STONEHAGE FLEMING

FOUR PILLARS OF CAPITAL FOR THE TWENTY FIRST CENTURY

WEALTH STRATEGIES FOR INTERGENERATIONAL SUCCESS

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CONTENTS

EXECUTIVE SUMMARY

In December 2013 Fleming Family & Partners (FF&P) published "The World in 2043: Wealth Strategies for Intergenerational Success." In January 2015 FF&P merged with Stonehage to form one of the world's leading independently owned family offices represented in eight jurisdictions, offering a wide range of investment and family office services. This follow-on report contains the input from a survey conducted during 2015, which benefited from 85 responses from 78 families and advisers; 22 of the respondents were from the "Next Generation" (aged 18-25).

Since the financial crisis in 2008, there has been increased scrutiny of the rich and of the perceived widening of the gap between the "haves" and "have nots". There have been moves by various governments to increase tax revenues and what might previously have been considered efficient tax planning is now regarded with suspicion and even opprobrium. In light of this public and political sentiment, families have a renewed focus on their responsibilities as stewards of capital. The findings of our new report show the majority of Ultra High Net Worth (UHNW) families are seeking to strike a balance between preserving and growing the assets they are able to hand on to members of their own family and ensuring that they do this in a socially responsible manner. Giving back to society and local communities is important to these families.

In this context, we find there have been subtle but highly significant shifts in attitudes, which suggest a change in the way families approach the long-term management of their wealth and their legacies. A substantial majority of respondents believe quite strongly that great wealth can only be preserved across generations if it has a defined purpose and is used not only to benefit those who inherit, but also to make a positive contribution to the community in which they live and to the wider society. They also believe wealth is only sustainable if the family has the skills and experience to respond to the challenges and opportunities of an uncertain environment. These views were even more strongly held by the Next Generation, suggesting they will become more central to the management of family wealth.

The impact of this change of emphasis is likely to be:

- A greater desire for active participation in direct investment opportunities,
- An expansion of philanthropic activities which play a key role in the development of family culture; and
- More focus on passing down the intangible aspects of the legacy, the experience and values of the founders.

From the many responses, concerns and ideas from the families that we spoke to for this survey we have tried to group these themes around four "pillars of capital". In addition to the purely ***financial*** pillar, we identified these as ***intellectual***, ***social*** and ***cultural***. As the report will show, these Four Pillars all support a family's success and its legacy; reliance on any one, or a reluctance to embrace the benefits of all four could conversely be detrimental to a family's long-term interests. The four can be defined as follows:

FINANCIAL CAPITAL

Financial Capital comprises those tangible assets, business and intellectual property of the family which have quantifiable financial value.

INTELLECTUAL CAPITAL

The Intellectual Capital of the family is its accumulated skill, knowledge, experience and wisdom, which it can apply to the management of its wealth, its contribution to society, the individual fulfilment of family members and the collective wellbeing of the family.

SOCIAL CAPITAL

This is the way in which the family relates to and engages with the society and the communities in which it lives and operates. It includes social positions and the networks which help the family to use its wealth and other assets to the benefit of society and the good of the family.

CULTURAL CAPITAL

A family culture brings the family together by identifying shared perspectives and themes in the way family members conduct their lives, their approach to business, the way they treat others, the way they contribute to society, their attitude to wealth and the things they value.

In our research for our "The World in 2043" report we spoke to families still reeling from the aftermath of the global financial crash and, as such, found that their primary focus was a protective, conservative one of preserving their Financial Capital. Our research for this follow-on report has taken place against a background of economies beginning to recover from the global downturn and return to growth (albeit at far lower levels than seen before the crash), and the focus of families has shifted with this growth. Despite the obvious risks in the current environment, families are now taking a longer term view and there is greater emphasis on growing capital as opposed to merely preserving it. We are beginning to see that UHNW families are becoming more entrepreneurial and willing to accept a degree of risk, where the opportunity merits it. There is also some indication that wealthy families will accept higher taxes, provided that tax rates do not create a disincentive to wealth creation.

Beyond the Four Pillars, the principal findings of our new report are:

- 71% of respondents listed capital preservation as the greatest concern but capital growth and succession planning ranked joint second at 57%, amongst the respondents to the main questionnaire.
- Concern about income varied significantly between the Next Generation respondents and the main respondents (57% versus 34%), suggesting that the future stewards of family wealth are more anxious than their parents about income provision.
- Family disputes and breakup were seen as the principal risks to long-term wealth, along with lack of planning. Poor investment management was the top concern of the Next Generation, though only 21% of core respondents cited it as a top three concern.
- 82% of all respondents believe that there is a link between preserving wealth and benefiting society. This has major implications for business, investment strategy and philanthropy and has required families to be more structured in passing down their values.
- 65% of Next Generation respondents thought the financial crisis had changed attitudes to the wealthy and wanted to ensure there was a balance between having wealth and contributing to society.
- Private foundations and direct giving are the most common form of philanthropy but impact investing, and microfinancing are popular alternatives.
- Many felt that their family had a defined set of values; this contrasted with 56% of the Next Generation who did not believe this to be the case for their family. According to our survey, only 6% of the Next Generation felt involved in developing their family's code of conduct.
- Real Estate remains the asset class of choice for wealthy families to hold for intergenerational wealth preservation and growth with Equities and Private Equity deemed to be the next most interesting asset classes.
- The question that produced an intense and stimulating debate was "has your family agreed the purpose of wealth?" and much of the content of this report was generated through discussions on this topic.

We are grateful to all the contributors to this report for the time and insight they have given us.

METHODOLOGY

This paper has drawn on the following sources of evidence:

- Wide-ranging face-to-face interviews with 30 Ultra High Net Worth families and advisers, discussing their long-term plans, attitudes and areas of disquiet.
- A 14-item questionnaire, completed by 78 families and advisers, generating 85 individual responses. 22 responses came from Next Generation contributors who completed a version of the questionnaire tailored to them. The results are set out in datasheets in the Appendix, and represented graphically where appropriate within the text.
- Extensive analysis of third party research, fully attributed and footnoted throughout where we have drawn upon this.

In the interests of openness we guaranteed that all remarks would be non-attributable unless otherwise agreed.

We have structured the document into five sections, first examining the "Four Pillars of Capital" and then how they are then transmitted to the Next Generation of a family:

- Financial Capital
- Intellectual Capital
- Social Capital
- Cultural Capital
- The Next Generation

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FOREWORD

The objective of the paper is to focus on key changes in attitudes and approach to wealth over the last few years, the drivers of these changes and the impact they have had on behaviours and decision-making in families.

The families contributing to the study represent a diverse sample of UK and international families, including those with first generation ("new") money and those with long established wealth. Many own family businesses and have other commercial interests whilst others have their wealth mainly in financial assets and property.

As a result, our report reflects significant cultural and practical differences, with some families having much better established practices for succession and intergenerational transfer than others. It should also be noted that whilst some of the families are relatively small in terms of family members, with wealth which far exceeds anything they could conceivably use for personal consumption, others are large families, collectively very rich, but with individual family members who do not regard themselves as wealthy.

There are still outstanding opportunities for families to grow their wealth, despite the world economy being underpinned by quantitative easing and exceptionally low interest rates, though the risks are of course still high. Most families are willing to accept a degree of risk in pursuit of business and investment opportunities, but we learnt that families are developing risk mitigation strategies which go beyond the traditional financial risk management tools offered by investment managers.

While we would agree that each family requires a customised plan to suit their circumstances, our experience of 'failed' intergenerational families has highlighted some key actions or omissions that are likely to have contributed to their failure:

- A lack of diversification of assets;
- Insufficient encouragement to the Next Generation to make their own way, allowing them instead to live off income from the family wealth;
- Rigid control by the previous generation, not allowing their successors to become integrated into the business; and
- A lack of common vision or shared values bridging the generations, which even a written constitution cannot overcome.

We believe there is great benefit to heeding these lessons, which clearly demonstrate that the long-term success of families entails far more than the preservation or growth of their financial assets. It entails the nurturing of three further "pillars of capital" too: Intellectual Capital, Social Capital and Cultural Capital.

