THE EMERALD ISLE

Wealth in a Downturn

UNIQUE STRONG IMPOSING DYNAMIC RESOLUTE ENDURING DEPENDABLE

National Irish Bank

THE EMERALD ISLE

Wealth in a Downturn

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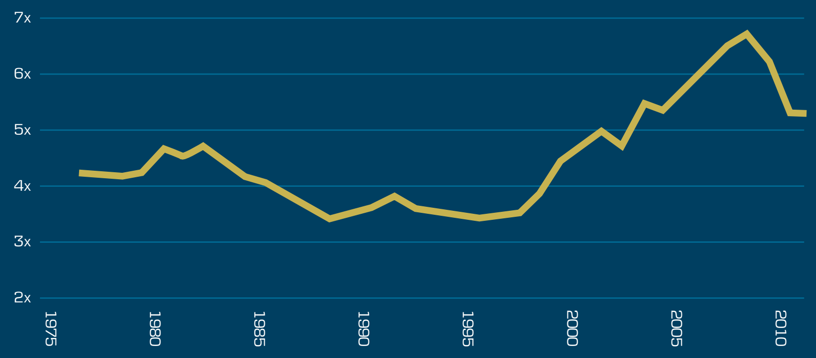
Executive Summary

> THE SHARP REVERSAL OF BOTH FINANCIAL AND HOUSING ASSETS FROM 2007-2009 HAS REDUCED HOUSEHOLD WEALTH SIGNIFICANTLY.

Wealth in a Recession

As countries get richer, the amount of wealth they accumulate as a multiple of national disposable income tends to rise. As can be seen from Figure 1, this did not happen for a long time in Ireland – wealth as a proportion of income stayed within a narrow band of a multiple of 3- to 4-times' national disposable income from 1975 to 1995.

Figure A: Ratio of Gross Household Wealth to National Disposable Income, 1975 - 2010
SOURCE: NIB CALCULATIONS



This began to change in 1997, when higher incomes brought about by national economic buoyancy fed through to strong increases in the value of financial and housing assets. The sharp reversal of both of these financial and housing assets from 2007-2009 has reduced this ratio significantly. Further declines are anticipated in 2009.

Aggregate household wealth fell by €150 billion (-15%) in the year to 2008. At the end of 2008, the average Irish household had a wealth holding of €539,000, compared to €646,000 at the end of 2007. The corresponding level of household debt has continued to rise, and reached €133,000 in 2008, up from €128,000 at the end of 2007.

The drop in net wealth has forced many Irish households to reappraise the way they spend. According to market research company Nielsen, Irish households have been 'cutting kings' in the current downturn, paring back on both domestic and lifestyle spending. Irish households have saved through a combination of buying less, buying cheaper products, and switching where they shop, particularly in relation to domestic spending. Households are also turning to private 'own-brand' goods in supermarkets in greater numbers, which are on average 33% cheaper than branded products. Only one out of five of all supermarket purchasers report that they don't buy any private label goods at all.

Consumers are also switching their spending away from convenience stores, and turning to the German discount stores Aldi and Lidl in greater numbers. While in the past number of years the growth in sales of these companies has matched the growth in the number of stores they operate, the period since summer 2008 has seen an acceleration in sales.

Irish people have not altered their holiday spending in reaction to the recession as much as they have cut back in other areas, such as car purchases. Total expenditure abroad has remained strong because the average spend per trip abroad has increased sharply. This may reflect the 'shopping' motive, with consumers taking advantage of the strong Euro to fund shopping trips to the US and UK as the appetite for high-end design and luxury goods has matured and hardened.

One area where the slowdown in consumer spending is most evident is in the car market. In particular, sales of new cars have fallen dramatically. New registrations in January were one-third the level of the previous year, with the more expensive Marques faring poorly. For example, sales of Porches in January 2009 fell from 23 the previous January to 2 (-91%), Lexus' sales fell from 372 to 68 (-82%) while sales of Land Rovers and Chrysler Jeeps were down 94% and 87% respectively.

Philanthropic organisations are likely to suffer from a double whammy from the economic slowdown. On the one hand, many will have lost money invested in financial markets due to the market turmoil. Further, the deteriorating economic conditions are likely to impact on donations, both from public and private sources.

Executive Summary

> IN 2008 THE FALL IN PROPERTY PRICES, COUPLED WITH THE DECLINE IN EQUITIES, RESULTED IN AGGREGATE IRISH HOUSEHOLD WEALTH DECLINING BY €150 BILLION.

The Contraction of Wealth

The Irish economy experienced a rapid reversal of fortune in 2008, with sharp declines in asset prices resulting in a significant loss in the value of Irish wealth. The rise in the wealth of Irish households prior to 2007 was fuelled by stronger income from Ireland's burgeoning export sector, financial sector reforms and a property boom, the unwinding of which is having a significant effect on aggregate wealth holdings today.

Gross household wealth in Ireland is estimated to have fallen by around €150 billion during 2008, as asset values fell. As can be seen from Figure B, net assets (gross assets minus debts) have now fallen to €640 billion. Net financial assets have fallen more dramatically.

Property markets suffered a torrid year in 2008. A commercial property investment of €10,000 in 2007 showed a decline to as low as €5,500. There is a strong expectation that the capital reversals will continue into 2009. Residential property values have also undergone a rapid reversal. House prices peaked in late 2006, and have since fallen by 30%.

There has been a sharp fall in global equity markets since the onset of the credit crunch, though the Irish Stock Exchange has been particularly badly hit. The Irish stock market declined 66% during 2008, the worst performance for Irish equities since the foundation of the Irish stock exchange in 1793[2].

Much of Ireland's wealth is tied up in owner-occupied housing, accounting for over half of all wealth. Nearly one-quarter of total wealth is accounted for by stocks and shares. Much of this equity holding is through pension funds and other investment funds. Irish households' holding of currency and deposits is around €100 billion, one-tenth of all wealth holdings.

Figure C: Capital Return on Investment of €10,000 to end Q3 2008

SOURCE: JONES LANG LASALLE, IRISH STOCK EXCHANGE. EQUITIES TO END DECEMBER.

