Art as an Alternative Investment Asset

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Art as an alternative investment asset.

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Abstract.

The paper constitutes a discussion of the trend around the rise of art as an alternative investment. With financial markets in turmoil, art as an alternative asset class is being incorporated into portfolios in the interest of diversification. Art's low correlation with the equities market and desirable risk and reward ratio, as price appreciation defies all logic, makes it an attractive investment.

The volatility, irrationality and illiquidity of the art market make it hard to compare to more conventional investments. The paper will look at how investors are treating art as an asset class and how art compares to more traditional assets such as equities and bonds.

Introduction.

The role of art is changing. Art is no longer just appreciated for its aesthetic value and the expression of its lofty ideals but as an investment. Developments within the art market over the last ten years in the UK have been followed almost as closely as those within the stock market. Prices paid for pieces have gained international publicity and art as an object of investment has become particularly alluring. The art industry has really come of age: it is now worth over $3 trillion and has an annual turnover of $30 billion[1]. It has its own indexes for tracking performance (Mei Moses All Art Index, Art Market Research and artnet.com), showing that returns are just as attractive if not better in art than the stock market. Art has become the new hip must-have investment.

Indices tracking the performance of fine art have held up well in the recent economic slowdown with auction houses continuously reporting record prices. While art has been debated for quiet some time, there has been little investigation into the reasons why only a handful of the many small art funds that have proliferated during the past four years has been successful in building significant public and financial support. With uncertain stock market returns and interest rates at their highest in decades, nervous investors are now considering alternative investment avenues.

Art as an investment has an increasing demand coupled with an absolutely limited supply and the ability to survive the economic downturn. Although putting money into art is not as straightforward as investing in bonds or equities, the market is attracting increasing interest. Art as an asset is in a class all of its own. While art is seen by many in the financial community and beyond as an attractive investment as it outperforms more conservative investments, it is also extremely risky. It is an alternative investment earning capital gains rather than a dividend. Art does not behave in the same way as other assets such as real estate, or bonds. As investors take on a more hands-on approach to wealth management and portfolio diversification and with heightened exposure to alternative investments, the worlds wealthiest are looking to find adventure in new territories.

[1] Source: Thompson financial data, 2006.

Investing in art disregards the traditional benchmarks of financial analysis. Since art does not generate an income stream, such as dividends, the ability to assess a value by calculating future cash returns based on estimating future inflation and interest rates cannot be used to value a work of art. Instead it is a bet on the price appreciation of something whose values defies financial logic. Moreover, art incurs a negative income in the form of storage, insurance, transportation and other associated costs. Whilst contemporary art has appreciated enormously in value over the last few years, not all art works earn a positive rate of return.

The economics of art.

Art is a heterogeneous product, artworks are unique. Loyalty to an artist is low and the perceived value of the product very much depends on art dealer's taste. There is a lot of competitive pressure in the industry and barriers to entry are high due to high fixed costs, these include the finding and commissioning of artists, advertising, insurance, and distribution. Costs of exiting the industry are also high as it is difficult to liquidate assets. There exists a clear mutual interdependency between firms, dealers, and art fund mangers. The big three auction houses (Christies, Sotheby's, Philips,) are said to be price-makers and not price-takers. The art industry tends to compete on uniqueness of artwork and not on price.

The relationship between supply and demand for art is very similar to luxury goods. To begin with, there is limited supply, giving art a higher value. Secondly, exclusivity that comes with art often leads to higher prices, thus having an affect on the demand curve. There are a number of indicators that point towards an inelastic demand curve, these include:

- Changes in taste
- Changes in income
- Pricing and accessibility
- Threat of substitutes

In the art market there are "numerous pricing strategies and commission packages" (Schweizer, 2008). Artists interested in maximizing their profits will set relatively high prices, which relates to quality and exclusivity like luxury goods, in turn decreasing accessibility. Art fairs that represent galleries and dealers represent the lower priced end of the market as they rely heavily on volume sales than charging customers premium prices.

Art prices can be assumed to be determined by supply and demand. However, there are many factors that affect the price of art within art markets, such as uniqueness of product and limited supply of works. Price is very much dependent on consumer preferences and differentiation. There are two types of cost affecting the price: production costs and selling costs (Jyrämä, 1999). In art, as a rule, the price of the works of art consists of its production costs plus the aesthetic value of the piece. Selling costs is associated with the making of a new artist in terms of distribution and public relation efforts.

Factors affecting price are intertwined can be divided into four groups:

1) the work of art,
2) the artist,
3) the market and
4) the macroeconomic environment.

Factors relating to the work of art include the quality, content of the work, technique used, size and the authenticity of the artist.
Artist's fame and the valuation of previous are important.
One key distinctive feature is the rarity of the works. Legitimization and reputation affect both the demand and supply side. Customers are reliant on the opinions of expert buyers to determine whether the price is correct or not.
Macroeconomic factors include "the state of the economy and economic upswings and downswings which the art market follows" (Post, 2007).

