

[Translated from Polish]

report financial services in the United States

How it's done in the States

American private banks are at the avant-garde of progress,
but American investors don't always keep pace with them.
The best example lies in structured products

American politicians, such as Senate Majority Leader Harry Reid (D-Nevada), often warn that in the world's richest country the rich are getting richer and the poor are only getting poorer.

Whether they're right or not, the fact is that last year alone assets under management in the United States rose to \$36.3 trillion – up from \$33.2 trillion in 2005, according to the Global Wealth 2006 report from American firm The Boston Consulting Group.

“Over the last few years we have had a wealth creation cycle as big as anything we've ever seen,” comments Robert Weissenstein, who, as the chief investment officer of private banking at Credit Suisse Securities (USA) in New York oversees more than \$100 billion of assets under management.

The question thus arises: what are the richest Americans doing with their money that enables them to multiply it so quickly? Bankers who manage the assets of America's wealthiest investors answer in accordance with time-tested wisdom: diversification remains the surest strategy, except that the typical private banking client these days has a far bigger menu of new products and financial instruments to choose from than ever before.

“You didn't have the opportunity 5 years ago to invest in a private equity deal in China. Today, you can do that – if you do it carefully – but you have that chance,” says Weissenstein.

A new, important and readily observable trend is Americans' preference for structured investments. They can be easily tailored to a client's individual risk profile and expectations. Americans have taken a particular shine to principal protected investments, which guarantee complete return of invested principal in exchange for a share of the upside.

“You can get anywhere from 70-80% of the upside in the market, but would be protected against the downside,” says Craig Walling, CEO of private banking at UBS Wealth Management U.S. in New York.

This is possible because structured products are built from many different investments which have different risk profiles and returns. If, for example, an investor wants to invest \$1,000 in the stock market,

the private bank can propose allocating \$800 to zero-coupon U.S. bonds and treasuries which, upon maturity, will be worth \$1,000.



Robert Weissenstein:
American wealth is
growing quickly

The banker use the remaining \$200 to buy stock options with an 80% participation in the potential gains in a broad-based market index, such as the S&P 500 (which contains the stocks of the largest companies traded on the New York Stock Exchange as well as NASDAQ) or the Dow Jones Industrial Average (DJIA, stocks of the largest public firms in the United States).

Should the S&P 500 or the DJIA rise by 50 percent, the investor would earn 80 percent of the gain on the investment, meaning that value of the investment would rise to \$1,400. Should the S&P or the DJIA fall, the investor will be left with just the \$1,000 from the treasuries.

This is just a theoretical example, but to invest in these types of instruments, an investor would have to put in much more than just \$1,000. The minimum investment is often set at 100 thousand dollars, or about 270 thousand zloty. However, some brokers may accept smaller amounts.

This type of investment is often recommended to investors who are entering a certain market for the first time.

Billions in structured investments

64

billion USD

The value that American portfolios invested in structured products reached in 2006

Other general categories of structured products include buffer zone investments, which allow the investor to lose principal below a set threshold in exchange for greater participation in the upside, as well as return-enhanced investments, the riskiest and most liquid type of structured products, which do not at all protect principal but allow the greatest upside.

Yet it remains a glaring irony that this American invention, despite gaining popularity in the United States, enjoys greater interest abroad. According to data from the Structured Products Association, headquartered in New York, which consist of about 2 thousand members from across the financial services industry, in 2003 Americans invested 28 billion dollars in structured products and by the end of 2006 this number exceeded 64 billion. Looking at the size of the whole market for investments in the United States this is still a small sum.

“Structured notes are much more widely used in Europe than here. It is one of the few places in the investment space where I think the U.S. investor base is further behind than the international investor base,” Weissenstein admits.

Americans are also eagerly investing more and more money into hedge funds and private equity.

“[Today,] it’s not unusual to have 30 or even 40% of assets put into the alternative space, which could include private equity or hedge funds. That’s a very different picture from the 90s, when you might have put 5-10% of assets in the alternative space,” comments Weissenstein.