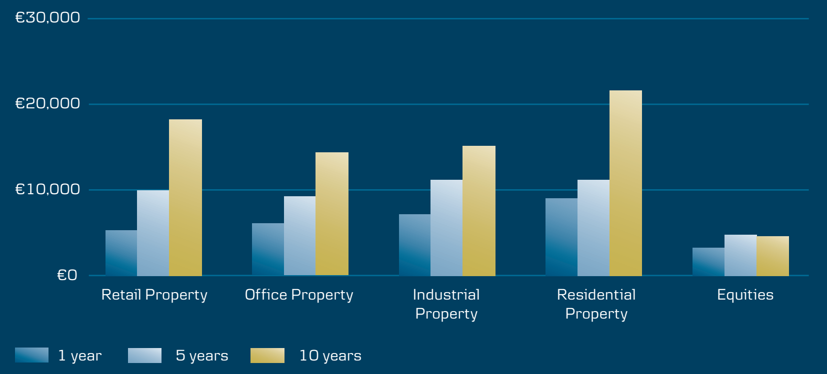
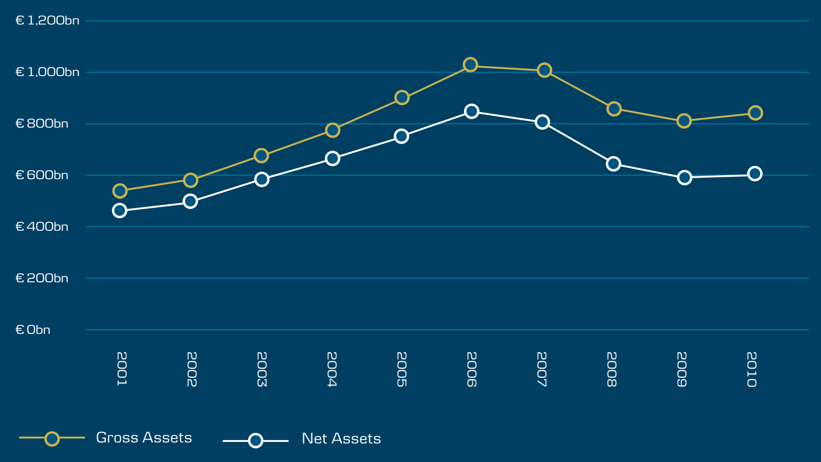


Figure B: Gross and Net Household Wealth, 2002-2010

SOURCE: NIB CALCULATIONS

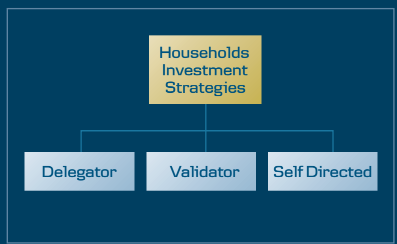


Executive Summary

> INVESTORS ARE FACED WITH THE CHALLENGE OF REASSESSING THEIR INVESTMENT PORTFOLIOS IN LIGHT OF CURRENT MARKET CONDITIONS.

Managing Wealth

Irish households suffered a significant contraction in wealth of 15% in 2008, or €150 billion in aggregate. Against the backdrop of the deterioration in the domestic and global economies, households now face a number of challenges, and are adopting different strategies to deal with these issues. Many investors with a lot of financial experience manage their portfolios directly (self directors), while others will have strong opinions about how their wealth should be managed, but require financial advice to put their choices into operation (validators). Others still prefer to pass most of the choices around their investment strategy to an independent advisor [delegators].



Most capital markets suffered significant corrections in 2008, particularly the domestic equity and property markets. While no asset class or strategy has been unaffected by the financial turmoil, those who have taken measures in the past to implement a diversified investment strategy should have had some protection from the market events of 2008. A well spread investment portfolio should be better placed to weather the effects of the ongoing crisis. While traditional asset classes such as equities, bonds and property should form the foundation of a portfolio, the addition of 'alternative' strategies can help reduce the overall risk exposure of the investor.

Investors should continually assess their holdings, particularly those that are sensitive to present risks. This would include banks, property and insurance companies that have been particularly exposed to events of 2008. Concerns remain over companies that have significant activity in the US, companies dependent on housing construction in Europe, and any companies that may be negatively affected by sector-specific problems.

In the long term, the prospects for alternative energy and infrastructure-based investments look compelling in a portfolio context. The need to develop infrastructure is not particular to the developing world, with much infrastructure in the US, Europe and many parts of the developed world having been previously neglected.

Company directors should now re-evaluate the risk of linking their personal wealth to the fortunes of their business. Many owner-directors do not distinguish between the wealth they hold personally and the wealth they have accumulated in their businesses. While business has been the driver of wealth over the past number of years, the current economic environment in many cases is quickly eroding this accumulated wealth. Extracting wealth from the business via pension contributions is a useful wealth protection mechanism, in addition to the well publicised and understood tax benefits.

In many cases, the earning potential of any individual or household is the largest 'asset' within their control, and should be managed in this context. Therefore, it is vital to ensure that this earned income is protected in the event of illness or death. For most individuals, income from employment or enterprise is the key to creating personal wealth. A simple review of life assurance and income replacement policies can highlight any potential deficiencies in this regard. Advantage can also be taken of the fall in capital values to realise losses, possibly with a view to repurchasing them after a month.

It has always made good financial sense to make lifetime gifts of assets to the next generation to allow wealth to accumulate in their hands, as opposed to a transfer on death. Many wealthy individuals are now using structures to allow their children participate in their business or in the investments they are making. In the current environment a significant revaluation in asset valuations has reduced the Capital Taxes associated with these structures, thereby facilitating longer term wealth and tax planning.


UNIQUE STRONG IMPOSING DYNAMIC RESOLUTE ENDURING DEPENDABLE

Section 1

Wealth in a Recession

> THE SHARP REVERSAL OF BOTH FINANCIAL AND HOUSING ASSETS FROM 2007-2009 HAS REDUCED HOUSEHOLD WEALTH SIGNIFICANTLY.