In practice, perfect knowledge of a market does not exist, and this is the case in the art industries. The market can be characterized as highly uncertain and knowledge is scarce. Thus the imperfection's in the market becomes a tool of competition. In art markets, information on markets and products, including potential customers is a way to achieve a competitive edge. There is no substitute for art, art products are unique. Furthermore, benefits sought by customers are numerous and the motives for art purchasing is wide ranging. Art consultant Mr. Philippe Abdini believes that the demand for art in the Middle East region "is not only due to fashion, and it being in vogue, but to the concept of showing off to your neighbour your new found wealth" (Abdini, 2007). Value in the art market is particularly variable and unsupported as it's based on a lot of intangible measures such as taste, fashion, mood, and importance.
The top price for a painting by Takashi Murakami was $624,000. Since then, the legendary art dealer Larry Gagosian has sold Murakanis and in

November 2007 one was auctioned for $2.4 million (Douglas, 2008). However, "there is a danger that the market for a work becomes an over-dominant measure of value which has a downside risk should something as simple as confidence fall" (Gerlis, 2007).

Art as an alternative investment asset.

The relationship of art as an investment brings up the question of how can art have any correlation to a mainstream asset class? The consideration of art being lurched into the same field as stocks, bonds and shares, causes much dismay to many within the art community. Gallery owner Guy Peppiat believes that, "art funds are dangerous, and unsafe for the market. They have not been set up for the right reasons and are destroying the notion of what art stands for, aesthetic beauty and too be admired in one's private collection or in a museum" (Peppiat, 2007). Artist Maria Bell-Slater also deems "these funds which effectively act like hedge funds to not be good for artists. They tend to keep artists work in storage for at least 12 to 18 months before selling them. Art should be about enjoyment and being displayed" (Bell-Slater, 2007). However, economists and banking institutions have quite responsibly shown the link between art and investment and most importantly, how art can be considered along side tradition financial assets.

Assets are grouped together based on their characteristics of their underlying companies. Just as in managing traditional assets, art is grouped based on the period in which it was made, the artist (whether they are living or dead), style and medium. The main attraction of the art market and the prime reason for its resurgence as an investment is its low correlation with other financial assets. Art is in a "special asset class of its own as it is generally more risky then stocks, bonds and securities and should in theory generate higher returns for investors" (Kusin, 2007). Art acts as an asset because it is a piece that is owned and holds monetary value and can be exchanged for such a value. However, the issue of value is often subjective because of its heterogeneous nature. Traditional assets are homogenous commodities they cannot be differentiated, as they are the same value per stock per company. In art, each piece is unique, thus making it a market comprised of heterogeneous products.

Art fund mangers have touted the inclusion of 15-30% return of portfolios as a suitable investment and inflation hedge, citing benefits such as diversification and price appreciation while recognizing drawbacks such as illiquidity and high transaction costs. The attractiveness of art as an asset class is not solely because of its shown returns. Today's high net worth individual wealth is over $30 trillion and is increasing by 7% per annum. Currently, $300 billion is potentially available to be invested in art (ABN AMRO report, 2005). Art market consultant, Spencer Ewen explains the appeal of art by "unique features of international marketability, a comparatively low correlation to other stock, lack of transparency and the possibility of desirable risk/reward ratio where if you get it right profits can be large" (Ewen, 2007).

When it comes to asset planning, one of the key concerns for investors is how well an asset can hedge against inflation. Due to the high volatility of art's value, it is necessary to invest over a longer period to adequately hedge (Schweizer, 2008). India, one of the booming markets for contemporary art, works by leading painters have shown price appreciation in value of twenty fold since 2000[2]. Annual inflation has remained low. Art which outperforms inflation has become a valuable and sought after holding for an overall portfolio. The present situation of art as an inflation hedge can be explained through the past, "it was the inflation panic of the late 70's-early 80's that was the real economic fuel behind the new vitality of the art market. This newly prosperous, aesthetically orientated generation, saw their cash eroding in value and rushed to put their money into tangible assets such as art" (Deitch, 1989). Many art dealers flaunt the tangible characteristics of art as a valid asset. Philipe Abdini "it's safer than shares it's always there and there will always be a value for it" (Abdini, 2007). There is truth to the theory that when the stock market is in a downturn the art market booms. When markets are bad, people like to invest in something they can touch (Schweizer, 2008).

While some speculators see inefficiencies in the market as an opportunity, in relation to the art market the weaknesses have led to varying support. Some banks support investing in art especially investors favoring a buy-and-hold strategy. Art presents an alternative approach to the diversification of portfolios, giving investors optimal allocations and an opportunity for risk (ABN AMRO report, 2005). It offers returns that can outperform other asset classes with small or negative correlations to traditional classes. Art investment can also decrease a portfolio's risk because of its low or negative correlation to domestic or international equity. Investing in art can also have tax benefits. In the United States, the Internal Revenue Service considers an 'investor' in art someone who can claim that one's interest is purely as an investment, and indicates that one must consult occasionally with experts and subscribe to the relevant

[2] Source: Thompson financial data, 2006.

periodicals (Grant, 2006). Furthermore, the structure of the art market is relatively unregulated, prices fluctuate and returns are high. “The demand for art is very much dependent on people’s wealth, the belief that this wealth will last and on the whims of society’s taste” (Gerlis, 2007).

