

THE  
PRICE  
OF PASSION

Art as an asset class

By David Bester





**We  
are  
your  
circumstantial**

**evidence**

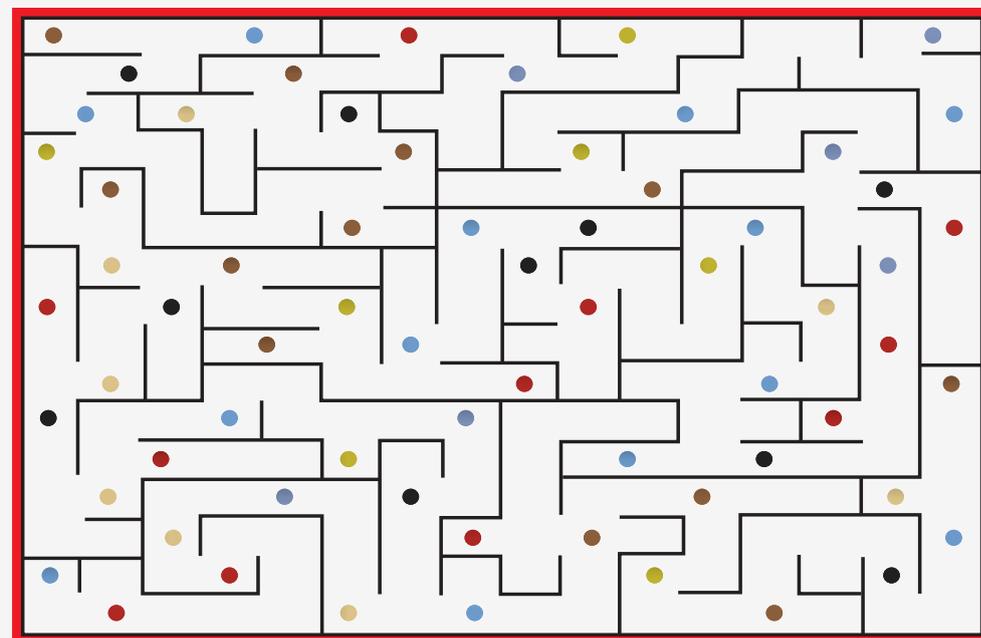
**E**ven non-collectors know there's money in art. Edvard Munch's *The Scream* set a new record for art auction sales earlier this year, bringing in \$119.9 million from an anonymous bidder at Sotheby's in New York. Despite the amount being relatively small for a global business deal, art auction results are regularly reported on the front page of newspapers, magazines, and websites around the world. Some commentators focus on the profit when art is resold for 10, 20 or 50 times its purchase price. Others gasp and ask, "Can it be worth that much?"

As traditional asset classes struggle to meet shareholder expectations, investors are open to exploring less traditional options. Art, with its seemingly outsized returns and aura of prestige, is attracting its fair share of attention. Yet this market can be intimidating and opaque to novices, particularly for the highly prized conceptual pieces of the contemporary art world.

With the curiosity and number of potential collectors on the rise, THINK spoke with four experts to better understand the inner workings of art as an asset class.

#### THE ART ECONOMIST

Don Thompson was puzzled. An economist, contemporary art collector, and a Professor at the Schulich School of Business at York University in Toronto, he was regularly asked about the process of pricing and valuating contemporary art. Why was a



work valued at millions of dollars, when the artist was still alive, still producing, thus there was no scarcity factor? Who determined which artists made it to the peak of the contemporary pyramid, the evening contemporary auctions at Christie's and Sotheby's in New York and London? More than just technical skill was obviously involved. These questions led Don to research and write *The \$12 Million Stuffed Shark: The Curious Economics of Contemporary Art*.

The title refers to British artist Damien Hirst's *The Physical Impossibility of Death in the Mind of Someone Living*. Hirst's 1991 piece consists of a tiger shark preserved in formaldehyde, mounted in a glass vitrine. Charles Saatchi, an influential collector, sold the work of art to New York collector Steven Cohen in 2004 for a reported \$12 million.

