.P., Julius Baer

¹ Wealth levels as measured by market values in July 2014.

Business success means having the courage to lead and to be innovative.

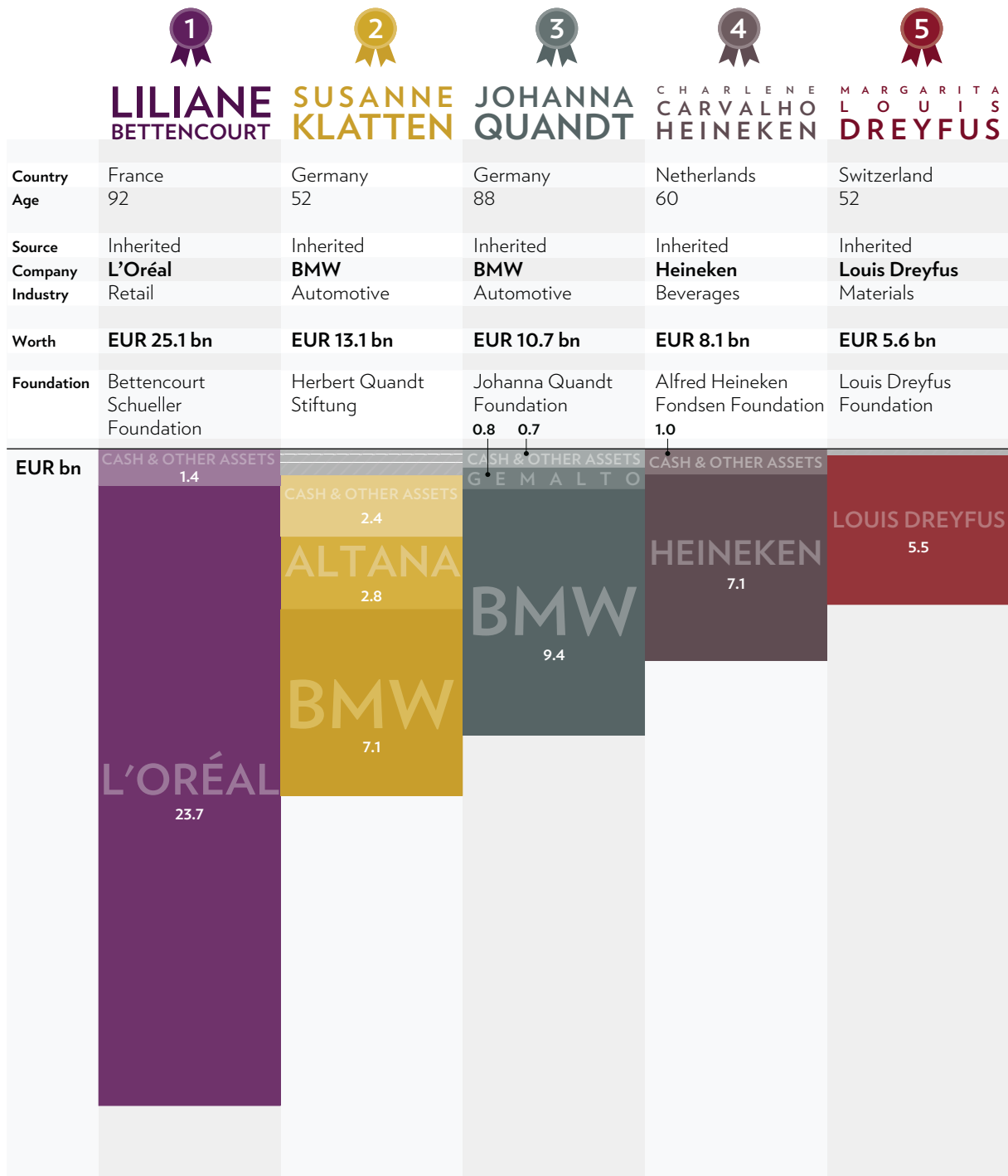
Dieter Schwarz



EUROPE'S WEALTHIEST BILLIONAIRES: TOP 10 WOMEN¹

Europe's ten wealthiest women also own significant fortunes themselves. It is noteworthy here that all of the women profiled below inherited their wealth, which stands in sharp contrast to the majority of Europe's ten wealthiest men having built up their wealth themselves. But as social norms shift in the 21st century, more 'self-made' female billionaires can arise.

Andreas Bächli, Julius Baer



Source: Bloomberg Finance L.P., Julius Baer

¹ Wealth levels as measured by market values in July 2014.

It's a man's world, and most of the time, men don't take women seriously.

Margarita Louis-Dreyfus



A VIEW FROM THE TOP: MANAGING WEALTH IN A LOW-YIELD ENVIRONMENT

As private wealth in Europe continues to grow, Dr Burkhard P. Varnholt talks about how the management of private wealth is being shaped by artificially low bond yields, high levels of European government indebtedness, and the fallacies of average inflation rates.

Interviewer: Andreas Bächli, Julius Baer



DR BURKHARD P. VARNHOLT

is Head of Investment Solutions Group, Chief Investment Officer and Member of the Executive Board of Bank Julius Baer. Previously, he was CIO and Member of the Group Executive Board of Bank J. Safra Sarasin and Member of the Group Executive Council at CS Group. He gained his PhD at the University of St. Gallen and taught at the Massachusetts Institute of Technology and Stern School of Business, New York University.

Private wealth in Europe continues to grow. At the same time, extraordinary monetary stimulus continues to keep bond yields at artificially low levels. What does this mean for European savers?

The artificially low bond yields have a big impact on savers, not least because savers are no longer able to earn a decent nominal yield by buying government bonds. And if one adjusts these historically low nominal yields for the impact of inflation, one notices that most investors actually earn a negative inflation-adjusted (or real) yield on their investment. This is tantamount to a transfer of real wealth from savers to debtors.

Moreover, it is important that savers understand that inflation rates may mean different things to different people. For example, my children face a different inflation rate to the one my parents face. This is because my children mainly consume items that have fallen in price like t-shirts and mobile phones, while my parents consume goods and services for senior citizens that have risen in price in recent years, like health care and perhaps the odd luxury good.

As a consequence, the inflation-adjusted bond yields that Europe's senior citizens are earning on government

bonds are deeply negative. In other words, the historically low nominal interest rates mean that senior citizens are essentially losing money if one corrects the meagre yield they earn on government bonds for the strong price inflation of the goods and services they consume. What can European savers learn from this trend? That protecting their capital in nominal terms is not necessarily sufficient to protect the purchasing power of their wealth.

The flipside of the secular lows in bond yields is that equity markets continue to reach new highs. Do you think this bull market can continue? And if so, why?

My hunch is that the equity bull market will carry on for at least another five years. Why? Because the political and institutional logic of monetary and fiscal policy dictates so. Given benign inflation and sluggish growth, the real focus for central bankers today is increasingly on generating jobs and economic growth than it is on price stability. And given that many governments are over-indebted, the only trick left to stimulate the real economy is through near zero interest-rate policies and ultra-loose monetary policy, both of which are a boon for equity markets.

Conveniently, artificially low interest rates are also helping over-indebted governments repair their balance sheets. This therefore creates an aligned interest between over-indebted governments and central banks, the latter of which have exploded their balance sheets by buying government bonds. So there is every interest in the world to keep bond yields low for longer.

If one is convinced that interest rates are likely to stay low for longer, it's also important to compare stock valuation levels to bond yields. This is because if bond yields stay low for longer, the relative valuation case for equities versus bonds also becomes more compelling. Allow me to explain by way of an example.

If German government bond yields trade at levels as low as 1%, the implied price-to-earnings ratio (or inverted bond yield) is 100. If one compares this value to the German stock market's price-to-earnings ratio of about 16 and adds to this a dividend yield of over 2% for the same index (i.e. double the yield of the government bond), then equities look particularly attractive relative to bonds. This gap – the equity risk premium – is still at extraordinarily high levels. Just a small narrowing of the gap would drive equity prices up substantially. As such, I believe the secular bull market remains intact, notwithstanding any short-term price volatility along the way.

What impact does this have for the asset allocation decisions of European savers?

In this complex environment in which central bank liquidity is keeping bond yields low and equity prices high, I think the best advice I would give to savers is to delegate their asset allocation decisions to a portfolio manager whom they trust. This way, they can make sure they participate in the secular real asset bull market in a disciplined and diversified fashion.

In Europe, a household with over EUR 850,000 has enough net wealth to belong to the top 10% of European households. Together, this bracket owns over half of the total European wealth. What are the implications of this sort of concentration of wealth?

The big issue here is not only the fact that 10% own 50% of wealth, but rather that the bottom 10% have

far too little. Without even having a normative view on this, I think it is important to understand that excessive inequality slows a country's economic growth and weakens its aggregate demand, as is also confirmed by research from the International Monetary Fund.

Every society and every generation must tackle this issue. That's why it's imperative for policymakers, business leaders, entrepreneurs and wealth holders to engage with the broader civil society on this issue in order to help create more opportunity for more people. Sir Richard Branson's interview in this report (on page 32) on fostering a vibrant entrepreneurial culture in Europe offers important insight on how best to drive this movement forward.

What role can wealth holders play in tackling some of Europe's most pressing challenges, like high youth unemployment?

Like inequality, high unemployment in Europe is one of the biggest issues of our time. With youth unemployment rates in Spain and Greece having exceeded 50% after the financial crisis, the challenge is particularly formidable.

Business leaders, policymakers and wealth holders must work together to help build a social context that offers fertile ground for the creation of new jobs. To achieve this, wealth holders can use impact investment opportunities to channel capital into projects that offer a very clear and measurable social benefit (as described on page 42). Another way to create more opportunity is for policymakers to cut taxes and liberalise labour markets, just like Germany did to turn itself into one of Europe's most competitive countries.

If politicians remain pragmatic, where do you see the state of Europe ten years from now?

Anyone can and should be confident that the European currency union is here to stay – not only for the next 10 years, but even for the next 100 years. It will ultimately force Europe to grow together more firmly and unfortunately it takes crisis situations for politicians to realise that. Europe cannot carry on having multiple voices in a world economy that is increasingly shared by regional trading zones like Asia and the Americas. Europe thus has every chance to remain one of the dominant economic zones in the world.

UNPRECEDENTED MONETARY POLICY SPURS LUXURY GOODS INFLATION

The historic monetary stimulus following the financial crisis of 2008 has lifted asset markets to all-time highs, substantially raising the gross financial wealth of asset holders, even as wage earners remain strapped in the aftermath of the recession. This wealth effect has driven the prices of luxury goods higher, while the prices of common goods remain muted.

Robert Ruttman, Julius Baer
Dimitri Bellas, Julius Baer

Maximum liquidity lifts markets, but not economy

Five years after the global financial crisis, the degree of monetary stimulus in the financial system remains unprecedented. This extreme monetary response has resulted in global central bank liquidity rising by roughly USD 10.3 trillion since 2009, and global interest rates having been cut no less than 357 times (table 1). This historic monetary response continues to lift asset markets to new record highs.