Despite the promises of large returns and the hedging against inflation, many features of the new commodity of ‘art’ have investors shying away from it. For one thing, art is very volatile, as an alternative asset it has performed in some decades then others. In the 1970’s, gold was the best investment, providing a lower degree of risk than stocks. Art at that time provided the most nominal twelve month returns, but provided the greatest chance of loss (Sandler, 2006). In the 1980’s, however, art outperformed gold, stocks, bonds and real estate. In the following decade, art returned to its slump. Gold and many commodities showed over 50% loss. Currently, only real estate and some small stocks have been performing well, making art and S&P shares the worst ventures (Sandler, 2006). Art, gold and commodities offer the least attractive risk-reward potential, but provide inferior returns while generating substantially more risk (Merrill Lynch report, 2006). These three asset classes may be more appropriate investments for those with truly long term horizons (Ginsberg, 2007).

A characteristic that is unique to art among asset classes is supply and availability. There is an inelastic supply for art, since most tradable art is trapped in private collections while dealers wait for a deluge resulting from one of the four eventualities: death, debt, divorce, or dissolution. Many desirable pieces from old masters to contemporary art are held in museums, which have de-accessioning restrictions (Groysberg, Podolny & Keller, 2006). Some commentators describe the art market as inefficient because of the absence of market prices where values cannot be determined due to lack of published data. Unlike other markets, the transparent sales of the art market are only held at auctions, on set dates and in specific seasons. “You don’t wake up one morning, look at the FTSE, phone your broker and say ‘get out of industrials and into impressionists’…..if you are buying shares, you can sell them and know what price you’re going to get. You can’t do that with art (Ecsktein, 2006).

There are many disadvantages in art. These include liquidity, pricing, performance, costs, track records and conflict of interests. Concerning liquidity, most art funds cannot just sell the majority of their artworks from one day to the next, for the sake of retaining their value they are normally held for a period of 18 months and thus characterized with high illiquidity (Ewen, 2007). Regarding pricing and performance, there is no price standardization and transparency in the market. Art fund managers can only rely on Mei/Moses Fine Art Index, artprice.com or Art Market Research. These are however boutique indexes and have not been given the stamp of approval by any formal ratings agency. Art needs to be estimated on size, date of creation, condition, name and reputation of artist. “Price opacity of art is a unique characteristic that will remain. The market is unregulated and pricing is based on strong networks and information shared between dealers and clients. It’s a bit like a conspiracy” (Abdini, 2007). In relation to, the fourth drawback, costs, in the art market they are hidden. “They are associated with distribution channels in the forms of commission rates, insurance, transportation and value added taxes. The fact is that owning art costs money” (Kusin, 2007). Investing in art funds is a nascent market and track records have not yet been established. Managers of these funds may have esteemed credentials, like Philip Hoffman, CEO of The London Fine Art Fund was the Finance Director for Christies for 20 years, their ability to achieve in this capacity has not been tested yet for more than a couple of years. Inherent in fund structures are conflicts of interest, for example, acquisition strategies when dealers inventory are concerned. The appraisal and purchase of the value of an artwork should be from an independent party.

Art funds' risk.

The British Rail Pension fund is the one of the most prominent examples of art investing, where in 1974, for nearly a decade thereafter, invested 2.9% of its overall retirement fund portfolio in the art market. Buying Old Masters, Impressionist paintings, Chinese porcelain, medieval works of art and antiquities under the guidance of Sotheby's from 1987 to 1999, cashed out in a series of sales, the portfolio of artworks sold for roughly $300 million. With good advice and during a time when the markets were booming, even though there was not a gain on every purchase, the pension fund came out ahead, with a reported compounded annual return of 11.3%. While the British Rail Pension fund success is often hailed as positive proof of art investment, there are many who are skeptical and who believe that its downfall was due to over diversification.

However, over the years a number of smaller investors have attempted investment funds, hoping to achieve the same amount of success. These included in the 1990's the Athena Fund marketed by Merrill Lynch, in 2000 Fernwood Art Fund backed by Wall Street veteran art collector, Bruce Taub, ABN AMRO Art Fund and Falk Art Management. All have since closed their doors. On the frontier for art fund investment are emerging markets, areas such as the UAE, India and China. Art from these countries are relatively cheap and will become more valuable in the years to come. It has been reported in the press that there are small groups in India, Singapore and China that are speculating.

The most recent initiatives in formalizing art as an investment that are still standing was launched in 2004, The Fine Art Fund, owned by Philip Hoffman and, in 2005, The Art Trading Fund by Justin Williams. Both are privately owned and not backed by banking institutions. Newly available research, new indices and strong investor interest because of the high performance of the art market have helped these two companies flourish. Spencer Ewen, Managing Director of a London based art investment consulting firm believes that "the springing up of art funds will go a long way towards making art a mainstream asset class" (Ewen, 2007).