1.1 Introduction

After a long period of strong growth, 2008 saw a dramatic reversal in Irish wealth holdings, with further declines anticipated in 2009. While aggregate household wealth surpassed €1 trillion at the height of the property boom, the effect of the depreciation in the value of financial and housing assets reduced this by €150 billion (-15%) in the year to 2008.

At the end of 2008, the average Irish household had a wealth holding of €539,000, compared to €646,000 at the end of 2007, and €693,000 at the peak of the housing market in 2006. As such, the accumulated wealth of the average Irish household has declined by €153,000 over the last two years, equivalent to a fall of over one-fifth. Excluding owner-occupied housing, average household wealth is now €252,000, compared to €308,000 at the end of 2007.

The corresponding level of household debt has continued to rise, however, and reached €133,000 in 2008, up from €128,000 at the end of 2007. This combination of falling assets and rising liabilities has squeezed the net worth of Irish households, which has fallen by almost 30% since 2006. The average net worth of Irish households was €426,000 in 2008, down €145,000 from its peak.

1.2 Household Wealth in Ireland

As countries get richer, the amount of wealth they accumulate as a multiple of national disposable income tends to rise. As can be seen from Figure 1, this did not happen for a long time in Ireland - wealth as a proportion of income stayed within a narrow band of a multiple of 3- to 4-times' national disposable income from 1975 to 1995. This ratio even declined from 1980 to mid-1995, as a result of the anaemic national economic performance of the 1980s.

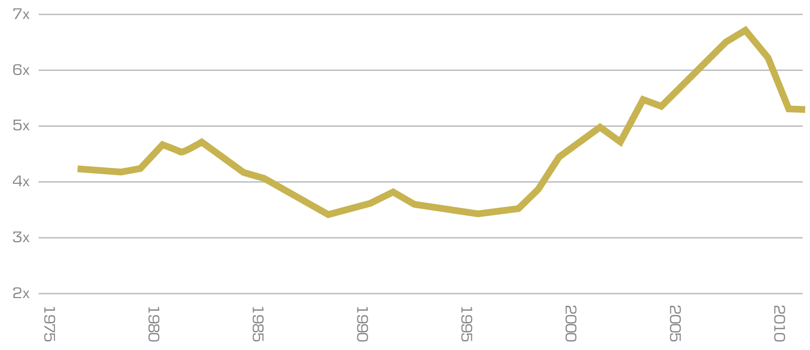
This began to change in 1997, when higher incomes brought about by national economic buoyancy fed through to strong increases in the value of financial and housing assets. At its peak, aggregate household wealth reached a multiple of 6.7 of national disposable income.

The sharp reversal of both of these financial and housing assets from 2007-2009 has reduced this ratio significantly. It is likely to settle at a multiple of over 5 times of national disposable income, significantly down on the peak at the height of the property market.

It should be noted that the ratio of wealth to disposable income is likely to remain significantly higher in the next number of years than in the 1975-1995 period. While there has been a significant erosion of wealth over the last 12 months, there has also been much productive investment in Ireland

Figure 1: Ratio of Ratio of Gross Household Wealth to National Disposable Income, 1975 - 2010

SOURCE: NIB CALCULATIONS



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Section 1

Wealth in a Recession

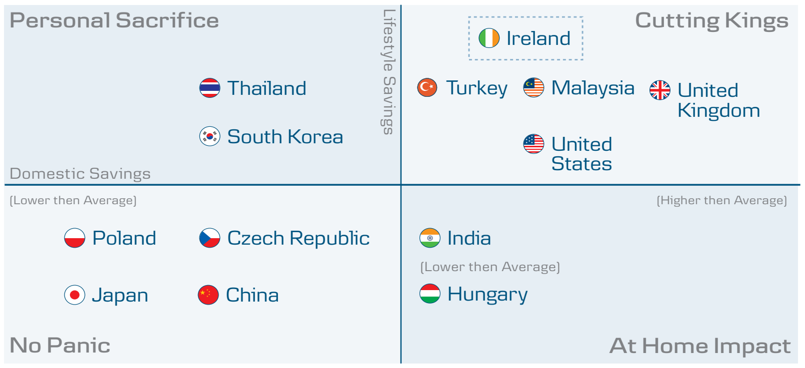
> THE CHANGED ECONOMIC CIRCUMSTANCES AND THE DROP IN NET WEALTH HAVE FORCED MANY IRISH HOUSEHOLDS TO REAPPRAISE THE WAY THEY SPEND.

over the last two decades, which has improved our long-term outlook.

Many of the most dramatic effects of the economic downturn, such as falling income, rising unemployment and higher taxes were not fully felt in 2008, but will be felt in 2009. There is evidence however that in 2008 families had increased saving substantially over the course of the year. The rapid fall in car sales at the start of 2009 has brought the volume of retail sales back to levels last seen in 2003. In terms of money spent, consumers are now spending as much in shops as they did in 2004. However since 2004, the aggregate national wage packet has grown by over one-quarter. As such, the fall in retail spending to close to 2004 levels reflects a huge increase in household saving.

Figure 2. Consumers Reaction to Recession

SOURCE: NIELSEN



1.3 Lifestyle Changes

The changed economic circumstances and the drop in net wealth have forced many Irish households to reappraise the way they spend. In this section we review a number of ways that Irish households have reacted to the slowdown.

Consumer Spending

According to market research company Nielsen, Irish households have been 'cutting kings' in the current downturn. In Ireland and other English speaking countries with very weak property markets (notably the UK and the US), consumers have pared back on both domestic and lifestyle spending. Other countries such as India have seen consumers cut back on the amount of money they spend on domestic purchases, though not making significant changes to lifestyle purchases. Other countries such as South Korea have seen the opposite trend.

Irish households have saved through a combination of buying less, buying cheaper products, and switching where they shop, particularly in relation to domestic spending. While the year-on-year fall in the volume of retail sales in Ireland of over 8% indicates that consumers have increased their precautionary savings, there are some products that continue to be demanded, even during a recession. According to the Nielsen research, recession-proof product categories in Ireland include a lot of the basic necessities, including milk, tea, butter, bread and cream. On the other hand, toiletry products are proving highly sensitive to the recession, such as air fresheners, toothbrushes, shower gels and deodorants.

