PERSONAL FINANCIAL ASSETS REPORT

2013
1. EXECUTIVE SUMMARY

Oliver Wyman is pleased to present our Personal Financial Assets Report. This report provides perspectives on the size and trends of Personal Financial Assets (financial assets that are held by households, rather than companies or other institutions, henceforth referred to as PFA) from 1987 and projected to 2022 across asset groups and regions. The report therefore takes a decidedly long-term view of asset pools and structural trends, enabling market participants to develop and assess their global strategies over a 10-year time horizon.

1.1. HISTORICAL PFA

- PFA totalled $206 TN globally at the end of 2012, growing by 5.4% per annum over the last 25 years (5.6% for 1987-2002 declining to 5.2% for 2002-2012)
- This is approximately three times global GDP ($65-75 TN), and more than four times global equity market capitalization ($50 TN)
- Traditional “developed” markets (North America, Western Europe and Japan) account for $160 TN of assets, or nearly 75% of the total. The USA alone accounts for $50 TN or 25% of total global PFA
- The developed market share has fallen significantly (from over 90% in 1987) as developing markets have seen stronger and faster growth over the period as a result of higher incomes and population growth. Developing markets now hold for $35 TN of PFA. The largest PFA holding in developing markets is in China, which accounts for $10 TN of PFA
- Home Equity and Cash Deposits, both unmanaged asset groups, account for over half of current PFA at $110 TN. Cash Deposits are especially prevalent in many developing markets where they account for more than 50% of the asset base (e.g. India and parts of the Middle East), and Home Equity is the largest asset group in Japan and parts of Europe
- Managed assets (Life and Pensions, Occupational Pensions and Mutual Funds) account for a further $65 TN and have been the fastest growing asset groups, primarily a result of financial deepening across markets globally. These asset groups are much more prevalent in developed markets
- Direct Investments made by households are a further $30 TN (of which 50% is in the USA) and the remaining $5 TN of assets are held offshore

1.2. FUTURE PFA

We forecast that PFA will almost double over the next 10 years, reaching $394 TN by 2022, a growth rate of 6.7% per annum, as broad secular trends point to growth: annual population growth is forecast at 1% per annum, real GDP per capita growth projections are 3% per annum and annual global inflation rates are expected to be 2-3%.

- Developed markets will continue to contribute a larger share of absolute growth, accounting for $120 TN (a growth rate of 5% per annum). Also
in absolute terms, the USA will be the largest growth market, a $50 TN increase in PFA of which $20 TN will be new flows

- Developing markets will see a faster 10% growth rate, and account for $70 TN of the absolute growth; these markets will account for the lion’s share of new flows (as opposed to asset appreciation). Of the total expected $60 TN of net new flows, just under $35 TN will come from developing markets. Examples of interesting growth markets include Turkey, Brazil, Mexico, Russia, Indonesia and especially China, which will see PFA grow by $20 TN
- Putting aside asset appreciation, nearly all the net new PFA ($60 TN) are coming from developing markets ($35 TN) and the US ($20 TN) – other developed markets (e.g. Japan and Italy) forecast to begin to move to net outflows over the next decade as the population declines or ages

1.3. IMPLICATIONS FOR MARKET PARTICIPANTS

- Whilst there may be short term market difficulties, especially if global growth remains weak, long term demographic and GDP trends point to asset growth across almost all regions and asset groups, particularly in managed assets
- The growth of new flows to developing markets, particularly China will increase its importance in terms of both distribution and manufacturing for asset managers; however, the USA will still remain the largest region for net new flows and should remain a priority market
- The successful players will be those that tailor their product offering to the changing needs of each market, focusing on capturing deposits in geographies where PFA per capita are growing from a low base or offering asset management services in regions where wealth levels are growing more significantly
2. INTRODUCTION

2.1. PFA DEFINED

PERSONAL FINANCIAL ASSETS (PFA) COMPOSITION

PFA are all financial assets that are owned by individuals, rather than companies or other institutions (e.g. sovereign funds). The asset base is composed of the following seven asset classes, which we split between managed assets, i.e. those assets that are invested in the market via a professional adviser for a fee, and unmanaged assets (see table below).