Art funds pool resources to exploit the inefficiencies in the art market, by providing active management in art purchase and maintenance and have access to market intelligence and expertise not available to private individuals. Art fund managers that were interviewed for this paper believe that they offer the following benefits: access to art expertise, insider knowledge of the art market, low transaction costs if you are an investor in the fund, due diligence services, good advisory services and the potential for higher returns. Participating in an art fund gives access to co-investment and adds diversification benefits to a portfolio. Drawbacks in their view are minimal; they take the form of fixed exit strategies and lack of personal involvement with art (Williams, 2007).

Return on investment: art compared to other assets.

Investing in art has multiple benefits. Art has several attractive return characteristics for a long term investor, including low correlations with other asset classes and that it holds up well during weak economic environments (Post, 2007). Unlike stocks and bonds, art prices tend to have a positive correlation with inflation. The greatest risk involved in investing in art is that there is low transparency into the market. The art markets inefficiency is what makes investing in art so difficult. Expertise in the art market and knowledge of surrounding tax issues are scarce (Schweizer, 2008). The art market is driven by the following attributes:

- Art is a heterogeneous asset. There are few pieces of art of a specific author traded each year despite the number of fairs and auctions in the market.
- Market transparency is low.
- There are large differences in expertise between buyer and seller.
- There is low liquidity.
- Transaction costs are far higher than other markets.
- There are psychological benefits of owning arts, which are not calculated in the case of owning other financial assets.
- The art market has a much weaker equilibrium process than other securities.
- For dead artists, elasticity of supply is equal to zero.
- The inventories of stocks can be substituted by other securities, but each individual work of art is unique.
- Monopolies with art doe exist – mainly for owners of art.
- The equilibrium price is unknown, so an objective evaluation (for example the present value of future cash flows) is often impossible.

Mr. Karl Schweizer, Head of Art Banking for UBS feels that “successful investment in art requires extensive know-how about the artistic quality and authenticity of the object to be acquired but also peculiarities of the art market”. In addition, it requires the investor to understand international factors affecting art such as exchange rate movements, cultural factors affecting art and market preferences.

One of the greatest problems facing art as investment, is the question of value? Price value of art is a derivative of an emotional value and clearly reflects supply versus demand. The highest price one is willing to pay is often attributed to a work of art. This is indicative of the auction system and in most cases the price that has been paid is not reflective of the piece's true value. The market virtually lives on the frequently differing views of its players especially when contemporary art is concerned. Such works do not usually allow a final, detached and historically supported quality assessment (Kusin, 2008). This is the greatest challenge facing today's players. There is no sustainable formula to assessing a piece's ongoing value. This is normally done through due diligence services, by looking at past sales, and the artist's position in the market in terms of success and decline. The ultimate figure is purely guesswork.

Moreover, the value of an artwork stems from multiple factors, it is tied to, for example, the rising demand for artworks and increasing prices, which is driven by increasing global wealth. Value of artworks is constantly changing so one must be aware of artists' markets when buying. The Fine Art Fund considers a number of different factors when making a purchase to determine the value. These include: the condition of the work, the track record of the artist at auction and its freshness to the market among other things (Hoffman, 2007).

In the market for art, the prices behave randomly; there can be large gains and losses occurring within short holding periods, while returns during longer holding periods are very close to zero, indicative of a random process with a mean of zero (Baumol, 1986). Art yields a flow on non-pecuniary viewing services and capital assets, yielding a return from financial appreciation and is a market thought to largely benefit from surplus liquidity in the financial markets. Capital markets can temporarily stimulate the art market in the bull market phase through profit taking and portfolio restructuring; but they do not determine the long-term price behaviour in the art market. Even in times of weaker growth and an unattractive capital market trend, the art market has managed to rise significantly.

Most segments in the art market react quickly to the changes in the economic environment, especially for objects in lower price categories. Economic slowdown brings a drop to demand while increasing supply and thus forcing selling (Frey, 2003). However, this does not effect or rarely does so for artworks in the top price category since wealthy individuals have substantial purchasing power, even in economic downturn. Thus the distribution of income and wealth plays a key role in assessing the price sensitivity of the individual sectors of the art market.

With a market such as art functioning in a grossly disparate manner, one must consider if this is an alternative that will service the needs and tastes of the investor or if a more traditional investment should be regarded. While bonds or stocks are homogenous goods for which markets open every day, this is evidently not the case for art; transactions for paintings for which prices are known through auction houses are infrequent and paintings are the perfect example of heterogeneous goods.

Mei &Moses track sales in a database that now approaches 10,000 transactions. By focusing on repeat sales of the same piece, they hope to account for the fact that works, even by the same artists, are not identical (Palmeri, 2007). Other compilers of data use different approaches. Art Market Research uses results from the big auction houses but lops off the top and bottom 10% of prices under the theory that outliers unduly influence averages. Its contemporary art index shows the category returning 8.7% over the 25 years ending in 2005 (Art Market Research Index, 2007). This is lower then the art returns from Mei and Moses. Whichever method is used, it's unpredictable for investors to count on a similar return, especially if they're buying works from emerging artists.