FINANCIAL CAPITAL

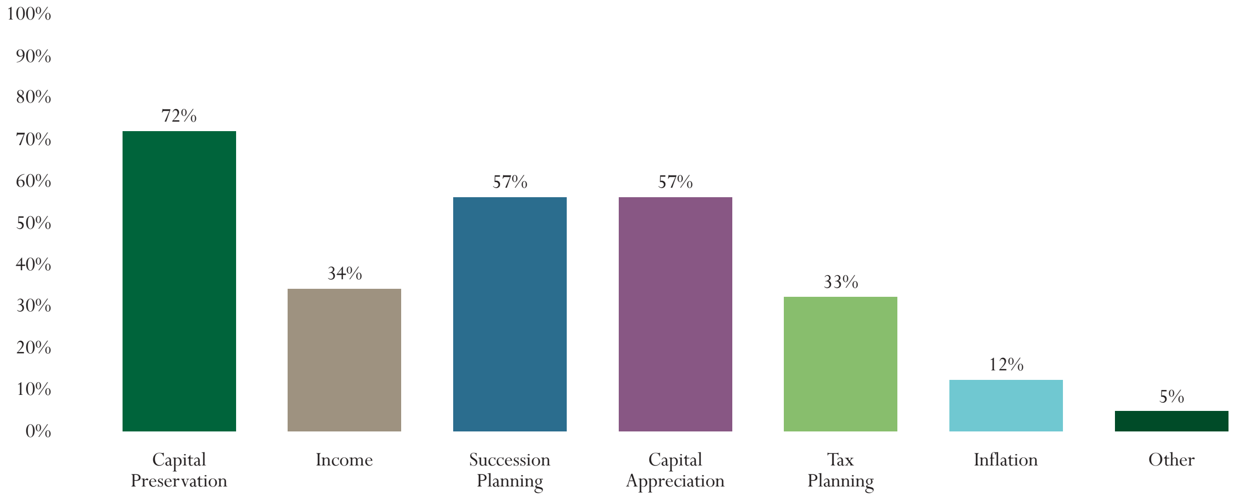
"Ultra-high-net-worth investors rank smart investing just below hard work and education as the key factors that are responsible for their financial success."

WENDY CONNETT, Financial Journalist

Financial Capital has historically been the most important pillar of capital, the one receiving the most attention – from investors, advisers, regulators and governments. The global financial crisis of 2007-08 had a deep and long-lasting impact on the Financial Capital of individuals and institutions. Indeed the UHNW population declined by 20% between 2008 and 2009, and its wealth by 22% over the same period[1]. The sudden loss of capital experienced by investors had an effect on their appetite for risk and this was clearly born out in responses to the FF&P 2043 survey in 2013; 71% of respondents identified real capital preservation as their greatest challenge. When we asked the same question again for this year's survey, the percentage seems to have remained constant, with 72% of main respondents listing capital preservation as one of their top three concerns. However, as we move away from the financial crisis, there seems to be a growing emphasis on capital appreciation, and a growing appetite for risk to achieve it. In our survey, capital appreciation was the joint second most frequently listed key concern.

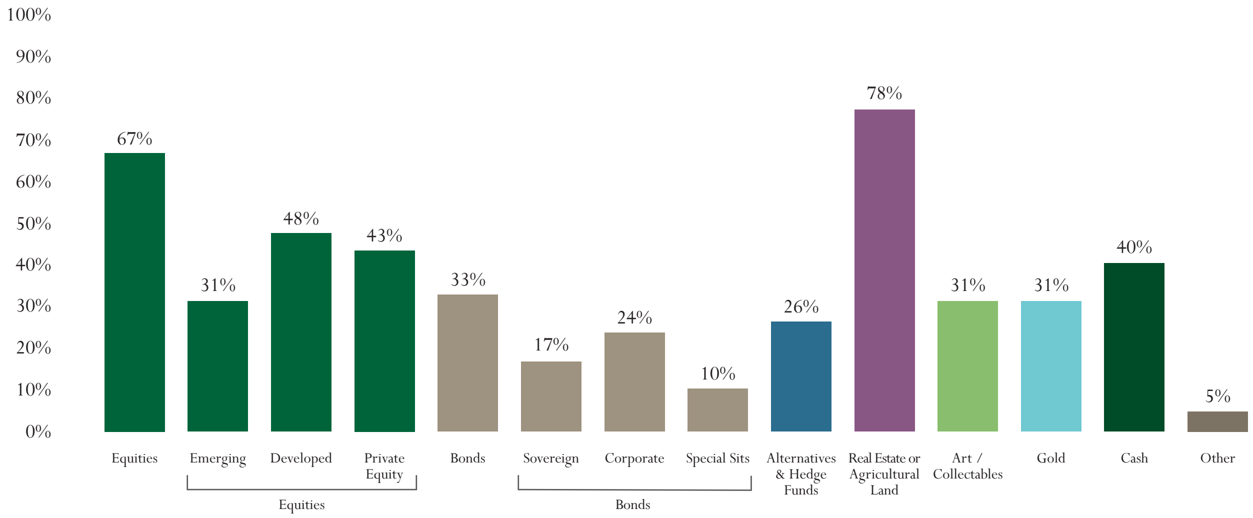
'Business assets' were repeatedly mentioned as an asset class in which many respondents would choose to hold significant portions of their overall wealth. This is perhaps unsurprising given that most of our respondents are business owners, or involved in some way with a family business. For many in fact, their assets are almost entirely wrapped up within the business, and this is also where they would choose to reinvest additional capital. This commitment to tying up capital in a family business also shows that the business has far more meaning to the family than the merely financial – it is a vehicle which carries the family's Intellectual Capital, which is often run in such a way as to espouse the family's values, often interwoven with the family's philanthropic interests and is seen as a way in which the family 'gives back' to their community. In the words of one respondent, "The business has a value

WHICH OF THE FOLLOWING WOULD YOU INCLUDE IN THE TOP THREE CONCERNS FOR UHNW FAMILIES PREPARING FINANCIALLY FOR THE FUTURE?



1 Wealth-X and UBS, World Ultra Wealth Report, 2014

TODAYS MACROECONOMIC ENVIRONMENT IS MORE DIFFICULT TO READ THAN EVER. GIVEN YOUR PERCEPTION OF THE CURRENT ECONOMIC CLIMATE, WHICH OF THESE ASSET CLASSES WOULD YOU CHOOSE TO HOLD?



to the family which goes far beyond measurable financial worth". Most importantly of all, the Next Generation must have the capability and desire to continue as a 'responsible owner'.

Nonetheless, in the low interest-rate environment in which we find ourselves, growth is difficult to come by. To preserve capital in real terms, and to achieve capital growth, 67% of families would hold equities as part of a long-term strategy. At the same time, developed market equities and Private Equity were far more popular asset classes than emerging market (EM) equities, in stark contrast to our 2043 survey in which families preferred emerging to developed market equities. This reflects cumulative disappointment that EM stocks are not producing the over-performance that investors have long hoped they would – they have delivered returns of -2.1% since the start of 2010, compared with the 69.1% return of developed markets[2].

Bonds continue to be seen as an undesirable asset class, whereas Real Estate and Agricultural Land significantly outstripped all other asset classes, with 78% of respondents saying they would choose to hold this asset class. Interestingly, when we spoke to the 'Next Generation' – the children of our respondents – they were far more bullish on alternatives such as hedge funds than their parents, with 43% choosing to hold them, compared to 26% of their parents. Linked to Real Estate and Agriculture is Forestry, which was mentioned as an 'other' asset class as it is non-taxable, can obtain good government grants, and grows without cost and with very little maintenance.

Respondents once more reported a growing attraction to Private Equity and direct investments, particularly as part of a longer term strategy. This interest in Private Equity and commitment to Real Estate assets shows that investors are seeking to diversify the risks in their portfolios, but also invest in assets which require greater levels of involvement, both in terms of knowledge about the investment itself, and also the long-term nature of the commitment.

Art as an asset class seems mainly to appeal to those who have inherited significant collections or those who are particularly knowledgeable or passionate on the subject. To build a collection that could count as a significant asset allocation, respondents felt that it was vital to have the capital to invest in the very top end of the market. One respondent said "If I had £100m I would invest in absolute top end 19th century British watercolours, because I like it and know a little about it".

2 S Johnson, Financial Times, 19 November 2015

TAX

Over the last few years, as one adviser put it, "There has been a shift in tax perceptions, not a tidal wave, but a definite shift". While there is a view that respondents would do what they could to maximize tax efficiency and use government-endorsed schemes to this end, there was also a resounding sentiment among those interviewed that "it is our social duty to pay tax", and "responsible citizens have a duty to pay their taxes".

Around half the respondents felt that headline rates of tax are reasonably fair, though those interviewed felt that any rate above 50% is punitive and encourages people to find ways around it. The top 1% of earners now pay 30% of all the income tax and National Insurance received by the Treasury. In 1979, despite a top marginal tax rate of 83%, the top 1% paid only 11% of income tax, under a regime where Denis Healey had declared he wanted to elicit "howls of anguish" from the rich and squeeze them "until the pips squeaked".

