Fine art as a wealth asset class

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Since Renaissance times, the possession of art has been a symbol of power for the noble class. Until today, the royal collections of Europe assembled in the time of the monarchies represent the long-term wealth of these nations. Art has also represented wealth and a high standard of living for industrial families and the landed gentry. At the beginning of the 20th century many of the industrial barons in America – such as J.P. Morgan and the Rockefellers – accumulated art collections of such high quality, that many of them formed the nucleus of some of the world's great art museums.

Upon his death in 2003, Gianni Agnelli not only left a diverse estate of financial investments and real estate, but also a distinguished art collection valued from 500 to 800 million euro. Taking into account the various estimates of his assets, the value of the paintings was approximately 20% of Agnelli's wealth. The legendary collection of Hans Heinrich Thyssen-Bornemisza compares favorably to that of Agnelli in value. The collection of the Niarchos family rivals the aforementioned, as well as those of Bernard Arnault (LVMH) and François Pinault (Gucci, Christie's).

Origins of the commercial art market

The art market as we know it today has its origins in the partial distribution of the substantial art collection of Charles I of England after his execution in 1649. England was practically bankrupt – partially because of the King's passion and high expenses for art. The Cromwell government used the paintings as payments for the King's household and tradesmen against unpaid salaries and accumulated debts. The collection included numerous treasures of the Renaissance – many of them acquired from the bankrupt Gonzaga family of Mantua and Philip IV of Spain – and paintings that Van Dyck and Rubens had created under the sponsorship of the king.

An active market opened up to the subsequent sale of these works to foreign buyers. Cardinal Mazarin, chief minister under Louis XIV, was an active bidder for paintings and tapestries, with a particular interest in Van Dyck, Titian and Caravaggio. He was represented by Antoine de Bordeaux, his "dealer" and ambassador to England. It is believed that his collection exceeded that of Louis XIV. For the first time in history, paintings of such extraordinary quality became available to the populace outside the nobility. Subsequent large dispersals of fine art from the privileged class to the general market also took place after the French Revolution.

Art market returns versus financial assets

Unquestionably, the purchase of fine art can be an aesthetic, emotional and personal decision. A phrase has been coined that the work could provide the buyer with an "emotional dividend". For instance, the satisfaction in beholding your 12-million-euro Canaletto might supplant your desire to receive a 3% p.a. (360,000 euro) "risk-free" return from government bonds.

Last spring's art fair in Maastricht featured several paintings in this price range from artists such as Botticelli, Guardi and Picasso. What does this situation say to an aspiring collector? For the reported 172 "resident" families in Switzerland with assets up to 800 million francs (Bilanz) or the 80,000 individuals worldwide with "liquid assets" of over US$ 50 million who might wish to build a "museum quality" art collection, the "barriers to entry" are considerable. An unreasonable portion of their assets would be necessary to enter the market at quality level. This does not suggest *not* to diversifying a portion of their assets into fine art. What is required is, perhaps, a more "quantitative" approach to the art market, which today is assisted by several research companies, scholarly analysis (Maastricht University, New York University) and comprehensive databases – some tracking art sales back to 1700. The ability to track pricing trends and repeat sales for individual artists and sectors of the market, and subsequently to correlate these results with the performance of the various components of the financial markets, can immeasurably aid a buyer's decision to purchase a suitable work and to build a collection.

Strong performance, low correlation

Between 2000 and 2008, while the Dow Jones Industrials had an annualized loss of 2.7%, the S&P 500 Index lost 5.7% and the Nasdaq Composite Index lost 10%, the "Artprice Global Indices" had an annual positive return

of 7.9%. From 1986 to 2006, during periods of "equity down markets", the cumulative performance of the S&P 500 was – 95.5% and the Morgan Stanley Capital Intl. EAFE Index was down – 81.6%, while the "Art Market Research All Art 100" had a positive return of 95.8%. In the period of "rising interest rates" from January 1978 to June 1981, the S&P 500 Index yielded 65.9% and 10-year bonds –4.9%, while the "Art Market Research 100 Index" returned a positive 131.7%.