"In traditional investment terms, art is not very exciting," says Don. "Contemporary art

**"A GALLERY OWNER WHO TELLS YOU, 'THIS ARTIST WILL SELL FOR FAR MORE, FIVE YEARS FROM NOW' IS ACTING AS A JUDGE IN A KEYNESIAN BEAUTY CONTEST."**

**- DON THOMPSON, ECONOMIST AND AUTHOR OF THE \$12 MILLION STUFFED SHARK**

as an asset class is high risk, illiquid, unregulated, with high transaction costs, subject to unpredictable collector trends, and produces no cash flow. Price movements are essentially unhedgeable." But while a non-traditional asset, art offers investors a number of non-traditional benefits.

An investment in the art market might literally be more rewarding than owning stock. In his book, Don recounts the work of economist John Picard Stein, who tried to quantify psychic returns and concluded that they were equal to a return on investment in art of 1.6 percent a year. Art in its many forms is used to diversify portfolios. Perhaps most importantly, there is the opportunity for art to convey status upon collectors. While it may not be practical or tasteful to display one's investment portfolio upon a wall, there's really no substitute for inviting a guest into your living room and have them exclaim, "Wow, is that a Picasso?"

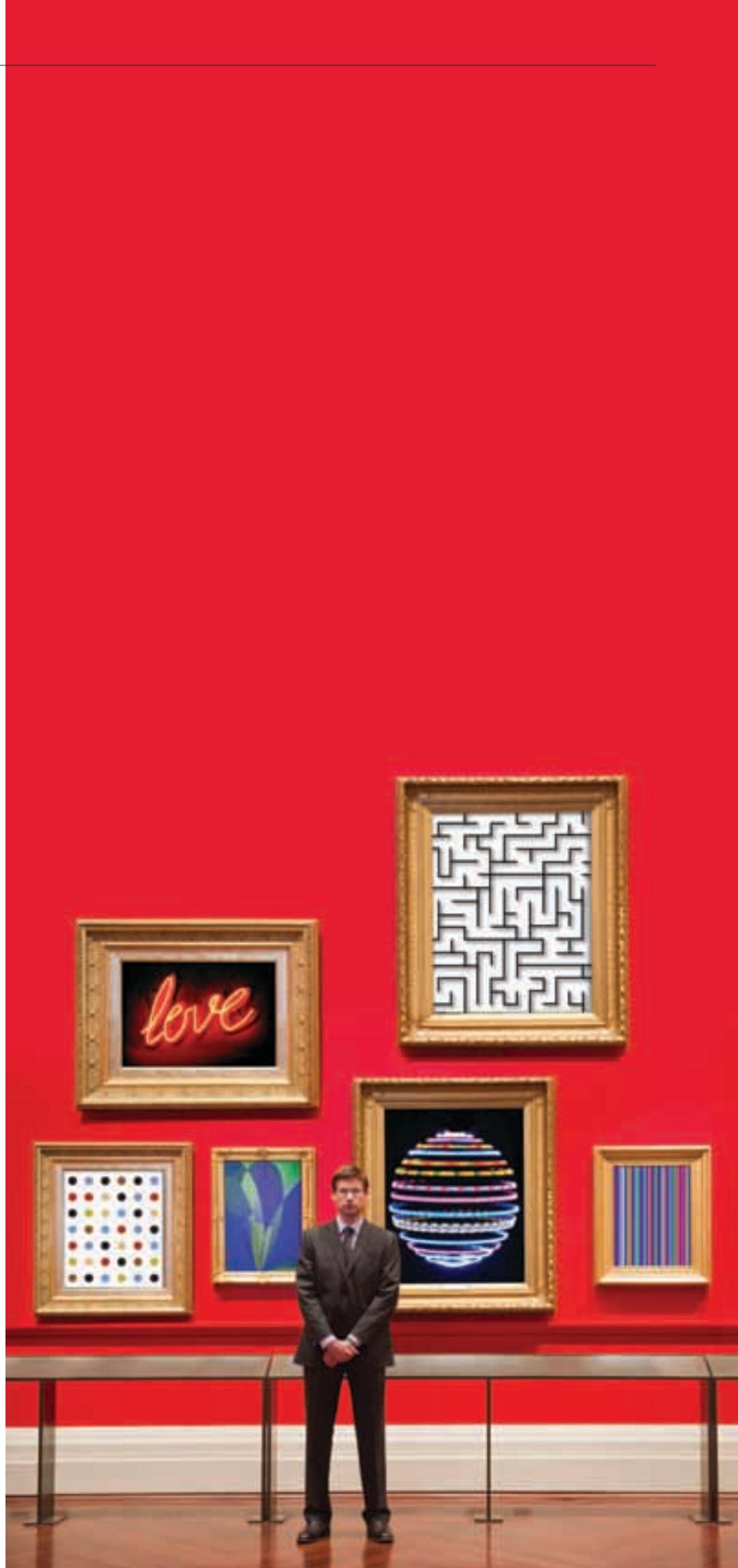
Barbara Kruger  
Untitled (We are your circumstantial evidence), 1981  
black and white photograph  
90 x 60 inches  
Courtesy of Barbara Kruger and Sender Collection