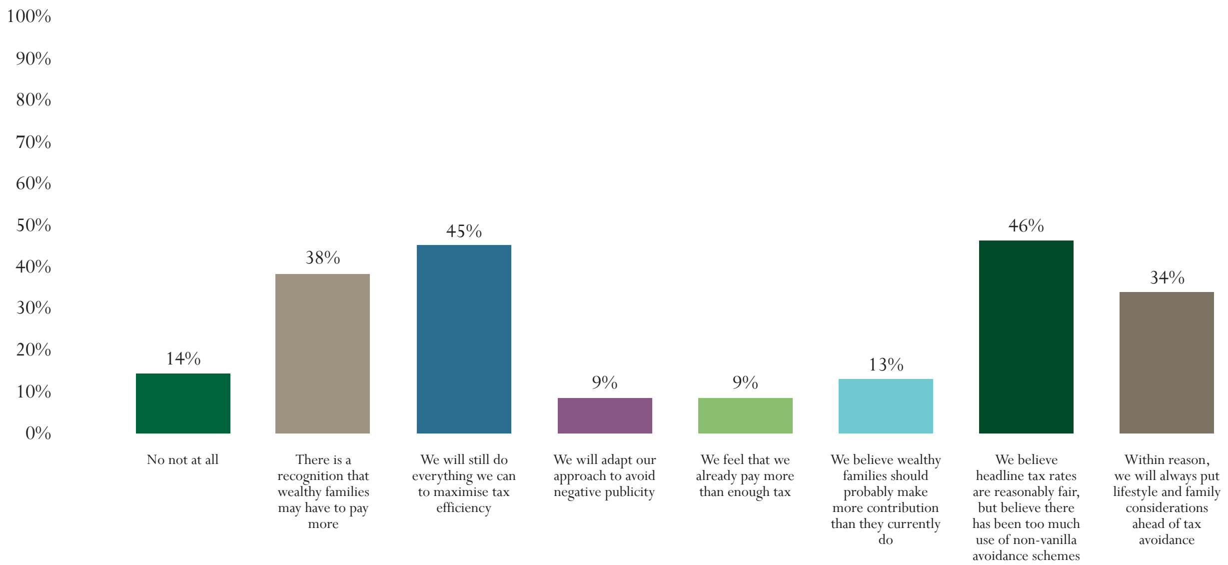
Individuals and their advisers, overwhelmingly have an aversion to non-vanilla tax arrangements, with clients describing themselves as "dead against" them or stating that they "wouldn't touch them with a pitchfork". The respondents who reported having no change in their attitudes towards tax only did so where they felt that they had "never gone for complex tax schemes and certainly will not do so in the future".

The subject of the Resident Non Domiciled (RND) regime was also of huge interest to our respondents. The changes to the regime are generally viewed as positive and one client went so far as to say, "As a UK Res Dom, I believe the special treatment for RNDs has always been unfair and I welcome the change".

The Next Generation respondents frequently held a different view from their parents and felt a greater moral obligation to pay a larger share of income tax than families have done in the past. Indeed they openly acknowledged this change in view with one saying, "Personally I feel wealthy families should probably pay more tax, but I doubt that is the view of my family".

Attitudes towards tax were however different when it came to end-of-life tax. A key concern for many of our respondents was Business Property Relief. They felt this was hugely important for keeping family businesses intact and passing them on to the Next Generation to run. Indeed there is an argument that, in its various forms, "inheritance tax hinders capital growth and capital creation".

HAS YOUR FAMILY'S ATTITUDE TOWARDS TAXATION CHANGED SIGNIFICANTLY IN THE LAST FEW YEARS?



DIRECT INVESTING

PRIVATE EQUITY FUNDS VS DIRECT INVESTMENTS

According to the families we spoke to for this report, views on the subject of Private Equity (PE) and direct investing are changing. The traditional approach of investing in a small selection of the best Private Equity managers around the world is being complemented by an increasing interest from families in investing directly in private companies. Private Equity is seen as an important asset class for delivering capital appreciation over time, with respondents in our survey giving it an increasing focus in addition to wealth preservation.

57% of those surveyed put capital appreciation as a top three priority.

Direct investment of private wealth is also seen as an appropriate source of capital, with a high degree of alignment to a family's objectives, given that companies often seek a long-term financial partner for their growth and families are frequently willing and able to take a much longer term view of capital appreciation than institutional Private Equity funds.

Many families in our survey indicated that they are more comfortable investing directly into a private company or start up because they feel they have more control and understanding of the investments – characteristics which they often fail to find in a fund or fund-of-funds structure. Some told us that they are unhappy with the charging structure of the fund model and in particular dislike paying 'fees on fees' which they feel are hard to justify in a low return world. Others told us that the returns generated by many Private Equity houses rely too much on leverage; once this is stripped out of performance data the excess returns over public markets are not so attractive.

THE CASE FOR PRIVATE EQUITY

45% of the surveyed audience believed Private Equity was a top three asset class.

Private Equity is a valuable part of asset allocation for most families, who are particularly well placed to take a long-term view and to tolerate short term volatility. There is convincing data out in the market demonstrating that investment returns in PE outstrip those in the public asset classes. However, it is important that families undertake careful financial planning so that investors are not forced to sell illiquid assets at times of stress and weak prices. Ensuring cash or liquid assets are available for known future financial expenditure events is vital. It is also important to be aware of the "Private Equity cycle": Avoiding putting capital to work when the sector is "hot" and potentially over-valued in order to generate the best possible returns.

A hybrid strategy of investing in a PE fund together with investments into single company opportunities is becoming more popular, provided the knowledge of the relevant industry is in place and specialist due diligence has been completed. Several people we spoke to said that they were keen to invest alongside other like-minded families. Co-investing is popular amongst the UHNW investors and can offer some protection, but is not a substitute for careful research.

SOURCING DIRECT INVESTMENT OPPORTUNITIES

Direct investment has many attractions, but the primary challenge is, of course, sourcing high quality ideas and target companies on sensible terms. Stonehage Fleming looks at several hundred direct private capital opportunities each year, but will only carry out deep due diligence on a small fraction of these. Co-investment with other families or investors that are specialist in their field is a growing feature. Families have told us that they are keen to put money to work in private opportunities in industries or sectors that they know well (often as a result of having sold a business in a particular sector). In recent months families we work with have told us that they had accessed private investments in a wide range of sectors including Insurance and Technology. A traditional approach to direct Private Equity investing is to back significant numbers of start-up enterprises in the hope of getting "the one winner". The downside of this method is that a significant amount of work has to be carried out on each investment, capital has to be put at risk and may ultimately be lost. In addition, positions need to be closely monitored during the investment period requiring significant time and resource.

"Invest in entrepreneurs and new businesses in the hope that one of them will be the next big thing" – a single family office.

PICKING THE WINNERS IN EARLY STAGE INVESTING

Despite the challenges it is clear from our survey that some family offices have joined angel investors, venture capitalists, corporate venture teams and acquisitive sovereign wealth funds in the increasingly competitive battle to find the 'next big thing'. Investing strategically in start-ups and early stage companies to create long-term value is clearly a popular approach.

"Invention is, after all, a secretive world"
Peter Kingsley, PJR.

We were told by several families that matching the best ideas from the world's best universities with well organised capital and entrepreneurial business experience is an attractive strategy for finding and creating value. One of the UHNW advisers to whom we spoke indicated that they worked with a client who had liquidated their entire investment portfolio and reinvested half into cash and half into commercial university-generated intellectual property start-up companies. This client had great concerns about public markets in a world post-quantitative easing but believed that the world is still in the early stages of "the technology wave".

ECONOMIC IMPACT

Small and medium enterprises and family businesses have been and are likely to remain a very significant part of the engine of growth for the real economy. In the UK there are three million family businesses, employing nine million people and contributing 25% of total GDP[3]. In the US, family owned businesses contribute 57% of the U.S. GDP and employ 63% of the workforce[4].

Many families feel responsible for supporting this engine. Moreover, those who do not have their own family business are often looking to invest in those enterprises which will provide vital economic energy as well as generating returns for their investment portfolio.

On respondent told us, "Families should be focussed on impact investing; the wealthy can take a long view and can afford to take more risk - commercialise projects that you are passionate about – treat them like a gift but set them up like an investment".

3 PwC, The Family Factor: Professionalising the UK Family Firm, 2014
4 FEUSA, 2011

INTELLECTUAL CAPITAL

> "The wealth of a family consists of the human and intellectual capital of its members. A family's financial capital is merely a tool to support the growth of the family's intellectual capital."
>
> **J E HUGHES JR**

Intellectual Capital is the intangible value of the collective skill, specialist knowledge, experience and wisdom of the family and family business, and is drawn from the people and the value inherent in the family relationships. The Intellectual Capital possessed by UHNW families is vast and with it is the opportunity to pass it on to subsequent generations within the family, but also to use it more broadly to benefit the wider society.