Households are turning to private 'own-brand' goods in supermarkets in greater numbers, which are on average 33% cheaper than branded products. The share of private label goods hit an all time high in terms of the share of consumer spend in September 2008. The growth in private label sales is most concentrated in frozen foods,

“CONSUMERS ARE SWITCHING THEIR SPENDING AWAY FROM CONVENIENCE STORES, AND TURNING TO THE GERMAN DISCOUNT STORES ALDI AND LIDL IN GREATER NUMBERS.”

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household products and general groceries. Only one out of five of all supermarket purchasers report that they don't buy any private label goods at all.

Consumers are also switching their spending away from convenience stores, and turning to the German discount stores Aldi and Lidl in greater numbers. While in the past number of years the growth in sales of these companies has matched the growth in the number of stores they operate, the period since summer 2008 has seen an acceleration in sales.

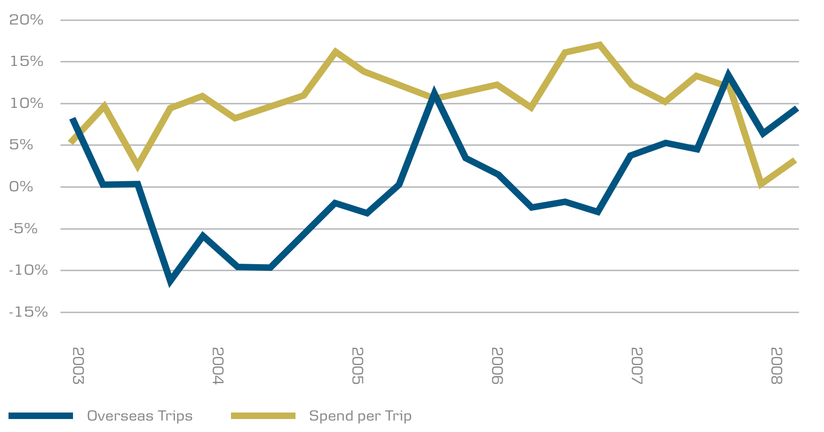
Travel

Irish people have not altered their holiday spending in reaction to the recession as much as they have cut back in other areas, such as car purchases. As can be seen from Figure 3, expenditure abroad by Irish people from July to September 2008 was 13% higher than the same period in 2007. This rate of increase is slightly lower than in recent years, though still represents a significant uplift.

What is noticeable, however, is that the growth in terms of the number of trips abroad has come to a standstill. This had been growing at an annual rate of between 10%-15% in recent years.

Figure 3. Growth in Irish Trips Aroad, Average Spend 2002-2008

SOURCE: CSO TRAVEL SURVEY



Total expenditure abroad has remained strong because the average spend per trip abroad has increased sharply. The average trip abroad involved an expenditure of €974 in the third quarter of 2008, up from €890 in the same three months in 2007. In contrast, people are spending more of their holidays at home in Ireland and are opting for short-stay breaks.

This reaction by Irish travellers during 2008 is in direct contrast with the last economic slowdown in 2002/2003. During these years, the growth in the number of trips abroad remained high, though the average spend on these trips fell significantly. This change in behaviour in 2008 may reflect the 'shopping' motive, with consumers taking advantage of the strong Euro to fund shopping trips to the US and UK as the appetite for high-end design and luxury goods has matured and hardened.

Transport

One area where the slowdown in consumer spending is most evident is in the car market. In particular, sales of new cars have fallen dramatically. According to the Society of the Irish Motor Industry (SIMI), new registrations in January were one-third the level of the previous year, with the more expensive Marques faring poorly.

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“PHILANTHROPIC ORGANISATIONS ARE LIKELY TO SUFFER A DOUBLE WHAMMY FROM THE ECONOMIC SLOWDOWN.”

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For example, sales of Porches in January 2009 fell from 23 the previous January to 2 (-91%), Lexus' sales fell from 372 to 68 (-82%) while sales of Land Rovers and Chrysler Jeeps were down 94% and 87% respectively.

A further indicator of the weakness in the car market is that the value of second-hand cars has fallen significantly. According to the GE Money Irish Used Car index, between January and August 2008 used car values have been hit substantially, mostly because of an over-supply on the market. The sector worst affected is the executive/luxury car class, with values falling by as much as €5,000 for three-year-old models and up to €4,000 for five-year-old models. The family and fleet car values fell by €1,500, or 11%. Even in-demand smaller cars have suffered, with prices dropping by 13% or €1,000 in cash terms.

Philanthropy

Philanthropic organisations are likely to suffer from a double whammy from the economic slowdown. On the one hand, many will have lost money invested in financial markets due to the market turmoil. Further, the deteriorating economic conditions are likely to impact on donations, both from public and private sources. One upside of the current downturn is that it may provide an opportunity for those who wish to use their commercial expertise to benefit a charitable cause.

Irish people are relatively generous compared with other European countries in relation to individual giving. However, what marks Ireland out as unusual is that charitable donations tend to be unplanned. According to John Kelly, director of 2into3, a firm that provides management consulting and recruitment services to non-profit organisations, Ireland is about to experience an integration of philanthropy and wealth planning, which has been well established in the US for many years.

As the recession forces donors to reassess their income and assets, it is expected that a more formulated and tactical approach to charitable giving will become evident.

Protecting Income

The current climate has caused consumers to think more defensively about their financial position, particularly with regard to protecting income and assets.
Protecting Assets: Property investors are not required by law to take out life assurance cover on their investment loans. The fall in property markets has moved consumers to protect these assets values by insuring their investment loans against death/serious illness.
Protecting Income: For many consumers their income is their biggest asset. Consumers are now insuring this asset is adequately protected against unforeseen health events.
In reassessing the level of cover they require from their financial products, consumers are also reassessing the premium levels they are paying. Consumers are shopping around.


UNIQUE STRONG IMPOSING DYNAMIC RESOLUTE ENDURING DEPENDABLE


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Section 2

The Contraction of Wealth

"THE IRISH ECONOMY EXPERIENCED A RAPID REVERSAL OF FORTUNE IN 2008, RESULTING IN A SIGNIFICANT CONTRACTION IN AGGREGATE IRISH WEALTH."

