

# Launching the ML Lifestyle Index

Equity | Europe | Luxury Goods  
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The objective of the ML Luxury & Lifestyle index is to provide exposure to stocks strongly associated with luxury and lifestyle brands globally. Stocks are selected from a wide range of developed market sectors including leather goods & fashion, eyewear, watches and jewellery, wines and spirits but also HNWIs service providers, leisure & recreation and lodging and gaming to name a few. Stocks are screened for liquidity and size to ensure the index has a high level of tradability.

### Luxury & Lifestyle - an important theme in coming years

Above and beyond the strong appetite of Generation Y for brands, the increasing relevance of emerging market clienteles will also continue to drive fast paced growth for lifestyle and luxury brands. The common denominator for all the stocks selected in our sample is they benefit from i) the increasingly hedonistic and eclectic consumption patterns for lifestyle brands across all price points including shorter product/service life cycles and ii) a progressive democratisation of desire for brands rather than democratisation of purchases *per se*.

### Out-performance related to power of brands

The average out-performance of 7.7% since 2000 of the ML Lifestyle index vs its benchmark illustrates the inherent "value" of brand names associated with luxury goods and lifestyle stocks. This is also apparent in the higher trailing annual dividend yield of 2.4% vs 2.0% for the benchmark. In addition, given the equally weighted nature of the index, and the broad sector representation, the volatility of returns of the index is at the same level as that of the benchmark.

**Antoine Colonna >>** +33 1 5365 5815

Research Analyst  
Merrill Lynch (France)  
antoine\_colonna@ml.com

**Rodolphe Ozun >>** +33 1 5365 5892

Research Analyst  
Merrill Lynch (France)  
rodolphe\_ozun@ml.com

**Alex Ypsilanti >>** +44 20 7996 0792

Equity-Linked Analyst  
MLPF&S (UK)  
alex\_ypsilanti@ml.com

[See Team Page for Full List of Contributors](#)

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## The ML Lifestyle Index

The ML Lifestyle index provides exposure to stocks strongly associated with the luxury and lifestyle brands. Stocks are selected from a wide range of developed market sectors including automobiles, beverages, financial services, travel and retail. Stocks are screened for liquidity and size to ensure the index has a high level of tradability.

### Selection of constituents

The composition of the index is reviewed twice a year, on the first trading day of February and August. The index review is carried out by a committee of analysts, the Lifestyle index Committee. After consultation with the relevant ML industry analysts around the world, the committee identifies stocks that have meaningful exposure to the luxury and lifestyle theme.

The eligible universe of stocks is screened to ensure liquidity and tradability according to the following three constraints:

- Liquidity: the six-month average daily turnover must be at least US\$ 5Mn
- Market capitalisation: the full market cap must be at least US\$ 1Bn
- Country of listing: Stocks must have a main listing in a developed market (according to major international global index providers)

All stocks that pass the above screening are selected as index constituents. However, at least fifteen stocks and at most fifty stocks will be included in the index. Should fewer than fifteen stocks pass the above screening, the size, and subsequently liquidity, constraints may be relaxed. If more than fifty stocks pass the screening, then the fifty most liquid will be selected. The committee will aim to represent all sub-sectors in the universe by at least one stock.

The new index composition is implemented on the close of the fifth trading day after the review (i.e. on the close of the sixth trading day of February and August). The index is equally weighted as of that date.

The index is calculated daily on a price return basis (i.e. no dividends re-invested) and published on Bloomberg under the tickers MLEILIFD (US\$) and MLEILIFE (EUR).

In addition to the above functions, the ML Lifestyle index Committee will have the following responsibilities:

- Ensure the rules of the index remain relevant following any significant changes in the luxury and lifestyle sectors or related theme.
- Decide on extending the implementation of changes to the index from one trading sessions to any period up to five trading sessions. This will be done in the event that a material increase in the liquidity/capacity of the index is required in order to minimise market impact. Any such decisions will be announced in advance.
- In addition, the committee may decide to include large IPOs with trading history of less than six months on a 'fast-entry' basis without waiting for the next index review if it believes such stock may have a significant impact on the theme.