Nearly all of the research into art as an investment concludes that it is riskier than stocks. Drawbacks include that it is far more difficult to get the same level of diversification in art that you would from mutual funds, which can contain hundreds of stocks. Commissions to buy or sell art at auction through a dealer can easily top 15% (Schweizer, 2008) far higher than what you would pay for a stockbroker. Liquidity is poor, even in hot markets items fail to sell at auction. If you are lucky enough to have long-term capital gains, art work is taxed at the full 28% rate vs. 15% for securities (Palmeri, 2007). Furthermore, dividends are limited to the enjoyment you get from looking at the art.

The uncertainty roiling the financial markets over the last few weeks has many asking questions about the future of the market for art. Maybe the market is ripe for correction (Taylor, 2007).

The graphs reported in appendix are comparing four art indexes from London based Art Market Research (ArtQart, Modern Art, Contemporary Art, American Art) with UK and US real estate indices, hedge fund indices, bonds, and equity (The New York Stock Exchange, FTSE 100, S&P 500), over a two year period, February 2005 to January 2008.

Looking at the overall picture over the last two year period, annual returns for art continue to exceed the return for stocks, bonds, equities and real estate, making it a good contender for those interested in diversifying their investment portfolio. The period looked at was short term, however, as stated earlier in the chapter, in the long term stock performance dominates art over the last twenty five years (Mei/Moses Art Index, 2007).

Sentiments about the future outlook of structured investments in art.

As for the market ahead there is great speculation into where art will be going. At this time, the market is in a great place for all sectors especially contemporary art, which is continuously increasing, and furthermore the art market is becoming more global with the emergence of Contemporary Indian and Chinese Art. With the emerging markets in India, China and United Arab Emirates, art pieces from these regions are becoming more and more popular. Not only is art being bought from these countries, but as people are getting richer there are more investors from these global regions. Patriotism is also an important part of the growth of the art markets in developing countries; many collectors are buying works from their own countries as a patriotic measure and as a confirmation of their cultural identity. While the art market is clearly in a boom right now and although there are predictions of increasing the value of the market, we know “everything happens in cycles” (Ewen, 2007). While the market is up right now it’s inevitable their will be a decline in the future.

Conversely, Ewen’s sentiments are not shared by all of the art market. Many are increasing their work force, new galleries are opening and there seems to be a constant supply of new clients wishing to start buying art. As long as global wealth creation continues the art market can evade a slump. Time will tell whether the credit crunch and looming recession will have any affect on the art market. “Wealth is a big contributing factor to the success of the art market. The ‘hedge fund’ billionaires are encroaching into the territory” (Ginsberg, 2007).

The idea of not buying into what is ‘in’ or something that will bring prestige is a lesson that has been learned from the art boom of the 1990’s, where the Japanese infiltrated the market and bought significant amounts of half decent Impressionist paintings. Since that catastrophic event in the art world, the market has been making maneuvers to make sure that an incident such as that does not happen again. Art professionals are concerned with the future of the market and making sure that it is an industry that remains strong. Therefore the presence of creative artists is important, as well as, servicing clients so that they will be challenged and excited by art.

What is the outlook for art funds themselves? The results of my research and interviews have lead me to argue that art funds have difficulty in meeting investor expectations and this is a key reason to why so many have failed. Going forward they need to be aware of these specific causes: lack of institutional support and management issues. High net worth individuals ready to consider investing are said to be having problems grasping the concept of art funds because of the lack of market transparency, lack of liquidity, ease of exit from the fund and a misunderstood risk/return ratio. Ultimately for art funds to become successful they will need the involvement and backing of some of the major banks – SGAI AI Art Fund could have a fighting chance in the future. From an institutional point of view, many of the funds lack structure from both an organisation and a legal aspect (Schweizer, 2008). In addition, banks make most of their revenue from commission fees from transactions, in art funds your money is normally lucked up for a period of 5-9 years.

Management of art funds is a rare combination of experienced investment skills and art market professionals. Institutions and private investors are concerned with this especially when it comes to the senior art advisors. Art advisors credentials hold little weight in the financial industry, and they are presumed to be lacking in ability to manage money, their role is also questioned because of the perception of conflict of interest. Are they acting on the behalf of the fund or because they are unable to persuade their own clients to buy the art? Most of the expertise in the art market lies with professionals who buy and sell art on their own account and that is in addition to advising a fund – this does lead you to wonder who is on the same side, against or in dispute with each other? Art funds need to be structured in a manner that protects them from such risks. The interviews have revealed that art fund managers prefer the private equity model over a hedge fund model as there is less risk.

Other deficiencies that art fund managers need to worry about are making sure that the structure of the art fund is clearly communicated. Potential investors are most concerned about the spread being too high. Huge money is spent in fees going to intermediaries and professional advisors. As art funds do not give a yield, the running cost of the fund most come from profits taken on pieces of art works sold or on interest of un-invested money. Such an added expense to a fund can affect the rate of return. Extra costs such as insurance, shipping, storage must also be considered in addition to management fees.