There are several market reports covering AuM more broadly. This broad asset class differs from PFA in the following ways:

- For individuals, managed assets (or AuM) include only assets that are invested in the market indirectly (via a professional investor), and not the additional financial assets that are held by individuals, such as home equity or bank deposits
- AuM data also normally include assets that are not held by individuals, such as those held by Charities, Endowments and Foundations ($2 TN+ of assets), Sovereign Funds (incl. central banks, SWF, state pension funds $13 TN+) or Corporates ($5 TN+)

Limited data availability means our estimates of PFA exclude two asset classes: non-financial assets (such as physical commodity holdings, jewellery and art) and individual wealth tied up in businesses and land holdings. We estimate that these may add 5% to global PFA, but with variations in regional importance: for example, gold and silver remain important personal asset classes in India.

<table>
<thead>
<tr>
<th>ASSET GROUP</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>UNMANAGED</td>
<td></td>
</tr>
<tr>
<td>Cash deposits</td>
<td>Cash held in accounts with banks and other deposit taking institutions</td>
</tr>
<tr>
<td>Direct investments</td>
<td>Investments made by individual in non-cash financial securities where the individual makes the investment decision and (typically) invests via a broker</td>
</tr>
<tr>
<td>Home equity</td>
<td>Total value of housing stock held by individuals less the value of outstanding mortgages</td>
</tr>
<tr>
<td>MANAGED</td>
<td></td>
</tr>
<tr>
<td>Life and pensions</td>
<td>Assets held in life investment policies and non-occupational (i.e. individual) pension schemes</td>
</tr>
<tr>
<td>Occupational pensions</td>
<td>Assets held in pension schemes provided by employers</td>
</tr>
<tr>
<td>Mutual funds</td>
<td>Investments in financial securities via a professional asset management business, typically in a fund structure</td>
</tr>
<tr>
<td>OFFSHORE</td>
<td></td>
</tr>
<tr>
<td>Offshore</td>
<td>Assets held in accounts not based in the individual’s home nation, often in jurisdictions where transparency is limited</td>
</tr>
</tbody>
</table>

Source: Oliver Wyman analysis
EXHIBIT 1: MANAGED ASSETS VS. PFA

PFA VS. MANAGED ASSETS

<table>
<thead>
<tr>
<th>PFA</th>
<th>Managed Assets/AuM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets held by individuals that are not managed by professional investors (e.g. cash deposits, home equity, direct investing)</td>
<td>Assets managed professionally on behalf of institutional end clients (e.g. corporates, endowments, sovereign funds)</td>
</tr>
<tr>
<td>~$20 TN</td>
<td>~$69 TN</td>
</tr>
</tbody>
</table>

2.2. THE VALUE OF PFA FORECASTING

Taking a view about the overall direction of PFA is an important part of strategic decision making at firms – such as retail banks, mutual fund managers or life insurers – that work directly with any part of household wealth. They face opportunities and threats not only from their competitors but from structural shifts in the way households allocate their wealth or PFA. Over the medium and long term, firms should allocate resources to the asset classes, regions and demographic segments which will grow and minimise investment into segments which will shrink.

The forecasts required are long term, covering many years or even decades. That is the timeframe on which structural shifts occur and that is also the timeframe over which building skills, performance track records, distribution networks and brands must take place. The financial crisis has shown the importance of long term strategic focus.

This PFA report looks at emerging trends over the required lengthy timeframes. It begins by briefly introducing the model on which our PFA forecasts are based. Then it explores historic trends in the market, broken down by asset class and region, before forecasting market growth dynamics and their implications for market participants.

We hope it will prove valuable for informing the strategy decisions of firms that serve individuals’ savings and wealth management needs.
3. OLIVER WYMAN PFA MODEL METHODOLOGY

3.1. METHODOLOGY

Our PFA model is based on the idea that changes in the size of the overall asset base and its distribution across asset classes are driven by three factors:

- **GDP per capita** As GDP per capita increases, the savings rate increases and the PFA per capita increases, a process known as financial deepening. However, the relationship is not linear. Savings rates move in an “S-curve” relationship with GDP. As economies mature, the mix of asset classes also evolves.

- **Population growth** As population grows, the overall asset base grows with a broadly linear relationship.