- Moreover, the committee may also exercise discretion on the treatment of non-standard corporate events (e.g. take-overs of constituents by non-constituents, spin-offs, etc) that may impact the relevance of the index to the investment theme.

## Current composition

The ML Lifestyle index composition as of the Feb-07 review is shown in the table below. This composition will remain unchanged (barring any corporate actions) until the next semi-annual review, scheduled in Aug-07. The table also includes the market cap, liquidity (six-month average daily turnover) and dividend yield of each constituent, all measured as of the latest review date (1-Feb-07). Based on the individual stock trailing dividend yields, we calculate the twelve month dividend yield of the index to be 2.4%. The country and sector weights of the current index composition are shown in Charts 1 and 2. The regional allocation to Europe, North America and Pacific Rim is 53.2%, 38.8% and 8.0% respectively.

Also, based on the liquidity numbers shown we are able to estimate the overall liquidity of the index. We calculate that a US\$ 1Bn programme trade across all the names in the index would represent 60% of the average daily volume per stock. This implies that one day's normal volume in the index would, on aggregate, represent a US\$ 1.7Bn trade.

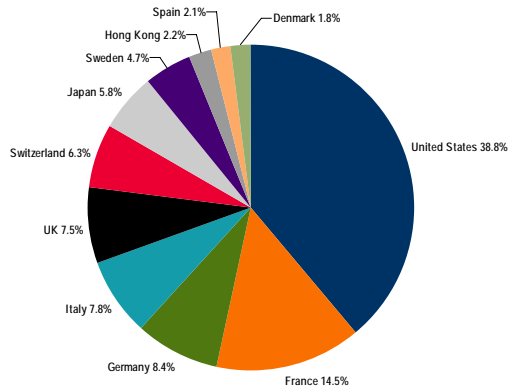
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**ML Lifestyle Index Composition (from Feb-07 to Aug-07)**