“The process for buying contemporary art is different when buying for your home, and buying for investment purposes. You buy for your family’s enjoyment on aesthetic grounds. It is a passion investment, purchased because your soul sees meaning in the work.” When art is viewed solely as an investment, purchasing decisions more closely resemble Keynes’ assessment of the stock market as a beauty contest. “A canny investor would choose not what he thought was the best stock, but the stock he thought other investors would choose as best five years hence, thus driving up its price. A gallery owner who tells you, ‘This artist will sell for far more, five years from now’ is acting as a judge in a Keynesian beauty contest.”

The deep pool of data attached to equity markets helps investors form expectations about a stock. Researching and modeling art portfolios is more challenging, as subjective criteria play a much larger role than for market data. Buyers may seek to reduce uncertainty by purchasing work from a branded artist, a branded dealer, or a branded auction house.

How does an artist become branded? It has a lot to do with where the artist’s work has been displayed, who else collects the artist, and in the case of a sale, who the previous owner was. In the art world this last point is known as provenance, the history of an artwork’s ownership. For works by Old Masters that have been in museums or private collections for generations, provenance helps rule out the risk of fakes and ensures that paintings are connected to their rightful owners. In the contemporary art market, the stature or celebrity of the previous owner can have a large influence on the artwork’s price. An impressive provenance can translate into higher satisfaction for a buyer while reinforcing the status of the artist.

Don observes that even the locations of an auction house or dealer can carry weight. “New York and London are themselves brands. Have a painting on your wall acquired in New York has a lot more cachet than having one purchased in Milwaukee.” The importance placed on an artist’s reputation, ownership and representation illustrates how today’s art world has become as brand-driven as other high-end luxury markets.



**THE ART CONSULTANT**

Alessia Zorloni is an Associate Research in Arts and Culture for The Boston Consulting Group. She is currently working in Milan, having been awarded a grant from the European Community (Marie Curie Fellowship) for a research project on performance management of museum and cultural institutions. Her book *The Economics of Contemporary Art* is scheduled for publication in 2013.

“The most interesting aspect of value creation in contemporary art is the role that asymmetric information plays in this market. It’s directly linked to the question of why some artists succeed and others fail.” Alessia has observed that in most art transactions, collectors don’t have the cognitive capacity to evaluate the quality characteristics of the good. As this information is only available through a specialist, the collector can instead form expectations about the quality of a work of art by using an artist’s brand as a substitute for information.

“If you go into a gallery and ask people why they chose a particular piece of art, you will often hear that the celebrity of the artist was a driving factor. This is a common practice, especially among new collectors who are attempting to reduce information costs.” When buyers limit their purchases to well-recognized pieces by famous artists, they leverage the established preferences of previously successful buyers, thereby reducing insecurities connected to personal taste. This celebrity effect ensures that the most famous artists remain in the highest demand and achieve the highest prices.

Alessia notes different motivations among collector segments. “The first group buys for the pleasure of living with a work of art, and to have a deep connection with the art and artist. On the other side, there are collectors who buy mainly as a status symbol, or as commercial investment with a financial expectation. And those collectors are the ones that make the market more active. They are also the group who make prices go up or down in unpredictable ways.”