But first let us consider how this capital was originally created in UHNW families. 64% of the UHNW population are self-made individuals[5] and indeed the idea of Intellectual Capital and entrepreneurship go hand in hand. These are pioneers, innovators who have capitalised on the originality of their ideas to create highly successful business ventures. The entrepreneurs and business owners with whom we spoke for this report often developed specialist expertise which lies at the heart of their wealth-creating activities. There is a wide basis of learning on which they developed their Intellectual Capital, be this in terms of chosen school and university subjects, further training, work experience or early career choices. If we also consider the UHNW families whose wealth is inherited, it frequently comes from an earlier venture established by one of their forebears. The key to longer term success then seems, in significant part, to rest on the effective transmission of Intellectual Capital from one generation of a family to the next as "it is important that families have the human capital and entrepreneurial skills to withstand the choices they make".

To ensure the management of Intellectual Capital within a family is handled successfully, strong leadership and carefully considered succession planning are required. One respondent felt that the greatest risk to long-term family wealth was the "inadequate development of the human intellectual capacity of family successors". And overall in our survey we found that the second most cited concern for families was that of succession planning, while the second most cited risk to long-term family wealth was a lack of future family leadership and direction.

All the individuals we spoke to understood the need to ensure that the Intellectual Capital their families have amassed is spread far wider than just the family unit. For some families this passing on of Intellectual Capital comes in the form of mentoring – using their experience to help a new generation of entrepreneurs. Others see it as part of their philanthropic efforts, particularly those in families unable to give as much financially to causes as they would like, due to a sense of being 'asset rich, cash poor'. One respondent said "I feel I give more [to charity] in terms of time, influence and provision of other goods and services" while another gives his time to charities saying, "I help [them] with financial know-how", bringing his own personal skills from a career in finance to help charities in which an understanding of this area may be lacking. Indeed according to the latest Wealth X and Arton Capital Philanthropy Report, "intellectual capital is as valuable as financial capital".

5 Wealth–X and Arton Capital, Philanthropy Report, 2014

SOCIAL CAPITAL

"We make a living by what we get,
but we make a life by what we give."

WINSTON CHURCHILL

Social Capital concerns the way in which families relate to and engage with the society and the communities in which they live and operate. It also refers to the network of social connections that individuals and families sustain, all of which have a bearing on another key element of Social Capital which is the reputation or 'brand' of a family.

A significant portion of the social contribution of UHNW families and the way in which they engage with communities comes through their business interests. Most of the families we spoke to have family businesses, and the value of that business is much more than financial. It gives the family a role and an identity and a means of continuing to contribute to society through the jobs it creates, the services it provides to customers, and the other benefits it brings to the community. Many felt that there was a more general lack of awareness of this wider societal contribution.

"Wealthy families, particularly those with businesses, drive job creation and are helping boost wealth." Family-owned firms make up 80-90% of firms worldwide[6], albeit firms of very different scales to those of some of the families to whom we spoke, and are important drivers of GDP and job growth. The scale of the businesses owned and run by the families we spoke to vary from multi-billion pound international firms to more modest small and medium-sized enterprises (SMEs). In America, the 10 richest entrepreneurs are responsible for sustaining 865,000 jobs[7] and in the UK family businesses account for 66% of all SMEs in the country, employing more than 9m people – 40% of all private-sector employment, generating revenues of £1.1 trillion[8]. These statistics support the comment of one respondent that, "It is wealthy families who run businesses that drive job creation, not the government".

The interwoven nature of running family businesses, giving philanthropic support, local community involvement and wider social contributions made by wealthy families came across in the responses we received to all the elements of the questionnaire and most strongly in our interviews. Several interviewees told us that "doing good is good business". As already noted, 64% of UHNWI investors are self-made and a further 19% are listed as inherited/self-made, but as one respondent observed, "You will only make money if society thinks [your business or idea] is worth it".

Many of the families we spoke to reported a strong desire for their business and their families to espouse values of corporate social responsibility, with 44% of respondents saying that they

"With extreme wealth comes extreme responsibility.
And the responsibility for me is to invest in creating new
businesses, create jobs, employ people, and to put money aside
to tackle issues where we can make a difference."

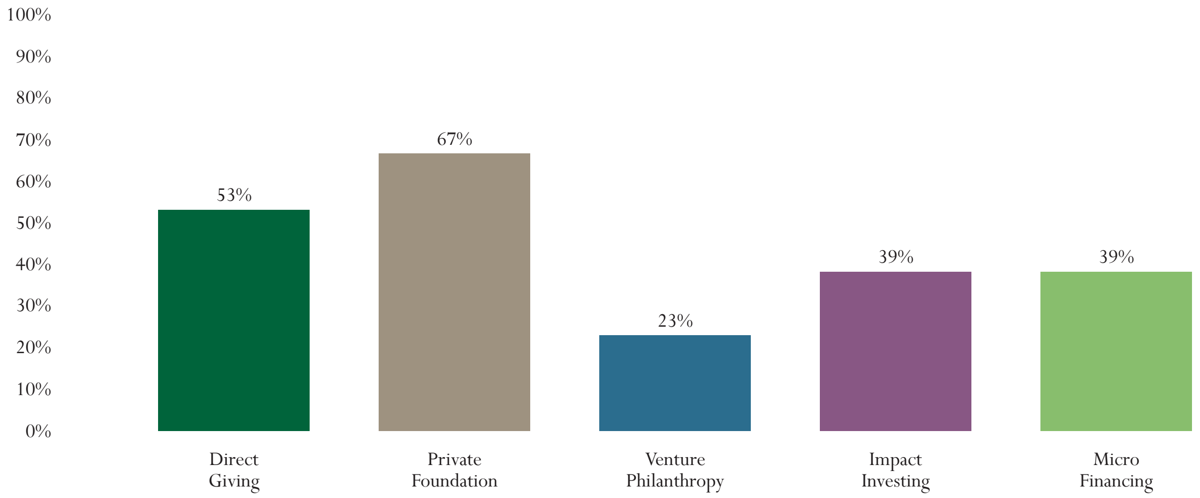
RICHARD BRANSON

6 University of St. Gallen, Global Family Business Index, 2015
7 Wealth-X and UBS, World Ultra Wealth Report, 2014
8 Institute for Family Business and Oxford Economics, The UK Family Business Sector, 2011

applied the same values to their businesses, their philanthropy, their investments and their conduct as a family. One industrialist, when talking about the aims of their business said, "It is good to do business that solves problems for the benefit of society".

However, it is not only within the context of their businesses that respondents acknowledge their external-facing responsibilities; 82% of all respondents agreed that there is a link between preserving one's wealth and using it to the benefit of society. For many this may mean their involvement with charitable causes, which we will come on to later in the report. But respondents to the main survey also showed a strong commitment to engaging with their local communities, with 79% stating that they have direct involvement in the particular community in which the family or family business is located. This involvement covers a wide spectrum of roles including membership of community councils, church councils and sitting on the board of local schools, through to using individual influence to campaign for local community causes, with one of the respondents a significant lobbyer of the government on sustainability issues, and another making their community heard on the issue of HS2[9]. There can be various motivations for this. For some, "Local initiatives and involvement is deemed good for the business"; for others they simply "use community engagement to put back into society". It is important, however, to be realistic about the amount of time one can commit to local causes and the impact one can make. As one respondent put it, "You have to be careful if you give time - can you make a difference? If not, you should avoid it".

HOW ARE UHNW FAMILIES / ENTREPRENEURS LIKELY TO DEMONSTRATE THEIR PHILANTHROPY?



9 High Speed 2 is a controversial planned high-speed railway linking London, Birmingham and Manchester

PHILANTHROPY

When we think of philanthropy, we often think of monthly direct debits to a chosen charity, of sponsoring friends and family, or the seemingly never ending invitations to fund-raising events. Perhaps for some it conjures up ideas of private foundations and endowments. However, we see philanthropy as a broad range of activities encompassing all these possibilities, and many more. Wealthy families are doing more than ever in terms of giving to philanthropic causes, with the typical UHNW philanthropist donating equivalent to more than 10% of their net worth during their lifetime[10]. Indeed, other members of the super-wealthy have pledged to give significantly more.