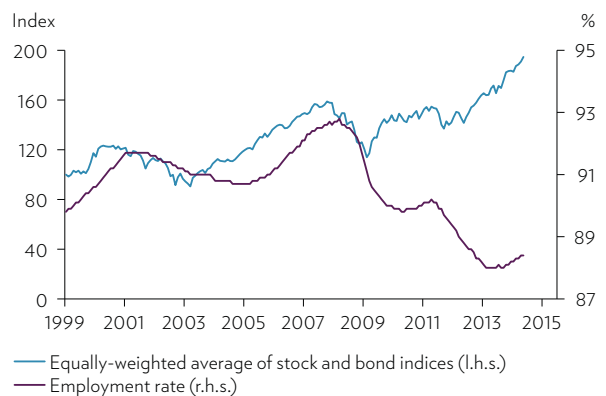
Since 2009, for instance, global equity market capitalisation has risen by USD 40.5 trillion (+159%), while global bond market capitalisation is up by USD 16.4 trillion (+61%). Interestingly, however, this extraordinary liquidity has had only a limited impact on the real economy until now, with global output having risen by only USD 14.6 trillion (+25%) since 2009 (table 1). And the longer it takes for the central bank liquidity to filter through to economic activity, the greater the risk that asset prices may rise higher.

Asset owners benefit most from rising markets

Clearly, capital owners have benefited most from liquidity-inspired asset price rises, even as wage earners remain strapped by the aftermath of the recession. In fact, chart 1 shows how an equally weighted index of

European bond and equity prices has risen to new highs in the last five years, and how this has coincided with a sharp fall in European employment levels. This dynamic has also had a clear impact on the general level of prices for goods and services.

Chart 1: Asset owners profit, even as labour struggles



Source: Bloomberg Finance L.P., Julius Baer

Luxury goods prices soar, as general prices sputter

The high unemployment rates in Europe have kept consumer demand growth muted, causing general prices to grow less quickly (disinflation) or even fall (deflation). In fact, in July 2014, euro-area prices grew at only

Table 1: Abundant liquidity has boosted asset prices, but not nominal GDP

	Then (Q1 2009)	Now (Q2 2014)	Change	Change in %
Global interest rate cuts	–	–	357 times	
Global liquidity	USD 12.6 trillion	USD 22.9 trillion	+ USD 10.3 trillion	+82
Global equity market capitalisation	USD 25.5 trillion	USD 66.0 trillion	+ USD 40.5 trillion	+159
Global bond market capitalisation ¹	USD 27.0 trillion	USD 43.4 trillion	+ USD 16.4 trillion	+61
Global nominal GDP	USD 58.1 trillion	USD 72.7 trillion	+ USD 14.6 trillion	+25

¹ Global Fixed Income Markets Index

Source: Bloomberg Finance L.P., Haver, Julius Baer

0.4% year-on-year, which is significantly below the 2% inflation level set by the ECB. This low general inflation reading has led to speculation that the ECB may begin printing money to buy up government bonds to prevent deflation.

Although the general European inflation rate remains benign, prices for luxury goods – from high-end wines, jewellery, designer handbags to sports cars – are rising at least twice as fast as the general inflation rate. In fact, chart 2 shows that the average price of a basket of luxury goods and services we have constructed grew nearly twice as fast as average inflation over the last ten years, up by 38% since 2004 versus just 18% for the general European inflation rate.

Chart 2: Luxury prices rise faster than average inflation

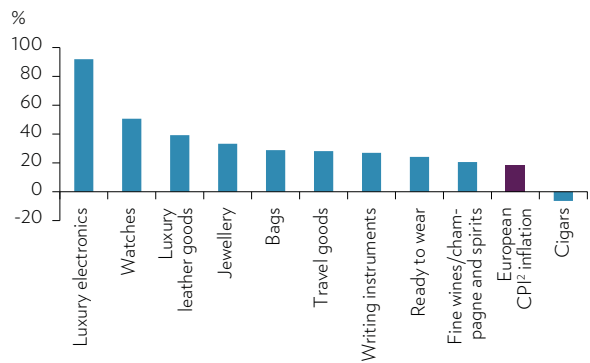


Source: Euromonitor, Bloomberg Finance L.P., Julius Baer

Rising wealth of asset owners drive luxury prices

The sharp rises in luxury prices have largely been driven by the increasing wealth of asset owners who benefited most from liquidity-inspired asset price rises. And with a growing amount of money chasing a limited amount of luxury goods, prices typically increase. This has been the case with all luxury goods segments, except for cigars (chart 3).

Chart 3: Luxury goods price change, 2004–2013



² CPI = Consumer price index

Source: Bloomberg Finance L.P., Bank of America Merrill Lynch, Euromonitor, Julius Baer

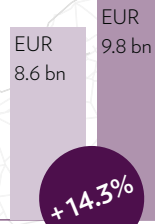
The sky is the limit for luxury goods and services

With little sign of a short-term end to the expansionary monetary policy that is propping up asset markets, the prices of luxury goods can continue to rise faster than the average inflation rate for some time to come. And as wealth continues to rise, luxury goods may become an increasingly desirable way to differentiate the scale of a wealth holder's discretionary economic power, causing prices to rise even higher.

These consumption trends are likely to have two clear effects: first, with rising luxury goods prices, wealth holders consuming luxury goods are likely to see a gradual yet persistent reduction in their purchasing power; and second, companies producing luxury goods and services are likely to benefit disproportionately from the structural trend causing luxury goods prices to rise higher and higher.

Pernod Ricard

- Pernod Ricard is the world's second-largest wine & spirits company, with a strong family of brands in premium cognacs (Martell), Whiskeys (Jameson and Glenlivet) and premium vodkas (Absolut).
- Pernod focuses on the fast-growing premium spirit segment with brands like L'Or, Chanteloup, Royal Salute scotch, and Perrier-Jouët champagne.
- The brand benefits from rising wealth and shifting consumption trends toward Western-style spirits.

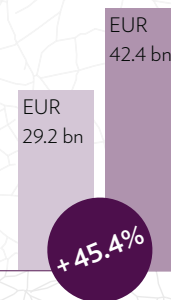


Paris



LVMH

- LVMH is a leading luxury firm, owning multiple premium brands in fashion (Louis Vuitton or Donna Karan), wines & spirits (Moët & Chandon or Hennessy Cognac), cosmetics (Sephora) and watches & jewellery (TAG Heuer).
- Louis Vuitton is its most iconic brand with strong pricing power. With an estimated EBIT margin of 55%, its handbags are sold at EUR 1,400 per piece at retail shops.
- LVMH premium brands are set to benefit disproportionately from rising wealth.



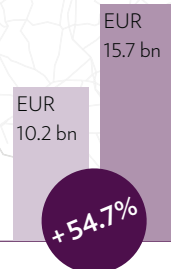
Geneva



- Sales 2013
- Sales 2018 estimated¹
- Growth

Richemont

- Richemont offers a diverse portfolio of luxury brands, with particular strengths in jewellery, luxury watches and writing instruments.
- The firm targets the very high-end consumer with brands like Cartier, IWC, Montblanc, Chloé, Piaget and Van Cleef & Arpels, all offering unique heritage and strong pricing power.
- With only 20% of global jewellery being branded, Richemont has potential to benefit from this rising trend.



EUROPEAN LUXURY GOODS COMPANIES SET TO BENEFIT FROM RISING GLOBAL WEALTH

Higher asset prices, growing global wealth and a sharp rise in luxury goods prices have increased public attention on the companies and brands catering to high-end consumers. This map offers an overview of eight European companies² producing the luxury goods that have continued to be met with ever greater consumer demand in recent years.

¹ Based on consensus estimates by Bloomberg Finance L.P.

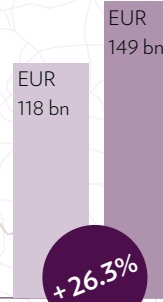
² All companies named in this report are listed for illustrative purposes only, and should not be mistaken for an investment recommendation.

Stuttgart



Daimler

- Daimler manufactures cars, trucks and buses, and is probably most famous for its premium-luxury brand Mercedes-Benz, which generates 55% of group sales.
- The Mercedes-Benz slogan is “Das Beste oder nichts” (English: “The best or nothing”).
- With nearly 40% of Mercedes-Benz sales coming from China, the brand is well positioned to benefit from rising wealth in China, the fastest-growing luxury car market globally.

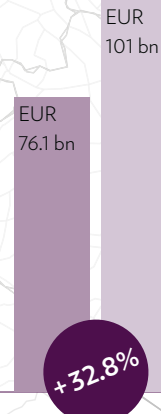


Munich



BMW

- BMW produces luxury cars and motorcycles on a global basis. Its most famous brands are BMW, Mini and Rolls Royce.
- Between 2013 and 2020, BMW expects the global luxury car market to grow by 35%, with 80% growth in China.
- BMW has an exceptionally strong brand, which should position the company to benefit from the increase in global wealth.

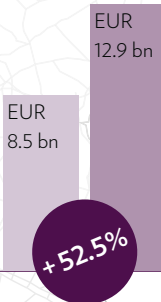


Biel



Swatch

- Swatch Group manufactures watches and jewellery, including very high-end luxury brands like Breguet, Blancpain, Longines, Omega, and recently ‘king of diamonds’ Harry Winston.
- With 35% of Swatch sales generated in the high-end segment, the firm is positioned to benefit from an increase in global wealth.
- The firm is also positioned to benefit from aspiring affluent consumers.

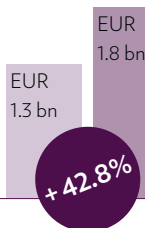


Florence



Salvatore Ferragamo

- Salvatore Ferragamo generates 43% of sales from shoes, 33% from leather goods and the rest from accessories.
- The business is built on the reputation of the founder supplying the finest shoes to the early Hollywood icons like Marilyn Monroe, Sophia Loren, and Audrey Hepburn.
- Salvatore Ferragamo remains the “brand of the stars”, but the firm is also broadening its target universe to include customers benefiting from rising global wealth.



Solomeo



Brunello Cucinelli

- Brunello Cucinelli has a core offering in cashmere knitwear. The company is at the top of the luxury pyramid, with an average price of EUR 1,400 per ticket.
- The brand benefits from a strong heritage around the founder, product and service excellence, exclusivity of distribution, and a commitment to sustainable business.
- With such strong pricing power, the brand is well positioned to benefit from increasing global wealth.