Ticker	Name	Sector	Sub-Sector	Country	Market Cap*	Liquidity*	Div Yield*
BOB DC	BANG & OLUFSEN A/S- B SHS	Personal & Household Goods	Leisure Time & Recreation	Denmark	1,463.8	11.4	2.3%
CDI FP	CHRISTIAN DIOR	Personal & Household Goods	Leather Goods & Fashion	France	19,971.3	18.7	1.3%
RMS FP	HERMES INTERNATIONAL	Personal & Household Goods	Leather Goods & Fashion	France	12,982.9	19.2	0.8%
OR FP	L'OREAL	Personal & Household Goods	Perfumes & Cosmetics	France	68,121.5	130.1	1.2%
MC FP	LVMH MOET HENNESSY LOUIS VUI	Personal & Household Goods	Leather Goods & Fashion	France	51,769.4	135.5	1.4%
RI FP	PERNOD-RICARD SA	Food & Beverage	Wines & Spirits	France	22,087.2	93.1	1.4%
PP FP	PPR	Retail	Retailing-Broadline	France	19,007.5	82.3	2.3%
RCO FP	REMY COINTREAU	Food & Beverage	Wines & Spirits	France	2,974.5	5.7	2.2%
ADS GR	ADIDAS AG	Personal & Household Goods	Sporting Goods	Germany	9,822.6	101.8	0.8%
BMW GR	BAYERISCHE MOTOREN WERKE AG	Automobiles & Parts	Leisure Time & Recreation	Germany	36,857.0	152.5	1.5%
POR3 GR	PORSCHE AG-PFD	Automobiles & Parts	Leisure Time & Recreation	Germany	11,159.7	84.4	0.8%
PUM GR	PUMA AG	Personal & Household Goods	Sporting Goods	Germany	6,472.1	54.4	0.7%
330 HK	ESPRIT HOLDINGS LTD	Retail	Retailing-Softline	Hong Kong	12,373.1	37.1	2.7%
BEN IM	BENETTON GROUP SPA	Personal & Household Goods	Retailing-Softline	Italy	3,115.0	10.2	2.8%
BUL IM	BULGARI SPA	Personal & Household Goods	Watches & Jewellery	Italy	4,400.4	20.9	2.3%
LUX IM	LUXOTTICA GROUP SPA	Personal & Household Goods	Eyewear	Italy	14,256.1	24.8	1.2%
TOD IM	TOD'S SPA	Retail	Leather Goods & Fashion	Italy	2,635.7	7.6	1.5%
8238 JP	ISETAN CO LTD	Retail	Retailing-Broadline	Japan	4,293.1	24.6	0.7%
4911 JP	SHISEIDO CO LTD	Personal & Household Goods	Perfumes & Cosmetics	Japan	9,288.9	29.3	1.3%
6758 JP	SONY CORP	Personal & Household Goods	Leisure Time & Recreation	Japan	47,007.9	266.0	0.2%
ITX SM	INDITEX	Retail	Retailing-Softline	Spain	35,671.5	77.2	1.5%
ELUXB SS	ELECTROLUX AB-SER B	Personal & Household Goods	Home Equipment	Sweden	5,603.4	58.6	4.2%
HMB SS	HENNES & MAURITZ AB-B SHS	Retail	Retailing-Softline	Sweden	39,584.2	111.4	2.4%
CFR VX	CIE FINANCIERE RICHEMON-BR A	Personal & Household Goods	Watches & Jewellery	Switzerland	29,430.3	79.0	2.6%
BAER VX	JULIUS BAER HOLDING AG-REG	Financial Services	HNWIs Service Providers	Switzerland	13,395.2	43.0	0.6%
UHR VX	THE SWATCH GROUP AG-BR	Personal & Household Goods	Watches & Jewellery	Switzerland	7,863.1	36.1	0.8%
BRBY LN	BURBERRY GROUP PLC	Personal & Household Goods	Leather Goods & Fashion	UK	5,767.9	48.4	1.4%
CCL LN	CARNIVAL PLC	Travel & Leisure	Retailing-Softline	UK	11,671.2	101.9	2.5%
DGE LN	DIAGEO PLC	Food & Beverage	Wines & Spirits	UK	53,334.7	254.9	3.5%
IHG LN	INTERCONTINENTAL HOTELS GROU	Travel & Leisure	Lodging & Gaming	UK	8,921.5	88.4	13.5%
AAPL US	APPLE INC	Technology	Leisure Time & Recreation	US	73,035.3	2,451.2	0.0%
AVP US	AVON PRODUCTS INC	Personal & Household Goods	Perfumes & Cosmetics	US	15,514.8	67.3	1.9%
COH US	COACH INC	Personal & Household Goods	Leather Goods & Fashion	US	17,183.2	129.4	0.0%
STZ US	CONSTELLATION BRANDS INC-A	Food & Beverage	Wines & Spirits	US	5,175.5	39.6	0.0%
EL US	ESTEE LAUDER COMPANIES-CL A	Personal & Household Goods	Perfumes & Cosmetics	US	5,893.7	50.0	1.0%
FOSL US	FOSSIL INC	Personal & Household Goods	Watches & Jewellery	US	1,526.6	7.5	0.0%
GPS US	GAP INC/THE	Retail	Retailing-Softline	US	15,880.1	139.0	1.8%
HOG US	HARLEY-DAVIDSON INC	Automobiles & Parts	Leisure Time & Recreation	US	17,818.1	148.4	1.4%
MGM US	MGM MIRAGE	Travel & Leisure	Lodging & Gaming	US	20,379.3	87.4	0.0%
NKE US	NIKE INC -CL B	Personal & Household Goods	Sporting Goods	US	18,936.8	165.1	1.3%
JWN US	NORDSTROM INC	Retail	Retailing-Broadline	US	14,635.9	116.0	0.9%
RL US	POLO RALPH LAUREN CORP	Personal & Household Goods	Leather Goods & Fashion	US	5,078.0	55.0	0.2%
RCL US	ROYAL CARIBBEAN CRUISES LTD	Travel & Leisure	Lodging & Gaming	US	9,625.6	54.0	1.4%
SKS US	SAKS INC	Retail	Retailing-Broadline	US	2,705.2	42.0	38.7%
BID US	SOTHEBY'S	Retail	Leisure Time & Recreation	US	2,422.0	32.0	0.7%
HOT US	STARWOOD HOTELS & RESORTS	Travel & Leisure	Lodging & Gaming	US	13,795.0	114.4	0.6%
TIF US	TIFFANY & CO	Retail	Watches & Jewellery	US	5,348.9	46.8	0.9%
TBL US	TIMBERLAND CO-CL A	Personal & Household Goods	Sporting Goods	US	1,532.4	12.6	0.0%
TOL US	TOLL BROTHERS INC	Personal & Household Goods	HNWIs Service Providers	US	5,271.6	103.9	0.0%
WYNN US	WYNN RESORTS LTD	Travel & Leisure	Lodging & Gaming	US	11,390.1	156.3	6.3%