The correlation of art-market performance to other asset classes has been low to negative. For the years 1875 to 2002, the "Mei/Moses All Art Index" had a correlation to the S&P 500 of 0.0419 and to government bonds of – 0.0400. From 1965 to 2002, the correlation with the S&P 500 was 0.0192 and – 0.1577 to government bonds. From 1980 to 2006, the general correlation of art with hedge funds and with real estate (REITs) was clearly negative.

The art market prices reflected in these indexes refer to auction sale prices known to the public. Art galleries and private dealers are significant players in the market but their sale results are unknown. It is a fair assumption that the pricing in the private market – at least in recent years – has taken its lead from what takes place at public auctions.

Indirect art investments

So where does all of this leave a budding collector? Because of the higher market transparency, increased "liquidity" due to many new buyers, massive marketing from auction houses, galleries and art fairs and correlative statistical analysis with other financial instruments, collectors are certainly better off than in 1700.

When buying art, as in private equity, it is advisable to have an "exit strategy": The price that favorably compensates for the risk in holding an illiquid investment during a "medium-term" holding period. This means not buying works that have reached a speculative phase (over, say, 40 million francs) with a low chance of significant price appreciation in the medium to long term – unless you just can't resist the beauty of it … But it will require a considerable cash outlay.

Fine art funds

An innovative product compensates collectors while waiting to sell, allowing them indirect as well as direct exposure to the art market (akin to real estate or private equity funds). It is the area of "fine art funds". It works the same way as stock funds: Investors "pool" their assets to purchase a diversified portfolio of art assets to achieve a superior medium-term return.

The concept of "pooled" art investing has been around for some time. From the 1970s to the 1990s, Artemis Fine Arts, listed on the Luxembourg Exchange, functioned as a "listed" art fund. It was affiliated with the Bank BBL and was managed by top art experts. For many years, Artemis paid a double-digit dividend in U.S. dollars from the proceeds of dealing in quality works that were not in the highest price range. Between 1974 and 1999, the British Rail Pension invested 4% of its assets under management in a diversified portfolio of worldwide art assets as a hedge against inflation and rising interest rates. When the "art fund" closed, it had yielded a nominal annual return of 11.3%.

Attempts to capitalize on a "securitized" art portfolio abound, but the benchmark in this area today is the *Fine Art Fund,* London. A medium-sized company, with good institutional backing, advised by top art experts, the Fine Art Fund is a long-surviving company in this field. It manages two funds investing in all periods, a Middle Eastern, a Chinese and an Indian Art Fund. Advisory services are offered from London or via BSI Lugano. Collectors have the chance to co-invest with the fund in "special situation" paintings, which are "sourced" by their experts.

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Guidelines for Collectors

1. When in doubt, seek the assistance of a major bank with an art advisory department (Deutsche Bank, BNP, Citi) or a quality "family office" (Kendris) with an art advisory. Ph.D. art historian staff are a good indication. Seek individual art advisors with no bias for selected periods of art.
2. Focus on well-known artists with a record of prior sales.
3. Paintings from an artist's middle period are often his most superior ones and achieve satisfactory prices in the market.
4. Works sold by prominent industrial families, noted collectors or museums often bring a substantial "price premium" to the market.
5. Identify works that have not come to market in about 20 to 60 years. Rarity pays a premium.
6. Beware of "emerging" and young artists who are excessively marketed by dealers, advisors and fairs. Their status might fall to the level of "penny stocks" and junk bonds in an illiquid market. This segment fell 40% since the financial crisis. These could be the Enrons or the Madoffs of the art market.
7. Paintings should pass stringent levels of authentication such as provided by the Maastricht Fine Art Fair.
8. Apply the same rigors to art collecting as to your other investments. It's real money!
9. Contemporary art from the BRIC countries (especially China and India) as well as art from the Middle East has generated considerable interest in the market. If at all, consider a «long-term» purchase due to lack of extensive repeat sale history.