Another concern for art fund managers is the fact that institutions, are calling for the art market to be regulated. Many in the art world believe that this will never happen. Economist argue that in the future the art market will be provided with a vehicle for price transparency, the large majority agree that private sales data, around the 50% mark, will never become available to those without insider knowledge. Art funds should be more concerned with obstacles facing them such as removing the mystery surrounding them in terms of how they operate. They are seen as the “last bastion of the asset market” (Ewen, 2007) and have loose intellectual property rights. The art market can be characterised as being localised and protectionist, gallery owners are themselves obstacles in their own rights and behave with silo mentalities.

The fact that art indices only work in the secondary art market and not the primary one is another obstacle. The Mei/Moses indexes are based only on auction results, not on private sales. Reliability of information makes it difficult to develop a reliable index. Another problem to note within the art market index is how often such an index can be updated to reflect current trends. Art Market Research index is updated monthly but Mei/Moses indexes are updated annually due to the smaller number of transactions in the art market place.

Social changes in taste and the way art funds are perceived can make or break them. Many private collectors have banded together against the notion of investing in an art fund, thinking it ‘unethical’ as they believe collectors should buy what they love and not confine themselves to limited areas of art and artists. The excitement to them comes when they find that ‘fantastic’ piece. Collectors are less likely to invest as they feel they need control over their purchases and want some sort of quality control.

The entering of more art funds into the market will create volume and greater choice for investors, all positive things for investors. As the concept is fairly new, time, has presented the gravest concerns for investors, track record will be corrected with the increase in competition. With more competition comes more public financial support which will help establish investor confidence.

The art market lags behind the stock market in its trends, so how the panic over the financial markets, sub prime mortgages and credit squeeze will affect the price of art is yet to be soon. Anyone whom can provide liquidity to a market that has none –whether by buying up or downgraded mortgages or, potentially, by creating a market in art futures – stands to make a lot of money (Taylor, 2007). Many in the financial world believe this is where the art market is heading and it's the beginning of a major liquidity squeeze.

While the returns on art may not always beat the stock market and art may not always be the fastest growing asset, when measured against spending on rapidly depreciating alternatives, it's a great asset and provides valuable portfolio diversification. There is a value of putting a portion of ones asset into art, as the art market has echoed the stock market over extended periods. Different kinds of art investments offer radically different risk return profiles. Buying the works of contemporary art, such as brand new 'undiscovered' artists is a very high risk/potentially high reward approach. How long the contemporary art market will continue to keep rising remains unclear especially as it is very much linked to the taste and interest of the wealthy.

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APPENDIX

Figure 1: Art vs. NYSE

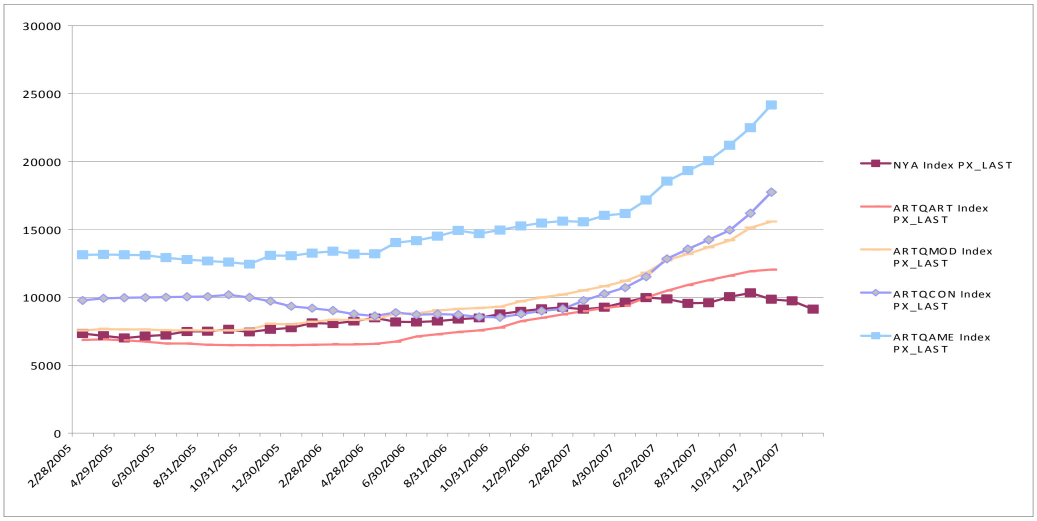


Figure 2: Art vs. S&P 500.

