

Art for investment's sake

Alternative investments are tipped to outperform conventional financial offerings this year, leading to a rapid rise in the number of indexes based on art, as well as increasing interest from fund managers. *Randall Willette*, managing director at Fine Art Wealth Management, reviews the landscape

> Recent surveys suggest that fund managers are building up their positions in alternative assets in the belief that these investments will outperform conventional financial market assets in 2010. Equally importantly, investors are emphasising diversification, as even institutional assets shift from the traditional to alternatives.

Art has emerged as a 'real asset' and a new alternative strategy for investors looking to increase the ratio of non-correlated instruments in their portfolios, and the launch of a number of art investment funds offering investments in an indirect manner into the art market is helping this process.

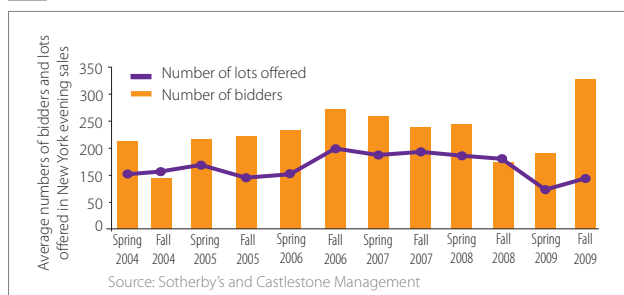
Art as alternative investment is not a new idea. The best known example of incorporating art into an institutional portfolio for diversification and as a long-term hedge against inflation is that of the British Rail Pension Fund which, beginning in 1974, invested £40 million (2.9% of its portfolio) across 10 art-collection categories. The fund's holdings were sold in the late 1980s, producing an overall return of 11.3% per annum. Most importantly, fine art was identified as an investment whose financial characteristics were ideally suited to the fund's objective, which was to beat inflation during the holding period and which closely matched its liabilities.

However, what is new is the preponderance of recent data that for the first time is providing investors with an understanding of the risk and return potential inherent in this alternative asset class. While the market has been characterised as inefficient and non-transparent, it is becoming more accessible. Over the past decade, leading academics and economists focused on art have substantiated the long-term correlation of art prices with those of other beneficiaries of economic growth, while further identifying the shorter term non-correlation that makes art an interesting diversification tool. Proven techniques and discipline common to every asset class can now be employed, allowing investors to incorporate art into their alternative investment strategy.

Many indexes, art price databases and analyses are now available to art market investors. The indexes have helped in comparing art to other assets such as equities and bonds, and use several methodologies, with the MeiMoses All Art Index and Art Market Research among the most widely quoted. However, both are reliant on data from sales at the main auction houses and the dealer market is largely ignored due to an absence of obtainable data. Though the information from the databases and indexes is not total, it does provide an indication of market trends.

Investors are expected to increasingly explore the role that art can play in their portfolios in 2010 through opportunistic, tactical or strategic investment. While many investment professionals agree that real assets

1. Number of art bidders in New York, 2004-2009



provide diversification benefits, there has been surprisingly little research into the appropriate allocation in an investment portfolio. Art used in the right way can enable investors to better tailor their investment strategies to address specific financial and investment concerns (for example, controlling volatility, boosting returns, or hedging against inflation).

Meanwhile, as financial markets improve, investors are becoming more worried about the inflationary effects of global stimulus plans. Unfortunately, many investors have low exposure to the types of assets that can protect their portfolios against inflation. Unlike other tools available to manage the impact of inflation on portfolios, art can provide an effective hedge against rising prices while also serving to enhance the overall risk and return profile for a portfolio.

In her research paper, *Art as an investable asset*, published in April 2009, Rachel Campbell of Maastricht University shows that art tends to outperform traditional financial asset classes during times of recession, and acts as a hedge against inflation with its price appreciating at a faster pace during high inflation and economic uncertainty. The low correlation with other asset classes means that, historically, the addition of art to an investment portfolio would have improved the investors' rate of return per unit of risk over the past 20 years, says Campbell.

As different asset classes provide varying degrees of inflation protection over varying time horizons and riskier assets such as art require longer holding periods to ensure positive real returns, a strategic allocation in art combined with equities into a portfolio with a long time horizon should provide good diversification and inflation protection. Portfolios with shorter time horizons should look to less risky assets.

When analysing the benefits of adding art to a portfolio, investors should consider the long-term advantages of inflation protection, volatility reduction for the overall portfolio via low correlation, and higher risk-adjusted returns. ●