Corporate collectors, most notably banks, represent a third segment. While this group follows similar market trends, they are driven by a different motivation. “We did a benchmark study of 15 banks and we found

that among those banks, a return on investment was not a main driver. It’s strange for a bank, but true.” Banks began investing in art in the 1980s, primarily as a symbol of innovation and creative thinking. Today,

they have found value through association with the art world. Deutsche Bank and UBS are well known for their substantial collections of contemporary art (estimated to contain 60,000 works and 30,000 works respectively, across all media). Their sponsorships of art competitions and large fairs such as Art Basel, Art Basel Miami Beach, and Frieze provide crossover opportunities to assist their clients with a broad spectrum of wealth management services.

The cumulative effect of individual and corporate collectors seeking contemporary art by branded artists creates a high barrier to entry for emerging artists. “It’s possible to say that the demand for contemporary art is characterized by a network effect. This means that the collector’s willingness to pay depends on the number of prestigious and influential collections in which the artist is already part of. This mechanism increases the power of a handful of famous artists, driving the superstar effect, and increases also the prices. This network effect is a theory in information economics, but is really useful to understand value creation in the contemporary art market.”

For those investors who have an interest in art, but not the education or resources to start their own collection, another option exists: to invest in an art-based fund.

**“IF YOU GO INTO A GALLERY AND ASK PEOPLE WHY THEY CHOSE A PARTICULAR PIECE OF ART, YOU WILL OFTEN HEAR THAT THE CELEBRITY OF THE ARTIST WAS A DRIVING FACTOR. THIS IS A COMMON PRACTICE, ESPECIALLY AMONG NEW COLLECTORS WHO ARE ATTEMPTING TO REDUCE INFORMATION COSTS.”**

- ALESSIA ZORLONI, ASSOCIATE RESEARCH IN ARTS AND CULTURE, THE BOSTON CONSULTING GROUP

**THE FUND MANAGER**

Philip Hoffman spent 12 years working for the global auction house Christie's, where he was involved in running their European operations. During this time, he saw how some of the world's richest families profited greatly from a buy and hold strategy in art. As founder and Chief Executive of The Fine Art Fund Group, he now develops and manages investment vehicles that

**“THERE ARE OPPORTUNITIES TO BE HAD IN THE ART WORLD, BUT THERE WILL BE EQUILIBRIUM BETWEEN BUYERS AND SELLERS EVENTUALLY. IN 10 TO 15 YEARS TIME, IT WILL BE TOO LATE.”**

- PHILIP HOFFMAN, CHIEF EXECUTIVE,  
THE FINE ART FUND GROUP

offer high net worth (HNW) families the opportunity to invest in art, with the added benefits of diverse professional expertise.

To support diversification, the fund is spread across five centuries of art, ranging from 15th Century pieces to contemporary works. Most importantly, the Fund focuses solely on museum-quality pieces. “We might invest in an artist such as Carl Andre (an American minimalist artist recognized for his linear format and grid format sculptures), or a very well-known artist such as Picasso. But to maintain the caliber of our holdings, we

would not aim to buy a third-rate Picasso just because it's cheap, while we might buy a great Carl Andre even if it's expensive,” explains Philip.

The Group's longest running fund, which closed to investment in 2005, has an 18.79% compound return on sold assets with an average art purchase price of \$600,000, though that doesn't mean the fund is producing 18.79% per annum. “If we focus on the purchase and sales of a work of art for that fund, our target for a picture purchased for \$1 million would be, on average, to sell it the next year for \$1.2m, or the year after for \$1.45m.”

The Fine Art Fund Group distinguishes itself from individual and private collectors by its information-gathering advantage. Experts in various fields, most with 20 to 30 years' experience in art, travel to every major art fair in the world, most major auctions in global city centers, and represent specific areas that the Fund invests in. These experts help the Group create detailed pre-purchase reports.