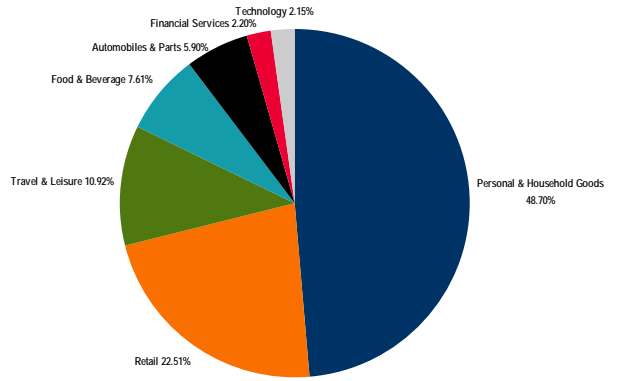
Source: Merrill Lynch Equity Derivatives Strategy \* - Market cap and liquidity in US\$ Mn. Liquidity is the 6M average daily turnover. All data as of last review date (1-Feb-07).

**ML Lifestyle Index Country Weights (29-Mar-2007)**



Source: Merrill Lynch estimates

**ML Lifestyle Index Sector Weights (29-Mar-2007)**

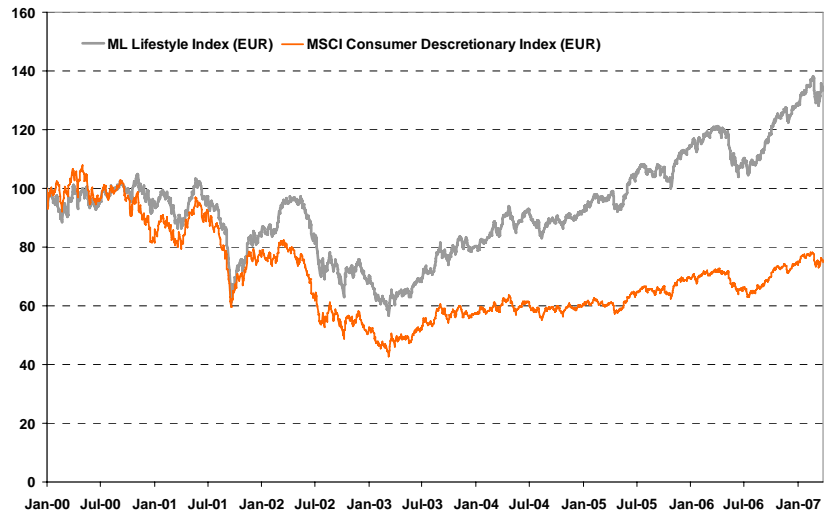


Source: Merrill Lynch estimates

**Historical index performance**

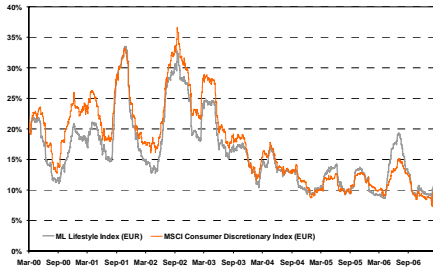
We backtest the theoretical performance of the index since Jan-00 assuming the current composition provided above. We also use a fixed number of shares per stocks based on an equally weighted index as of the Feb-07 index review. For the purpose of the backtest, we only include stocks in the index on their first day of listing – should that have been after Jan-00. The chart below shows the performance of the index relative to the major broad benchmarks for the global consumer discretionary sector, namely the MSCI World Consumer Discretionary, since Jan-00. In addition, Chart 4 shows the rolling 3M realised volatility of the index and that of the benchmark over the same period. The risk and return profile of the index, both on an absolute and relative basis, is provided in the table below. All of the calculations are based on the Euro denominated indices.

**Performance of the ML Lifestyle and MSCI World Consumer Discretionary indices**



Source: Datastream & Merrill Lynch estimates

**Realised volatility of the ML Lifestyle and MSCI Consumer Discretionary indices**



Source: Datastream & Merrill Lynch estimates