- **Changing demographic structure** The classic Life Cycle Savings model shows that the age distribution of the population in a country is a key driver of both how much wealth is held by each age band and the mix of assets within each age group.

Starting from these ideas, Oliver Wyman’s model forecasts PFA pools as follows:

1. Historic PFA, GDP and demographic data are collected for the 39 countries that form the basis of our model. The model uses data from 1987 to the present. The major sources are the national accounts for financial information and the World Bank for demographic information.

2. This historic data is then used to determine the regression parameters which help us make our forecasts, building in both the impact of life cycle savings and “S-curve” growth.

3. The PFA model then applies these parameters to forecasts of GDP and demographic data to generate forecasts for PFA broken down by country, asset class and age cohort.

4. At this stage, using Oliver Wyman estimates and experience, we include assets held offshore and allocate them back to the country of origin. For example, the non-Swiss assets held in Swiss private banks are allocated back to the home countries of the client base.

The forecasts take a long term view on the size of potential PFA pools. There are expected to be short term deviations from the long-term trend driven by factors such as financial shocks or booms. However, we would expect a reversion to the predicted trends in the long term.

3.2. MODEL COVERAGE

The model is built bottom-up on a country-by-country basis. We collate data from 39 countries that account for approximately 90% of global GDP in 2012 and 95% of the global PFA base. We then make estimates for the remainder of the asset pool.
EXHIBIT 2: PFA MODEL COVERAGE

COVERAGE OF THE PFA MODEL

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>POPULATION (BN)</th>
<th>GDP ($ TN)</th>
<th>PFA ($ TN)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20%</td>
<td>69%</td>
<td>91%</td>
</tr>
<tr>
<td>Rest of world</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>39 countries</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Oliver Wyman analysis

EXHIBIT 3: THE 39 COUNTRIES COVERED

<table>
<thead>
<tr>
<th>DEVELOPED/EMERGING</th>
<th>REGION</th>
<th>COUNTRIES COVERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEVELOPED</td>
<td>Developed Asia</td>
<td>Australia, Hong Kong, Singapore, South Korea, Taiwan</td>
</tr>
<tr>
<td></td>
<td>Japan</td>
<td>Japan</td>
</tr>
<tr>
<td></td>
<td>North America</td>
<td>Canada, USA</td>
</tr>
<tr>
<td></td>
<td>Western Europe</td>
<td>Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, UK</td>
</tr>
<tr>
<td>EMERGING</td>
<td>CEE</td>
<td>Hungary, Romania, Poland, Russia, Turkey</td>
</tr>
<tr>
<td></td>
<td>China</td>
<td>China</td>
</tr>
<tr>
<td></td>
<td>Latin America</td>
<td>Brazil, Mexico</td>
</tr>
<tr>
<td></td>
<td>MENA</td>
<td>Saudi Arabia</td>
</tr>
<tr>
<td></td>
<td>Other Emerging Asia</td>
<td>India, Indonesia, Malaysia, Philippines, Thailand, Vietnam</td>
</tr>
<tr>
<td></td>
<td>Sub-Saharan Africa</td>
<td>South Africa</td>
</tr>
</tbody>
</table>

Source: Oliver Wyman analysis
4. GDP PER CAPITA AND DEMOGRAPHIC TRENDS

4.1. GDP PER CAPITA TRENDS

As stated in 3.1, PFA per capita increases with GDP per capita. The relationship is not linear but follows an “S-curve”. In regions with low GDP per capita, households typically need to spend the majority of their income. PFA per capita is thus low in these countries. As countries get richer, savings rates accelerate quickly which helps drive PFA growth (moving them through the steep part of the S-curve). As countries become rich the proportion of their incomes that people save levels off – as, therefore, does growth in PFA.

4.2. DEMOGRAPHIC TRENDS

Demographics are the second major driver of PFA. The global population is expected to grow at a rate of 1% per annum, but there are significant regional and country variations. Populations are beginning to level off in many developed economies, limiting PFA growth. Population growth in China, after many years of large increases, is also slowing. On the other hand, strong population growth is expected in India, Malaysia, and many countries in Africa and the Middle East, which will aid future PFA growth there.