2.1 Introduction

The Irish economy experienced a rapid reversal of fortune in 2008, with sharp declines in asset prices resulting in a significant loss in the value of Irish wealth.

The rise in the wealth of Irish households prior to 2007 was fuelled by three interwoven developments. First, and most importantly, the **Celtic Tiger boom** provided the source of the greater additional wealth. Second, **financial sector reforms** in the 1980s facilitated the growth in wealth that was observed. However these culminated in the third development - a **property boom**, the unwinding of which is having a significant effect on aggregate wealth holdings today.

2.2 The Fall in Aggregate Wealth

Gross household wealth in Ireland is estimated to have fallen by around €150 billion during 2008, as asset values fell. The growth of household debt has continued, albeit at a slower rate than recent years, with the year-on-year growth rate falling from over 30% in the middle of 2006, to under 7% by the end of 2008. Within this figure, residential mortgage lending showed very modest month-on-month growth in the last three months of the year, an indicator that there is likely to be limited lending growth in Ireland during 2009.
As can be seen from Figure 4, net assets (gross assets minus debts) have now fallen to €640 billion. Net financial assets have fallen more dramatically, from €131 billion in 2006, to €49 billion in 2008, as the level of household debt continued to rise, while the value of assets declined.

2.3 Savings and Capital Appreciation Patterns

As can be seen from Figure 6, while both savings and investments returns were behind the growth in Irish wealth up to the end of 2006, a dramatic fall in asset values has reversed some of these gains since then.

Figure 4: Gross and Net Household Wealth, 2002-2010
SOURCE: NIB CALCULATIONS

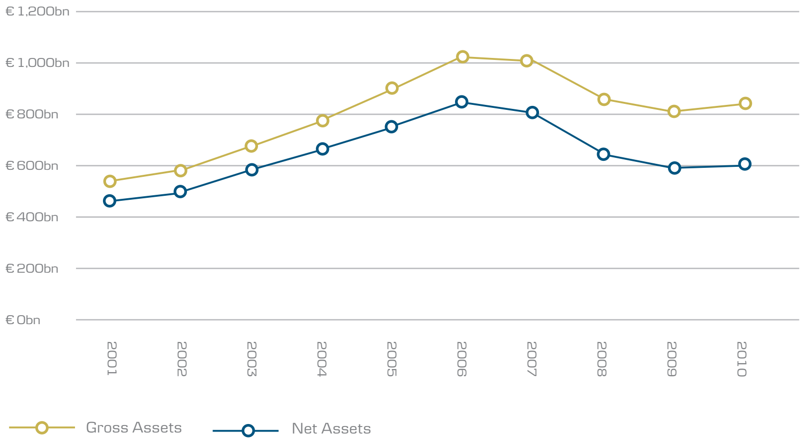
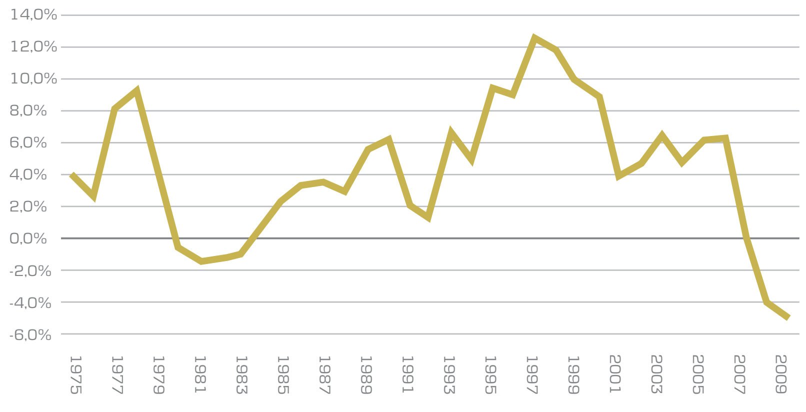


Figure 5. Growth Rate of Irish Real Disposable Income
SOURCE: NIB CALCULATIONS



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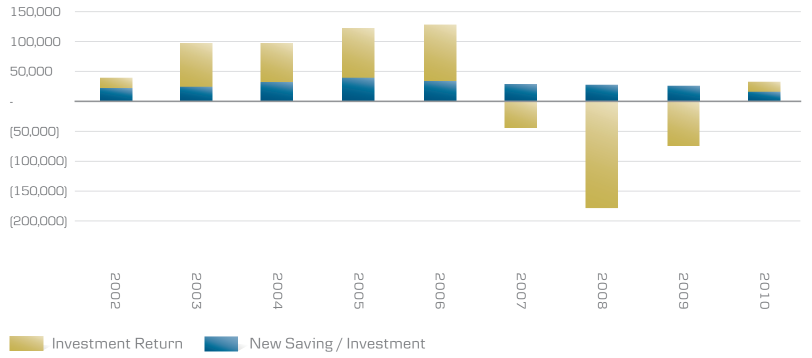
The Contraction of Wealth

> IN 2008 THE FALL IN PROPERTY PRICES, COUPLED WITH THE DECLINE IN EQUITIES, RESULTED IN AGGREGATE IRISH HOUSEHOLD WEALTH DECLINING BY €150 BILLION.

Figure 6: Source of Wealth Gains in Ireland, 2002-2010

SOURCE: NIB CALCULATIONS



The most dramatic element of the graph is the sharp fall in investment values in 2008, when a fall in property prices, coupled with a rapid decline in the value of equities and other investment vehicles, resulted in aggregate Irish household wealth declining by €177 billion. As the fall in property prices nationally begins to level off, asset values are expected to decline by a much more modest €73 billion in 2009, with a continued fall in housing assets being offset by a modest rebound in equity values.

The level of new investment in household wealth is expected to remain broadly stable in the coming years, though somewhat lower than the 2004-2006 level. This is as a result of two offsetting factors – the increased precautionary savings of very liquid assets such as cash, coupled with the current sharp reduction in the purchase of houses.