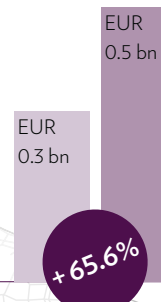
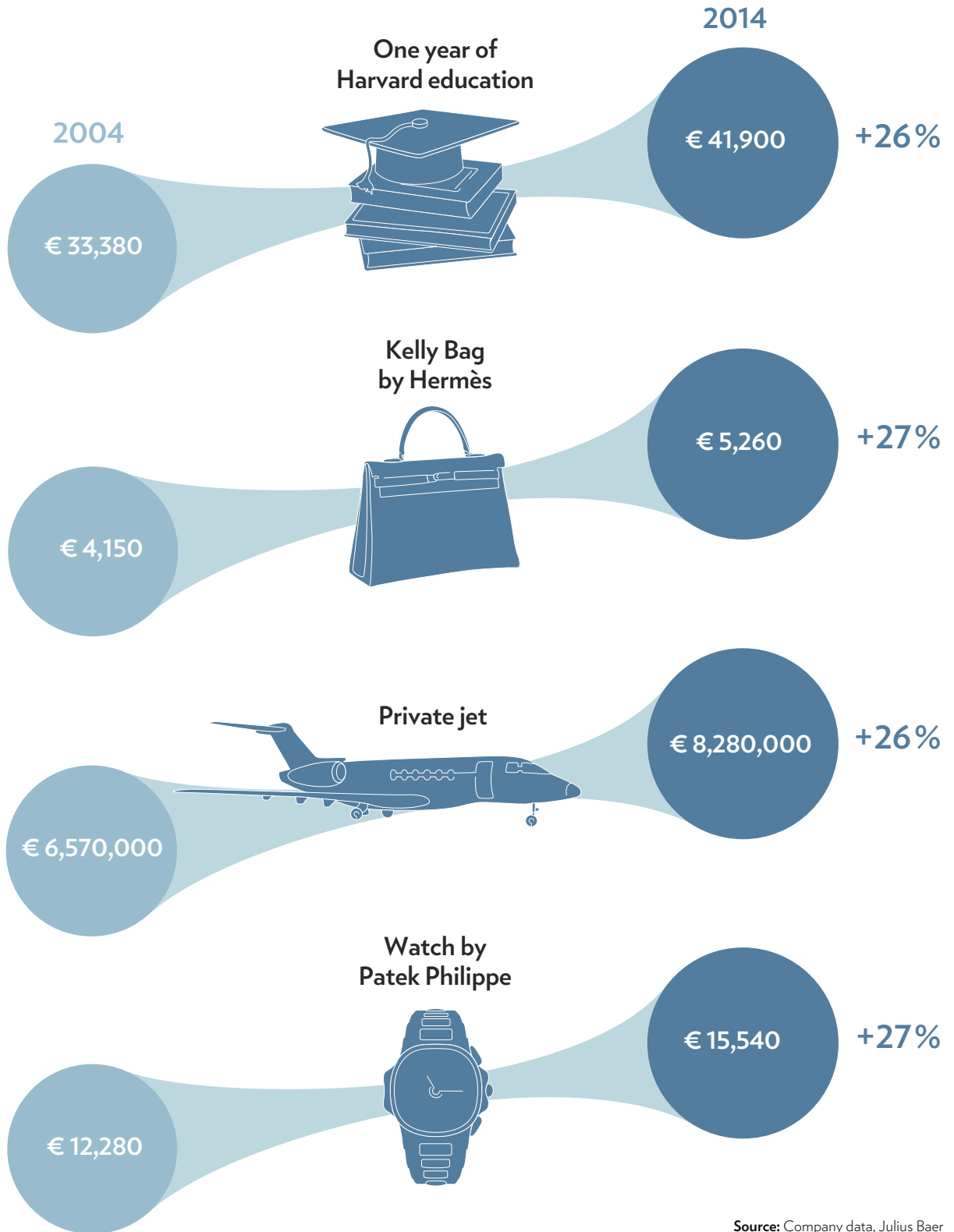


Chart 4: Price increase of luxury products since 2004



Source: Company data, Julius Baer

As a family
we are part of Heineken's
past, present and future.

Charlene de Carvalho-Heineken, owner at Heineken

Source: Bloomberg Finance L.P.



KEEP IT IN THE FAMILY: BUILDING WEALTH THROUGH THE FAMILY FIRM

Family-run firms have always played an integral role in economic progress – and as vehicles to generate family wealth. Although many of Europe’s best-known family businesses diluted their ownership in the second half of the 20th century, many of its enduring corporate powerhouses today continue to be guided by a family interest – a so-called ‘family edge’.

Robert Ruttmann, Julius Baer
Andreas Bächli, Julius Baer

European family firms as a driver of wealth

Family-run companies have always played a key role in driving forward economic progress and building family wealth. These businesses include a vast range of companies¹ from the tiny neighbourhood ‘mom-and-pop’ stores to the millions of small- and medium-sized enterprises, to the multinational giants such as Swatch, L’Oréal or BMW. And although many of the world’s best-known family businesses diluted their ownership in the second half of the 20th century, many of these corporate powerhouses remain at least influenced if not controlled by their founding families today. They also remain as strong drivers of European family net wealth.

Family businesses are more profitable

The companies in which the founding families still own large or controlling stakes typically tend to have an enduring, multi-generational competitive edge over other businesses. In fact, according to a BCG study² this ‘family edge’ is confirmed by family-run firms typically delivering more consistent profitability ratios – as measured in return on equity – than non-family

businesses. This higher profitability persists over all parts of the cycle, in all countries examined, and especially in times of crisis (chart 1). Another study³ with highly robust results for some of the oldest family-run companies in Japan also suggests that family control is closely related to long-term financial outperformance.

Family business equities also outperform

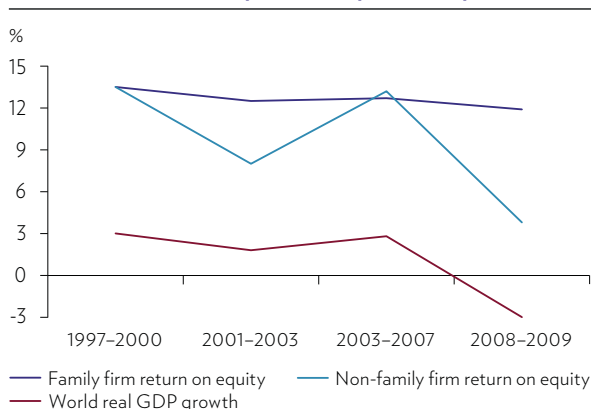
The more consistent profitability ratios that family businesses tend to produce are typically also reflected in their stock market performances. Family firms tend to outperform non-family firms in the long term, suggesting that family ownership can add value for investors too.

For instance, the DAXplus Family Index, which tracks the 30 largest German family businesses, has delivered a consistent outperformance over the broader DAX index of 79% over the last ten years (chart 2). Firms like Volkswagen (+782%), Henkel (+337%), BMW (+190%) and Fresenius (+176%) have performed particularly well in this context. The precise reasons for this consistent outperformance of family businesses are difficult to pin down exactly. But broadly speaking, we trace this ‘family edge’ back to three enduring advantages.

Family firms have a long-term horizon

The first driver behind the ‘family edge’ is that family firms tend to have a clear long-term focus, often avoiding the pitfalls of ‘short-termism’. Indeed, a key feature that characterises most family firms is their long-term focus on building businesses that can be passed on to future generations. This focus on ensuring the multi-generational survival of the firm usually trumps any desire to boost short-term profits by taking reckless bets or making cuts in areas that undermine

Chart 1: More resilient profitability for family firms



Source: Boston Consulting Group, Harvard Business Review, Julius Baer

¹ All companies named in this report are listed for illustrative purposes only, and should not be mistaken for an investment recommendation.

² Kachander, N. et al. (2012), ‘What you can learn from family businesses’, Boston Consulting Group (BCG).

³ Mehrotra, V.; Morck, R.; Shim, J.; Wiwattanantang, Y. (March 2011).

‘Adoptive Expectations: Rising Sons in Japanese Family Firms’, National Bureau of Economic Research (NBER) Working Paper No. 16874.

the long-term competitiveness of the firm – for example, in areas such as research and development or employee safety. This long-term approach is especially valuable in an era defined largely by an excessive focus on the next quarterly earnings cycle and short-term share price gyrations.

Conservative financial management

The second driver behind the ‘family edge’ is that family businesses tend to manage their finances more conservatively, carrying less debt and investing their capital more cautiously. Families that have guided their businesses through multiple business cycles understand that limiting the downside risks also means lower debt, since debt results in less room to manoeuvre when setbacks occur. The financial crisis confirmed the strength of this strategy, as family firms entered the crisis with leaner cost structures and lower leverage ratios than non-family firms (debt-to-total-asset ratios of 37% versus 47% for non-family firms, according to the BCG study), which meant that they did not have to make sacrifices in meeting large financing demands during recession.

This lower level of indebtedness is also closely related to the judicious approach family firms tend to have for capital expenditures and expansion plans. As such, family firms tend to avoid costly acquisitions, preferring instead to engage in partnerships or joint ventures, where the need for large capital outlays and integration risks are lower. In many cases, families even appoint a ‘watchdog’ to the company board to prevent management from engaging in strategies that may not be aligned with the long-term goals of the family.

Inspiring an emotional commitment to the firm

The third driver behind the ‘family edge’ is that family firms seem to be able to inspire an emotional commitment to their brands – among both customers and employees. Families tend to recognise that the firm’s reputation is closely aligned with the family’s legacy. As such, they typically have a strong sense of responsibility in terms of creating good jobs, avoiding lay-offs and investing in their own employees. For instance, according to BCG, family firms spend nearly three times more on employee training than non-family firms do.

Chart 2: DAXplus Family Index outperforms DAX



Source: Bloomberg Finance L.P., Julius Baer

This investment not only boosts employee competence, but also tends to lead to higher levels of trust, a stronger company culture and lower employee turnover rates. In fact, according to BCG data, family firms have only 9% annual turnover rates relative to 11% for non-family firms. These higher retention rates clearly have a direct impact on the company’s bottom line, but perhaps more importantly, they also reflect the fact that the family firm is seen as an attractive place for employees to work. This family-based brand identity can thus also work to attract top talent, and also to inspire the creativity and innovation that leads to better products and better services.

The financial crisis of 2008 put most companies¹ under unprecedented pressure. But even in this hostile environment, many family firms differentiated themselves from others through their reluctance to cut their workforces. The most visible example was probably Alexandre Soares dos Santos, Chairman of the Portuguese food distributor Jerónimo Martins, who declared that his company would lay off workers only as a last resort after cutting salaries, bonuses, investment and dividends. This commitment not only tends to build high levels of trust among employees, but also creates a strong company culture – which also serves to strengthen brand value of the firm among customers.

Managing family-related company risks

Family businesses also present a number of risks specific to this form of ownership – risks such as succession planning, nepotism and family feuds. Firms in their second generation of ownership have typically already set up systems to successfully navigate some

of these most vexing challenges. For instance, many families establish explicit verbal and written agreements that address potential challenges (e.g. conditions by which family members can or cannot work in the business, boundaries for corporate and financial strategy).

Table 1: Europe's 40 largest family businesses, ranked by market capitalisation

Rank	Firm ¹	Country	Sector	Family ownership	Family name
1	Roche	Switzerland	Health care	50% ²	Oeri/Hoffman
2	Anheuser-Busch InBev	Belgium	Consumer staples	45%	Stichting Foundation
3	Volkswagen	Germany	Consumer discretionary	32%	Piëch/Porsche
4	L'Oréal	France	Consumer staples	31%	Bettencourt
5	Inditex	Spain	Consumer discretionary	59%	Ortega
6	BMW	Germany	Consumer discretionary	47%	Quandt
7	Hennes & Mauritz	Sweden	Consumer discretionary	38%	Persson
8	Richemont	Switzerland	Consumer discretionary	50% ³	Rupert
9	AP Moeller - Maersk	Denmark	Industrials	55%	Mc-Kinney Møller
10	Henkel	Germany	Consumer staples	53%	Henkel
11	Associated British Foods	Britain	Consumer staples	55%	Weston
12	Heineken	Netherlands	Consumer staples	50%	Heineken
13	Merck	Germany	Health care	70%	Merck
14	Porsche	Germany	Consumer discretionary	100%	Porsche/Piëch
15	Swatch	Switzerland	Consumer discretionary	41% ⁴	Hayek
16	Luxottica	Italy	Consumer discretionary	67%	Del Vecchio
17	Kering	France	Consumer discretionary	41%	Pinault
18	Kone	Finland	Industrials	51%	Herlin
19	Bolloré	France	Industrials	50%	Bolloré
20	Sodexo	France	Consumer discretionary	38%	Bellon
21	Kuehne & Nagel	Switzerland	Industrials	58% ⁵	Kuehne
22	Ferrovial	Spain	Industrials	45%	Del Pino
23	Dassault Aviation	France	Industrials	100%	Dassault
24	Metro	Germany	Consumer staples	50% ⁶	Haniel/Schmidt-Ruthenbeck
25	Bouygues	France	Industrials	30%	Bouygues
26	Fiat	Italy	Consumer discretionary	30%	Agnelli
27	Koc	Turkey	Industrials	75%	Koç
28	Peugeot	France	Consumer discretionary	25%	Peugeot
29	Jerónimo Martins	Portugal	Consumer staples	56%	Soares dos Santos
30	Haci Omer Sabanci	Turkey	Financials	61%	Sabancı
31	Colruyt	Belgium	Consumer staples	47%	Colruyt
32	Wendel	France	Financials	34%	Wendel
33	Wacker Chemie	Germany	Materials	50%	Wacker
34	Acciona	Spain	Utilities	49%	Entrecanales
35	DKSH	Switzerland	Industrials	47%	Diethelm/Keller
36	Groupe SEB	France	Consumer discretionary	44%	Lescure
37	Italcementi	Italy	Materials	60%	Pesenti
38	Fomento de Construcciones	Spain	Industrials	52%	Koplowitz
39	Edoardo Guida Garrone	Italy	Energy	56%	Garrone
40	Schmolz & Bickenbach	Switzerland	Materials	40%	Schmolz/Bickenbach

¹ The firms named above are listed for illustrative purposes only, and should not be mistaken for an investment recommendation.