EXHIBIT 4: TYPICAL LIFETIME CONSUMPTION AND SAVING PROFILE IN A DEVELOPED ECONOMY

Source: Oliver Wyman analysis
EXHIBIT 5: THE SAVINGS LIFE CYCLE

Source: Oliver Wyman analysis
The relationship between PFA and population growth is complex because, as population growth is a result of increased birth rates or reduced mortality rates, the age profile of the population will change. This affects PFA growth because asset accumulation rates vary at different stages of life, as per the savings life cycle hypothesis. This hypothesis states that individuals plan their consumption and savings behaviour over their lifetimes. When individuals are young they typically spend more than they earn; income is low and debts are incurred, for example, to go to university. As individuals move towards middle age they increasingly earn more than they spend which results in asset accumulation. Ages 35-65 are the time when the vast majority of assets are amassed, and we call individuals in this age band Peak Savers. Economies that have a larger proportion of Peak Savers have faster PFA growth rates. Finally, as individuals retire, they start to spend some of the assets they have accumulated.

Western Europe, North America and Japan, which between them hold 80% of PFA (see next section), will all see significant falls in the share of Peak Savers, which will slow the growth of PFA. There is concern across these regions about ageing populations and the implications for public pensions. China has benefited over the last 10 years from a large boost in the share of peak savers. But this is expected to quickly slow, primarily as a result of the one child policy, and there is uncertainty over how this may affect the Chinese economy over the next 30 years.

Other countries, such as India, Indonesia and Saudi Arabia, will see their share of Peak Savers grow over the next 20-30 years, which will be a positive driver of PFA growth in these countries.
The global total stock of personal financial assets is approximately $206 TN (see Exhibit 6). This is approximately three times global GDP (estimates vary between $65 TN and $75 TN) in nominal terms, and more than four times global equity market capitalization ($50 TN).

As one would expect, a large share of PFA is held by people living in traditional “developed markets”. North America, Western Europe and Japan, together account for nearly $160 TN or 75% of assets. This dominance is a result of strong historical economic growth which has fostered savings and asset accumulation in these regions over the last 50 to 100 years.

In stark contrast, India and China, with large populations and GDPs, as well as high rates of economic growth, are still far behind in terms of wealth. The 2.4 BN inhabitants of these two countries hold $11 TN in PFA— the equivalent of $4 k per capita compared with $165 k per capita for the USA.

Globally, a little over half of household wealth is held in the form of two asset types. Home Equity accounts for about 30% of the total global asset base and Cash Deposits makes up another 20%. Managed assets (that is Life and Pensions, Occupational Pensions and Mutual Funds) account for a further $60 TN. Direct Investments made by households are a further $25 TN and the remaining $5 TN of assets are held offshore.

The asset mix today varies significantly across regions. Economics, history and politics all play a role in whether it is Cash Deposits, Home Equity or Direct Investments that make up the majority of assets within a country. Exhibit 7 highlights some of the major outliers by asset group, and the reasons why these asset groups dominate in these regions.

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Source: IMF, CIA World Factbook, World Bank
Source: World Federation of Exchanges
## Exhibit 7: Asset Group Anomalies – Countries/Regions with Unusually High Exposure to the Various Asset Groups

| Asset Group          | Share of Global PFA | Example Countries/Regions with High Share of this Asset Group | Share of Country/Region PFA | Comments                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |}
<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Deposits</td>
<td>22%</td>
<td>China, India, Middle East, Sub-Saharan Africa</td>
<td>50%+</td>
<td>Households in countries with lower per capita assets and limited/no social safety net hold a greater share of assets in cash</td>
</tr>
<tr>
<td>Home Equity</td>
<td>33%</td>
<td>Japan, Romania, Hungary, Italy, Spain, Greece</td>
<td>60%+</td>
<td>Japan has a strong culture of home ownership and an elderly population which, over the last 20 years have paid off mortgages</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Home ownership is the key focus of wealth in parts of Europe – e.g. Hungary has a 90%+ home ownership rate</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>6%</td>
<td>Switzerland, Germany, France</td>
<td>10%+</td>
<td>Well established retail Mutual Fund markets, particularly with distribution via banks</td>
</tr>
<tr>
<td>Direct Investments</td>
<td>12%</td>
<td>USA, Taiwan</td>
<td>20%+</td>
<td>US households comfortable with equity investing – strong retail brokerage market</td>
</tr>
<tr>
<td>Occupational Pension Funds</td>
<td>11%</td>
<td>Netherlands, Switzerland, Australia, USA</td>
<td>20%+</td>
<td>Markets with well-established and pre-funded pension systems, encompassing both the private and public sectors</td>
</tr>
<tr>
<td>Life Pensions</td>
<td>14%</td>
<td>Denmark, UK, Sweden, Norway</td>
<td>20%+</td>
<td>Markets with history of promoting personal pensions and often of annuitization of savings</td>
</tr>
<tr>
<td>Offshore Assets</td>
<td>2%</td>
<td>Saudi Arabia, Russia, Philippines</td>
<td>25%+</td>
<td>Countries with a high number of HNW individuals domiciled in countries with recognised political/economic risks</td>
</tr>
</tbody>
</table>
6. GLOBAL PFA GROWTH