Property Markets

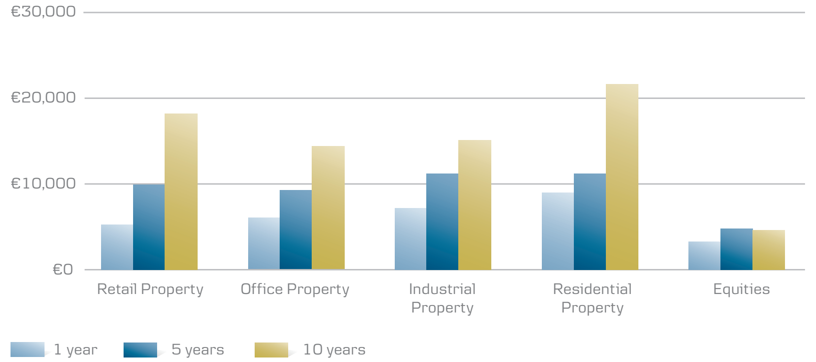
Property markets have suffered a torrid year in 2008. As can be seen from Figure 7, a property investment of €10,000 in 1998 would have increased by around 50% in value by the end of 2008, with some classes of property faring better than others. However this represents a significant fall in terms of 2007, with an investment of €10,000 in 2007 showing a decline to as low as €5,500. There is a strong expectation that the capital reversals seen in 2008 are likely to continue into 2009, so the figures presented are unlikely to represent the full fall in property values.

Residential property values have undergone a rapid reversal. House prices peaked in late 2006, and have since fallen by up to 30%. An overhang of unsold housing has built up, particularly in rural areas, and the expectation is that further price falls are inevitable.

Commercial property has also seen a dramatic reversal in fortune. The Jones Lang LaSalle property index has shown that capital values of non-residential property declined significantly in 2008, with capital values of office accommodation falling by 37%, retail by 45%, and industrial by a less severe 28%. These falls in value will probably result in a sharp reduction in new commercial building activity in 2009, as soon as existing projects are completed.

Figure 7: Capital Return on Investment of €10,000

SOURCE: JONES LANG LASALLE, IRISH STOCK EXCHANGE. EQUITIES TO END DECEMBER.



UNIQUE STRONG IMPOSING DYNAMIC RESOLUTE ENDURING DEPENDABLE

Section 2

The Contraction of Wealth

> THE DRAMATIC TURMOIL SINCE AUGUST 2007 HAS PRODUCED LEVELS OF VOLATILITY THAT MAY NEVER HAVE BEEN EXPERIENCED PREVIOUSLY BY MANY INVESTORS.

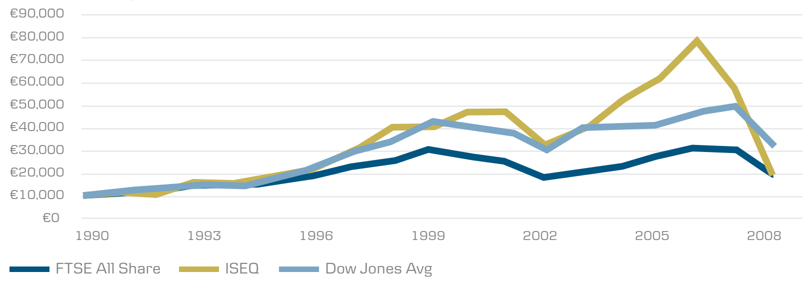
Farm land also experienced a boom in recent years. A survey compiled by the Irish Farmers' Journal[5] shows that the average price paid for land dropped off in 2008 along with the rest of the property sector, with an average price of €17,820 per acre. This represents a drop of over €1,200 per acre when compared to the same period last year.

Many Irish investors were also very active in many international property markets, particularly the UK, and often highly leveraged. UK investments will also have been affected by the decline in sterling, which would be particularly damaging if any debt was raised in euro. The sharpest falls in commercial property outside Ireland were seen in the UK, with falls of up to 50% by spring 2009, though falls were recorded in many major European cities. According to property consultancy Knight Frank, the fall in office capital values was at least 25% in each of Amsterdam, Barcelona, Edinburgh, London, Madrid, Paris and Stockholm.

Equity Markets

There has been a sharp fall in global equity markets since the onset of the credit crunch, though the Irish Stock Exchange has been particularly badly hit. As can be seen in Figure 8, following a strong rise up to February 2007, the Irish stock market declined 26% from then to December 2007, followed by a decline of 66% during 2008, the worst performance for Irish equities since the foundation of the Irish stock exchange in 1793[6]. A €10,000 investment in December 1998 would be worth only €5,000 by the end of 2008. If the same investor had invested in the US in 1998, $10,000 would have fallen to $9,343, while a corresponding £10,000 investment in the UK would have fallen in value to just over £8,000[7].

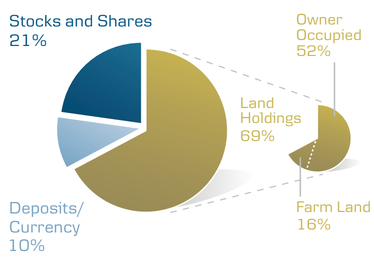
Figure 8: Growth in Equity Markets, 1990-2008
SOURCE: finance.yahoo.com



2.4 Investment Volatility

The dramatic turmoil since August 2007 in financial markets has produced levels of volatility that may never have been experienced previously by many investors. Nowhere is this more evident than the most common measure of volatility in the US stock market, the VIX Index, which reached a closing high of 81 in November 2008 compared to a closing average of 18 in 2007. The impact of this has in many cases been to severely reduce the capital value of investment portfolios and forced many investors to re-evaluate investment tactics and decisions that have been made in the past.

Figure 9: Composition of Household Wealth
SOURCE: NIB CALCULATIONS



2.5 Composition of Household Wealth

Much of Ireland's wealth is tied up in owner-occupied housing. Figure 9 shows the structure of Irish household assets. The graph shows the importance of housing to an Irish household's wealth holdings. Owner-occupied housing accounted for over half of all wealth. While owner-occupied housing is an important form of wealth, it is also highly illiquid, as people will always need somewhere to live.