We are in agreement with one of our clients who stated that "There is a wide spectrum of what is considered philanthropy". We determined private foundations and direct giving to be the most common form of giving according to the respondents with 67% and 53% stating, respective to each form of giving, that these were ways in which they were likely to demonstrate their philanthropy. But impact investing, and microfinancing came out as popular alternatives, with 39% of respondents likely to use these methods of giving as well. Indeed the Next Generation respondents were even more likely to do so, with 45% equally as likely to look at microfinancing as at private foundations.

Wealthy families have a long history of setting up private foundations to manage the capital attributed to philanthropic donations and also to help put structure around their choice of causes. Some families put their name on their foundations and are open about the contributions they make. However, historically it seems that families have more commonly remained quiet about their charitable involvement. Some of the comments on the subject we received included, "The people in the charities know that I've given, but I never talk about it", and "In terms of personal giving, I tend to keep my head down about it". Our clients feel that there is a disconnect between what the public seems to be asking for in terms of societal contribution from the wealth and what they actually see – "the general public doesn't understand or take on board the philanthropic contributions made by the wealthy". Therefore it is perhaps time, in an age where such information is easy to come across at the click of a button, for families to be more open and forthright about their philanthropic involvement.

The way in which families select causes to which to donate seems to be rather haphazard, with many saying it is "whoever gets to you first", or just about being "caught at the right time". Despite this, there were some strong themes in the causes selected, with most having a local or personal connection. Education was a cause mentioned frequently and in fact major educational causes account for 40% of UHNW donations[11]. Our research also showed that, given the propensity for business ownership and entrepreneurialism in the UHNW community, they also looked to contribute to programmes that aim to help entrepreneurs and start-up firms, with one saying, "I invest in entrepreneurs and new

IMPACT INVESTING - investments made with the intention to generate a measurable, beneficial social or environmental impact alongside a financial return

MICROFINANCING - providing financing for entrepreneurs and small businesses lacking access to banking and related services

10 Wealth-X and Arton Capital Philanthropy Report 2014
11 Ibid

businesses in the hope that one of them will be the next big thing". This response was given in relation to demonstrating philanthropy through impact investing and microfinancing, but also echoes the point raised earlier in the paper that people are increasingly looking for opportunities for early-stage investing in game-changing opportunities.

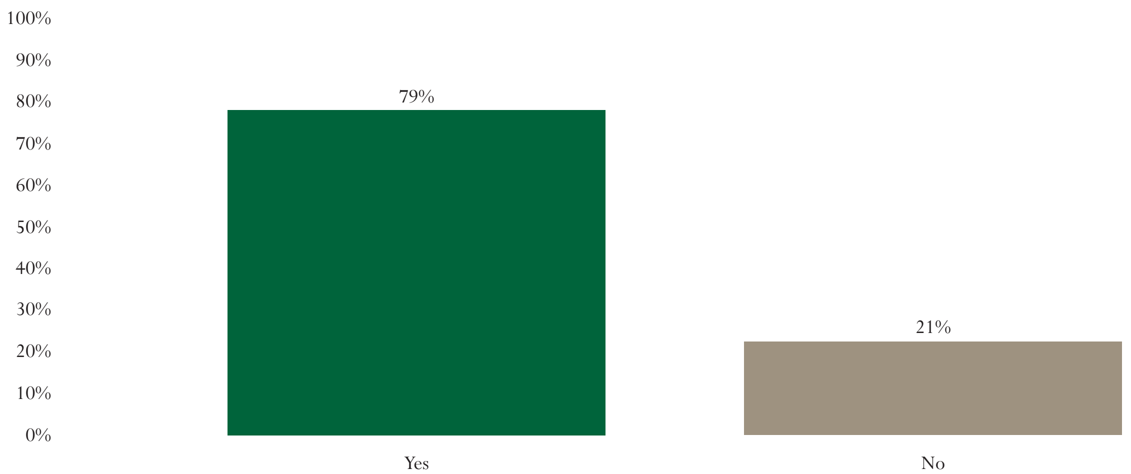
It was clear from our discussions with the contributors to this report that many feel direct investment is not only seeking investment returns but also a way of contributing to society. As we have discussed, many families – particularly those who have a business carrying the family name – regularly invest in local business and support local entrepreneurs as they feel there is a direct benefit to both their own business and the wider economy. One adviser said that "Families should be focused on impact investing" while another family said that they "Take 10% of invested capital every year to put into impact investment-type projects". Indeed socially-conscious investments are becoming more prevalent in core portfolios, with impact investments, such as social impact bonds, set to account for 1% of professionally managed assets within next 10 years.

Several contributors to this report believed that direct investing is the centre of a Venn-diagram, the outer circles being sustainability, supporting entrepreneurs and philanthropy. There is sometimes strong cultural alignment between successful entrepreneurial families and innovators leading early stage companies. Many families also use philanthropic investments to train the Next Generation.

"Give them small pots of money to go away and invest – show them it's not as easy to make money as they might think!"

What has been clear from the responses and conversations we have had is that, for families, philanthropy "is not just a tick the box exercise, it needs to be about the time and effort invested as well as the money". The concept of philanthropy is incredibly broad and methods of contributing are equally so. However given that all the families we have spoken to contribute in some way, it would seem, as one client put it, that "Philanthropy holds families together".

DO YOU HAVE DIRECT INVOLVEMENT IN THE LOCAL COMMUNITIES WHERE YOU ARE BASED OR WHERE THE FAMILY BUSINESS IS BASED?



CULTURAL CAPITAL

"When your values are clear to you, making decisions becomes easier."

ROY E DISNEY

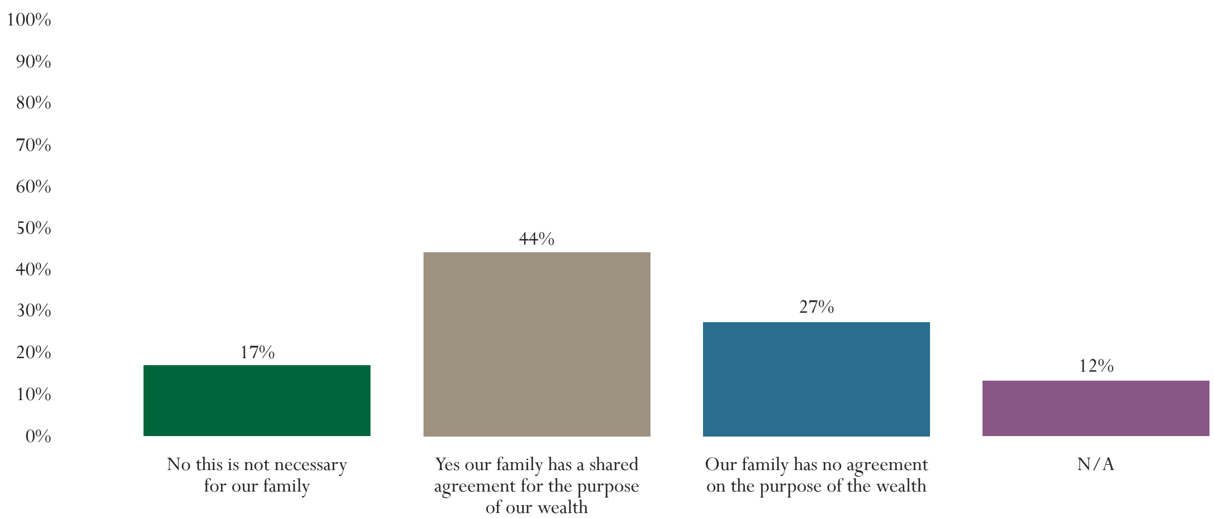
'Culture' can be thought of as an amalgam of beliefs, values, practices, norms and ideas. It is a powerful concept, acknowledged as the secret weapon of many successful businesses, giving them a competitive edge which is difficult to define and hence difficult to replicate.

Nearly all businesses write down a set of values which are their guiding principles, but such documents are usually often bland and uninspiring, with little to differentiate them from the competition. Culture seems impossible to capture entirely in the written word and only acquires true meaning when it is handed down and developed from one generation to the next, usually inspired by the founders of the business.