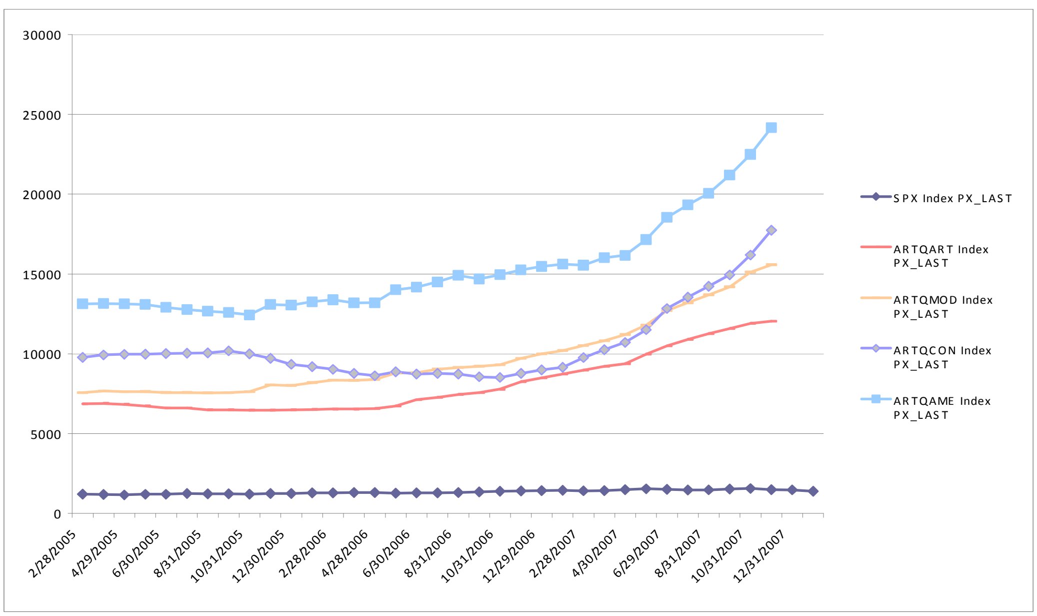


Figure 3: Art vs. FTSE 100.

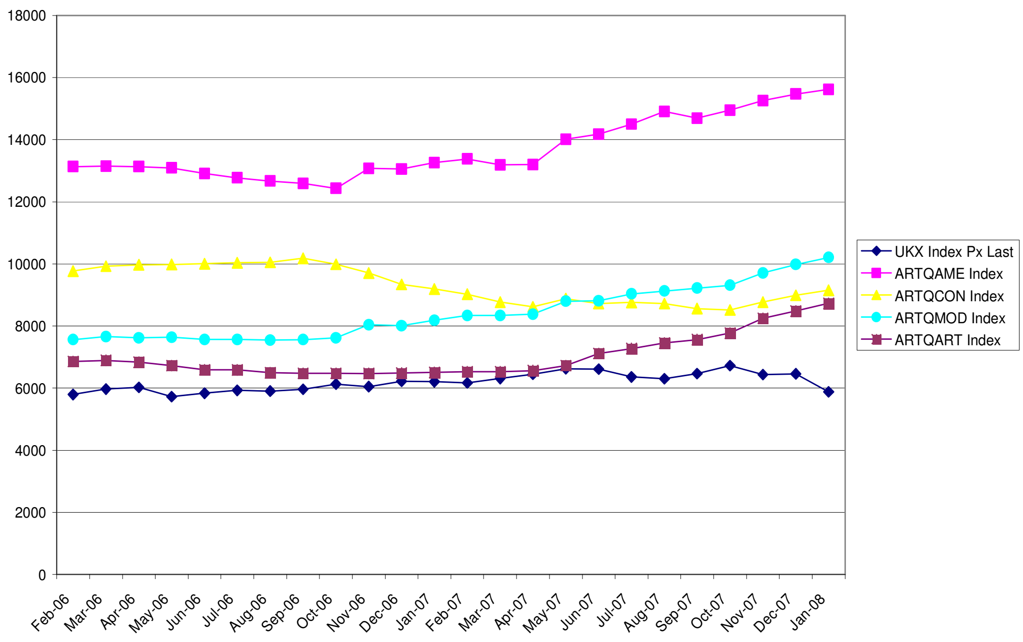
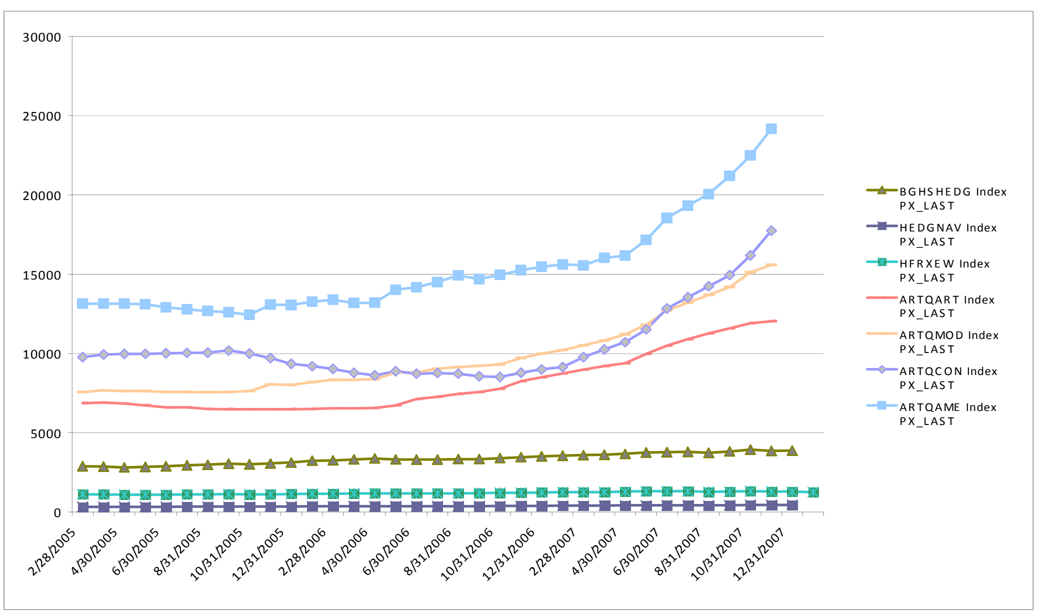


Figure 4: Art vs. Hedge-funds.