“Given the individualistic nature of art pieces – even for a well-branded or superstar artist – there are many variables involved. For each picture we buy, we produce a 10 to 20 page document that is approved by three or four of our experts and our management team. Our documents are audited by KPMG to ensure that the relevant sign-offs and due diligence have been performed.” The group hedges against valuation risks by having Christie's and Sotheby's value everything, in addition to the estimates provided by its own experts. Fire, theft and forgery risks are addressed through insurance.

The Fine Art Fund Group also provides advisory services to private clients. Mostly this advice is directed towards wealthy families and individual collectors, but Philip sees the potential for another segment to get involved in the art world: institutional investors. “A number of pension funds are starting to come around and kick the tires. They are reflecting on the fact that they got into the hedge fund world late, and didn't get the benefit of investing when those funds were small, disciplined, and able to operate freely. Pension funds are now considering moving faster into asset classes where the world's wealth is being invested. There are opportunities to be had in the art world, but there will be equilibrium between buyers and sellers eventually. In 10 to 15 years time, it will be too late.”

Looking over the investable art market, Philip sees demand growing and supply shrinking, as works of art are removed from circulation each year to take up residence in private collections or galleries. A focus on museum-grade pieces and mastering the information complexities of their market has helped The Fine Art Fund Group gather \$200 million in assets under management, a figure Philip hopes to move closer to \$400 million by early 2013. “I continue to see a bright future for art investment. We're just trying to stay focused on what we do best, and make sure we get our numbers right.”

**THE COLLECTOR**

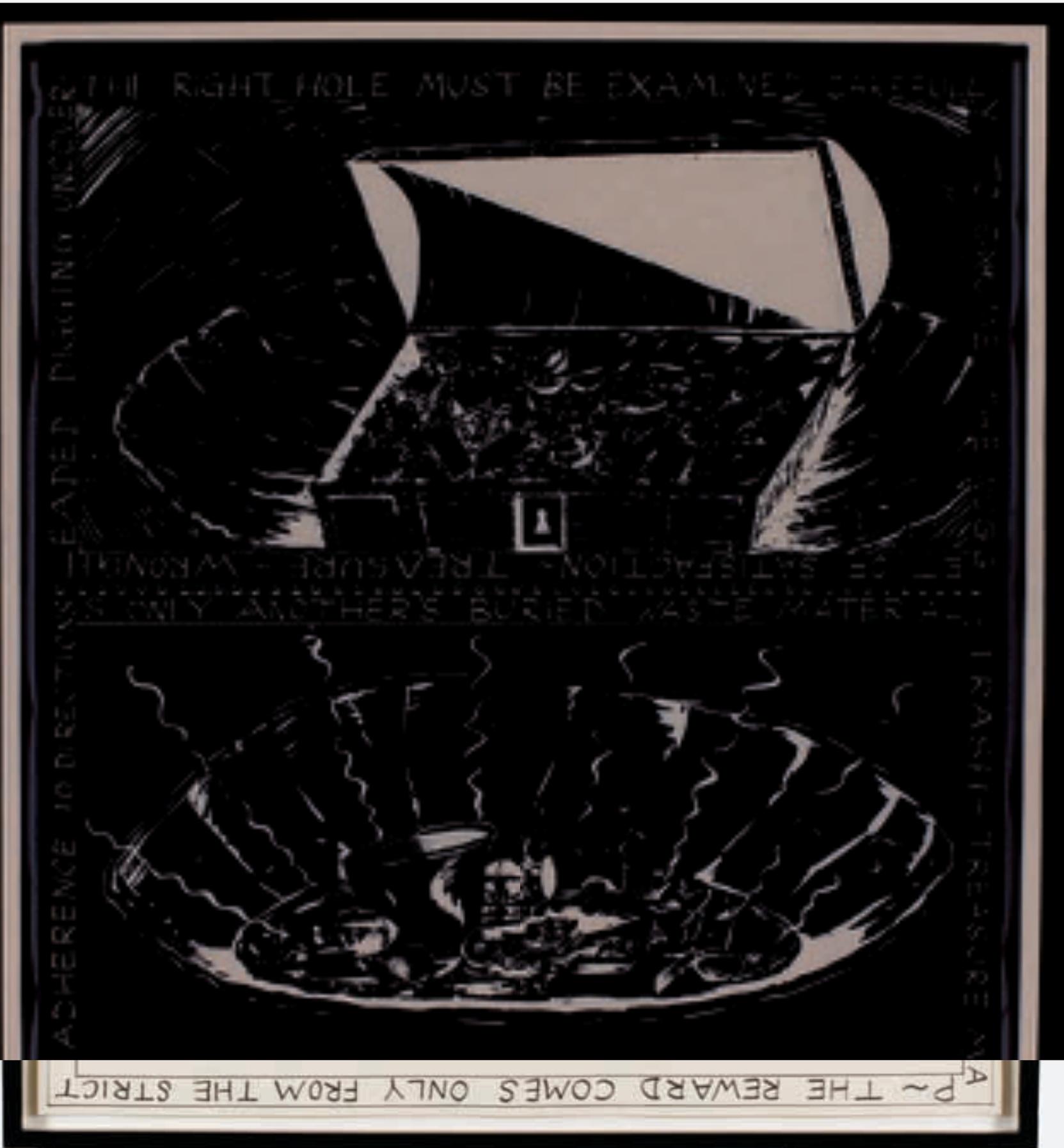
Adam Sender is Chairman, CEO, and sole shareholder of Exis Capital Management. As an active hedge fund manager, he is aware that many investors are seeking new ways to generate investment returns, having been disappointed by the recent performance of traditional assets. “I've heard people grumble that the last 10 years have been a lost decade for stocks. People ask, ‘What are my alternatives post 2008? I held this stock and it's gone nowhere. If I had a piece of art on my wall, at least I'd get something tangible to appreciate every day’. As both an investor and collector, I understand that argument. I really do.”