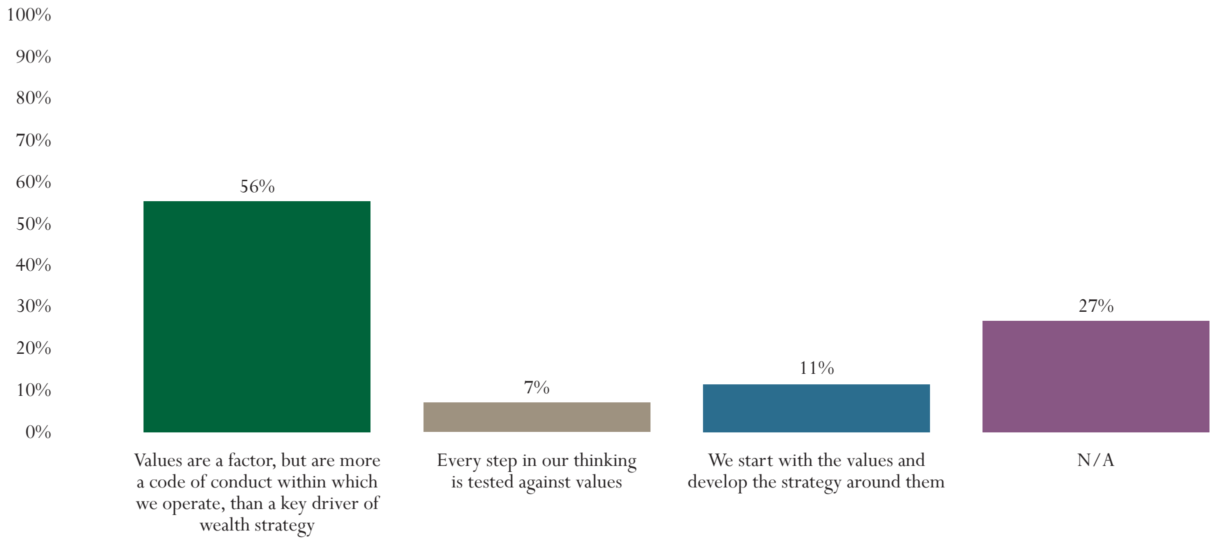
A strong culture can also be a powerful legacy for a family and many families believe they inherited a culture which is worth preserving and handing on to the Next Generation. It is normally passed on informally through the upbringing of the children, the example of the parents, and the values that are usually implicit and assumed. However in a modern society, individual identity and fulfilment are generally regarded as so important that there is some reluctance to train the Next Generation too rigidly to step into the shoes of their parents. Most of the families interviewed recognise that greater effort should be made to help the Next Generation to tread the fine line between understanding and embracing their heritage whilst also pursuing their own life ambitions and developing their own identities.

While "constitutions were in vogue 10-15 years ago", we see families moving away from a 'business-like' management of culture and values. Often families have found such documents to be "too structured, too restrictive", with 56% of respondents feeling that their values are more a code of conduct within which to operate than a family doctrine. Many families did feel that there would be merit in writing down their values and in planning how to hand down the culture, just as families plan for the handover of physical and financial assets; this this was viewed as a process to encourage communication and engagement across the generations.

HAVE YOU AND YOUR FAMILY AGREED A PURPOSE FOR THE FAMILY'S WEALTH?



HAVE YOU PUT IN PLACE A FORMAL PROCESS TO ENSURE YOUR VALUES HELP TO DRIVE YOUR STRATEGY FOR PRESERVING AND GROWING FAMILY WEALTH?



Most families believe they should do more to enable a better understanding of how the family wealth was built (including the extent of the endeavour, courage, risks undertaken, sacrifices, disappointments and setbacks), the qualities and values of the founder and how he or she would wish their legacy to be used, to the benefit of both heirs and the wider society. One family has a Next Generation "education day that explains the history and pioneering spirit of their forebears and how lucky they are to be a part of it". Another says that they "make members of the family aware of those with talent and ambition who are achieving things, in order to inspire and motivate other family members".

41% of respondents had, within their family, agreed a purpose for the family's wealth, and many of those who had not done so felt that defining such a purpose would be beneficial. Overwhelmingly, the families we spoke to saw themselves as custodians of wealth for a generation with a "duty to hand it on, not to dissipate it". Family wealth is seen as a tool to ensure the Next Generation have access to education and are able to buy a home, and where the wealth is based on a family business it is to ensure the "preservation and survival of the business".

According to a recent work by Yale Law professors Amy Chua and Jed Rubenfeld, the three themes common to 'successful cultures' are a superiority complex, insecurity and impulse control[12]. While we found that the cultures of successful families were varied, a number of common themes arose in the face-to-face interviews we conducted:

- Culture can bring families together by identifying common values and themes in the way they conduct their lives, their approach to business, the way they treat others, the way they contribute to society, their attitude to wealth and the things they value.
- Nearly all respondents want the wealth to help those who inherit to lead more fulfilling lives, but importantly to enable them to make a contribution to society rather than financing extravagant consumption.
- Active involvement in philanthropic giving is an essential responsibility of wealth and will help to shape the family values and culture for the future.
- Philanthropy is often linked to and reflective of the family heritage, supporting their local communities and the trades related to the family business.
- One of the most notable features of this study is that the Next Generation is significantly more strongly motivated to contribute to society both in general terms and more specifically through philanthropy.

12 Chua and Rubenfeld, The Triple Package, 2014

THE NEXT GENERATION

"I believe that whoever is successful should help ensure the next generation can be successful too."

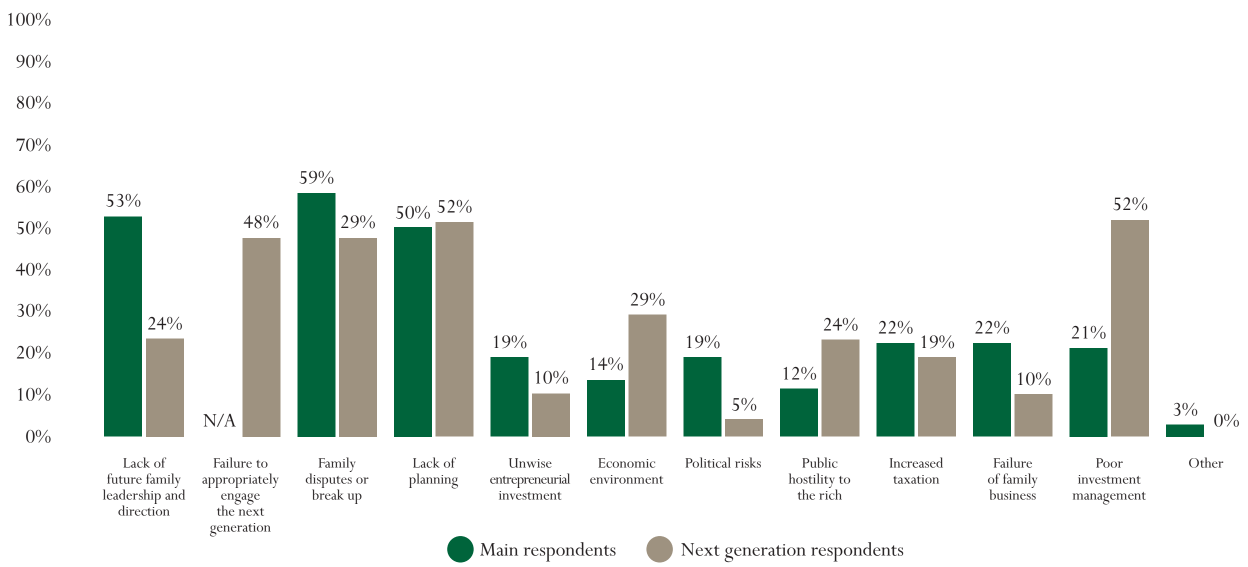
HASSO PLATTNER, SAP

Almost every wealthy family owes a debt of gratitude to a man or woman of courage, vision, determination and perseverance. Wealth creators are usually deliberate and often single minded; however the clarity of their professional vision too often fails to be matched by engagement with the Next Generation. The intergenerational transfer of Financial Capital, so often tax driven, is more straightforward than the transfer of Social, Cultural and Intellectual Capital. There are striking features to the survey which highlight generational differences in the desire to understand and pass down the values and cultures that underpin these families. 68% of families surveyed felt they had started to engage the Next Generation whereas just 47% of the Next Generation felt they had been engaged, despite all of the Next Generation respondents having attended the Stonehage Fleming "Next Generation Programme". This programme is designed to encourage families to initiate conversations about planning and succession, though it seems these subsequent conversations may not be happening in many cases. This gap in perceptions lies at the heart of the intergenerational challenges that families face.