Section 2

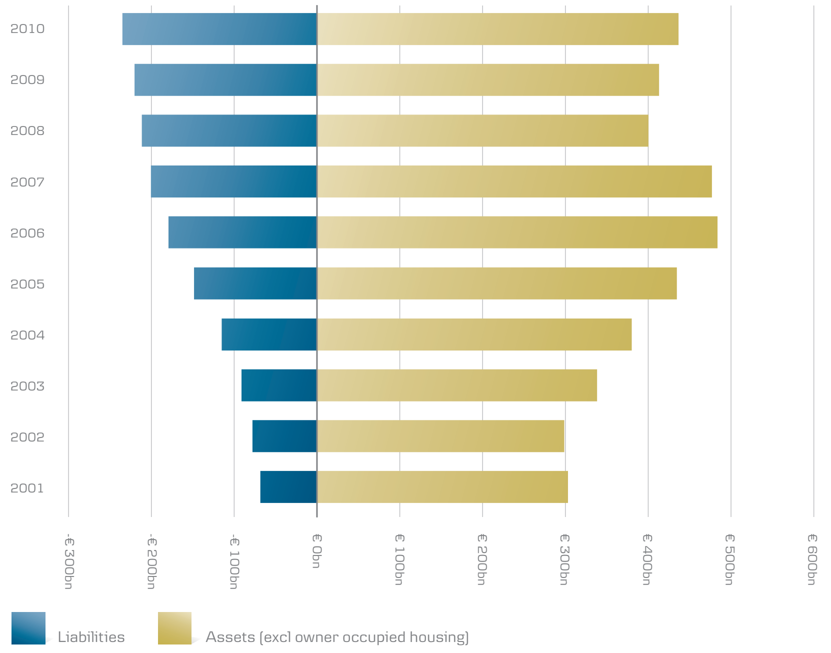
The Contraction of Wealth

> EVEN WHEN OWNER OCCUPIED HOUSES ARE EXCLUDED, IRELAND'S WEALTH BALANCE SHEET HAS DETERIORATED IN LINE WITH FALLING ASSET VALUES.

The graph shows that nearly one-quarter of total wealth is accounted for by stocks and shares. While many households have direct equity holdings, much of this equity holding is through pension funds and other investment funds. Irish households' holding of currency and deposits is around €100 billion, and accounts for one-tenth of all wealth holdings.

Figure 10: Growth in Financial Assets and Liabilities, 2002-2010

SOURCE: NIB CALCULATIONS



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Section 3

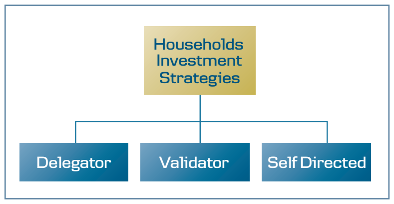
Managing Wealth

> "INVESTORS ARE FACED WITH THE CHALLENGE OF REASSESSING THEIR INVESTMENT PORTFOLIOS IN LIGHT OF CURRENT MARKET CONDITIONS."

3.1 Introduction

Irish households suffered a significant contraction in wealth of 15% in 2008, or €150 billion in aggregate. Against the backdrop of the deterioration in the domestic and global economies, households now face a number of challenges. These include sharply lower capital values, highly volatile markets and the challenges of a weaker economic outlook.

Households are adopting different strategies to deal with these issues. Many investors with a lot of financial experience manage their portfolios directly (self directors), while others will have strong opinions about how their wealth should be managed, but require financial advice to put their choices into operation (validators). Others still prefer to pass most of the choices around their investment strategy to an independent advisor



(delegators).

It is still difficult to predict when global financial market activity will normalise. However, investors are still faced with the challenge of reassessing their investment portfolios in light of current market conditions and previous investment decisions. In the next number of sections the report reviews a number of actions which investors should be taking now in order to protect and grow their assets over the coming months and years.

3.2 Diversification

Most capital markets suffered significant corrections in 2008, particularly the domestic equity and property markets. While no asset class or strategy has not been affected by the financial turmoil, those who have taken measures in the past to implement a diversified investment strategy should have had some protection from the market events of 2008. This is not to say that they have been fully insulated from the vast depreciation in the value of financial assets, but a well spread investment portfolio should be better placed to weather the effects of the ongoing crisis.

An investment portfolio should focus on the correlation of the performance of the different assets to ensure it has the ability to perform at different stages of the economic cycle. While traditional asset classes such as equities, bonds and property should form the foundation of a portfolio, the addition of 'alternative' strategies can help reduce the overall risk exposure of the investor.

3.3 Rebalance Existing Holdings

Investors should continually assess their holdings, particularly those that are sensitive to present risks. This would include banks, property and insurance companies that have been particularly exposed to events of 2008. Concerns remain over companies that have significant activity in the US, companies dependent on housing construction in Europe, and any companies that may be negatively affected by sector-specific problems.

In the long term, the prospects for alternative energy and infrastructure-based investments look compelling in a portfolio context. The need to develop infrastructure is not particular to the developing world, with much infrastructure in the US, Europe and many parts of the developed world having been previously neglected. The OECD believes that on a global basis, $16 trillion of investment will be required over the next three decades for energy infrastructure alone. The slowing of the global economy is prompting many countries to accelerate investment on civil infrastructure, as a means of boosting short-run economic activity.

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Of course, infrastructure is not the only example of an area in which to diversify for growth, and there are many sectors or themes that do and will provide opportunity. Equal or greater importance should be placed on the downside of moving out of existing assets, particularly if losses are being crystallised.

3.4 Managing Business Equity

Company directors should now re-evaluate the risk of linking their personal wealth to the fortunes of their business. Many owner-directors do not distinguish between the wealth they hold personally and the wealth they have accumulated in their businesses. While business has been the driver of wealth over the past number of years, the current economic environment in many cases is quickly eroding this accumulated wealth.

Extracting wealth from the business via pension contributions is a useful wealth protection mechanism, in addition to the well publicised and understood tax benefits. Once pension contributions are paid from the business the accumulated funds are not an asset of the business and are therefore not available to creditors. In others words, this is now ring-fenced from business assets even though they have come from the same source. Of course, care must be taken to ensure sufficient funds are left in the business, particularly in this tough trading environment.