**ML Lifestyle index risk and return characteristics**

Returns	ML Lifestyle (EUR)	MSCI Consumer Discretionary (EUR)
2000	-4.5%	-17.2%
2001	-12.0%	-6.1%
2002	-19.2%	-34.9%
2003	18.2%	13.5%
2004	15.1%	5.3%
2005	23.4%	14.6%
2006	12.5%	7.1%
YTD*	4.0%	1.0%
Since 2002	33.4%	-25.1%
Avg Return per annum	5.5%	-2.0%
Avg Outperformance pa	-	-7.5%
Div Yield	2.4%	2.0%
Risk (volatility)	16.2%	17.6%
Correlation	93%	-

Source: Merrill Lynch Equity Derivatives Strategy, \* - YTD is up to 29-March-07

The average outperformance of 7.7% since 2000 of the ML Lifestyle index vs its benchmark illustrates the inherent “value” of brand names associated with luxury goods and lifestyle stocks. This is also apparent in the higher trailing annual dividend yield of 2.4% vs 2.0% for the benchmark. In addition, given the equally weighted nature of the index, and the broad sector representation, the risk (as measure by the volatility of return) of the ML Lifestyle index is at the same level as that of the benchmark.

# Merrill Lynch LifeStyle Index

## Key Points

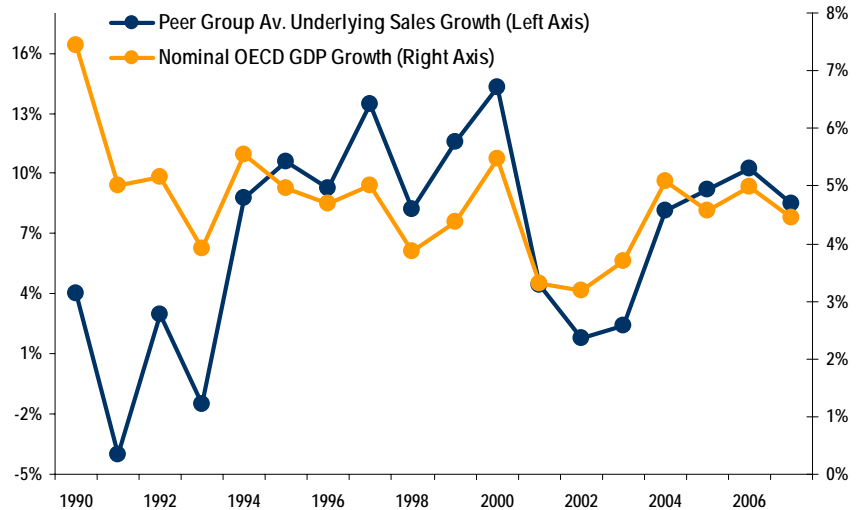
- First ever tradable certificate built on luxury and lifestyle stocks
- Provides access to the strong growth potential of the Luxury and Lifestyle sectors
- Growth driven by sustained rise in living standards worldwide

## Introduction

The Luxury and Lifestyle sectors are characterised by their cyclical nature and structurally higher growth profile than the world economy. There are three main reasons for this:

- Increased level of economic inequality around the world
- Democratisation of consumer appetite for luxury brands, especially among the young
- Strong growth in the number of customers from emerging countries (China, Russia and Middle-East).