6.1. RECENT TRENDS

The stock of PFA has grown from $55 TN in 1987 to $206 TN in 2012, a nominal growth rate of 5.4% per annum. The real growth rate was 2% (in US$) because the weighted average inflation rate over this period was ~2.5% per annum. PFA growth over the last ten years (2002-2012) was 5.2% per annum, slower than the 5.6% of the previous fifteen years (1987-2002). This is primarily a result of the financial crisis of 2008, which saw a PFA decline of 7%.

As one would expect, PFA growth rates in developing regions (11% per annum) have been higher than in developed regions (4-5% per annum, with Japan at below 2%). Stronger economic growth in these regions has increased both GDP per capita and saving rates (see more on this below).

Home Equity accounts for the largest share of the total asset base but it has seen the slowest growth over the last twenty years, and especially in the last decade. Cash Deposits have seen a steady annual increase, especially in times of economic decline, and over the last ten years they have shifted from being the slowest to the fastest growing asset group. Over the last 20 years, the fastest growing asset classes globally have been Mutual Funds and Life & Pensions, reflecting the growth in asset management. Offshore Assets have grown as the number of HNW individuals and their propensity to use offshore booking centres have increased over the past twenty years.

6.2. FUTURE TRENDS

In 2012 global growth in PFA was 5%, $10 TN in absolute terms – broadly in line with the average growth rate over the last 25 years. Global population growth and rising incomes lead us to forecast that the PFA asset pool will grow by 6.7% per annum over the next ten years, resulting in a $188 TN increase in PFA stock to reach a total of $394 TN by 2022. Shifting demographics and growing per capita income are also shifting asset mix. As people become wealthier they invest more in Mutual Funds, Life & Pensions and Occupational Pensions and hold less in Cash Deposits.

Developing markets will continue to see the strongest growth rates, exceeding 10% in many cases, as populations grow and individuals get wealthier and save a bigger portion of their incomes. Despite slower growth rates (between 3% and 7%), developed markets are expected to contribute a larger share of total growth in absolute terms. The total increase in the asset stock from these markets over the next ten years is expected to be $120 TN compared to $70 TN from developing markets.
EXHIBIT 8: PFA GROWTH BY REGION ($ TN)

Source: Oliver Wyman analysis

EXHIBIT 9: PFA GROWTH BY ASSET GROUP ($ TN)

Source: Oliver Wyman analysis
7. SPOTLIGHTS

7.1. A REBALANCING ACT

Over the next ten years most major developing markets are expected to have nominal annual PFA growth rates that exceed 10%, compared with 3% to 6% for developed markets. The five fastest-growing markets over the next ten years will all be developing markets, and China’s PFA will experience the second largest growth absolute terms.

This continues a trend that we have seen over more than 20 years of historic data. For example, China and India have had historic PFA growth rates of 25% or more, the highest growth rates globally. This is as a result of significant increases in household savings rates, which now exceed 30% in both countries, easily the highest in the world, driven by both strong population growth and higher GDP per capita coupled with a limited social safety net until very recently. The developing markets’ share of the total PFA has increased from less than 10% in 1987 to over 20% in 2012. We believe that this will be close to 30% by 2022.