² 45.01% family pool, 5% Maja Oeri

³ voting rights

Source: Datastream, Bloomberg Finance L.P., Campden VB, Julius Baer; data as at 7 July 2014.

Building European wealth in the 21st century

Over the medium term, we believe family businesses are likely to continue being strong drivers of private wealth accumulation in Europe. As such, their 'family edge' can even lead them to grow more consistently than non-family companies. To this end, we include a

list of European family firms below that are at least in their second generation of ownership and where the family voting rights make up at least 25% of the total rights. These firms are likely to play a major role in creating good jobs, producing great products and driving European household wealth in the 21st century.

Market capitalisation (EUR bn)	Revenue (EUR bn)	Profitability (ROE)	Leverage ratio (D/E)	Dividend yield (%)	Forward (P/E)
189.1	38.5	65%	0.9	2.9	16.6
135.4	43.2	31%	0.9	2.4	19.3
91.1	197.0	12%	1.3	2.1	7.8
76.9	23.0	14%	0.0	2.0	21.2
71.0	16.7	27%	0.0	2.0	24.4
60.9	76.1	16%	2.0	2.7	10.3
52.0	13.8	50%	0.0	3.3	21.9
43.3	8.8	19%	0.1	1.1	16.6
39.5	6.4	9%	0.4	2.0	10.9
34.5	16.4	16%	0.3	1.4	18.3
31.2	16.8	10%	0.2	1.2	28.3
30.9	19.2	12%	1.0	1.7	16.4
28.2	10.7	12%	0.3	1.5	13.4
23.6	0.0	32%	0.0	2.6	7.3
23.1	7.0	18%	0.0	1.4	14.6
20.4	7.3	13%	0.5	1.5	25.3
19.9	9.7	0%	0.4	2.4	13.8
16.2	6.9	51%	0.1	5.3	18.2
12.9	10.8	4%	0.4	0.7	28.7
12.6	18.4	17%	0.9	2.0	19.7
11.6	14.1	24%	0.0	5.0	20.0
11.6	8.2	12%	0.9	4.4	30.5
11.4	4.6	9%	0.1	0.8	22.5
10.6	65.7	2%	1.5	-	15.2
10.1	33.3	-5%	0.9	5.3	14.3
9.5	86.8	8%	2.4	-	7.8
8.9	22.8	16%	0.7	1.6	9.3
8.9	54.1	-28%	0.0	-	12.2
7.4	11.8	27%	0.4	2.6	15.8
6.8	3.3	9%	0.9	1.0	8.0
6.0	8.7	19%	0.0	2.6	16.0
5.0	6.4	13%	2.6	1.8	15.2
4.6	4.5	3%	0.6	0.6	30.0
3.8	6.6	-47%	2.3	2.6	40.1
3.5	7.9	19%	0.1	1.6	19.2
3.2	4.2	15%	0.5	2.2	14.0
2.5	4.2	-6%	0.7	0.7	34.0
2.2	6.7	N/A	31.0	0.0	21.2
1.7	5.3	2%	0.9	8.7	21.1
1.1	3.3	-11%	0.8	-	17.7

⁴ voting rights

⁵ 53.3% Kuehne Holding, 4.3% Kuehne Foundation

⁶ 34.24% Gabuek, 15.77% Schmidt-Ruthenbeck

FOSTERING AN ENTREPRENEURIAL MINDSET

Many European countries remain plagued by strikingly high unemployment rates, especially for people between the ages of 18 and 25. Sir Richard Branson discusses the important role entrepreneurship can play in sparking job creation in Europe, the qualities needed to succeed as an entrepreneur, and the critical role business and policy leaders play in promoting and nurturing entrepreneurial initiative.

Interviewer: Robert Ruttman, Julius Baer



SIR RICHARD BRANSON

is the founder of the Virgin Group. Virgin is one of the world's most recognised brands, with more than 100 companies worldwide and approximately 60,000 employees in over 50 countries. Since starting youth culture magazine *Student* aged 16, Branson has found entrepreneurial ways to provoke positive change in the world. In 2004 he established Virgin Unite, the non-profit foundation of the Virgin Group, which strives to make business a force for good.

You have talked a lot about the role entrepreneurship can play in tackling pressing global challenges, from access to health care, clean energy and micro-finance. What role can entrepreneurship play in being part of the solution to help mend some of Europe's long-term structural challenges like high unemployment and high debt?

Encouraging entrepreneurship, especially in European countries that have been hit hard by rising unemployment, is unquestionably a good way to spark job creation. The pleasing thing is that even in the face of adverse conditions, start-ups are proving that they can make a go of things and not fold at the first hurdle. At a recent Virgin Disruptors debate¹, we were lucky enough to hear from two Greek entrepreneurs who told us of their experiences, they certainly didn't view themselves as being from a 'lost generation'.

What these entrepreneurs wanted was more help and encouragement from those in charge, as with countries like Greece where the financial system has collapsed, there needs to be a strong set of rules to ensure that everyone has a fair chance of making a go of a business. It's slightly strange because so often we argue how regulations can stifle start-ups, yet there's some occasion where it works in reverse.

What are some of the skills and abilities successful entrepreneurs seem to have in common?

You have got to want to be in business for the right reasons, you can't just be focused on making a quick profit. Those entrepreneurs who are the most successful run companies that make a positive difference in the lives of their customers and employees.

There're a few qualities that you'll need to pick up, and quickly. As your business starts to grow it's crucial that you master the art of delegation, otherwise you'll find yourself overrun. This may sound easy but I all too often come across entrepreneurs who can't let go or trust their employees. If you've deemed someone good enough to hire them then you should realise that it's a smart decision to give them a task to do and not be looking over their shoulder every five minutes.

How can one promote these types of attitudes and qualities? Where and how early should one start?

I've always been a big advocate of teaching business skills from an early age, it seems strange to me that there isn't more of an onus put on this at school. In countries such as the UK, there seems to have been a misguided desire to push everyone through the same, narrow school system. It wasn't until recently,

¹www.youtube.com/watch?v=WVDs7y9KL-E

as a result of lobbying from Virgin (amongst others), that the government agreed to give young entrepreneurs a loan on a similar basis to those students heading to university. There needs to be a level of acceptance that higher education is a wonderful thing, but it's not for everyone: some of the world's most successful entrepreneurs are college dropouts. We need to find more inventive and widely available ways to help nurture young entrepreneurial talent.

A celebration of an entrepreneurial spirit seems to be embedded in Virgin's DNA. What can companies do to help support young entrepreneurs?

Helping young entrepreneurs might mean paying invoices on time when a start-up works for you (it's easy to forget how reliant entrepreneurs can be on this cash flow when a business is in its early stages), it could mean making space in your office for young entrepreneurs to come in and hot-desk for free or it could even mean that you act as a mentor for someone. There are countless ways by which corporations can support young entrepreneurs, even the smallest of gestures can go a long way to build confidence or enhance their understanding of how business works.

What do companies have to gain from mentoring and guiding the next generation of entrepreneurs?

Europe has many thriving entrepreneurial hubs where there are some incredibly exciting things going on. From London to Tel Aviv, we're seeing all sorts of innovations coming out of the Continent. For larger, established companies there can often be a disconnect between the fresh ideas coming from these areas and what's going on in their own office. Mentoring the next wave of talent will expose you to a lot more than you might think. You'll probably end up learning a great deal, the flow of knowledge will certainly not be one way.

Access to capital remains one of the biggest challenges for young entrepreneurs – especially in peripheral Europe, where banks demand more collateral, charge higher interest rates and reject more credit applications. What can be done to improve the accessibility to credits?

In the UK last year we launched Virgin StartUp, a not-for-profit organisation that works with the government

to hand out loans to start-ups at a fair rate, as well as set them up with a mentor. We're seeing more and more people register for loans and there have been some real success stories, from across the country, coming out of the scheme. One of the most frequent questions I'm asked is why is this scheme not available in other countries? The simple answer is that I don't know, but it should be. I'd encourage other countries to follow the example set by the UK government on this occasion.

You have often spoken about the importance of promoting female entrepreneurship. Why do you feel so strongly about this and what can be done to inspire more women to become entrepreneurs?

Earlier this year, we conducted some research into women in business², needless to say the results didn't make for good reading. Of the women surveyed, 75% asked believe that in terms of promotion and salary men receive preferential treatment in the workplace. There can't be any argument that this is a problem that needs confronting. Encouraging female entrepreneurs to be job creators would be one way to start turning the tide. My greatest role model is my mother. On top of this we have some fantastic women in high-level positions at Virgin companies, but we all still need to do more to encourage equality in business.

In your words: business does not need to be a zero-sum game. What does it mean for the next generation of entrepreneurs?

Business doesn't have to result in some winning while others lose, if we all do things right then everybody stands to gain. That goes for our communities, the planet and everybody on it. Businesses should be playing a major role in tackling global problems; it's clear that governments aren't in a position to do it all on their own. Entrepreneurs, at heart, are problem solvers and there're certainly a lot of problems out there that need solving.

The rise of business models such as the sharing economy mean that everybody can take part in working towards common goals, for too long businesses have been narrowly focused on profit. It will be those entrepreneurs who take a wider view of the world around them that last the longest.

² www.virgin.com/entrepreneur/infographic-are-women-discriminated-against-in-the-workplace

THE GROWING ROLE OF INHERITED WEALTH IN EUROPE

If the first half of the 20th century saw steady increases in European inheritance tax rates to pay for the costs of war, the second half saw the opposite effect. With lower inheritance tax rates and high returns on capital, the importance of inheritance in Europe is set to grow.