Hedge funds indices chosen for comparison are listed below:

- *Credit Suisse Tremont Hedge Fund (HEDGNAV)*
- *Barclay Global Hedge Source Fund (BGHSHEGDG)*
- *Hedge Fund Research Equal Weighed Strategies (HFRXEW)*

Figure 5: Art vs. Bonds.

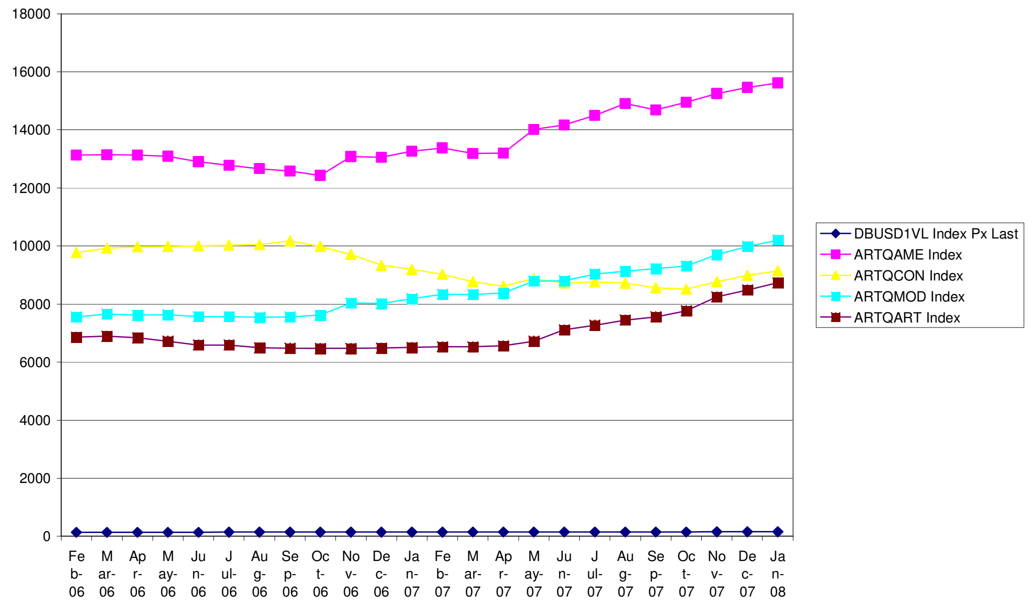


Figure 6: Art vs. Real Estate.

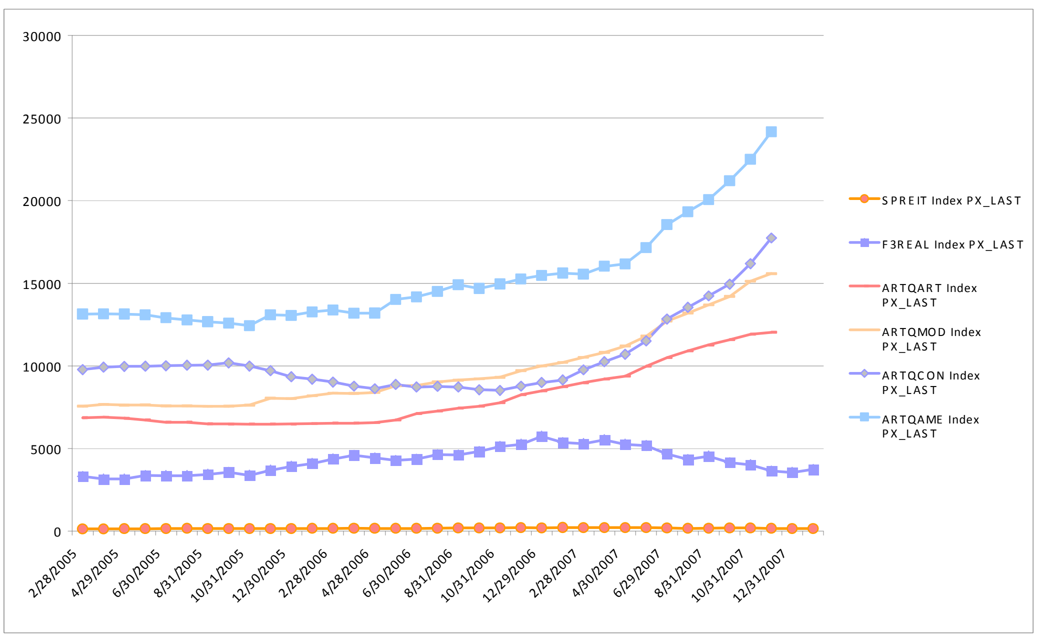


Figure 7: Art vs. All Indexes.