Whilst developed markets will have a larger share of asset stock appreciation (mainly a result of a larger current asset stock) and thus larger absolute PFA appreciation, the majority of new PFA flows are likely to come from developing regions. This is because developing countries have fast-growing populations, including Peak Savers (see Section 4) and strong economic growth. We believe that this is a significant structural shift that could change the way businesses position themselves to capture PFA.

There are some potential threats to this familiar story. The economic boom in Asia appears to be slowing. For example growth forecasts have been revised downwards especially for China. China also faces a “demographic cliff” of its own – primarily a result of the one child policy – which it will need to tackle in the near future.

What does this mean for businesses working with PFA? Given the large existing pools but limited new flows in many developed markets, firms might aim to build a businesses based on servicing existing assets or aim to win share from peers. In developing markets high net new flows of PFA mean that participants could position themselves to win this entirely new business. However, given that 70% of these new flows are expected to be into Home Equity and Cash Deposits, which are both unmanaged, asset managers should focus their business on specific developing markets: namely, those where managed assets are likely to grow rapidly, such as South Africa, China, India and South Korea.

Despite the importance of developing markets, the USA will still remain a key growth market. We expect over $50 TN of PFA growth of which $20 TN is net inflows over the next ten years if the economy recovers as expected.

3 Source: OECD
EXHIBIT 10: REBALANCING ACT 2013-2022

REGIONAL ABSOLUTE AND RELATIVE GROWTH

\[ \Delta \text{PFA} \text{ $TN (2013-2022)} \text{, Bubble Size } = \text{2012 PFA} \]

- North America
- Western Europe
- Other developed
- Asia
- Other developing

\[ \text{2012 PFA ($TN)} \]
\[ \text{Increase in PFA stock 2012-22 ($TN)} \]
\[ \text{Of which net new flows 2012-22 ($TN)} \]

Source: Oliver Wyman analysis

* Of the 39 countries covered in detail

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7.2. THE CURIOUS CASE OF JAPAN

In “Preparing for the 21st Century”, written in 1993, historian Paul Kennedy famously predicted that Japan would continue on the path of strong growth from the eighties and that the “21st century would belong to Japan”4. At the time of writing, many would have agreed with Mr Kennedy’s view. Post-war Japan’s economy saw spectacular growth, especially on a per capita basis. Demographics were also favourable, with a limited elderly population to support and a large young workforce ready to move from rural Japan to centres of economic growth. The sixties, seventies and eighties saw Japanese household savings rates hold at or above 15%5, then easily the highest in the world, allowing individuals to amass wealth, a large portion of which was invested in homes but also in other assets.

Since the nineties, however, economic climate has turned and savings rates have declined. The reasons for this decline are well documented (see, for example, Richard Koo’s6 book covering the subject). Demographic change is certainly an important factor. Japan’s population quickly shifted from young to old. The population has declined and the portion over 60 is now 29%, compared with a world average of 11%.

Economic stagnation has significantly slowed Japanese PFA growth over the last 25 years. Japanese PFA have grown at less than 2% compared with global PFA growth of 5%. In addition, new flows into every asset class have been either negligible or negative. Cash Deposits have seen the strongest growth across the period, at 3% per annum.

Firms servicing Japanese PFA markets must adopt strategies that revolve around asset dispersion rather than asset gathering: for example, helping the elderly take advantage of accumulated assets effectively (e.g. via

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4 Source: Preparing for the 21st Century, Paul Kennedy
5 Reaching a high of over 25%, Source: Economic and Social Research Institute of the Cabinet Office of the Japanese Government
6 The Holy Grail of Macroeconomics: Lessons from Japan’s Great Recession

EXHIBIT 11: THE CURIOUS CASE OF JAPAN

<table>
<thead>
<tr>
<th>JAPANESE HOUSEHOLD SAVINGS RATES</th>
<th>GLOBAL AND JAPANESE PFA GROWTH (1992 = 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>16</td>
<td>300</td>
</tr>
<tr>
<td>12</td>
<td>225</td>
</tr>
<tr>
<td>8</td>
<td>150</td>
</tr>
<tr>
<td>4</td>
<td>75</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Oliver Wyman analysis
annuities) or transferring assets to the next generation. The broader lesson to take from the Japanese experience is to prepare the business model for similar situations in other mature markets. Several major economies in the West have similar demographic issues and firms operating in these markets need to ensure that their proposition and operating model matches the resulting changes in PFA.