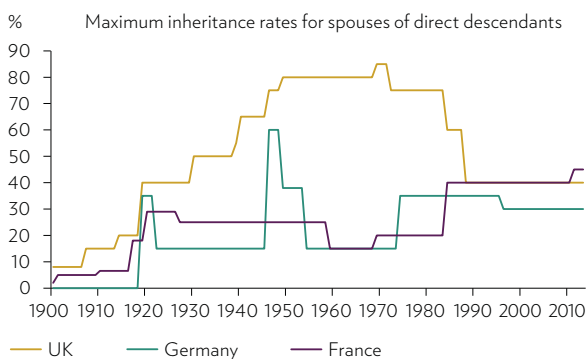
Robert Ruttmann, Julius Baer
Dimitri Bellas, Julius Baer

Inheritance as a part of property rights

The intergenerational transfer of wealth – or inheritance – has long played an important role in human societies. Inheritance is inextricably linked to a right to property, which also includes the ability to determine who should receive the wealth after its owner has died. However, this right to property is not absolute, as many nation states demonstrated in the 20th century by significantly raising inheritance taxes to finance the enormous costs of war.

second half of the century witnessed the opposite effect, as most European governments took steps to lower inheritance taxes considerably (chart 1). Indeed, today most European countries tax their citizens' biggest fortunes at less than 15%, with some countries like Sweden, Austria and Cyprus even having abolished inheritance taxes altogether in recent years. Only France, Spain and the UK have set their respective inheritance tax rates at around the 40% level (chart 2).

Chart 1: Inheritance taxes rose sharply to fund wars



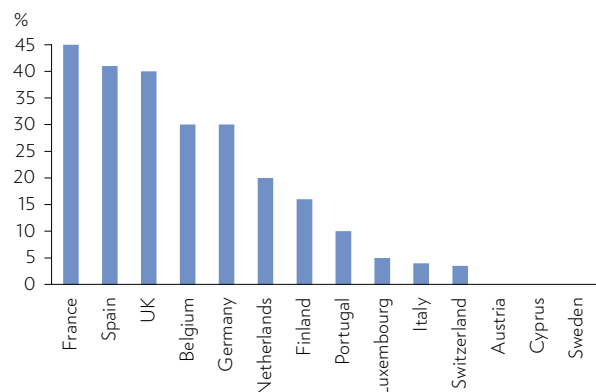
Source: 'Capital in the Twenty-First Century' (2014), T. Piketty, Julius Baer

Indeed, chart 1 shows that inheritance tax rates in Europe's largest economies increased sharply during the two world wars to help raise revenues to finance the big costs of war. The most prominent example of this trend was the UK, which raised inheritance taxes on large fortunes up to 40% during the First World War, before further increasing them to a stunning 75% by the end of the Second World War in 1945 (chart 1). Clearly, countries that mobilised most for war also undertook the highest increases in inheritance tax rates.

Tax rates began to fall in second half of 20th century

If the first half of the 20th century saw steady increases in inheritance tax rates because of war, the

Chart 2: Inheritance tax rates in Europe are varied



Source: National statistical agencies, 'The 2013 International Estate and Inheritance Tax Guide' (Ernst and Young), Julius Baer

Growing importance of inheritance in Europe

Lower inheritance tax rates have clearly increased the importance of inheritance in Europe. But so has the impact of growing wealth. The reason for this is clear. Whenever the rate of return on capital is durably higher than the growth rate of the economy (as has been the case in the last few decades), it is all but inevitable that fortunes accumulated in the past begin to overshadow the role of private savings in the present. This mechanism leads to an increasing concentration of wealth, which in turn also affords a greater meaning to the role of inheritance in society.

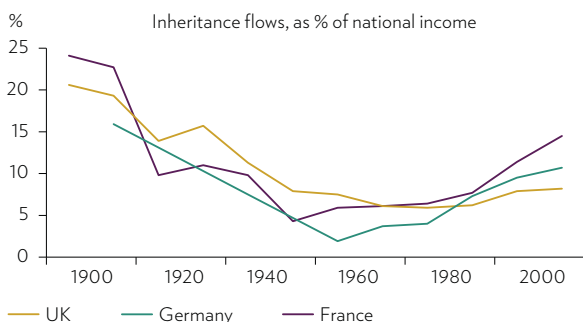
But how exactly does one measure the importance of inheritance in Europe? One approach is to rely on tax data, but this is often incomplete and makes international comparisons difficult (because of the different tax treatment of asset classes). An alternative approach, as advocated by Thomas Piketty, is to look at economic flows to estimate a country's annual inheritance flows as a proportion of GDP.

To this end, Mr Piketty multiplies a country's ratio of national wealth-to-GDP with its mortality rate (i.e. the proportion of the nation's population that dies in any year) and again by the ratio of average wealth at the time of death to the average wealth of the living. In other words, if a country has a capital/income ratio of 400%, a mortality rate of 3%, and its deceased are 1.5 times as wealthy as its living people, then the annual inheritance flow for this country would be $400\% \times 3\% \times 1.5$, or 18% of GDP (national income).

Rising inheritance flows reach pre-war levels

The ability to calculate the values for annual inheritance relative to an economy's GDP means that this methodology allows us to more precisely estimate the importance that inheritance plays in society at a given point in time. To this end, chart 3 shows that the inheritance flows relative to GDP for France, the UK and Germany all declined significantly in the middle of the 20th century, due to war and depression, but have since staged a strong recovery. Indeed, the importance of inheritance has risen particularly sharply in France, where annual inheritance flows make up no less than 15% of national income, reflecting levels last seen in the early 20th century.

Chart 3: Inheritance flows rising back to 1920 levels



Source: 'Capital in the Twenty-First Century' (2014), T. Piketty, Julius Baer

Impact of growing importance of inheritance

A quick look at this data suggests that we may be moving into an era in which the importance of inheritance in Europe continues to grow. This can have several important societal implications. On the one hand, an inherited gift may serve as an inspiration for a person's own personal efforts to continue the process of wealth preservation across generations. For instance, family businesses are a common vehicle to build and preserve a family's wealth beyond the life of the founder.

However, the prospect of a large inheritance among heirs can also have a negative effect on personal motivation. This phenomenon is known as the Buddenbrooks effect, which is a reference to Thomas Mann's celebrated novel *Buddenbrooks* tracing the gradual decline of a mercantile family over three generations. A consequence of this effect is that wealth owners are increasingly transferring the majority of their wealth to foundations. For instance, many billionaires have already signed the Giving Pledge¹, established by Warren Buffett and Bill Gates, a campaign inviting the wealthiest families in the world to commit to giving the majority of their wealth to philanthropy.

Growing importance, higher complexity

If the 21st century turns out to be a time of low economic growth for Europe with capital returns kept high due to international competition for capital, the role of inheritance in Europe is likely to become ever stronger. At the same time, as European governments continue to rebuild their fiscal balance sheets after the financial crisis, some governments may seek to raise tax revenues from wealthy individuals that have benefited most from increased asset values. It is in this context that the topic of inheritance and succeeding generations is likely to increasingly grow in complexity in the coming years.

¹ www.givingpledge.org

TIPS AND TRICKS FOR WEALTH AND TAX PLANNING

Sibylle Grass and Jasmina Gaspar, Wealth and Tax Planning, Julius Baer

1. Preparation is key

The best way to reach your long-term wealth planning goals is to prepare well for life's predictable and unforeseeable events. This requires a tailor-made solution that reflects your financial, legal and personal needs.

2. Start early

Begin planning for your retirement and inheritance at an early stage. Comprehensive and detailed analysis is essential to ensure the preservation of family assets for your benefit and for the benefit of future generations. Your advisor can help you set up an appropriate solution.

3. Focus on good governance of family assets

Transferring family assets or legal ownership and control of a family business can be a complex process, from a rational but also from an emotional point of view. Consider structuring a family council to ensure good governance and the long-term survival of the family business.

4. Optimise the legal constellation

Selecting the most appropriate solution (e.g. trusts, companies, foundations, insurance, private funds, etc.) is key to ensuring a smooth transition between generations.

5. Do your homework before giving to charity

Before donating assets to a charity, do your due diligence on where you will get the biggest impact with your charitable contribution. Consider impact investing as an equally valid and in some cases even more effective vehicle for social change than pure charity.

6. Pay attention to changing tax jurisdictions

Be aware of potential legal and regulatory changes in the tax jurisdictions, which could have an impact on the planning and structuring of your wealth and your residence/domicile.

7. Reduce complexity

Keep your succession planning solution as simple as possible to minimise the risk of having different jurisdictions involved in the legal process and to reduce complexity and time involved in transferring the control of your assets.

8. Rely on a trusted expert

Families can gain their peace of mind by relying on the trusted professional advice of their advisors, who can help them navigate the increasingly complex world of wealth and tax planning in a clear and transparent way.



TACKLING EUROPE'S STRUCTURAL CHALLENGES

European leaders continue to struggle to find policy instruments to help the world's biggest economic region back to growth after the financial crisis. Professor Simon Evenett discusses his views on how Europe is likely to manage its structural challenges, including fiscal, monetary and demographic dimensions. He also includes some important considerations for investors to keep in mind.

Interviewer: Dimitri Bellas, Julius Baer



PROFESSOR SIMON J. EVENETT

is Academic Director of the St. Gallen MBA and Professor of International Trade and Economic Development. His research is taught at dozens of universities around the world. Prof. Evenett obtained his PhD in economics at Yale University and a B.A. (Hons) in Economics from the University of Cambridge. He has taught at the University of Oxford, the University of Michigan Business School and Rutgers University.

As Europe emerges from the crisis, what lessons do you think policymakers have learned in the aftermath of the 2008 financial crisis?

There's almost certainly a long list of technocratic lessons that policymakers could have learned from the crisis. However, I suspect that misses the bigger picture. I won't be surprised if senior political leaders are appalled at the lack of effective tools to restore national economic growth. After all, none of these leaders went into politics to preside over tight budgets.

Policymakers have been convinced that fiscal stimulus packages don't work, or at least fear that saying they do will make them look irresponsible. At the same time, monetary policy simply isn't delivering a strong recovery. Structural reforms may be a good idea in the longer term but the pain is felt here and now. Political leaders must feel as though there is nothing that works in the tool box.

Even waiting for the world economy to pick up has not worked either – with the slowdown in emerging market growth. Policymakers must feel like hostages to fortune. That's not good since desperate politicians and electorates often take drastic, even populist, measures.

The lessons from this crisis for assessing policy risk are, from a wealth management perspective, probably just as important as the lessons drawn by technocratic policymakers.

European public indebtedness remains high in many peripheral countries. How would you recommend that countries manage these fiscal challenges?

I don't subscribe to the hysteria concerning levels of public indebtedness in most of the eurozone countries. For sure, Greece has high debts compared to its national income, but the simple fact is those debts were a lot lower before austerity policies were implemented. The clean way to deal with these debt problems is to get growth going again – ideally, growth that doesn't rest on another mountain of debt, private or public.

More likely, however, politicians may be tempted to press for sustained moderate inflation that will reduce the real value of public debts over a decade or so. That's how heavily indebted Britain and the USA managed to take a sizeable chunk out of the huge public debts they ran up during the Second World War.

Finally, what worries me more than public debt is the huge amount of private-sector debt that is still being carried around by European households and firms. As that private debt gets written off or renounced, plenty of creditors are going to get hurt. It's naive to think that only governments default on their debts.

Europe's ageing populations represent another important structural challenge for policymakers. What effect can demographic change have on business activity, and what can be done to mitigate the challenges arising from a changing European demographic profile?

Spending patterns are said to change dramatically in retirement. As more of us hang up our boots, outlays on goods and services for older people will surely surge and this must benefit certain sectors of the economy. Demand for labour will shift too, reinforcing the premium on those that deal with people, many of whom will be demanding older people.