### Luxury Goods Sales Growth vs OECD GDP Growth (1990-2006)



Source: Merrill Lynch Equity Research & The Economist Intelligence Unit

## The Luxury and Lifestyle sector: favourable growth drivers

### ■ A high-profitability sector

Beyond the increasing number of entry barriers, companies in this sector are in general benefiting from strong profitability linked to brand strength. This allows them to significantly increase their selling prices over time.

#### Profitability Across Key Selected Luxury Product Categories

	Gross Margins (%)	Operating Margins (%)
Leather Goods & Shoes	35%-80%	20%-50
Ready to wear	50%-65%	5%-20%
Cognac & Champagne	30%-40%	25%-35%
Jewellery & Watches	55%-70%	15%-20%
Perfumes & Cosmetics	15%-35%	5%-12%
Writing Instruments & Lighters	10%-50%	0%-15%
Tableware	10%-50%	0%-10%

Source: Merrill Lynch Luxury Goods Team

### ■ Imbalanced increase of the wealth around the world

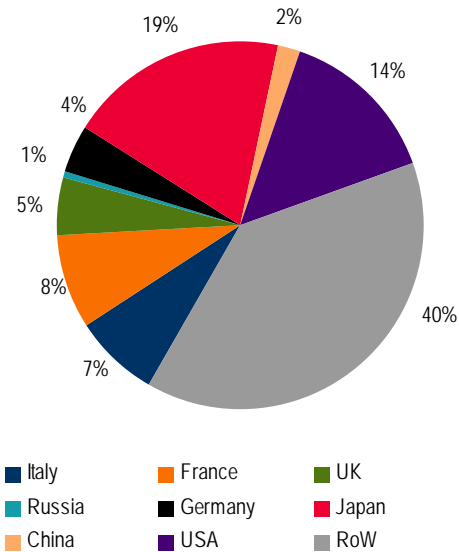
More than 8.7 million high net worth individuals (HNWIs) around the world each have over one million US dollars in financial assets. According to Merrill Lynch & Cap Gemini this totalled approximately US\$33tn as at the end of 2005.

Worldwide, the wealth of HNWIs increased by 8.5% in 2005 supported by world economic growth and the significant rise in share prices.

Emerging countries have seen superior growth in individuals' wealth than the average for the world. However the increasing wealth imbalances are also spreading to G7 developed countries, including Japan and Continental Europe.

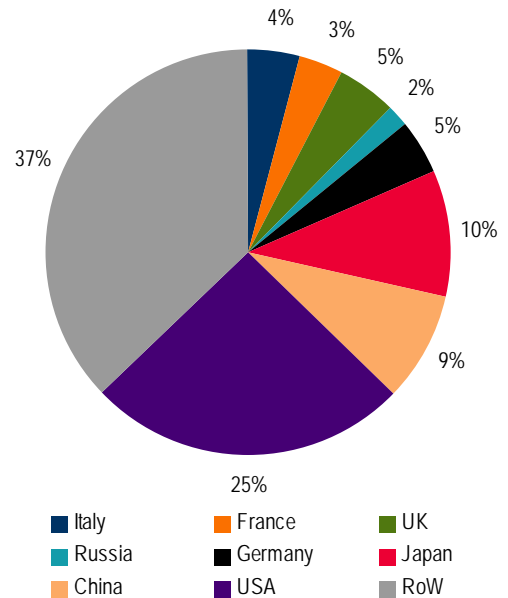
Merrill Lynch & Cap Gemini estimates indicate that the total financial assets of HNWIs will increase by 6% per year during the next five years, to reach US\$44.6tn by the end of 2010. In our opinion, this should lead to a more coherent distribution of the Luxury market relative to the distribution of wealth around the world.