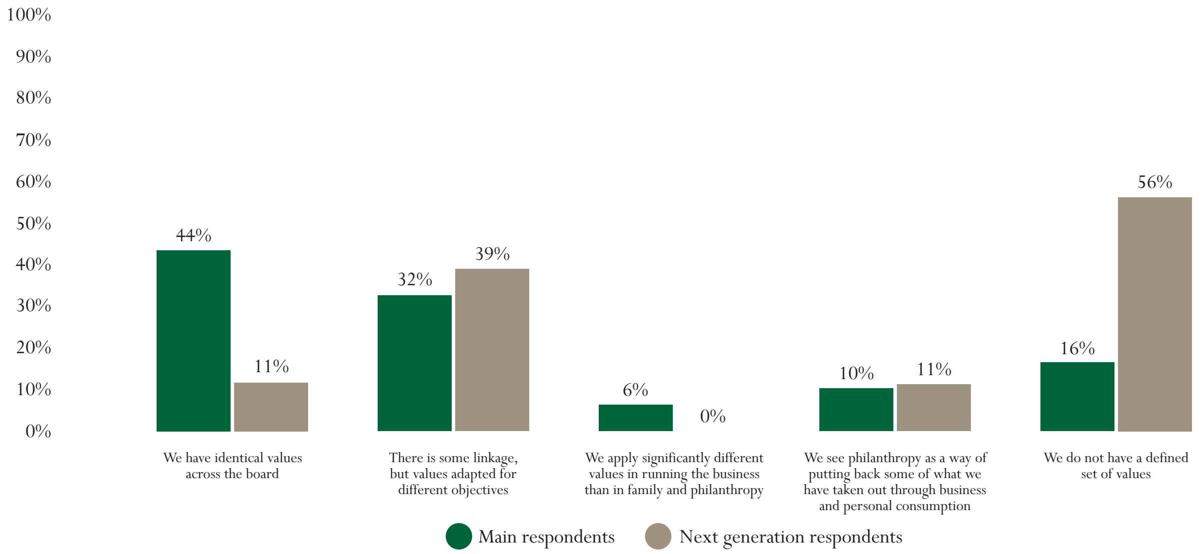
Perhaps due to their relative life experiences, the first notable difference in opinion between generations in our survey came when we asked respondents to list their top three risks to long-term family wealth. Parents focused on problems internal to the family, with 59% citing family disputes and 53% a lack of future leadership as their top risks. Their children however saw poor investment management and lack of planning as the greatest threats. To tackle the potential issue of family disputes, parents seemed keener on the traditional "bring our children up properly" model than on taking a more recent approach of a written constitution to ward off future disagreements. "We have strong values as a family but they are not formally coded".

Parents appeared more committed to "assumed values" and, as a result, the Next Generation felt strongly that failure to engage them appropriately was a key risk to wealth. The survey showed a particularly strong desire among the younger generation to see family values and objectives well defined, properly agreed and clearly documented.

WHICH OF THE FOLLOWING WOULD YOU INCLUDE IN THE TOP THREE RISKS TO LONG TERM FAMILY WEALTH?



ARE THERE A SET OF VALUES YOU APPLY TO YOUR BUSINESS, YOUR PHILANTHROPY AND YOUR INVESTMENTS AND THE GENERAL CONDUCT OF THE FAMILY?



Perhaps the first step in this is defining the purpose of a family's wealth, an exercise which was widely thought to be valuable but which few families felt they had done satisfactorily. In answer to "Have you put in place a formal process to ensure these values help to drive your strategy for preserving and growing family wealth?", 56% felt values were part of an unwritten code of conduct, 8% felt every step was tested against values and 13% started with their values and built the strategy around them. In stark contrast 53% of the Next Generation felt there was no defined set of values and 41% felt the values had merely been imposed. As one family leader stated, "We do not have a formal process but should do this. Formal communication of values has lapsed in the last generation and it is hard to put the genie back in the bottle".

There is a strong association between the existence of a family business, especially one that bears the family name, and early engagement around the family values, the purpose of wealth and the role of the family moving forwards. Our survey reveals a seemingly surprising emphasis on natural evolution and self-selection when identifying the future guardians and leaders of a family business. All generations agree that experience and perspective gained away from a family business are essential and some go as far as to say that they would sell the family business if self-selection did not throw up a successor that was willing and able. Families also seem to accept that their children should be encouraged to establish careers and explore their own vocational interests, even at the expense of engaging with the family business. "If neither child had shown the skill or inclination to take on the business we would have been disappointed but rich, as we would have sold the business!"

Where there is no family business, "just wealth", families are slower to engage the Next Generation. In these circumstances the emphasis often falls on a trustee or adviser to encourage families to start conversations around succession, responsibilities and roles within a family. Despite primogeniture being dubbed "the most politically incorrect mode of preserving family wealth" it was also acknowledged by several respondents to be "the most successful method in the UK for 500 years".

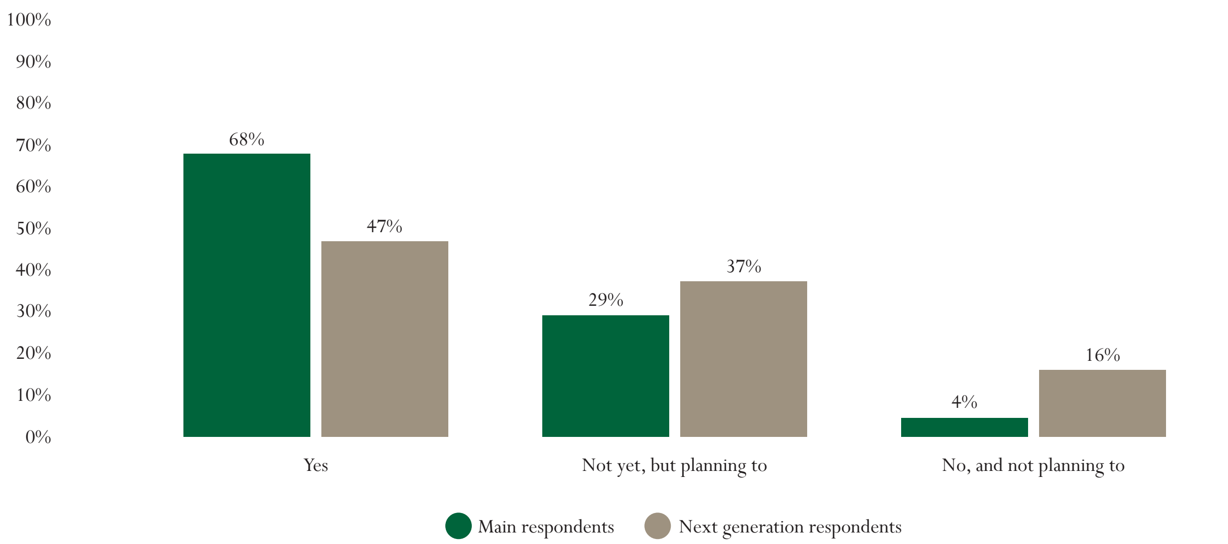
The majority of families expressed a desire to give the Next Generation "the best possible chance of success" by encouraging appropriate education and experience, with many using Philanthropy and even modest exposure to Private Equity as appropriate methods of preparation for the future. This growing awareness of the significance of a family's Intellectual Capital and a desire to encourage diversity and self-fulfilment is a common theme.

"Tough love" is emerging as a principle for families with multi-generational aspirations. Ensuring the Next Generation had worked, had a breadth of experience, had made mistakes and earned respect were understandably common themes. Few talked about the unconditional transfer of wealth and one went as far as to propose that an independent consultant should measure all children against a "balanced scorecard" and wealth, leadership and influence should then be transferred according to the results.

How families position themselves is increasingly a matter for debate. Businesses employ PR agencies and have marketing teams. Should families consider the same? The growing gap between the haves and have nots and an intrusive media which provides an immediate and unquantifiable risk to Cultural and Social Capital are acknowledged as threats to family wealth by both generations, yet it is the younger and more technologically savvy who would choose to get on the front foot over family PR, in contrast to the traditional "low profile" approach of many multi-generational families. There are exceptions and these are usually families with businesses that carry their name. "Our primary concern is social capital over financial. We could take a financial hit but the family only has one name".

Families often overlook the similarities they share with business and underestimate the challenges they face. Businesses of similar size to significant wealthy families have Boards of Directors and leadership teams to help define the vision, mission and strategy, and HR departments to ensure that the business has the culture, skill sets and necessary training to succeed. Families usually have far more at their disposal than they appreciate: multi-generational skill sets, assets and behaviours ingrained during the journey that each family has been on, be they Financial, Social, Cultural or Intellectual, "The Four Pillars of Capital". For the vast majority of families the successful transfer of wealth, assets or a business to the Next Generation will be a priority and therefore a good succession plan, which embraces the views of all involved and the Four Pillars is essential. PJ O'Rourke wrote "Wealth brings great benefit to the world. Rich people are heroes." The integrity of the intergenerational transfer of all forms of capital will prove him right or wrong.