Pension funds are not normally accessible by a director until retirement at the age of 60, although the fund may be accessed from the age of 50 on early retirement. A proprietary director can retain ownership and control of their pension fund in retirement through 'Approved Retirement Funds'. These funds may be passed to spouses and/or children on death, and can facilitate succession planning, whilst also continuing to enjoy tax free growth status.

3.5 Income Protection

In many cases, the earning potential of any individual or household is the largest 'asset' within their control, and should be managed in this context. Therefore, it is vital to ensure that this earned income is protected in the event of illness or death. For most individuals, income from employment or enterprise is the key to creating personal wealth. This income funds everything from everyday family costs, servicing a home loan and saving for retirement. When planning wealth, it is easy to focus on the sophisticated and complex at the expense of the basics. A simple review of life assurance and income replacement policies can highlight any potential deficiencies in this regard.

3.6 Succession Planning

It has always made good financial sense to make lifetime gifts of assets to the next generation to allow wealth to accumulate in their hands, as opposed to a transfer on death. Succession planning has evolved significantly over recent years and is not solely about gifts or inheritances. Many wealthy individuals are now using structures to allow their children participate in their business or in the investments they are making. The benefit of these structures is that capital appreciation will accrue to the children while control will remain with the parents. This is particularly useful in family businesses situations.

High asset valuations in equities and properties in recent years have made the tax cost of this type of planning prohibitively high. Perhaps a silver lining in the current environment is that the significant revaluation in asset valuations has reduced the Capital Taxes associated with these structures, thereby facilitating longer term wealth and tax planning.

Advantage can also be taken of the fall in capital values to realise losses, possibly with a view to repurchasing them after a month

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3.7 Future Market Drivers

There is no certainty that global equity markets will have a positive outcome in 2009, despite the various measures being taken by Governments and Central Banks. There are, however a number of factors that investors can monitor to help signal when the global macro economy and corporate world have reached their low.

Consumer Confidence: A bottoming-out in international consumer confidence measures often signals a turning point in investor confidence. Consumer confidence has not been as low as it is now since the oil crisis of 1974. Consumers may react to interest rate, tax and energy price cuts that are in the pipeline in most regions. This will be a key metric;

Credit & Money Market Spreads: The spread between 3 month interbank lending rates and equivalent government bonds has fallen sharply during 2008. Yields on Corporate Bonds remain elevated, signalling the highest risk of corporate collapse in 25 years. A significant improvement here could send equities higher;

US Housing Activity: The US housing market was the first point of reaction to the current crisis, and it may well be where we see the initial signs of the crisis fading. New home sales in the US have reduced dramatically from 1.25m annually in 2005, to around 400,000. With the fall in mortgage rates and improved affordability, activity could well stabilise soon.

Analyst Earnings Expectations: Forecasted profits have been revised down very sharply over the first months of 2009. In March 2008, expected earnings were projected at $92/share, which has now been revised down to $47, and is still falling. Any future upward revisions may provide a sign that the corporate economy is starting to navigate a safer course.

Equity markets don't reflect matters today, but reflect the markets' prediction of the future. As such, when the markets predict that the future is brighter, values are likely to improve. There is no certainty that all or any of the above may take place throughout 2009, but if we do see significant shifts in these factors it may provide a timely signal to investors that equity risk premium has been restored to more acceptable and attractive levels.

Wealth Management Services

"NATIONAL IRISH BANK OFFERS A COMPREHENSIVE AND HOLISTIC WEALTH MANAGEMENT SERVICES TO PERSONAL, BUSINESS AND CORPORATE CUSTOMERS."

Our experienced team of Financial Planning Managers steer their customers through a consultative process to identify their financial requirements. Using our in-house advice model, our team can assist customers in prioritising their needs and ultimately assist them by presenting tailored solutions to address those needs. Investment patterns are changing, now more than ever, and many investors are looking for a partner with the knowledge and expertise to assist them in managing their portfolio to meet an ever-changing world.

Regardless of the level of income or assets a customer has, there are three pillars that we use to assist in the planning of personal wealth.

Our model is based on:

Protecting Wealth – An assessment of current financial assets and income takes place, to ensure that for unforeseen life-changing events such as death or illness, our customers are aware of the consequences, and the solutions they can implement to mitigate where needed;

Generating Wealth – By reviewing cost of living patterns and disposable income, we help our clients assess whether appropriate income planning is in place for life cycle events, such as saving for children's education or more importantly retirement. We then help to determine how best to achieve these objectives, maximising all the available incentives, including tax;

Growing Wealth – Having seen and experienced phenomenal growth in personal wealth over the past decade in particular, we establish plans with our clients to ensure that they continue to grow their personal worth, but in an appropriately diversified manner. We take into account their tolerance for risk versus reward, their income requirements, and the specified timeline;

The solutions and investment strategies that we recommend not only comprise of those available in the Irish marketplace (National Irish Bank has arrangements with all the major Insurance and Investment providers), but we also have access to the broad range of European products and services available from our parent, Danske Bank. Danske Bank Group has over 650 professionals working in its Wealth Management and Asset Management businesses, and has in excess of €85bn under management.

For customers who don't require advice but who are active investors in equities and funds, access to a market trading platform and tools is available through our Online Trading Service. Whatever way you decide to access our Wealth Management solutions, we will continue to work with you to ensure your plan changes as your circumstances change so you stay on track to meet your goals.

Contact Details

To arrange a meeting with a National Irish Bank Financial Planning Manager or to find out more about our Online Trading Service and range of Danske Funds, call 1850 818330, or alternatively contact your local branch or Relationship Manager.

**Lines are open Monday to Friday from 8.00am to 4.00pm. For security reasons, and to maintain a high level of Customer Support, telephone conversations may be recorded or monitored. This service may be temporarily unavailable during periods of routine maintenance.*

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FootNotes

1. These indices refer to capital only returns;
2. Bloxham Quarterly Report
3. http://www.independent.ie/lifestyle/jobs-careers/returning-the-favour-1573888.html
4. These indices refer to capital only returns;
5. http://www.farmersjournal.ie/2008/0920/farmbusiness/business/property.shtml
6. Bloxham Quarterly Report
7. These figures relate to capital returns only.

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