Luxury Market by Country in 2006



Source: Merrill Lynch Equity Research - Luxury Goods Team

Wealth by Country in 2006

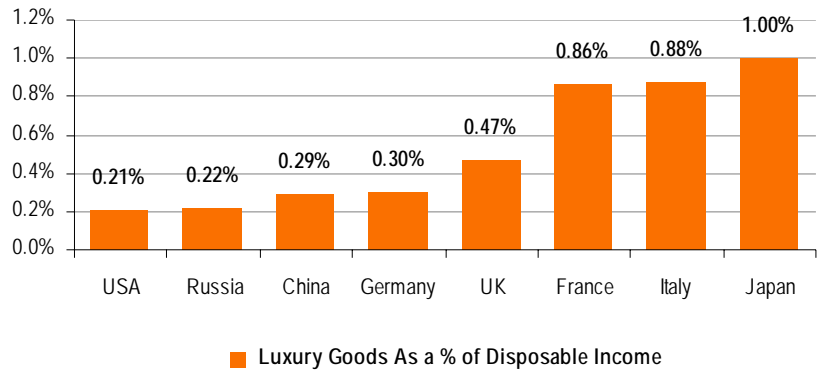


Source: Merrill Lynch Equity Research - Luxury Goods Team

Democratisation of the desire for luxury goods

Beyond the obvious but not easily quantifiable attraction of luxury goods for new generations, it is interesting to quantify the residual growth potential for the sector by comparing expenditure levels with disposable income within the main luxury markets. Japan seems to be the market where penetration of luxury brands is the most significant. Expenditure levels in Italy and in France are skewed by the contribution from tourism, especially from Russian and Japanese visitors. This is not the case for the US market, which we believe conceals considerable growth potential, or indeed for the main emerging countries, China and Russia in particular.

Luxury Goods as a percentage of disposable income in 2006



Source: Merrill Lynch estimates

■ **Importance of customers from emerging countries**

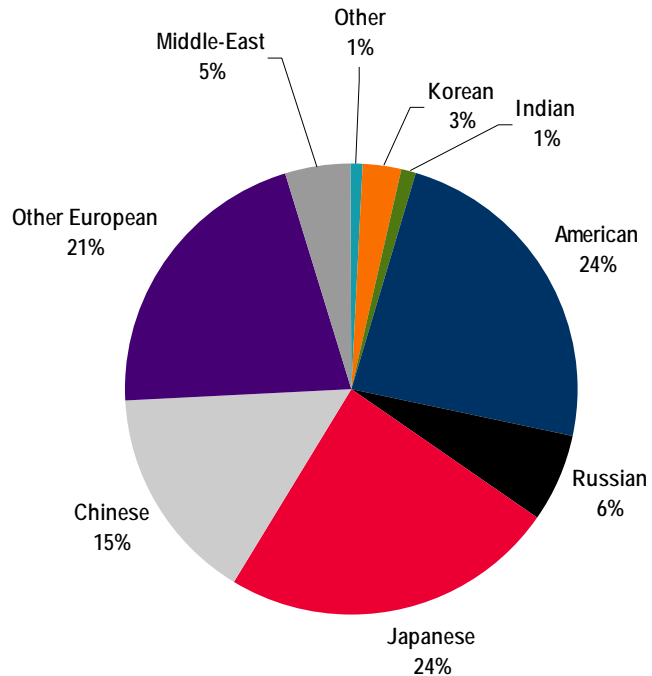
We see emerging countries as the main source of growth in the Luxury sector in coming years.

China, in particular, has an important and growing number of millionaires, and increasingly favourable environment supporting the development of large luxury brands.

According to our estimates, turnover in the luxury goods market generated by the Chinese could exceed that of US customers as early as 2009.

Finally, by 2014, we estimate that emerging markets could become the number one consumers of luxury goods in the world and represent a quarter of luxury sector sales.

Consumers of Luxury Goods in 2006 by Nationality



Source: Merrill Lynch Equity Research

■ **Main risks**

1. A brutal and/or significant deceleration of the world's economy.
2. A brutal and/or significant depreciation of the main invoicing currencies (US dollar, Asian currencies, Japanese yen) compared to the euro.
3. A medical (eg, bird flu) or geopolitical exogenous shock (major conflict), especially in one of the main revenue generating countries for the sector.