7.3. HOME SWEET HOME

In many major economies home ownership is the foundation for household wealth. It is often the first major asset that individuals invest in and it is the last asset they divest in times of economic difficulty. An understanding of the likely movements in Home Equity is therefore important for all firms that operate in the PFA space.

Below we look at two major themes related to Home Equity. What happened in North America during the crisis? And what will happen in China?

7.3.1. THE “AMERICAN NIGHTMARE”?

Nowhere can the impact of the financial crisis of 2008 be seen more clearly than in what happened to Home Equity values in the US. Between 2005/6 and 2011 wealth held in houses fell by nearly 50%, and until recently the market has seen limited signs of recovery. At the end of 2012, nearly 30% of homeowners (14 mm households) were still in negative equity. The fall in Home Equity values also resulted in pressure on other components of PFA as people sought to keep their homes and thus sold stock and bond portfolios and other financial assets.

Continuing market difficulties would present a challenging environment not only for real estate agents and mortgage providers but for firms across financial services. Owning a house has been the basis of the “American Dream”, and drives the economic behaviour of households. Fortunately, the market

EXHIBIT 12: HOME SWEET HOME

Source: Zillow Negative Equity Report Q4 2012

Source: Oliver Wyman analysis
is showing clear signs of recovery: house prices rose by over 5% in 2012\(^8\) and 2 mm households moved out of negative equity\(^9\), and the trend has continued in 2013. In the long term, the “American Dream” seems set to continue, with 70% of US non-homeowners citing that home ownership is part of their “dream”, providing support to asset values, albeit with some regional nuances. Housing will remain a key asset class in the largest global asset pool.

7.3.2. AND THE “CHINESE DREAM”

Until 1998, when the government launched policies to begin an era of private home ownership\(^10\), privately owned residential property in China was rare. Since then home ownership has picked up quickly. Statistics from the People’s Bank of China released this year suggest that nearly 90% of homes are now in private hands (though this figure is much disputed). Prices peaked in 2009 and remain high despite some levelling off caused by policy efforts to cool the market.

Whilst there are signs of the market faltering, we believe that in the longer term Chinese home ownership will continue to grow in importance for the domestic and global economies. Population growth, urbanization and an abundance of savings mean that PFA will grow rapidly. Population growth is expected to slow but remain positive over coming years; just a 1% transfer from rural to urban areas would mean that more than ten million additional people would need new urban housing; and there are now limited investment opportunities for the average Chinese citizen outside of housing. There are also calls to relax legal restrictions in the Chinese housing market, such as those on multiple purchases by a single buyer, which could increase demand for housing. On these grounds we expect Chinese Home Equity to grow rapidly over the next ten years, and start to form a cornerstone of household wealth, although products like reverse mortgages may also emerge to enable asset allocation shifts away from real estate.

7.4. THE CASE FOR MANAGEMENT

Asset management businesses, such as Mutual Funds and Occupational Pensions, have seen the strongest growth over the last 25 years, especially outside of North America and Western Europe (though starting from a smaller base in those areas).

The situation in recent years has been more difficult for asset managers, with weaker net new flows in many markets and low returns, particularly in Europe and North America. While there may be further market difficulties to come, we believe that the broad trends point to underlying market growth in the coming ten years:

- Greater focus on retirement savings in developed markets as populations age over the next 30 years
- Continued growth and maturing of developing markets, which will provide a larger share of new flows. This will increase demand for asset management in these regions and provide scope for new products focused on these regions
- New product innovation and continued growth of certain alternative assets and low cost beta products

We now consider developments in each of the three managed asset groups in more depth.

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\(^8\) Source: FT: S&P/Case-Shiller index
\(^9\) Source: Zillow Negative Equity Report Q4 2012
\(^10\) Note that “home ownership” in China is a vastly different concept than that in most other markets and does not include land ownership – a typical contract is a 70-year lease rather than full freehold
7.4.1. MUTUAL FUNDS

Mutual Funds (defined broadly here to include investment trusts, ETFs etc.) have grown quickly across all geographic markets, averaging 7% per annum, the highest growth rate of any asset group over the last 25 years. This is a result of three trends

- Geographic expansion of international asset managers into new markets and the emergence of local players
- Product and asset innovation. A prime example is exchange-traded products, which grew over 20% in AuM terms in 2012
- Reduced costs and increasing financial sophistication resulting from scale.