Many firms fear that ageing will result in skill shortages and, if they come to pass, then hopefully that will trigger initiatives to train employees over the longer term. No doubt there will be the temptation to poach staff from rivals at home or abroad, which will be good for the staff concerned, if nothing else.

Wealth disparities will inevitably increase as will pressure on governments from a greying population to increase state pensions and other benefits. Employers – public and private – will do what they can to evade their pension promises. The cat and mouse games involved could get unpleasant.

What impact is the ECB's accommodative monetary policy likely to have on the evolution and distribution of wealth in Europe?

Given how long it takes for the ECB to build a consensus for each new monetary policy step, those confident in timing their investment decisions will probably be presented with some tempting options in the coming years. This may seem paradoxical but, as in other industrialised economies, the ECB's actions are likely to be both stabilising and destabilising as the monetary policy guessing game continues.

Meanwhile, heightened uncertainty will continue to dampen firm capital expenditures in the eurozone and abroad. Deleveraging and fear induced by structural reforms will continue to weigh down on consumption as well. Overall, financial markets will continue to appear detached from stagnant product markets.

The redistributive effects of low interest rates are now pretty clear. But that is not all. Investors seeking yields that offer decent returns above their advisors' fees will continue to face the reality of having to take on greater risks than they would probably like. Unless an investor is willing to sit out current markets, their confidence in being able to predict their portfolio's value in ten years' time is slim. The reality of being a hostage to fortune may make some save more.

What is the long-term impact of growing income disparity?

If the amount of private-sector credit available remains checked, then the long-term consequences of income disparity are going to test many societies' tolerance of income and wealth differences. For sure, envy will play an unpleasant part. But disparities such as these will probably have more glaring intergenerational effects, as the children of the wealthy appear to have an even better start in life than the rest.

Access to higher education and better-quality health care will risk becoming the preserve of the few, potentially generating a political backlash. It's true that – historically speaking – the decades after the Second World War saw unusually low levels of income and wealth inequality, but enough European voters remember the 'good old days' that political risk should increasingly be factored into wealth preservation strategies.

It's hard to know what level of inequality would trigger a redistributive backlash, just as it's hard to know when a heart attack befalls someone who eats a steak every day.

WEALTH EFFECT OF DEVALUATION AND DEBT RESTRUCTURING

Economic crises can result in the destruction of wealth. The cases of Iceland and Greece after the financial crisis suggest that investors generally have a higher probability of recovering their losses when the crisis is managed by economic laws rather than political ones.

David Kohl, Julius Baer

Systemic crises can destroy wealth

The last decade shocked investors with a systemic crisis in various European countries that had serious repercussions for private wealth. The specific ways of how and to what degree wealth has suffered have been markedly diverse.

Iceland, for instance, was hit in 2008 when foreign money stopped flowing in. All three major Icelandic banks heavily reliant on foreign wholesale financing were placed under receivership, setting in motion a battle over the limited funds of the deposit guarantee scheme.

More than half a million foreign depositors found their accounts frozen and had to learn that governments can change the rules of the game quickly. Iceland passed a law – the day before Landsbanki bankruptcy – that guaranteed full coverage of domestic deposits but refrained from guaranteeing foreign deposits.

Iceland's refusal to guarantee foreign deposits had been driven partly by the lack of access to funding, but also by the sovereign's intention not to cover losses caused by privately owned banks. Due to its refusal to bail out foreign depositors, Iceland was confronted with serious negative consequences, which included even the use of anti-terrorism legislation by the British government against Iceland.

The Icelandic adjustment process was driven by economic principles

Several settlement proposals had been rejected by the Icelandic sovereign. Finally, the case was sent to the EFTA Court, which cleared Iceland of all charges and maintained the foreign claims towards the Landsbanki receivership. The ability to fulfil at least some of

these claims was markedly influenced by the speed and determination of the adjustment process to which the Icelandic economy has been subjected.

The sharp devaluation of the Icelandic krona was both the trigger for the banking crisis and at the same time also a very effective way to tackle the huge imbalances the economy and banking system had accumulated. Furthermore, the sharp devaluation laid the foundation for the economic recovery. This ensured the return to capital market borrowing, thus increasing the readiness to 'play fair' again with foreign investors and lenders.

Discretionary politics was the root of the Greek debt crisis

In contrast to the Iceland case, the other major crisis in Europe that unsettled investors' confidence in the last decade had nothing to do with bank failure. It was rather a rarely seen dimension of demolition of a government's credibility.

Greece had already been suffering from structural weakness and precarious public finances for quite some time. But in the aftermath of the deep global economic contraction in 2009, the government tweaked the official statistics to an unprecedented degree. In 2010 the reported 2009 public deficit was revised from 6%–8% to 12.7% and later to 15.7% of GDP.

Credibility took a serious hit during this time and the government's access to financial markets soon dried up. The government's funding problems quickly evolved into a full-fledged solvency crisis due to very weak competitiveness of the economy accentuated by exploding debt levels.

Governments can change all but natural laws

Politicians and economists have a fundamentally different understanding about laws. While politicians rightly claim that laws are agreements reached and written down by the sovereign that can hence be changed at any time, economists argue that the principles that rule economic activity – prices, money and trade – have the status of natural laws from which there is no escape.

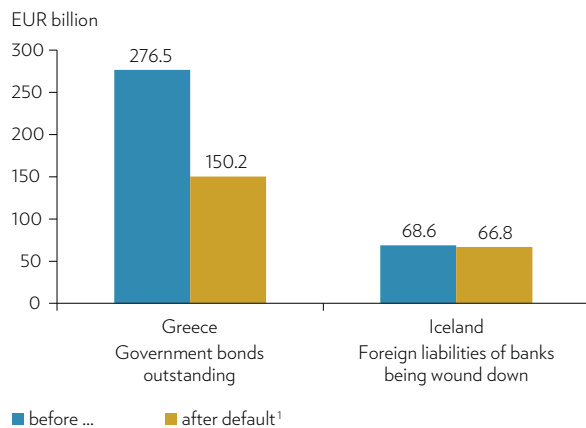
The difficult task of rebuilding credibility

While credibility can dwindle away with the spreading of some piece of information, regaining it is hard work. In the case of a sovereign's credibility, the hard work needs to be done on the national economy's level. The sharp devaluation in Iceland was a valid way to improve competitiveness and earn credibility again. This was not possible in Greece because the country entered the European Monetary Union (EMU) in 2001, giving up both an autonomous monetary policy and its currency.

Furthermore, the EMU then had no mechanism that would be suitable to manage such a crisis. Without a script at hand, the eurozone heads of state and governments made debt restructuring a necessary pre-condition for support. The reduction of the debt burden was seen as an important part of a strategy to strengthen growth in Greece by reducing the burden from debt servicing. Similar to Iceland, the wealth destruction was primarily passed on to foreign lenders. Although no discrimination was applied in the debt restructuring, foreigners simply were large holders of Greek government bonds.

In hindsight, it is fair to say that the demand to restructure debt as a pre-condition for international support did not have the desired effect. It has been dropped in subsequent support exercises within the EMU. As such, it would be thoughtless to expect debt restructuring in each and every case of sovereign debt crisis inside and outside the EMU.

Chart 1: Wealth destruction during crisis



¹ Greece: February 2012 debt restructuring with hair cut; Iceland: October 2008 major Icelandic banks placed under receivership

Source: ECB, Central Bank of Iceland, Julius Baer

The most critical factor for wealth preservation during a debt crisis in general – and in the case of Greece in particular – is the question of how quickly and how resolutely the borrower is capable of working off the imbalances that led to the crisis, thus regaining competitiveness and better fiscal integrity. Greece had to undergo a painful internal devaluation process with sky-high unemployment rates and sharp wage reductions. The larger involvement of the real economy than in the currency devaluation route taken by Iceland lengthened the adjustment process in Greece, made it more dependent on political decisions and hence more uncertain and destructive of wealth.

The more politics, the more wealth destruction

The case study of the crises in Iceland and Greece shows that investors should be aware that the more politics is involved in the necessary adjustment process, the more painful is the impact on private wealth.

FROM PHILANTHROPY TO IMPACT INVESTING: REDEFINING THE MEANING OF RETURN

Many investors are increasingly rejecting the notion that they face a binary choice between investing for maximum risk-adjusted financial return or donating money to social and environmental causes. These impact investors are proactively using their investments to generate a tangible social or environmental impact, while also having the potential for some financial return.

Robert Ruttmann, Julius Baer
Andreas Bächli, Julius Baer

From philanthropy to impact investing

Over the last decade, the concept of philanthropy has undergone a fundamental change. The focus has shifted away from the generosity of the donor towards an explicit focus on the results (or impact) of each donation. Indeed, sophisticated donors today are no longer asking “How much money was given?” but rather “What did the money accomplish?”.

Impact investing as a new vehicle for change

Today, more investors are proactively investing their capital in solutions designed to provide scalable solutions to a number of social problems. And although the investment may face some risk of financial downside, there is no deliberate aim of consuming capital as with a charitable donation.

If done right, investments in small businesses can become powerful drivers of entrepreneurship, job creation and ultimately poverty reduction. At the same time, impact investment can offer market-like returns of 4%–6% p.a.

Funding social businesses

Perhaps the most common impact investment structure is one that provides debt or equity capital to small businesses that use market-based mechanisms to solve social challenges. These investments can target a wide range of sectors, from agriculture to education to microfinance (table 1). For example, just last year, a group of investors set up a USD 25 million fund with the purpose of catalysing growth of small agribusinesses across East Africa.

Innovative financial engineering for impact

Apart from investing directly in companies, many new financial innovations are also offering investors a number of exciting opportunities to invest for impact. For instance, green bonds and climate bonds are like normal, tradable bonds, only that they are issued specifically to raise money for environmental projects. These bonds also often include a tax exemption on the bond’s return.

Another new example of how innovative financing can be used for social benefit are aid-financing bonds, such as the USD 3.5 billion in vaccine bonds issued by the International Finance Facility for Immunisation. These bonds are backed by the British government and convert multi-year foreign aid commitments into immediate cash (up to USD 3 billion) so vaccines can be administered earlier, and to more people.

An equally innovative example is the social impact bond, which channels private funding into social programmes, with the government paying interest that rises or falls with the measured success of the venture. The first social impact bond was launched in 2010, aiming to finance the rehabilitation and early intervention programmes for ex-convicts. If the programme meets its goals of steering the target group away from crime, interest rates on the bonds will rise. As such, the investor bears the upside and downside risk of the effectiveness of the programme, while the government saves money on policing, processing and jailing offenders.

Table 1: Major impact areas and objectives

AGRICULTURE Environmentally and socially sustainable agricultural production and food system	EDUCATION Quality education and academic opportunity for all students	ENERGY Expanded access to clean energy technology, reduction of carbon emissions, climate change mitigation
FINANCIAL SERVICES Financial inclusion for marginalised individuals and industries and small/micro enterprises	ENVIRONMENT Conservation of natural resources, reduced threats to biodiversity, reduced pollution	HEALTH Expanded access to basic, low-cost preventive and treatment services, particularly among poor and rural population
HOUSING/COMMUNITY FACILITIES Access to quality and affordable housing, sustainable and accessible community facilities	WATER Access to safe drinking water and sanitation, particularly for poor and vulnerable populations; water conservation	

Source: Julius Baer

Another example is Carbon War Room, a non-profit organisation set up by Sir Richard Branson to accelerate the flow of capital to low-carbon solutions by identifying and helping to remove market barriers. The group is currently working on self-financing mechanisms for retrofitting tankers and large maritime vessels, utility-scale renewable energy in the Caribbean, and energy efficiency in buildings in USA. All of these initiatives deliver both financial and social returns.