## Team Page

<b>Antoine Colonna &gt;&gt;</b> Research Analyst Merrill Lynch (France) antoine_colonna@ml.com	+33 1 5365 5815
<b>Flavio Cereda &gt;&gt;</b> Research Analyst MLPF&S (UK) flavio_cereda@ml.com	+44 20 7996 1455
<b>Virginia Genereux</b> Research Analyst MLPF&S virginia_genereux@ml.com	+1 212 449 5100
<b>Lorraine Maikis, CFA</b> Research Analyst MLPF&S lorraine_maikis@ml.com	+1 212 449 7622
<b>Rodolphe Ozun &gt;&gt;</b> Research Analyst Merrill Lynch (France) rodolphe_ozun@ml.com	+33 1 5365 5892
<b>Aymeric Poulain &gt;&gt;</b> Research Analyst MLPF&S (UK) aymeric_poulain@ml.com	+44 20 7995 5547
<b>Jaime Sheinheit</b> Research Analyst MLPF&S jaime_sheinheit@ml.com	+1 212 449 1991
<b>Stacy Turnof</b> Research Analyst MLPF&S stacy_turnof@ml.com	+1 212 449 8262
<b>Emma V. Whybrow</b> Specialist Sales MLPF&S (UK) emma_whybrow@ml.com	+44 20 7996 1544
<b>Katharine Wynne &gt;&gt;</b> Research Analyst MLPF&S (UK)	+44 20 7996 1563
<b>Matthew Yates &gt;&gt;</b> Research Analyst MLPF&S (UK) matthew_yates@ml.com	+44 20 7996 4537
<b>Nicolas Sochovsky &gt;&gt;</b> Research Analyst MLPF&S (UK) nic_sochovsky@ml.com	+44 20 7996 2141
<b>Nico Lambrechts &gt;&gt;</b> Research Analyst MLPF&S (UK) nico_lambrechts@ml.com	+44 20 7996 1591
<b>Hakan Ipekci</b> Research Analyst MLPF&S hakan_ipekci@ml.com	+1 212 449 8167
<b>Hidehiko Aoki &gt;&gt;</b> Research Analyst Merrill Lynch (Japan) hidehiko_aoki@ml.com	+81 3 6225 7633

<b>David Tovar &gt;&gt;</b> Research Analyst MLPF&S (UK) david_tovar@ml.com	+44 20 7996 1222
<b>Stephen Reitman &gt;&gt;</b> Research Analyst MLPF&S (UK) stephen_reitman@ml.com	+44 20 7996 2676
<b>Ritsuko Tsunoda &gt;&gt;</b> Research Analyst Merrill Lynch (Japan) ritsuko_tsunoda@ml.com	+81 3 6225 7184
<b>Christine Farkas, CFA</b> Research Analyst MLPF&S c_farkas@ml.com	+1 212 449 2088
<b>Richard Farmer</b> Research Analyst MLPF&S richard_farmer@ml.com	+1 212 449 6946
<b>Christopher Ferrara, CFA</b> Research Analyst MLPF&S c_ferrara@ml.com	+1 212 449 7479
<b>Derek De Vries, CFA &gt;&gt;</b> Research Analyst MLPF&S (UK) derek_devries@ml.com	+44 20 7996 4185
<b>Hitoshi Kuriyama &gt;&gt;</b> Research Analyst Merrill Lynch (Japan) hitoshi_kuriyama@ml.com	+81 3 6225 7639
<b>Ian Rennardson &gt;&gt;</b> Research Analyst MLPF&S (UK) ian_rennardson@ml.com	+44 20 7996 4748
<b>Amanda Bryant, CFA</b> Research Analyst MLPF&S amanda_bryant@ml.com	+1 212 449 2922
<b>Denise Chai &gt;&gt;</b> Research Analyst Merrill Lynch (Hong Kong) denise_chai@ml.com	+852 2161 7735
<b>Kenneth Zener</b> Research Analyst MLPF&S kenneth_zener@ml.com	+1 212 449 2146

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