Nowhere has the take-up been as strong as in the USA, where households have embraced most forms of financial assets.

However, there are signs that much of the developed world is reaching saturation. In Western Europe, for example, Mutual Funds’ share of PFA has dropped from 7% in 2006 to 5% in 2012. While we expect market recovery and positive net flows (especially to new products) to cause a modest increase in Mutual Fund assets, we doubt their share of total PFA will rise materially above previous peaks.

7.4.2. OCCUPATIONAL PENSIONS

Occupational pension funds have been a central pillar of retirement in many countries. For example, in Denmark, the Netherlands and Sweden around 90% of employees participate in some form of occupational retirement scheme. Occupational pension funds have been around since the 19th century in some countries but became a mainstream activity in the 1950s.

Occupational pension schemes in China, though now small, are growing rapidly and will be a key driver of PFA growth. Globally there is a move to “defined contribution” (DC) style pensions, away from traditional “defined benefit” (DB) schemes. This should

EXHIBIT 13: TRENDS IN MANAGED PFA ASSET CLASSES

<table>
<thead>
<tr>
<th>CHANGE IN PFA 2012-22 ($ TN)</th>
<th>EXPECTED NEW FLOWS 2012-22</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>12</td>
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<tr>
<td>20</td>
<td>10</td>
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<tr>
<td>15</td>
<td>8</td>
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<td>10</td>
<td>6</td>
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<td>5</td>
<td>4</td>
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<tr>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>-2</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Oliver Wyman analysis
make it more likely that employers will offer a pension scheme, and the result should be growth in this segment of PFA. Regulations may drive further growth. For example, in the UK we have recently seen the roll out of “automatic enrolment” for employees of the largest businesses.

7.5. CASH IS STILL KING (IN DEVELOPING MARKETS)

As economies develop, Cash Deposits typically fall as a share of PFA. The amount of cash people must hold for day-to-day transactions does not increase at the same rate as their wealth. Economic development also leads to a greater array of investment opportunities, and individuals seeking higher returns and having more confidence in non-cash assets as stores of wealth. North American households, for example, typically keep a low share of their PFA as Cash Deposits, instead trusting higher return financial instruments, such as equities, as long-term stores of wealth.

From 2012 to 2022 we expect global PFA held as cash deposits to grow by $37 TN, or 6% per annum. Of this total growth, $23 TN will come from new flows and $19 TN (90%) of these new flows are likely to come from developing markets where PFA per capital remains low. In India, for example, where PFA per capita is below $2,000, nearly 60% of new flows over the next ten years will be into Cash Deposits.

The long-term future in developing markets looks promising, with some shift away from Cash Deposits as economies continue to increase PFA per capita. However, focusing the right products on the right markets at the right time is what will drive success. For example, India and Indonesia are relatively far from reaching the levels of wealth per capita where the shift away from cash will be substantial. Offerings in these markets should thus be structured around traditional banking products. In markets such Brazil and Mexico, where PFA per capita is greater than $5,000, only 20% of new PFA flows from 2012 to 2022 will be into Cash Deposits. So a strong asset management offering will be needed to attract new flows.

EXHIBIT 14: CASH IS STILL KING

<table>
<thead>
<tr>
<th>PFA/CAPITA VS. CASH AS SHARE OF PFA, 2012 ($K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>250</td>
</tr>
<tr>
<td>150</td>
</tr>
<tr>
<td>100</td>
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<tr>
<td>50</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

Source: Oliver Wyman analysis
CONCLUSION

As Niels Bohr said, prediction is very difficult, especially about the future. But some predictions are easier than others. Demographic trends depend on the population today and things which change only slowly, such as birth rates. And long term economic growth is reasonably predictable too, at least over periods of decades in politically stable countries. Because PFA depend on these predictable trends, they are themselves relatively predictable. Firms that profit from PFA enjoy the unusual luxury of being able to position themselves to respond to future demand.
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