Alternative investments are, to a large extent, an international asset class. Private banking and wealth management industry observers see increasing interest in funds that specialize in investing in specific regions and geographies.

“People are starting to invest in sector funds and more specific industry country funds, like steel in Korea,” says Bruce M. Holley, partner and managing

director at the Boston Consulting Group in New York, a co-author of the Global Wealth 2006 report.

These types of investments typically interest clients with bigger wallets who wish to diversify their investments and look to take on above-average risk.

“We don’t have people with a conservative [risk] profile looking for regional hedge funds in Central Europe,” notes Craig Walling.

Private banking advisors often urge their clients to invest 1/3 of their assets in overseas markets. Walling names the falling value of the dollar and, of course, high rates of return from foreign securities – both equities as well as debt – as reasons for doing so.

“In the 90s, if you could get 10% [of assets invested] in the non-U.S., non-domestic international space, that was a big deal. Today? Non-domestic? More than 10%? You bet,” notes Weissenstein.

Regardless, even when investing domestically, Americans empower their capital with the strength of global markets. One of the most popular domestic investment tools are so-called Exchange-Traded Funds (ETFs). This kind of investment, well-known in Poland, represents a closed-end investment fund actively traded on a regulated stock exchange – in Poland, the Warsaw Stock Exchange. They invest index-linked securities. One of the most popular ETFs in the United States is Standard and Poor’s Depository Receipts, nicknamed “spiders” (thanks to their abbreviation, SPDR). Spiders are based on the S&P 500 index and are actively traded on the AMEX (American Stock and Options Exchange in New York).

Equally important – warns Walling – ETFs do not constitute the core of affluent clients’ portfolios but merely complement their other investments in achieving the goal of diversification.

Structured products, closed-end investment funds, investments in specific regions and industries – this all sounds familiar to Polish private banking clients. But the similarities don’t end here. Across the ocean, just like in Poland, bankers are changing their approach towards the services they provide. In the United States, there is already talk of a rapid decline of the transaction-oriented approach toward customer service, in which bankers focus on how to best execute a client’s stated strategy or investment objective.

Now they will have to focus on the whole of their clients’ financial needs, goals, requests and dreams. In the United States, this is referred to as a holistic approach to investment management.

“Bankers are asking themselves what their clients are trying to enable in their lives with their wealth,” explains Andy West, director of the SEI Private Banking Research Center at investment firm SEI

Investments in Oaks, PA. To better understand this, “they’re . . . taking money out of product manufacturing and trying to reinvest resources in the front office, client relationship management, client advice development and delivery,” West adds.

As Walling explains, the whole world of private banking in the United States is undergoing drastic changes resulting from the fact that Americans, particularly those of the so-called baby-boomer generation born during the high wave of natural population growth in the aftermath of World War II, are retiring in masses.

Trillions under management

97.9

trillion USD

This was the total value of assets under management worldwide at the end of 2006

“Over last 10-20 years, their [baby boomers’] demand has been driven largely by wealth creation. They’re now moving into their 50s, 60s, 70s and their interests are changing. They’re retired, moving on to other careers and . . . they increasingly rely on someone else to provide a complete suite of financial services,” Walling explains.

In response to this, SEI Investments has developed a new business model, SEI Wealth Network, one created specifically with the needs of baby boomers in mind. Since they require their bankers to provide them with an increasingly complex set of services, SEI’s model is designed to have only one investment advisor – backed by a whole team of experts – interacting with the client, which will allow him or her to address the entirety of the financial needs of the client.

Though this model looks attractive, the question remains of how achievable it really is. Research by The Boston Consulting Group indicates that clients on average make use of the services of 2.8 private banks. Certain investors thus want to work with advisors from several different firms because that makes them feel more confident. And thus we return to the theme of diversification.

Cezary Podkul



Bruce M. Holley:
Clients are investing
in specific countries
and sectors

[Note: the caption for the photo of the NASDAQ exchange building reads as follows:]

American capital markets offer an enormous range of investment products