HAVE YOU STARTED TO ENGAGE THE NEXT GENERATION OF YOUR FAMILY IN TERMS OF PREPARING THEM TO LOOK AFTER FAMILY ASSETS IN THE FUTURE? (FOR NEXT GEN – HAVE YOU STARTED TO BE ENGAGED?)



CONCLUSION

At Stonehage Fleming, investment management sits within a broad array of family office advisory services. We believe it is critically important for us to develop a deeper understanding of the universal circumstances of the families we work with, and not just to focus on their financial positions and interests.

The process of developing this report, particularly the input we have had from clients and advisers, has been not only fascinating but hugely enjoyable. We are tremendously grateful for their time and effort, the insight they have provided and interest they have shown in this project.

What we have understood from the interviews and survey responses is that families who concentrate solely on managing their Financial Capital, and do not develop a holistic long-term strategy that encompasses the other pillars of capital, will struggle to break free from the mould of 'clogs-to-clogs in three generations'. An understanding of their Intellectual, Social and Cultural Capital, and planning for its transfer to the Next Generation, is key to a family's intergenerational success.

Successful families are also acutely aware of their responsibility to contribute to their local communities and to society more widely. Understanding that internal family-facing responsibilities and external-facing societal ones are not mutually exclusive, but rather are complementary to achieving a family's long-term goals is essential for success.

Under the heading of Financial Capital, respondents felt that committing to asset classes which require a longer-term investment horizon, such as Private Equity or Real Estate, or holding equities through market cycles would be the most desirable positions to take. At the same time, there was significant interest in deploying non-core assets into direct investment opportunities.

The Intellectual Capital of a family needs to be successfully transmitted to the Next Generation to enable it to preserve the wealth that has been created, or indeed to capitalise on the knowledge passed on to it to succeed in its own ventures. Externally, many other businesses and charities would benefit from more widespread mentoring or intellectual investment from successful families and business owners.

The social contribution of successful families is wide-ranging and the way in which they 'give back' to society can be seen as running through a spectrum from the jobs created by the businesses they own to the philanthropic contributions they make. This aspect of Social Capital is well understood by Stonehage Fleming, with our CEO, Giuseppe Ciucci, recently stating, "Philanthropy and social responsibility are at the heart of our philosophy and our culture - we believe that playing a useful role in the community is a moral imperative".

The way in which a family approaches its planning of Financial, Intellectual and Social Capital is invariably governed by its culture. An understanding of the path a family has taken and the values it wishes to adopt for the future is crucial to ensuring the Next Generation is successful in taking on the stewardship of a family's wealth.

APPENDIX

A 14 question survey was developed for families and advisers. A modified version was completed by Next Generation (18-25) respondents.

MR = Main questionnaire respondents
NG = Next Generation questionnaire respondents
AR = All respondents

1. Which of the following would you include in the top three concerns for UHNW families preparing financially for the future?

	MR	NG	AR
Capital preservation	72%	67%	71%
Income	34%	57%	41%
Succession planning	57%	67%	59%
Capital appreciation	57%	24%	48%
Tax planning	33%	52%	38%
Inflation	12%	10%	11%
Other	5%	0%	4%

2. Which of the following would you include in the top three risks to long-term family wealth?

	MR	NG	AR
Lack of future family leadership and direction	53%	24%	46%
Failure to appropriately engage the Next Generation	N/A	48%	N/A
Family disputes or break up	59%	29%	51%
Lack of planning	50%	52%	51%
Unwise entrepreneurial investment	19%	10%	16%
Economic environment	14%	29%	18%
Political risks	19%	5%	15%
Public hostility to the rich	12%	24%	15%
Increased taxation	22%	19%	22%
Failure of family business	22%	10%	19%
Poor investment management	21%	52%	29%
Other	3%	0%	3%

3. Since the global financial crisis attitudes to the rich have become significantly more negative. In which of the following ways has this affected your views?

	MR	NG	AR
The way you run your business	20%	29%	23%
The way you spend or family members spend your wealth	22%	24%	23%
Philanthropy	26%	38%	30%
Your own values, in particular the balance between personal or family achievement and the need to contribute to society	26%	67%	38%
The values which you want to pass on to subsequent generations	28%	62%	38%
The needs for better PR by the family	16%	24%	18%
No effect on views	36%	10%	28%
Other	2%	0%	1%

4. Has your family's attitude towards taxation changed significantly in the last few years?

	MR	NG	AR
No not at all	14%	10%	13%
There is a recognition that wealthy families may have to pay more	38%	38%	38%
We will still do everything we can to maximise tax efficiency	45%	38%	43%
We will adapt our approach to avoid negative publicity	9%	10%	9%
We feel that we already pay more than enough tax	9%	14%	10%
We believe wealthy families should probably make more contribution than they currently do	13%	14%	13%
We believe headline tax rates are reasonably fair, but believe there has been too much use of non-vanilla avoidance schemes	46%	19%	39%
Within reason, we will always put lifestyle and family considerations ahead of tax avoidance	34%	14%	29%

5. Do you believe that there is a link between preserving wealth and using it to the benefit of society as well as the family?

	MR	NG	AR
Strongly agree	38%	38%	38%
Agree	42%	48%	44%
Neutral	16%	14%	15%
Disagree	4%	0%	3%

6. If so, how has this view impacted on the following:

	MR	NG	AR
The family business and other enterprises	31%	11%	25%
The upbringing of the family and family values	59%	83%	67%
Philanthropy	44%	28%	39%
Other	10%	6%	9%

7. Do you have direct involvement in the local communities where you are based or where the family business is based?

	MR	NG	AR
Yes	79%	61%	73%
No	21%	39%	27%

8. How are UHNW families or entrepreneurs likely to demonstrate their philanthropy?

	MR	NG	AR
Direct giving	53%	75%	58%
Private foundation	67%	45%	61%
Venture philanthropy	23%	20%	22%
Impact investing	39%	35%	38%
Micro financing	39%	45%	40%

9. Are there a set of values you apply to your business, your philanthropy and your investments and the general conduct of the family?

	MR	NG	AR
We have identical values across the board	44%	11%	35%
There is some linkage, but values adapted for different objectives	32%	39%	34%
We apply significantly different values in running the business than in family and philanthropy	6%	0%	4%
We see philanthropy as a way of putting back some of what we have taken out through business and personal consumption	10%	11%	10%
We do not have a defined set of values	16%	56%	26%

10a. Were you involved in the process of developing these values? (Question only posed to Next Generation respondents)

	NG
Yes	6%
No, a particular set of values was developed and imposed	38%
No, we do not have a defined set of values	56%

10b. Have you put in place a formal process to ensure your values help to drive your strategy for preserving and growing family wealth? (Question only posed to main questionnaire respondents)

	MR
Values are a factor, but are more a code of conduct within which we operate, than a key driver of wealth strategy	56%
Every step in our thinking is tested against values	7%
We start with the values and develop the strategy around them	11%
N/A	26%

11. Have you started to engage the Next Generation of your family in terms of preparing them to look after family assets in the future? (The Next Generation were asked: Have you started to be engaged by your family to prepare to look after the family assets in the future?)

	MR	NG	AR
Yes	68%	47%	63%
Not yet, but planning to	29%	37%	31%
No, and not planning to	3%	16%	6%

12. Have you and your family agreed a purpose for the family's wealth?

	MR	NG	AR
No this is not necessary for our family	17%	30%	21%
Yes our family has a shared agreement for the purpose of our wealth	44%	35%	41%
Our family has no agreement on the purpose of the wealth	27%	15%	23%
N/A	12%	20%	15%

13. Today's macroeconomic environment is more difficult to read than ever. Given your perception of the current economic climate, which of these asset classes would you choose to hold?

	MR	NG	AR
Equities	67%	48%	62%
Emerging	31%	33%	32%
Developed	48%	29%	43%
Private Equity	43%	43%	43%
Bonds	33%	24%	30%
Sovereign	17%	19%	18%
Corporate	24%	14%	22%
Special Sits	10%	0%	8%
Alternatives & hedge funds	26%	43%	30%
Real estate or agricultural land	78%	86%	80%
Art / Collectables	31%	24%	29%
Gold	31%	14%	27%
Cash	40%	19%	34%
Other	5%	0%	4%

14. We see families becoming ever more multijurisdictional / international. Which of the following jurisdictions do you believe will prove the most attractive for establishing a primary 'trust relationship' over the next 30 years for UHNW families?

	MR	NG	AR
London	75%	62%	71%
Switzerland	14%	10%	13%
New York	7%	5%	6%
Hong Kong	5%	5%	5%
Singapore	16%	5%	13%
Multi-centre	29%	19%	26%
Other	14%	0%	10%

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