Adam has a unique perspective on the worlds of art and investment. Over the last two decades, he has personally acquired nearly 1,000 works of art, focused mostly on minimal and conceptual works from the 1960s forward, including works by emerging artists. These pieces form The Sender Collection, an ongoing testament to his appreciation for art.

Rosemarie Trockel  
o.T. (death's heads), 1990  
wool (yellow-black, beige)  
78-3/4 x 59 inches

Courtesy of Rosemarie Trockel and Sender Collection





Mike Kelley  
The Buried Treasure, 1983  
acrylic on paper  
44-3/4 x 38 inches  
Courtesy of Mike Kelley and Sender Collection

Managing an art collection and managing a portfolio of equities do have some similarities. Both must take into account holding periods, trends, and a culling process based on market factors. For these reasons, Adam views art as a legitimate asset class. “Art can provide diversification, and if you believe there will be inflation at some point and the US dollar will be worth less than it is today, owning assets can be an effective hedge.”

But the similarities only extend to a point. “Unlike works of art, equities need to be actively managed and are fairly liquid. There might be some exceptions for globally well known artists such as Warhol, but in general, finding the right piece, or connecting the right piece to the right buyer, can take much longer.”

Because works of art are unique objects, Adam feels that profitability is an unwise goal for new collectors. “Some people buy art out of love for a particular piece or artist. They want something beautiful in their home or office. Others justify their purchase as an investment. I consider both perspectives valid, but without the patience to build a collection and some sort of art education to base your acquisitions on, the likelihood for disappointment can be extreme.”

When Adam considers an acquisition for his own collection, he is more concerned about reputation and visibility than financial markers. “When I make a purchase I want to know who’s representing the artist: is it Larry Gagosian (founder and owner of the Gagosian Gallery, considered one of the most influential art dealers in the world)? Are they being exhibited right now? These can be important determining factors.” Adam also remains

**“SINCE (EMERGING ARTISTS) DON’T HAVE A PRESENCE IN THE MARKET, YOU CAN’T RELY ON THE MARKET TO HELP YOU MAKE A DECISION. YOU REALLY NEED TO BE GUIDED BY YOUR PASSION FOR THE ART ITSELF.”**

- ADAM SENDER, CHAIRMAN & CEO,  
EXIS CAPITAL MANAGEMENT

committed to purchasing works by emerging artists, but explains that their lack of profile requires them to be treated differently.