Beware of the risks of impact investing

But for all the promise, investors should also be aware of a number of risks associated with the sector. Many of these risks also apply to traditional private equity investments and can include factors like low liquidity for long periods of time, high start-up costs, exit risks, high due diligence costs and emerging market risks where the rule of law may be less well defined.

In addition to these factors, impact investors also need to grapple with the complex topic of measuring the social return of an investment. Indeed, social returns are not fungible like financial returns, so an investor may be neutral between two investments with the same financial returns, but not necessarily between two investments, one of which promises to improve access to health care and another increases income to impoverished farmers in Africa.

Channelling investments for social benefit

Although the field of impact investing is still at a relatively early stage of development, the movement represents a very real opportunity to channel large-scale investment capital for social and environmental benefit. As such, impact investing has the potential to become a powerful engine of global economic, social and environmental improvement.



TIPS AND TRICKS

- 1 FIND AN IMPACT AREA YOU ARE PASSIONATE ABOUT**

This way, obstacles will be overcome with greater ease and successes will be all the sweeter.

- 2 ADOPT AN IMPACT-FOCUSED MINDSET**

In all stages of the investment – from the initial screening to the exit – remember that impact (or social return) is the currency.

- 3 START SMALL, BUT START**

Start with a small, satellite proportion of your wealth to gain experience, but allow your engagements to grow with your experience.

- 4 COLLABORATE WITH OTHER IMPACT INVESTORS**

Peer learning is essential, so join forces with other impact investors to share experiences, exchange ideas and learn from one another.

- 5 INVEST IN DUE DILIGENCE**

Small ticket sizes in impact investments make due diligence relatively expensive, but nonetheless indispensable in the long term.

- 6 OFFER BOTH FINANCIAL CAPITAL AND BUSINESS INSIGHT**

Often social businesses benefit not only from your financial capital, but also from your business savvy. Make both count.

- 7 AVOID MISSION DRIFT**

Should the road ever get bumpy, remember that you have invested to address a specific social or environmental challenge. Stay true to this mission.

- 8 BE PATIENT, MONITOR IMPACT AND HAVE FUN**

Impact-oriented businesses need longer to mature so you will need patience. Still, you should know where you stand so measure and monitor impact generation and don't forget to have some fun along the way.

Dr Ernst von Kimakowitz is founder of the Humanistic Management Centre, offering tailor-made advisory on impact investing and business strategy.
ernst.von.kimakowitz@humanisticmanagement.org

INVESTING IN ART: SATISFIES BOTH OUR HEADS AND HEARTS

Collecting art was once the preserve of a small group of well-informed enthusiasts. But the art market has now become global. The increase in demand for art in the last decade has coincided with a substantial increase in the global number of high net worth individuals (HNWIs), who have also started considering art as a form of alternative investment to be integrated in their portfolios.

Fabiano Vallesi, Julius Baer

The pros and cons of art as an investment

As highlighted in table 1, the pros and cons of collectibles as an investment in general are all the more valid to art since the art market is the largest collectible in terms of market size. The positives in terms of the pleasure derived from owning such status assets, the portfolio diversification benefit and the potential financial return over the long term are easy to understand, but from an investment perspective there are some negatives to consider.

For example, valuing art is very challenging since most often the unique pieces are difficult to compare and do not carry a fundamental value. Indeed, fine art does not come with any income-generating aspects in contrast to traditional financial assets such as equities and bonds and cannot be marked to market, since the only way to find out the market price is by selling the art. Furthermore, collectibles are illiquid and subject to high transaction and holding costs. Lastly, they are also more exposed to changing tastes and trends in the market.

Table 1: The pros and cons of investing in collectibles

Positive	Negative
Financial return potential over the long term	Illiquidity of collectibles requires a long-term investment view
Portfolio diversification potential due to different market characteristics	Often subject to high taxes, holding and transactions costs
Safe-haven potential	Substantial risk of loss, damage, authenticity and theft
Happiness derived from owning treasure	Vulnerable to changing tastes and trends

Source: Julius Baer

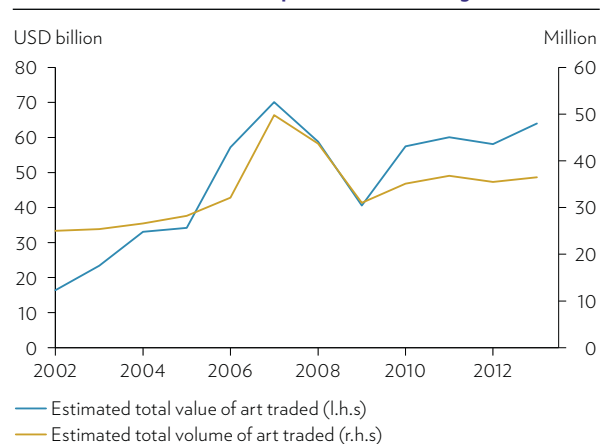
The art market is near the 2007 highs

In May this year alone, art sales in New York accounted for a combined selling value of USD 2.2 billion. In 2013, the global art market hit a record USD 64 billion in sales volume, according to The European Fine Art Foundation (TEFAF), marking a 7.5% increase versus 2012 and nearing the 2007 highs of USD 70 billion. In the last decade, the growth of the art market and in general the global collectibles market has coincided with a dramatic increase in the global number of HNWIs in emerging markets and especially in China. For example, the recent Hurun 'Chinese luxury consumer' survey states that China's super-rich are avid collectors with 70% of wealthy Chinese ranking collecting as their hobby. Furthermore, Chinese art buyers are slowly migrating to Western artwork as they become more educated on fine art.

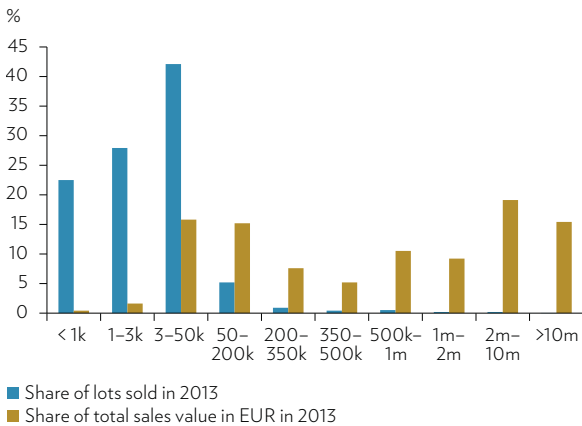
The online auction market for art is growing

Online purchasing is becoming the norm even for a sector as traditionally conservative as the art market. Thanks to specialist websites and a handful of

Chart 1: The art market experienced a strong decade



Source: Arts Economics, Julius Baer

Chart 2: Online auctions gain importance in smaller lots

Source: Arts Economics, Julius Baer

international dealers entering the digital auction market, transparency is slowly increasing while competition is also intensifying. TEFAF estimates that online sales in art in 2013 amounted to over USD 3.2 billion or around 5% of global art market sales. Roughly 93% of art sold at auction in 2013 was priced at less than EUR 50,000, and online auctions are starting to take an increasing share of the lower-priced lots. We believe that the growth of new technology and new online businesses will further increase competition, bringing the high transaction costs down and broadening the network of available expertise.

Conclusion

Headline-catching record prices could encourage people to buy trophy assets. But the headline sales are the exception rather than the rule. In reality, only a few works of art have maintained their value or even been consistently appraised over the long term. Art prices are subject to fashion and swiftly changing tastes, the artwork is illiquid and costly to trade. But just because such items are hard to value it does not mean that they do not have value. We would therefore refrain from investing in alternative assets such as art for pure financial reasons. Collecting art is a long-term investment made first for a return of joy and only second for financial gain.

TIPS AND TRICKS

1 EXPLORE YOUR TASTE

Art collecting is closely related to your identity. Challenge your habits, which will refresh and develop your knowledge.

2 FOLLOW A CONCEPT

An art collection cannot be based on speculation and first of all has to interest you. Establish a basic concept to follow that you can always redefine over time.

3 LOOK CAREFULLY

Art is a visual matter. So look carefully at your artworks, which will allow you to discover many new facets and deepen your understanding about your possession.

4 BE CURIOUS

Go around, visit exhibitions, galleries, fairs and read about art. Knowing the context well will help you to make the right decisions.

5 TAKE YOUR TIME

Take your time before you buy artwork. You can place a reservation, but you have to be convinced by the work of art you are considering buying.

6 FOLLOW-UP COSTS

Possessing an artwork involves some logistical issues, which range from preservation matters to the problem of how to store a collection. Keep in mind that building a collection involves costs other than just the price of the art piece.

7 RESALE

You can always resell or exchange artwork. This will allow you to free up some liquidity to buy other artwork that complements your existing collection.

8 ENJOY

Art is not just an investment. Art provokes emotions, stimulates new thinking and is a catalyst for unexpected encounters. Enjoy this!



Giovanni Carmine, Curator and Director of the Kunst Halle St. Gallen. carmine@k9000.ch

WINE INVESTING: IMPROVING WITH AGE AND NOT JUST FOR DRINKING

The rich heritage and multifaceted nature of wine buying and consumption have always attracted a global audience. But when it came to investing, fine wines were only considered by enthusiasts. Over the last decade, however, speculators and high net worth individuals (HNWIs) have progressively entered the market, driving up prices of premium wine.

Fabiano Vallesi, Julius Baer

A message in a bottle going global

Thanks to globalisation, it is now easier than ever for people to buy wines¹ from countries around the world. In the past, fine wines were sold mostly in northern Europe, but now there are many buyers and investors in the USA, Japan, Russia, India and especially China. The emerging markets in China and Hong Kong have been particularly important for investors. These areas have accounted for a high percentage of the orders from major wine merchants globally. Newly rich Chinese used to desire well-known brands such as Lafite Rothschild, pushing prices to record highs, but as tastes shifted to other grapes, this particular market inevitably experienced a downturn.

The elite: Premier and Grand Cru

Only a small percentage of the world's fine wine is suitable for financial investment (less than 1% of global volume). While the range and regions of fine wines to invest in have increased, most portfolios still own the traditionally reliable high-grade-investment Premier Cru and Grand Cru from Bordeaux.

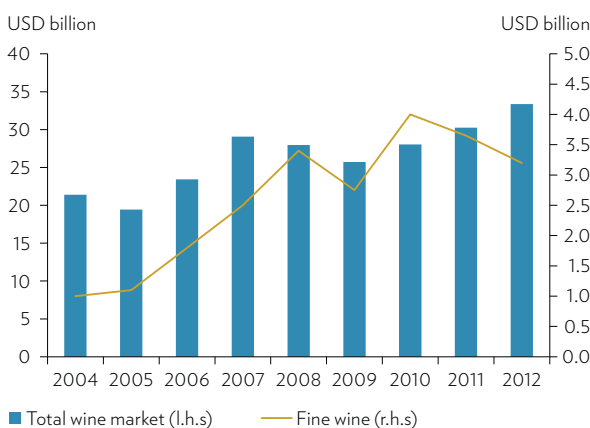
Fine wine from properties like Châteaux Latour, Margaux, Mouton Rothschild and Haut-Brion, or Merlots from Pomerol (Petrus and Lafleur) and top wines from Saint-Émilion (Angélus and Cheval Blanc) remain the most popular. While lesser-known Burgundy wines have sold for some of the highest prices ever paid for wine, these tend to be produced in very small quantities and only occasionally reappear in the secondary market. Rare Burgundy Grand Crus are usually snapped up by collectors immediately after release, serving to drive up prices to astronomic levels. Bordeaux is still the most 'liquid' of investments. The best vintages have proven their value for longer-term investors, as buyers are easily found for well-known brands. Nevertheless, auction prices for Bordeaux came under pressure in the last few years as highlighted in the section below.