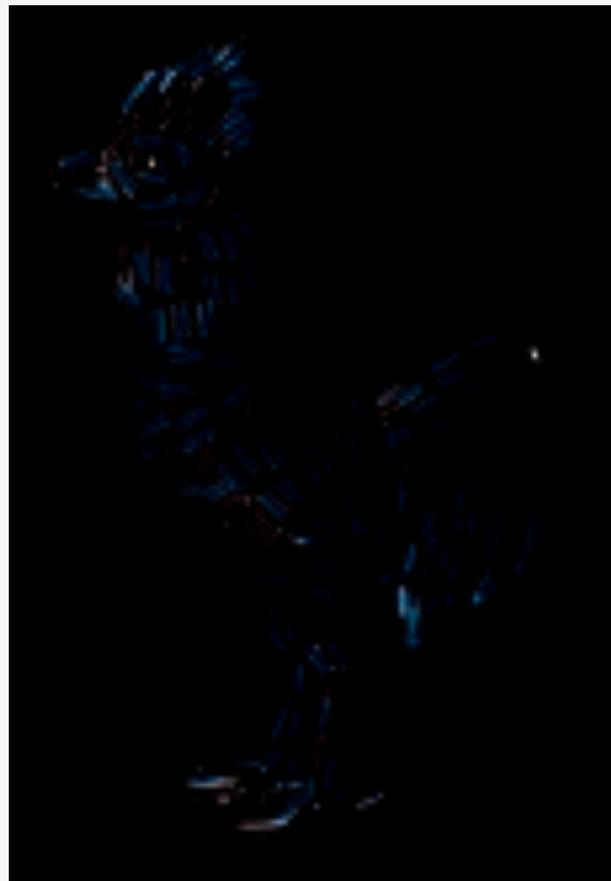
“I enjoy getting involved on the ground floor when I feel a connection with an artist’s work. In these cases you’re primarily investing in quality, and the potential growth of a great young artist. Since they don’t have a presence in the market however, you can’t rely on the market to help you make a decision. You really need to be guided by your passion for the art itself.”

In December 2011, Adam decided to exhibit for the first time. A selection of works from The Sender Collection was exhibited for the first time as a freestanding exhibition during Art Basel Miami Beach. Entitled Home

Alone, the exhibit received an overwhelmingly positive critical response, as over 1,200 people explored the collection in a 5,000 sq ft unoccupied home.

“Sarah Aibel, my curator, did a fantastic job of orchestrating the show. I think what resonated with a lot of people was our desire to showcase art in a different environment. We did a pop-up exhibit as an experiment. After seeing the response, it’s definitely something we’d be interested in trying again.”

“I’ve got two passions: finding great investment for our investors and finding great investments in art. Both markets offer exceptional opportunities if you do the work and make a commitment to understand them,” Adam concludes.



Sarah Lucas  
Cock, 2005

metal cockeral, cigarettes, and glue  
24 x 19 x 8 inches

Courtesy of Sarah Lucas and Sender Collection

As an asset class, art has a high barrier to entry. It is an unregulated industry that requires patience, resources, and a deep understanding of its subject matter. Yet the collectors keep on coming. New investors now compete with established collectors, funds, buyers from emerging markets, and institutional investors for a finite supply of high quality, branded art. In the contemporary art market, where many of the most prized objects take unique forms beyond traditional paintings and sculptures, an additional challenge is to determine what is being purchased: a unique work of art, or an idea?

Let us return to the eponymous \$12 million shark. After being installed in its vitrine, the shark started to deteriorate. Upon its sale from Saatchi to Cohen, Hirst offered to replace the shark and preserve it with better techniques. Since the main character of the piece was replaced, was it still the same artwork? Hirst shared his thoughts on this process with the New York Times in a 2006 article, *Swimming With Famous Dead Sharks*:

Artists and conservators have different opinions about what’s important: the original artwork or the original intention. I come from a conceptual art background, so I think it should be the intention. It’s the same piece. But the jury will be out for a long time to come. ■