The boom years and the collapse

Between 2009 and mid-2011, Bordeaux prices surged some 80%, as buyers in China and elsewhere struggled to own the best vintages from the top châteaux. Ever since, Burgundy and Champagne wines have drawn a growing number of old-world investors. Although Asian interest began to slow from 2011, sufficient demand has remained for these wines to help them significantly outperform Bordeaux, according to Liv-ex, the London-based exchange for investment-grade wine.

After the price fell in the Bordeaux segment in the past three years, more than 50 wine investment companies collapsed according to the Wine Investment Association (a self-regulatory body for wine investment companies in the UK). Global sales of fine and rare wine at auction fell 13% this past year, from USD 389 million in 2012 to USD 337 million in 2013, according to figures released by the major

Chart 1: Trade in fine wine lost momentum

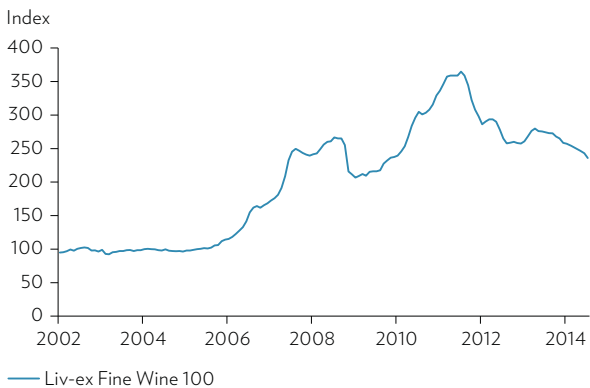


Source: OIV, Liv-ex, Julius Baer

¹ All wines named in this report are listed for illustrative purposes only, and should not be mistaken for an investment recommendation.

commercial auction houses. It was the second consecutive annual drop following 2011's record USD 478 million in sales.

Chart 2: Fine wine index back to 2010 levels



Source: Bloomberg Finance L.P., Julius Baer

Conclusion

Although wine is primarily destined for personal pleasure, investment and speculation have played a crucial role in the fine wine segment to the point where it has almost been compared with commodity trading. Nevertheless, fine wine is one of the rare pleasures that improve with age, and therefore we recommend looking at wine first of all as a long-term investment for enjoyment before considering the financial return potential. Finally, you may love your flamboyant tasting selection in your wine cellar, but the market may not, and in the worst of all scenarios you can still enjoy a good drink.



Source: NZZ am Sonntag, Zurich

TIPS AND TRICKS

1 GO FOR PREMIUM

Possible candidates are around 50 'blue chips'² from Bordeaux (Lafite Rothschild, Margaux, etc.) and famous brands such as 'Sassicaia'. Avoid speculative investments. Only consider excellent vintages.

2 TAKE A SATELLITE APPROACH

Wine should not make up more than two to five per cent of a portfolio. Minimum investment: CHF 50,000.

3 THINK LONG-TERM

The period should be at least five to ten years.

4 INVEST IN WINE AND HAVE FUN

This is no contradiction: acquire wines that you would gladly drink. If they don't perform well enough, you can still enjoy drinking them.

5 KNOW YOUR FACTS

Investors should be familiar with wine-growing estates and market mechanisms and not rely on third parties.

6 DON'T FORGET THE RISKS

The biggest problem is counterfeits. Wines should only be bought from trustworthy dealers and recognised auction houses.

7 BE WARY OF WINE FUNDS

Only choose those that have a top-class portfolio and do not demand exorbitant fees.

8 BEWARE OF WINE STOCKS

Caution is imperative. The selection is small with large price fluctuations in some cases.

Peter Keller is the wine editor for NZZ am Sonntag, Zurich, and conducts wine seminars. He holds the 'Wine and spirit education trust' (WSET) diploma. peter.keller@nzz.ch

² These are not covered by Julius Baer Research.

THE ROAD AHEAD FOR EUROPEAN WEALTH: LIVING IN INTERESTING TIMES

The view on Europe has been reshaped in the years of the euro crisis. An ageing society and structural weaknesses are holding back the 'Old Continent'. Yet, the prospects for private wealth for the years ahead may be better than you think.

OLD, RICH AND BORING

This was Europe according to Rudi Dornbusch around 15 years ago. I remember when we met at one of his last roadshows with us in the year 2000. The renowned Chicago professor of economics with German roots was hardly interested in discussing Europe at the time. The demographic burden, the wealth accumulated in post-war history and the lack of growth dynamics – all seemed quite predictable for Europe. And it prospered for at least another six to seven years before things changed. Does the verdict of Rudi Dornbusch still hold true today? If yes, will it hold true in the future?

OLD?

For demographics the answer is straightforward: yes the ageing society will remain a challenge for the 'Old Continent'. We claim in line with many demographers that the room for rising yields is limited. The reason for this is the massive need for income on wealth by an ever larger share of the population, which is no longer part of the workforce. Some call it the 'race to zero' for yields – others the 'new normal'.



RICH?

This is the main topic of our first Julius Baer 'Wealth Report: Europe'. On aggregate the answer is: yes, Europe is still rich – on average. But firstly the crisis of the European Monetary System made growth of wealth stall in the past five to seven years overall. And secondly, underneath the surface the redistribution effects both on a national level and amongst various wealth brackets have been quite substantial. Will the future bring a reversal of some of these trends? Yes, partly. As growth normalises, the projected growth of wealth in Europe for the next five years will be above the levels seen between 2007 and 2013. But almost certainly wealth formation rates seen in the 'golden years' of 2000 to 2007 will not be repeated from now until 2019, both on a regional level and within the wealth distribution.

BORING?

Well the past few years have proven to be far more exciting than anyone possibly wished for. Basic understandings had to be reshaped and a common ground had to be regained to prevent the system from falling off a cliff. Yet, the resolution of the crisis does not seem to be so advanced that Europe may go back to the 'good old days'. 'May you live in interesting times' – the infamous Chinese curse seems to remain in place for the years to come. Let us hope for boring times for Europe – and prepare for interesting ones.

Christian Gattiker, Head of Research, Julius Baer
christian.gattiker@juliusbaer.com

We claim in line with many demographers that the room for rising yields is limited. Some call it the ‘race to zero’ for yields – others the ‘new normal’.

Christian Gattiker



Important legal information

Frequently used abbreviations

Abbr.	Description	Abbr.	Description
BCG	Boston Consulting Group	Hurun	'Chinese luxury consumer' survey
CPI	Consumer price index	IMF	International Monetary Fund
D/E	Debt to equity	Liv-ex	London International Vintners Exchange
EBIT	Earnings before interest and taxes	N/A	Not available
ECB	European Central Bank	OIV	International Organisation of Vine and Wine
GDP	Gross domestic product	ROE	Return on equity
HNWI	High net worth individual	P/E	Price to earnings

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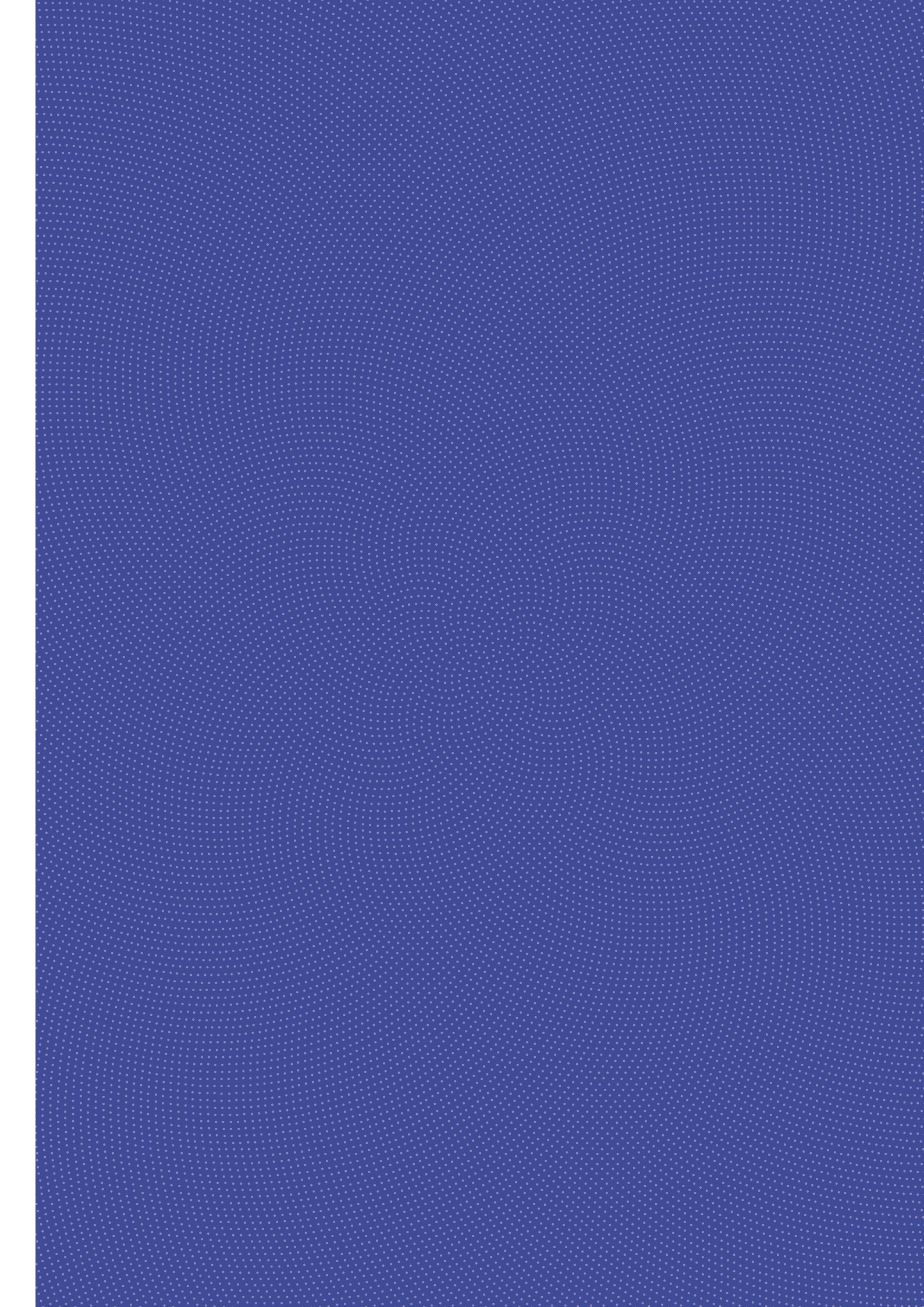
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JULIUS BAER GROUP

Head Office
Bahnhofstrasse 36
P.O. Box
8010 Zurich
Switzerland
Telephone +41 (0) 58 888 1111
Fax +41 (0) 58 888 1122
www.juliusbaer.com

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